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DEFENSE OR DISARMAMENT: THE TICKING TIME BOMBS OF U.S. NATIONAL SECURITY

Honored guests, colleagues, ladies and gentlemen.

It is a privilege to speak to such a distinguished group that continues to lead the way back to fiscal sanity. I was a relatively new U.S. Senate staffer when your founders Sen. Henry Bellmon and Cong. Bob Giaimo were giants in Congress in starting this endeavor.

Forty four years ago, as a new 2nd Lieutenant finishing the Marine Corps Basic School at Quantico, I rode in a cattle car with my fellow 2nd Lts to the Command and Staff College to hear the then Commandant - General Leonard Chapman - discuss the national security challenges we faced as a nation.

As new Second Lieutenants, we thought the greatest challenge was that first assignment in combat. I certainly was more focused that evening in 1969 on what Vietnam was going to be like when I went there in two weeks than the remarks of our now legendary Commandant.

But with the benefit of 44 years of experience in and outside the Corps, on Capitol Hill and in the defense industry, I know the national security challenges we face today are much greater than just Iraq and Afghanistan, North Korea, Iran, Syria and terrorism as urgent as they are to the 2nd Lts of today.

Our greatest challenge in this most dangerous world is strengthening the U.S. military in a weak economy whose foundation rests on the quicksand of deficit spending.

I would like to discuss what I call the ticking time bombs of our national security posture.

U.S. FISCAL SITUATION

First, let's talk about ticking time bomb number one, the alarming state of our country's finances on which this organization has been sounding the five alarm fire bell for 32 years.

As my Dad used to say, "When your outgo exceeds your income, your upkeep will be your downfall." The current projection of outgoing exceeding incoming is \$7 trillion over the next decade, adding to a total national debt of \$16 trillion.

The Administration and Congress made a sincere effort in 2009 to pull the nation's economy out of the ditch, but to do so they went on a spending spree of gargantuan proportions. And that's in addition to the out of control spending and

generous tax cuts which preceded them. And despite the Budget Control Act of 2011 and the “Fiscal Cliff” Compromise signed Jan. 2, 2013, I say in all sincerity that “spending more than we have” and “raising less revenue than we need” is one of the few things in Washington that is truly bipartisan.

The budget deficit for 2012 was \$1.1 trillion when the fiscal year ended last September 30; it is projected to be \$1 trillion for 2013 at the end of this fiscal year. And, depending on whose estimates you use, the deficit is projected to be \$6.6 trillion over the next 10 years. While a solid improvement over previous estimates, these are still staggering deficit levels and higher than any of the fiscal commissions have recommended.

The current deficit amounts to 8.5% of our entire gross domestic product.

And, of course, lots of our debt is owned by China and other foreign countries, something that has its own national security implications—currently 56% is owned outside the U.S. as compared to 5% in 1970 and 19% in 1990.

Even the President’s departed Director of the Office of Management and Budget, Peter Orszag, said the deficits are unsustainable. He said that deficits over four percent of GDP are not sustainable ---- and we are at nearly three times that. He was joined in that voice Jack Lew, the former White House Chief of Staff who is headed to be Treasury Secretary.

And don’t forget – we are paying interest on this money. Interest on the debt is \$360 billion or 10% of all spending. Current projections are that the net interest on the debt will exceed defense projected outlays in 2017 (\$565 billion to \$561 billion respectively).

Back in 2007, the then head of the Government Accountability Office was David Walker. David continues to lead efforts dedicated to putting the country’s fiscal house in order. In 2007 he said: – and I quote -- “Continuing on this unsustainable fiscal path will gradually erode, if not suddenly damage, our economy, our standard of living, and ultimately our national security.” Let me repeat – ultimately our national security.

Admiral Mike Mullen has spoken out publically that the national debt is a national security threat. This topic is finally at the top of the political dialogue. There is a keen awareness that one of the toughest challenges DOD faces under these fiscal pressures is how to preserve the right amount of combat structure and its readiness, maintaining our technological edge, and taking care of our troops and their families.

So the national debt and deficit spending is ticking time bomb number one, because you can’t have a strong defense on a rotten economy.

DEFENSE PIECE OF THE PIE IS SHRINKING AND ITS' OUTPUT IS LACKING

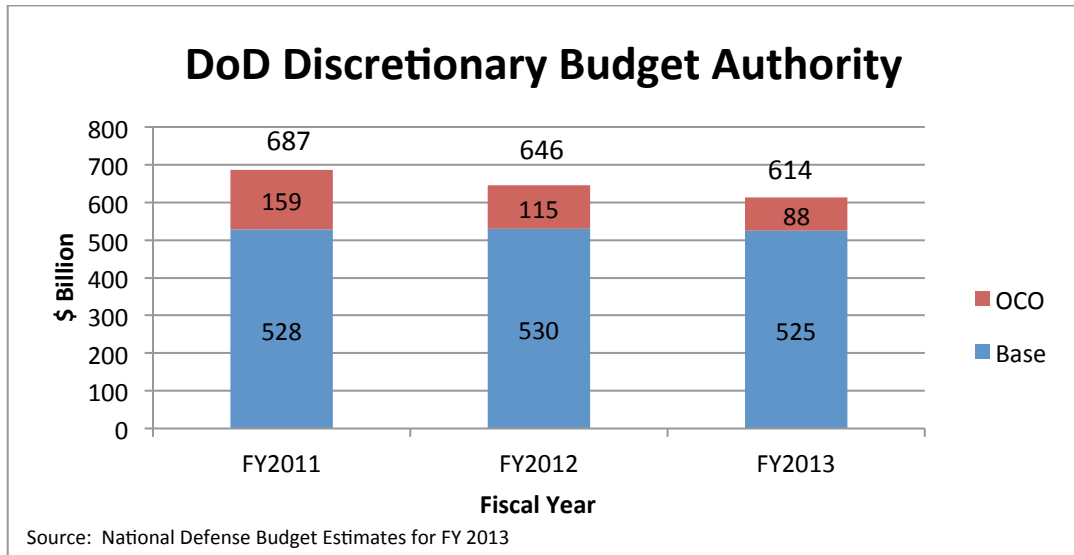
Now, let's focus on the defense budget top line and what we get for what we spend.

You are aware of the adverse trends with discretionary versus mandatory spending.

Once upon a time, in the 1960s, discretionary spending was two thirds of the federal budget. Today, it is exactly opposite that. Discretionary spending is now a little more than a third of total federal spending, and mandatory spending – entitlements – including interest on the debt accounts for two thirds of the total outlays. In fact, discretionary spending (domestic and defense) has remained relatively flat for over three years. Federal outlays grew at the slowest pace since Eisenhower ('53-'56) given four years of continuing resolutions: +0.6% from 2009-2012.

The discretionary wedge continues to get proportionally smaller. The six-month “food fight” with the House, Senate and White House over the appropriate level of discretionary spending for FY11 is illustrative. The final version, after seven continuing resolutions from 1 October 2010, contained \$1.21 trillion, or \$66 billion below the FY10 enacted level (approximately a 4% decrease). This is \$78 billion below the FY11 request. Within that total, the largest portion – defense spending was set at \$689 billion, which includes the base budget of \$529 billion and the overseas contingency fund of \$160 billion.

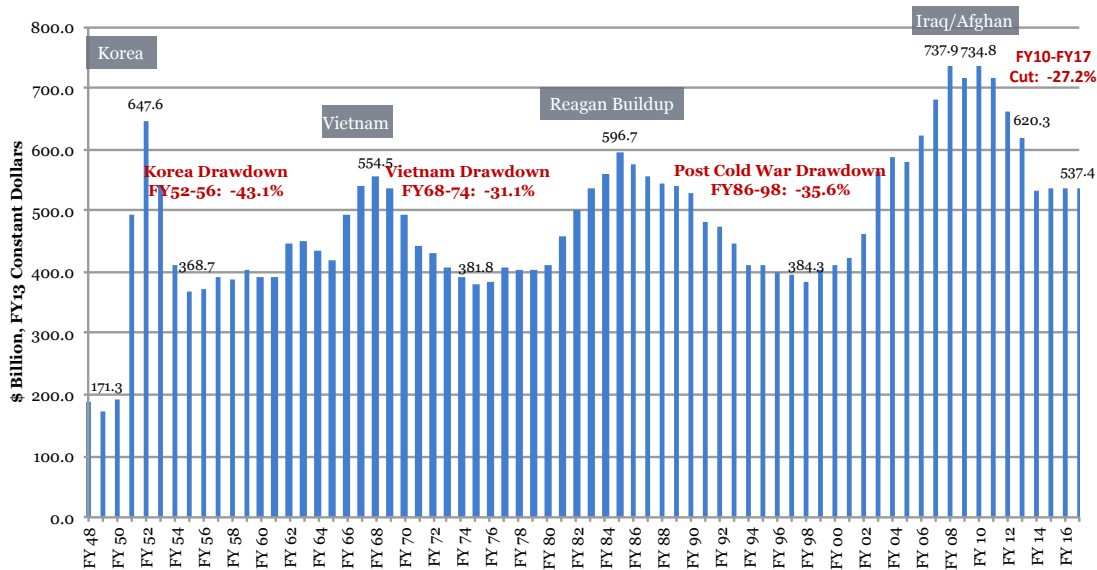
The FY12 request for defense was \$671 billion. This includes a “reduction” of \$40B in the overseas contingency funding. The proposed increase between the FY11 enacted defense base at \$529 billion and the FY12 requested base of \$553 billion was \$24 billion. The FY12 base budget was set in a continuing resolution at \$525 billion and the FY13 continuing resolution continues it at that rate which approximates the Administration's base budget request for FY13. Therefore the DOD base budget has remained relatively flat since FY11 as the follow chart indicates:



Even flat, we have to recognize that the base defense budget is huge.

I am reminded of the “Capitol Steps” parody on My Fair Lady’s “The Rain in Spain” during the Reagan Administration entitled “Immense Expense is Mainly in Defense”.

Defense BA in Constant FY 2013 Dollars



OBSERVATIONS: The current drawdown starts from a higher level in constant dollars and is less percentage wise than previous drawdowns. However, Korea and Vietnam were draft era forces and the internal composition of the budget was much different. While the topline will be larger than the valleys of Vietnam and Cold War drawdown eras, a much larger percentage goes to personnel and compensation, overhead, and more costly acquisitions. The combat forces are much smaller than in previous timeframes (see slide 2)



This slide depicts the most relevant measure of DOD spending over time – budget authority. The chart depicts budget authority in constant 2013 dollars from the end of World War two to the present for comparison purposes. You will

note quickly that spending in the Iraq/Afghanistan war period was substantially higher than both the peak years of Vietnam as well as the highly touted Reagan build-up. You will also note that the planned draw-down consistent with the Budget Control Act levels will be less percentage wise (-27%) than in the post Korean drawdown (-43%), or Vietnam drawdown (-31%) or the post cold war drawdown (-35%).

The current drawdown also starts from a much higher base. While the BCA topline will be higher than the valleys of Vietnam and the Cold war, a much larger percentage of the current budgets goes to personnel and compensation, overhead and more costly acquisitions. Actual combat forces are much smaller than in previous timeframes even with the current larger budgets.

So we need to do more than focus on total amounts. We need to look at how that money is spent.

As defense supporters, we have to ask ourselves: - - What are we getting for what we spend?

One answer is that we are getting the best military in the world by any measure. And that's thanks to the people in DOD, in industry, in Congress, and in this room who served and continue to serve and who work to improve the system.

However, DOD and the Congress have historically focused more on what goes into the budget—the top-line and how much goes to the large accounts like procurement and research and development (R&D). They don't focus as much on the output—what are we getting for what we spend and hardly anyone is asking-- much less answering-- the question: "Are we getting the bang for the buck our war fighters and taxpayers should expect for the dollars we spend."

In my view, the answer to that question is no.

This is ticking time bomb # 2—we are not getting the bang for the buck for the war fighter and the taxpayer we should for the dollars we spend.

Why is that?

There are three primary reasons for this answer: first—the excessive amount of dollars and personnel tied up in DOD's massive and inefficient overhead; second—the "all in" or "fully burdened" growing costs the support structure for the all volunteer force which includes retirement, healthcare, fringe benefits, and deferred compensation; and third—the substantial costs of DOD's acquisition processes and programs where the dollars increase while the quantities decrease.

HISTORIC DEFENSE COMPARISONS

If you examine how much we spent on defense from the Carter years through the end of the Bush Administration, and include the first two years of the Obama Administration on which we have hard data, you would see that the amount we spent went up dramatically both in constant dollars and in current dollars. In fact, over the past 33 years it went up over 300% in current dollars and doubled in constant dollars.

History of DoD Characteristics by Presidential Administration



Category	End of Carter 1980	End of Reagan 1988	End of Bush 1992	End of Clinton 2000	End of GW Bush 2008	Obama 2012	Projected end of FYDP 2017	Change 1980 - 2017	Change 1988 - 2017
Total Base Budget Authority (\$B – Constant \$)	\$411	\$545	\$476	\$410	\$548	\$546	\$529	29%	-2.9%
Total Base Budget Authority (\$B – Current \$)	\$143	\$284	\$282	\$291	\$483	\$536	\$529	270%	86%
Supplementals (\$B)	\$0	\$0	\$4	\$0	\$190	\$115	\$44.2		
Active Duty Personnel (K)	2,063	2,209	1,880	1,449	1,474	1,481	1,377	-33%	-38%
Reserve and Guard Personnel (K)	851	1,158	1,135	865	843	846	824	-3.2%	-28.8%
DoD Civilian Personnel (K)	991	1,090	1,006	698	707	791	783	-21%	-28%
Active in Commission Ships	521	573	471	341	282	285	300	-42.4%	-47.6%
Army Divisions (active)	19	20	20	10	10	10	10	-47%	-50%
AF Fighter/Attack (Total Active Inventory)	2,789	3,027	2,000	1,666	1,521	1,493	1,325	-52.5%	-56.2%

Sources: National Defense Budget Estimates for FY2013, Apr 2012, Defense Manpower Requirements Reports, President's FY2013 Budget Request, Congressional Testimony. BA numbers from table 6-8 less supplemental value, Active and Civ personnel from Table 7-5 (2017 values based on statements of planned reductions). Number of ships, divisions, and USAF inventory based on testimony.

Even with 'reductions', DoD budgets have increased substantially, yet the force structure that provides and supports warfighting capability is much smaller

If you look at how much war fighting strength this money bought, you would see exactly the opposite trend.

Compared to when Jimmy Carter was President:

Active duty personnel fell by almost 40% during the last 31 years.

Civilian DOD personnel fell by 30%.

The number of commissioned ships fell 45%.

The number of Army divisions fell from 19 to 10.

And the number of Air Force fighters fell roughly 50%.

And there were lots of other decreases in purchases of combat equipment. The decreases occur whether you measure from President Carter or if you measure from President Reagan where the spending levels were closer to today but the purchasing results were substantially better.

Background

Past DoD Downsizing Efforts

- After major war efforts, DoD's budgets declined (e.g. WWII, Korea, and Vietnam). Low point in all 3 cases was ~\$400B in today's dollars
- The Post Cold War drawdown budget declined 36% to \$384 billion (FY13 constant dollars), from a peak in FY86 of \$597B

DoD Resource	1986	1998	Change
Active Duty Military Manpower	2,100,000	1,500,000	-29%
Civilian Personnel	1,100,000	750,000	-32%
Army Divisions	18	10	-44%
Air Force Fighter Wings	24	12	-50%
Strategic Bombers	324	89	-73%
Navy Combat Ships	546	314	-42%
Navy Carriers	15	11	-27%
Major Aircraft Procurement Programs	8	4	-50%
Major Bases (reductions from BRAC)	495	455	-8%

Despite the dramatically increased spending today, the U.S. military has shrunk substantially over the past 33 years. So we are spending more and getting less numbers. Some will observe- smaller but more capable. That is true in some categories yet the issue remains how much more capable and why is the output so much less and does that output provide the necessary war fighting capability.

If you just take a snapshot of the ten-year post-Cold War drawdown above, you will quickly note that it would be irresponsible to cut the active duty or combatant forces at the same rate. Thus, we focus on reducing the tail and increasing the tooth.

DOD OVERHEAD

There is one area where we are spending more and getting more—and that's DOD's overhead accounts. If DOD's overhead was a gross domestic product, it would be larger with its \$218 billion total than the entire economy of Israel and has more people working in it than the entire state of Rhode Island. Congress and the Department have a very poor track record in addressing these expenses.

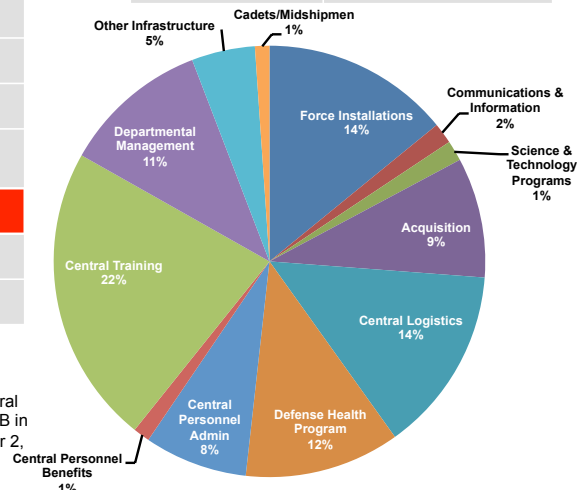
Putting DoD Overhead in Perspective

If DoD overhead was a separate country, it would rank 42nd in GDP

RANK	COUNTRY	GDP (\$B)
38	Portugal	229
39	Hong Kong	224
40	Singapore	223
41	Egypt	218
42	DoD Overhead	218
43	Israel	217
44	Ireland	207

Sources: Year 2010 Country GDP PPP Statistics (CIA Factbook); Federal Budget for Fiscal Year 2013 (Base Budget of \$531B, not including \$115B in OCO funding); FY11 Defense Manpower Requirements Report, Chapter 2, Tables 2-1a through 2-1d, Infrastructure (41% of the total).

Breakout of % infrastructure by Service	
ARMY	32%
NAVY	61%
USMC	32%
AIR FORCE	45%



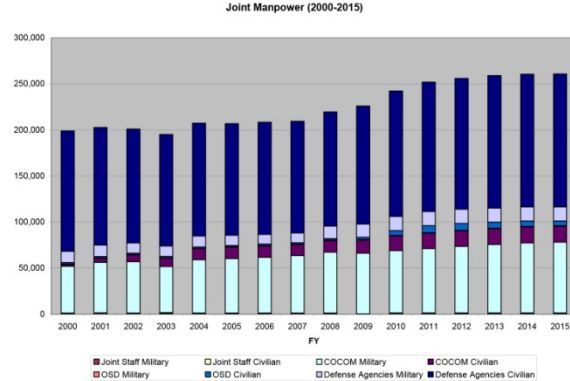
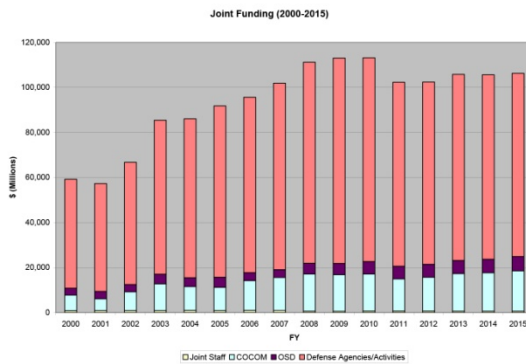
In terms of the number of personnel in OSD, the Joint Staff, the Combatant Commands and the Defense Agencies there are over a quarter million—240,000 people—and this does NOT include the very large contractor counts. The costs for these people are \$113 billion. These organizations show consistent growth from 2000. Sec. Gates in his “overhead reduction” efforts, subsequently supported by Sec. Panetta, identified these areas for reductions. However, the ratio of the overhead accounts to the combat side of the military is still adverse. The “tooth-to-tail” ratio which was poor when Sec. Gates and Sec. Panetta began pushing to improve this area has unfortunately gotten worse.

Organizational Totals

OSD, Joint Staff, COCOMs, and Defense Agencies

Dollars: \$113B

People: 240,000

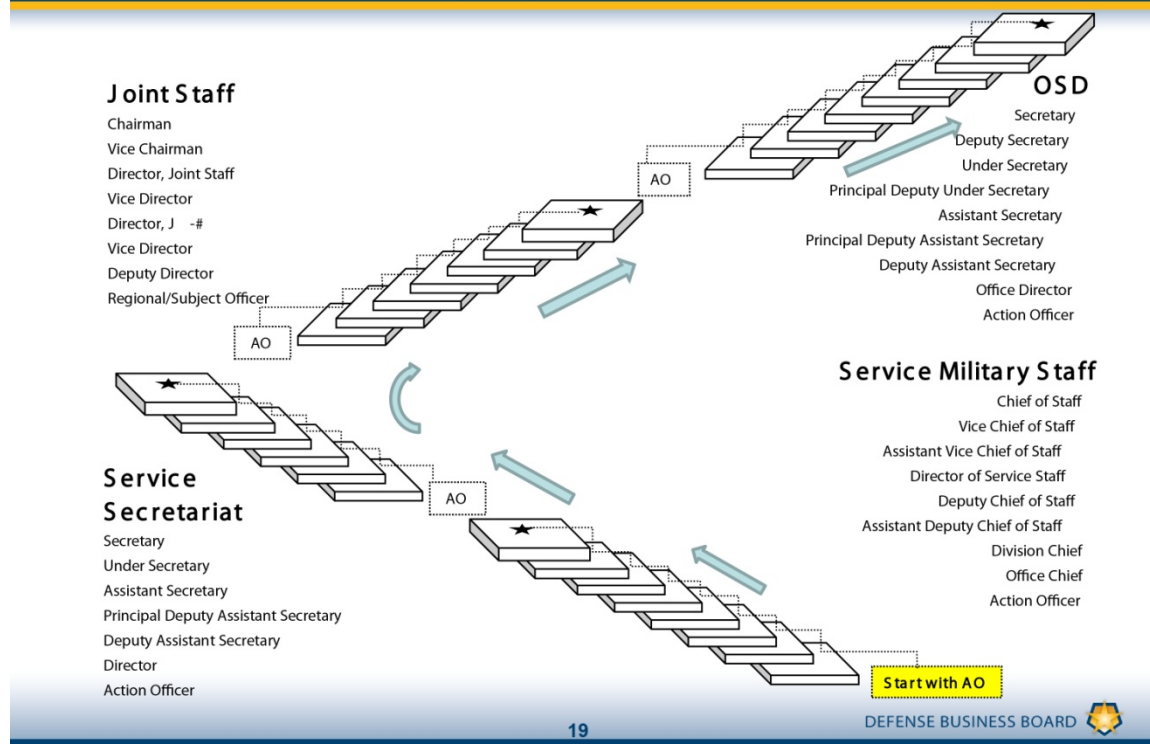


No Reliable Contractor Data Available



We have also known for years that the military structure of DOD institutionalizes layers of management. When you have lots of senior personnel, more layers follow. For example, when you have the top person in a layer- the head dawg- that person will have a "deputy dawg" and the "deputy dawg" will have a "deputy, deputy dawg" and so on. It is compelling that DOD needs to cut-out some management layers, which by some accounts has 28 layers from the action-officer in the military department to the Secretary of Defense. This is also what drives huge staffs and support personnel which continues to increase.

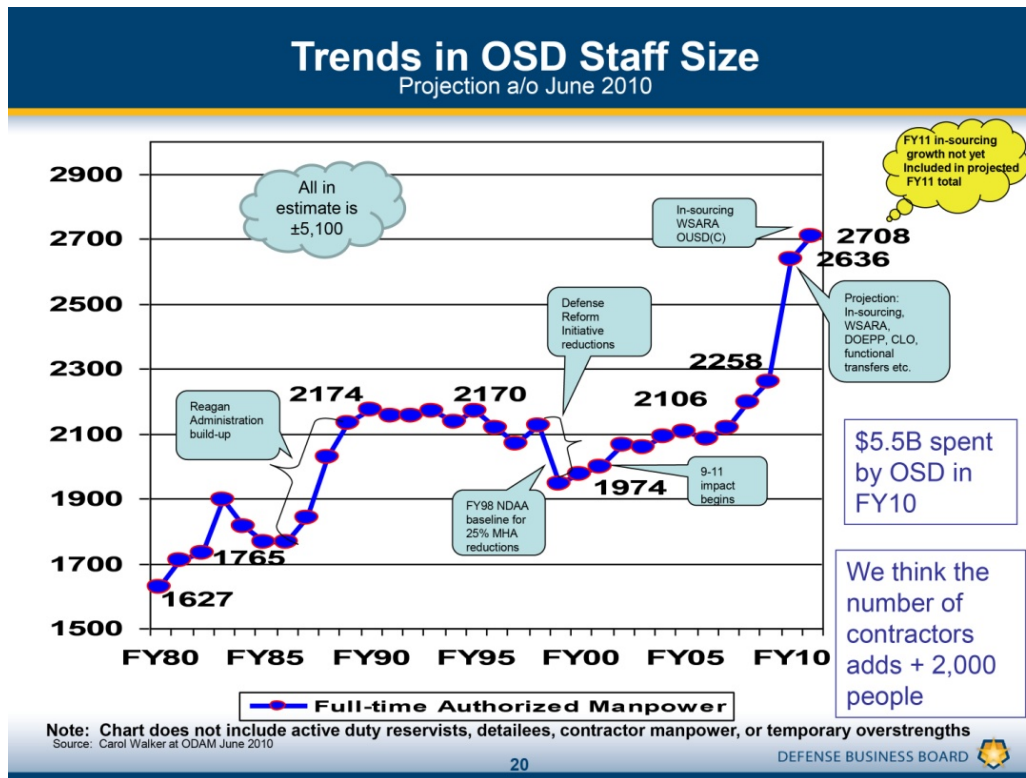
DoD Layers A Long Trip To The Top



OSD mirrors these trends. When Secretary Cohen asked a task force I chaired for him in 1997 to look at this, the Director of Administration reported that OSD was 2,000 people strong. We discovered an additional 1,000 people for a total of 3,000. Consequently, Secretary Cohen decided to reduce his organization back to the advertised level of 2,000.

Against this base, the OSD staff in FY10 was approximately 2,708. When you include the full-time reservists, detailees, and what OSD estimates to be the number of contractors, the staff count was over 5,000 as follows: there were 2,636 government civilians and military, about 76 full time reservists, 381 over staffs or detailees, and over 2,000 contractors.

OSD spent approximately \$5.5 billion a year of which some of this is R&D and system costs for programs that OSD is running. Sec. Gates tried to freeze it and to begin reductions, but are disproportionally smaller and insufficient given the reductions in the fighting forces. Today at FY12 levels, the “advertised” size of OSD is 2,665 military and civilians (not including contractors and guard/reserve). This is LARGER than the comparable FY10 and FY11 numbers and DOD acknowledges that “bookkeeping” entries to have made it look smaller.



DEFENSE AGENCIES ARE BIG BUSINESS

The Defense Agencies have also grown in number and scope and costs. These are not just Defense Agencies—these are very large business enterprises on today's scale. When you ask "who are DOD's largest contractors?" the expected answer comes to mind—Lockheed, Northrop, Boeing. Yet, in reality, the organization doing the most business with DOD is their own Defense Logistics Agency—who beats Lockheed's \$35 billion by over \$10 billion for a total of \$45 billion. This is based on the budget year for which we have completed contract data.

In the top twelve largest businesses are five of the Defense Agencies, not including several of the intelligence community agencies. Most of these Defense Agencies would rate in the Fortune 250 and several are in the Fortune 50. Yet again, they are not managed as businesses even though one is a grocery business, another is a worldwide communications provider, another is one of the world's largest and most expensive health care providers.



Defense Agencies are Big Business		
Rank	Contractors (Rank) / Defense Agencies	DoD Contracts / Agency Budget (\$,M)
1	Defense Logistics Agency	45,627
2	Lockheed Martin Corp. (1)	35,269
3	Defense Health*	32,486
4	Boeing Co (2)	29,085
5	Raytheon Co (3)	14,952
6	General Dynamics Corp (4)	14,571
7	Missile Defense Agency	9,787
8	United Technologies Corp (5)	8,268
9	SAIC (6)	7,408
10	L-3 (7)	6,961
11	Defense Information Systems Agency	6,758
12	Defense Commissary	6,500

Five of the Top 12 Defense Contractors are Defense Agencies

2012 Contract Data from USAspending.gov (prime contract awards only)

2012 Budgets based on Def Working Capital Expense; Rankings are based on prime contract awards only

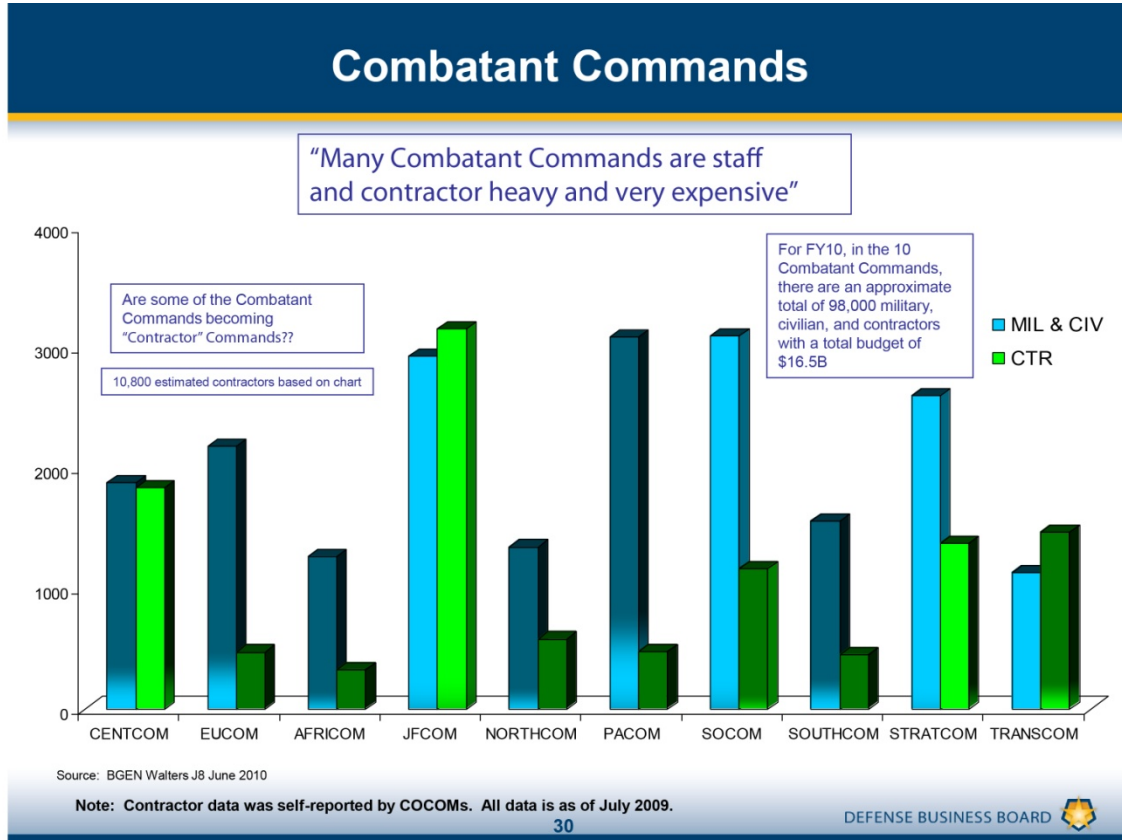
*Defense Health Programmed Portion Only

DEFENSE AGENCY AND FIELD ACTIVITY PROBLEMS

The number one reason these Defense Agencies should be managed more as a business is that their total expenditures are in excess of 20% of the entire defense budget. Worse yet, for the most part, they are supervised by OSD civilian political appointees whose day-to-day jobs do not provide them with ample time for management and leadership. These entities lack strong, disciplined business leadership, performance management systems, and several are non-core to the essential missions of the Department.

In this area, the Defense Business Board Task Group focused on recommendations to make the Defense Agencies more cost-effective and our conclusions were consistent with most every study done by the Pentagon and other commissions that DOD needs to consolidate, eliminate, privatize, devolve, merge, as well as instill best business practices in the mammoth Defense Agencies.

COMBATANT COMMANDS



Let's look at the Combatant Commands—the Department has added numerous Combatant Commands over the last 20 years yet there appears to have been no equivalent trades in the Military Departments to stand-up these organizations as the new CoComs grew. CoComs are important, such as U.S. Central Command which is running the wars in Iraq and Afghanistan and the new Cyber Command, which has been added since this chart was created. Yet, the estimated 98,000 people including contractors costing \$16 Billion is an area that must be reviewed, both in the CoCom and the Military Departments for redundancies and duplication. By comparison, these expenses are larger than the entire State Department or NASA budgets.

And to foot-stomp the contractor issue more, the Joint Forces Command (JFCOM) had more contractors on its payroll than government military and civilian personnel, and had its own multiple "joint commands."

For these reasons and others, our task force recommended disestablishment of JFCOM. The Secretary of Defense made the decision to furl the JFCOM flag having arrived at the same conclusion independently.

While Joint Forces Command has been disestablished, most of what was reduced were the contractors, a small number of civilians and no military. Over

1,000 military billets were added to the Joint Staff, which increased in size from 2,000 to 3,000 as our fighting forces were being reduced. The new U.S. Cybercom, not on the above chart, wants to add over 4,000 people to its existing size.

The point here is not the importance of the Combatant Commands but the size and cost which became even larger when you consider the service component commands under them.

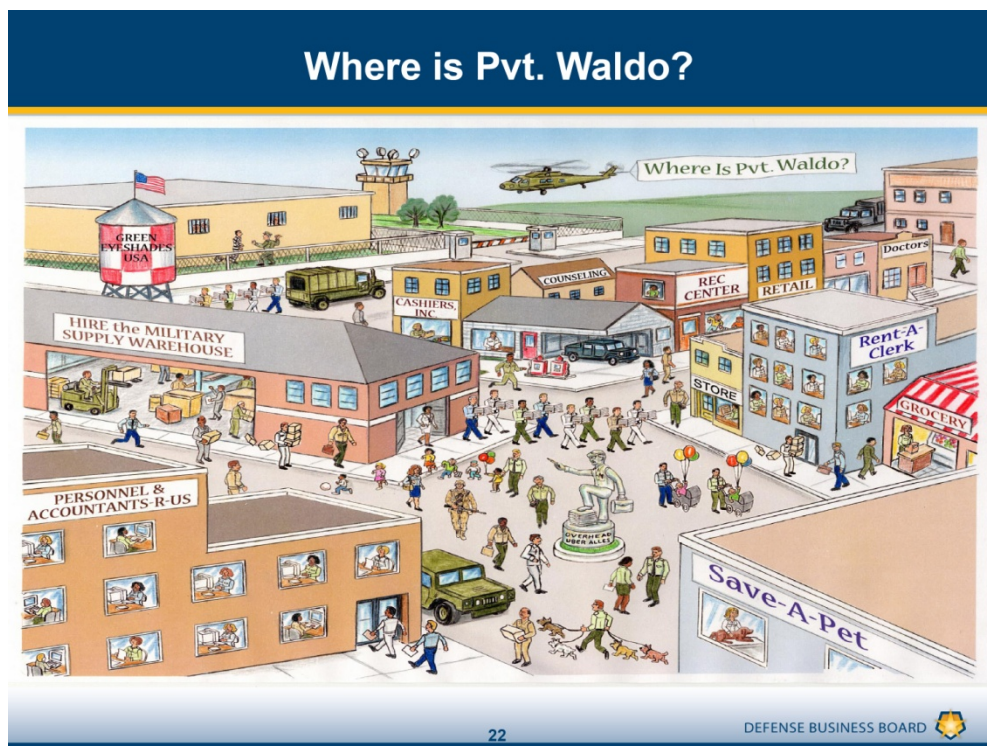
MOST INFRASTRUCTURE IS IN THE MILITARY DEPARTMENTS

Regardless of everything mentioned to this point with OSD, the Defense Agencies and the Combatant Commands, the vast majority of DOD's overhead in people and costs resides in the Military Departments—at least 70%.

There are literally hundreds of thousands of personnel in installations, and central logistics and training and personnel administration and in management headquarters, and in acquisition of systems. This is clearly a target rich environment that can become much more efficient and effective.

This is ticking time bomb #3—DOD's massive, layered and inefficient overhead.

WHERE IS PRIVATE WALDO?



We also need to focus on where DOD has its active duty military personnel—the most expensive personnel whether from a recruiting, training and retaining standpoint or from a life-cycle standpoint. Our military should be at the “pointed end of the spear” as much as possible since they are the only ones who can perform that role. And yet, we continually hear about the strains on the force, not having sufficient dwell time, and needing to cross level personnel to make up units. So, we ask the question since we have 1.4 million active duty personnel—where is Private Waldo.

We have 1.4 million active duty personnel, and 800,000 drilling reservists-- yet we had a hard time sustaining a force when it was 150,000 in Iraq and when we wanted to increase to 100,000 in Afghanistan. One might want to ask---What are the other 2 million doing? On any given day, 40% of the DOD is tied up in overhead. Let me repeat. On any given day, 40% of the DOD is tied up in overhead.

It is worth noting that of the 1.4 million total Active Duty Military, 340,000 were deployed when the current snapshot was taken. That's 24% of the Active Duty force deployed with the remaining 76% in either dwell or in the overhead "tail" or other duties. This 76% number should be scrubbed hard by the Department to determine what activities they are performing. I am not suggesting the non-deployed are idle or not engaged in important work, but DOD needs to push every person possible over to the combat side.

COST OF MILITARY PERFORMING INHERENTLY NON-GOVERNMENTAL COMMERCIAL ACTIVITIES

The Department's own 2009 report of its FAIR inventory indicates some of the 76% is in the 339,142 Active Duty Military performing commercial activities. This is another area the Department must correct. Here, we are using the most expensive personnel to perform activities that could otherwise be performed by less expensive personnel. Furthermore, freeing-up the uniformed personnel makes them more available for the inherently governmental and military activities. By conservative estimates, if by removing even 10% of the 339,142 people from this category, the Department could free-up \$5.4 billion for combat purposes. This is one that is really hard to change as DOD has worked it from a "pick and shovel" standpoint in the past. This is one where we all know we need to improve, want to improve, have made some improvements, but have so far to go.

Cost of Military doing not Inherently Governmental Commercial Activities



- 323,118 active duty military performing commercial activities (per FY2011 FAIR inventory)
 - Using an average cost of \$160K/yr (CRS Milpers/troop index), this costs over \$52B/yr!
 - Almost 10% of the FY11 base budget!
- Eliminating 10% of commercial activities positions could save \$5.2B
- Poor use of our most expensive personnel – active duty military

\$52 BILLION ANNUALLY!!!

Note:

1. Active Military in FAIR inventory of CA and CA exempt status with OMB reason code of A, B, E, and F
2. Costs reflected in current dollars
3. Source from Reserve Forces Policy Board data call

Military personnel should be at the tip of the spear—not in the rear with the gear.

There is another alarming personnel-related issue. No one seems to be able to answer the question – how many contractors work for DOD?

It is impossible for any leadership to control costs and manage personnel if they don't know how many people work for them. Many groups inside and outside government have tried to identify the number of contractors working for DOD both overall and in specific categories and at what cost. The Department is as frustrated as the rest of us since there seem to be no precise answers. Then Under Secretary Carter signed-out a document in July 2010 that pegs the number of contractors at approximately 766,000 at a cost of about \$155 billion. This exceeds the 750,000 civil service workforce in the U.S (which itself has grown by 100,000 people since 2000). This does not include the intelligence organizations. We were told by Sec. Carter the contractor number was not a “high confidence” figure.

This is ticking time bomb #4— too many of DOD's most precious and expensive asset, the active duty military, are in the rear with the gear vice being at the tip of the spear. And we don't know how many contractors work for DOD.

MILITARY PERSONNEL COSTS ARE RISING

Rising personnel costs for the active duty military are consuming an ever increasing percentage of the DOD Budget.

There is no doubt that the fastest growing costs in DOD's budget are those to support personnel, current and retired. In the last ten years the average fully-loaded cost for a mid-career individual on active duty has more than tripled--- from \$80k to a doubling toward the end of the Bush Administration at \$160k and the current estimates are close to \$250k per year. This is one of the reasons the military personnel accounts from 2000 to now have doubled in costs but the force size has stayed constant. The \$250k is not the fully-burdened cost but a composite rate used strictly for budgeting purposes. The fully-burdened rate is much higher.

In part, it is because the all-in costs of the All-Volunteer has grown and an ever increasing percentage is going to deferred compensation for those no longer serving. Typically advocates for military pay and benefits focus on the individual's paycheck and ignore the long-term, fully-burdened costs. In part it's because of the support structure we provide the military and their families such as a taxpayer subsidized grocery chain, a military dependents school and child care system and the list is long. When all these costs are added they are consuming an ever-increasing portion of the DOD budget. For FY 10 they were budgeted at 35% of all spending- a total of \$186 billion. DOD has another calculation they use called "taking care of people" and put these costs in the FY 10 budget at \$245 billion or 50% of DOD's base budget. For FY11 & FY12, the percentage remains roughly the same.

The Reserve Forces Policy Board recently completed a year-long analysis of the fully-burdened and life-cycle costs of military personnel. It concluded that the Department does not know, use or track the "fully-burdened" and "life-cycle" costs of military personnel in decision-making. The RFPB found that DOD consistently ignores some of the largest costs as the following charts depict.



Inconsistent Use of Cost Elements in Military Personnel Cost Analyses in DoD



- The RFPB project team convened 16 meetings of an informal working group of costing experts from across the Department in order to examine and compare current military personnel costing practices across Services and Components.
- Found that military personnel costing is neither complete nor consistent.

Cost Elements Used by Most Components
Basic Pay
Basic Allowance for Housing (BAH)
Basic Allowance for Subsistence (BAS)
Incentive Pays
Special Pays
Allowance - Uniform Clothing
Allowance - Station Allowance Overseas
Allowance - CONUS COLA
Subsistence in Kind
Family Subsistence Supplemental Allowance
Social Security and Medicare (Employer's Contribution)
Permanent Change of Station - All but Separation Travel
Retired Pay Accrual
Separation Payments
Education Assistance (e.g., portion of GI Bill)
Other Military Personnel Cost - Unemployment
Other Military Personnel Cost - Death Gratuities
Other Military Personnel Cost - Survivor Benefits
Other Military Personnel Cost - Other
Medicare - Elig Retiree Health Care Fund (MERHCF)
~ \$130 Billion in FY 2013

Cost Elements with Wide Variance in Use
Allowance - Family Separation
Allowance - Personal Money Allowance, Gen & Flag Offs
Permanent Change of Station - Separation Travel
Other Military Personnel Cost - Adoption
Other Military Personnel Cost - Partial Dislocation
Other Military Personnel Cost - Transport Subsidies
Family Housing Construction & Operation
Military Construction
Health Care
Discount Groceries / Commissary Cost
Child Day Care Facilities
Training
Recruitment Advertising, Etc.
DoDEA and Family Assistance
Child Education (Dept of Education Impact Aid)
Operations & Maintenance
Procurement
~ \$315 Billion in FY 2013

Cost Elements Not Used
Veteran's Employment and Training
Treasury Contribution to Retirement
Treasury Contribution for Concurrent Receipt
Treasury Contribution to MERHCF
Treasury Contribution to Survivor Benefits
Veteran's Benefits (Cash and In-Kind)
DoD Research Development Test & Evaluation
~ \$290 Billion in FY 2013

\$605 Billion in costs is **NOT** usually counted!

1



Why it matters

FY 2013 Fully-Burdened Per-Capita Cost to the US Government



Omitting these costs ignores about 20% of compensation



Military Personnel Account Costs*
DoD Defense Health Program
DoD Dependent Education
DoD & Service Family Housing
DoD Commissary Agency
TOTAL DoD Compensation Costs

O&M (Less DoD Dependent Education)
Procurement
Military Construction
RDTE & Other
TOTAL DoD Non-Compensation Costs

Dept of Defense Grand Total
Dept of Education "Impact Aid"
Dept of Treas - Concurrent Receipt
Dept of Treas - MERHCF
Dept of Treas - Mil Retirement
Dept of Veteran Affairs
Dept of Labor for Vet Education / Training

TOTAL COST TO US GOVERNMENT

	Active Component	Reserve Component
\$ 84,808	\$ 26,033	
\$ 19,233	\$ 8,157	
\$ 2,034	\$ 33	
\$ 1,235	\$ -	
\$ 996	\$ 49	
\$ 108,307	\$ 34,272	
\$ 110,532	\$ 26,477	
\$ 71,601	\$ 3,771	
\$ 5,556	\$ 1,512	
\$ 34,348	\$ 34,348	
\$ 222,037	\$ 66,108	
\$ 330,343	\$ 100,380	
\$ 355	\$ 9	
\$ 4,514	\$ 747	
\$ 3,264	\$ 2,230	
\$ 39,800	\$ 13,638	
\$ 6,334	\$ 6,334	
\$ 12	\$ 12	
\$ 384,622	\$ 123,351	

* Includes DoD contributions to MERHCF and Military Retirement Accrual

There has been a real reluctance to debate these trends publically so there needs to be a recognition first of just how much these costs are and then the nation's leaders in the Pentagon, Congress and here in this organization need to determine if they will put their hands on the helm or just leave it on auto-pilot. The RFPB recommended to the Secretary of Defense that as a matter of policy DOD should start calculating, tracking and using fully-burdened and life cycle costs in their decision processes.

We know there are unique aspects to being in the military. I spent thirty-five years in uniform and know first-hand the sacrifices the military and their families make. We know that we could never match with a paycheck the sacrifices they make in wartime.

Yet we must recognize that the costs are significant and that most of the management policies and strategies for personnel, pay systems and compensation are being questioned more and more by those inside and outside the Department. There are questions not only about their "affordability" but whether or not they will produce the force that is required to meet future threats. We are talking about the force of tomorrow. It takes 18 years to prepare a battalion commander and slightly less time for a battalion first sergeant.

The military personnel management system is anchored in a world war two "up-or-out" promotion process that provides little flexibility for modern practices or demographics. DOD has an antiquated military pay system that is based on time-in-grade and longevity vice skills and performance. Additionally the Department retains a pre-volunteer force military retirement system. This system encourages our military to leave at 20 years when they are the most productive and experienced and then pays them and their families and their survivors for another 40 years. So we pay them for 60 years to serve for 20 years. Thomas Gates, the Chairman of the Commission in 1970 that recommended moving from a draft-based force to an All-Volunteer force concluded that the AVF would not be affordable over time unless you eliminated the 20-year cliff retirement, changed pay and compensation from time in grade to skills and performance and toned down the up-or-out promotion system. None of these changes have occurred.

The GAO has questioned whether or not the "increasingly costly military compensation system is reasonable, appropriate, affordable, sustainable and fiscally sound over the long term" and said that "it is unlikely." Based on all the analyses I have seen coupled with my personal experience, I agree with the GAO that it is "not likely."

This is ticking time bomb # 5—the "all in" or "fully burdened" costs of the AVF with outdated personnel management, compensation and retirement programs.

HEALTH CARE COSTS ARE RISING

Nowhere are the rapid cost increases more evident than with health care and military retirement.

DOD's health care costs at appx. \$52 billion a year are spiraling up like elsewhere except most Americans don't have health care as expensive as what DOD provides. In the last 10 years costs have gone from \$20 billion to \$52 billion and are headed to \$70 billion by the end of the FYDP. The reasons are: (1) an increased number of eligibles (2) expanded benefits (3) increased utilization and (4) medical inflation. The largest increase in health care costs have been for retired personnel - - not active duty personnel. The active duty beneficiary population with dependents is 3.3 million and the retiree population is 5.5 million. No less an expert than then Secretary of Defense Robert Gates has said health care costs are "eating the department" alive. And every time he has tried to do something about it, Congress and the military associations have blocked him. The 43 years old new military retiree starting a second career pays \$460 dollars a year for the unlimited benefit Tricare for Life program for him and his family as does the retired Marine Colonel who left at career year 26 and took a job as a defense SES and draws his full military retirement, full civil service pay and pays \$460 dollars a year for Tricare for life as does the 64 year old more elderly retiree who may have little other income. These fees have essentially not changed in 16 years. It makes no sense.

In the FY12 budget, Sec. Gates proposed raising the fees by \$5 a month for working retirees and the screams and howls from the "protect" our benefits groups were very loud and the changes were not made.

This is ticking time bomb # 6—the out of control health care costs provided by a highly duplicative medical infrastructure.

MILITARY RETIREMENT COSTS ARE RISING

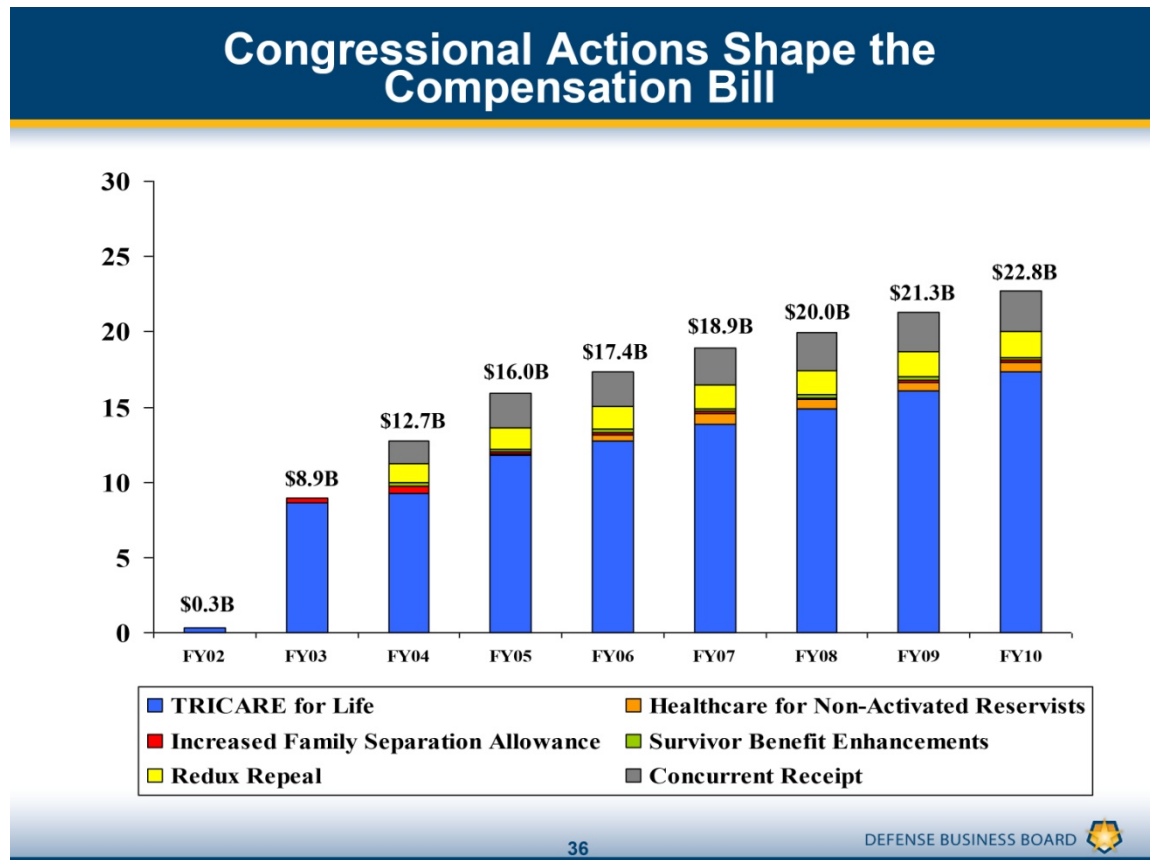
Military retirement faces the same rising total costs.

We have to look at whether this is the best system for the future demographics the military will recruit and recognize that the vast majority of those who serve in uniform do not ever share in these hugely expensive non-contributing benefits.

In 1986 Congress recognized military retirement as the largest unfunded liability of the federal government and there was concern the entire system might get the "axe" in the then Gramm-Rudman-Hollings "cut" environment. There was also a recognition that we needed to incentivize our most experienced people to serve longer. So Congress reformed military retirement—grandfathering everyone for

20 years. When the new system was about to go into effect in 2006 and save substantial sums of money and—more importantly-- keep our most experienced people longer, based on prodding by the Joint Chiefs and the military lobby, Congress changed it back to the system that originated in the 1950's.

Any projected savings were lost. In that same timeframe, Congress also added Tricare for life which is one of the most expensive new health care benefits ever. According to CRS, the costs of the all new benefits Congress has added totaled \$140 billion in expenses for just the past 9 years.



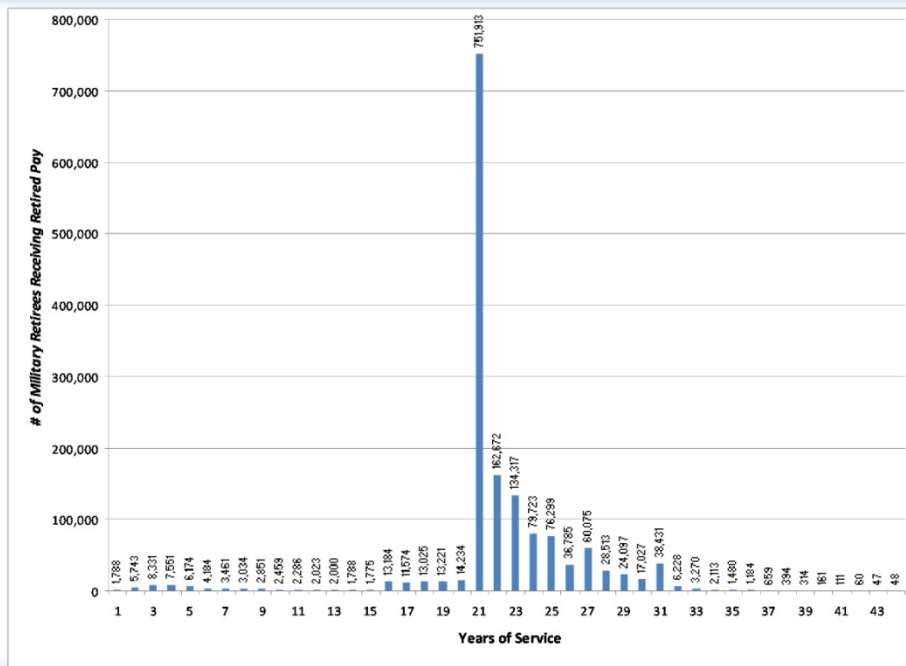
So well meaning decisions at the time not only add up but have huge future costs which are rarely considered at the time. You can read all the Congressional records of that day and you will not find any serious debate on Tricare for life.

In 2006, the federal government spent \$38 billion dollars on pay for retired component service members. That was more than the budgets of every state except New York and California. Today the federal treasury spends \$100 billion on military retirement—and that is just pay and does not include health care costs and other benefits.

We now have 2.4 million retirees—up 600,000 in just the last two decades. And who gets all these non-contributory retirement payments. Not most of those who

served in World War II, Korea, or Vietnam or the cold war or the recent wars in Iraq and Afghanistan because almost 80% of those who join our military never receive a nickel in retirement because they don't stay for 20 years. Only about 17% of those who ever join the military ever achieve 20 years of active service.

Number of Military Retirees receiving retired pay by years of service



38

DEFENSE BUSINESS BOARD



This very small percentage of those who serve and retire stay on average for 23 years and then take advantage of going into second and third careers at age 41 to 45. They draw retirement pay for 40 years as well as healthcare for life and access to many other benefits like subsidized commissaries. It is an unsustainable trend to pay people for 60 years to serve for 20 years. This is not about the people who served with distinction and earned this retirement at twenty years of service—it's about an antiquated system that incentivizes them to leave when they are the most productive and experienced.

This is ticking time bomb # 7—a military retirement system that is long past its prime.

Any changes in these areas of personnel, healthcare and retirement will be long-term fixes—mostly prospective-- that require discipline and the development of a comprehensive transition plan to address the complex and interrelated issues. We should not postpone the inevitable since it is mortgaging the current and

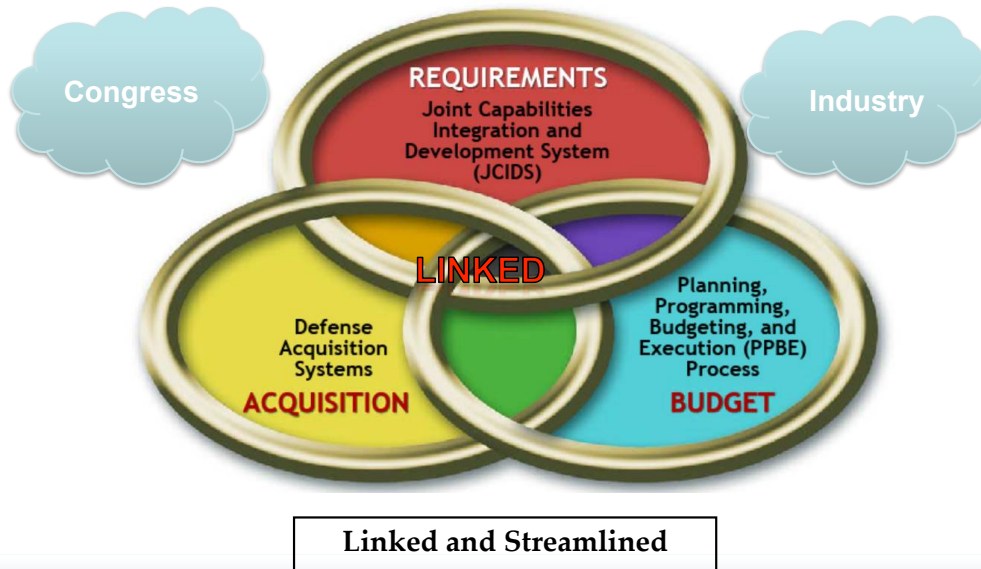
future war fighting force. I strongly support the recommendation of the QDR Independent panel which recommended a commission to look at all elements and make recommendations. The FY13 Defense Authorization Bill has included a commission to make such recommendation. I am sure they will conclude what every other outside panel has --including the DOD own 10th Quadrennial Review of Military Compensation-- that fundamental change is required. Changes such as focusing more compensation and benefits on those currently serving to include providing a portable retirement benefit. Even if everyone in the military today is grandfathered as they should be, substantial savings can occur in the accrual funds in the hundreds of billions.

In flat or declining budgets, the alternative to the status quo for these mandatory DOD expenses is a much much smaller active duty military force, or smaller procurement and R&D budgets, or less for operations and maintenance or decreases in all categories. No responsible policymaker should be faced with those Hobson's choices. We need to get back to the old slogan of "praise the Lord and pass the ammunition" versus "Praise the Lord and pass the benefit."

DOD ACQUISITION SYSTEM IS BROKEN

DOD does not employ proven business practices and processes in these areas of huge expenditure where American industry has proven conclusively that significant savings can occur. In total, from the most current federal procurement data, DOD spends a total of \$400 billion through roughly 1,200 contracting activities, about 50% on services and 50% on supplies and equipment. Areas like logistics and supply chain where DOD spends over \$190 billion a year and information technology which spends close to \$37 billion a year, and knowledge-based services where DOD spends \$52 billion. In the most recent selected acquisition report to Congress, DOD indicated that the costs for the existing program went up \$135 billion which is on top of \$100's of billions of increases in the past FYDP for those programs. There have been close to 100 studies done in the last 40 years and mountains of laws passed to "fix" the system. It has proven very resilient to change. The record is replete with examples of how the DOD acquisition process is clearly badly bent and even broken in four major areas: (1) gold-plated requirements that are frequently changed (2) failure to meet schedules, performance, and quantities (3) significant cost-overruns and (4) consistently poor management. In addition, DOD is suffocating under massive layers of bureaucracy as well as layers upon layers of rules and regulations. All you need to do is look at the following two charts to understand why the acquisition process is broken.

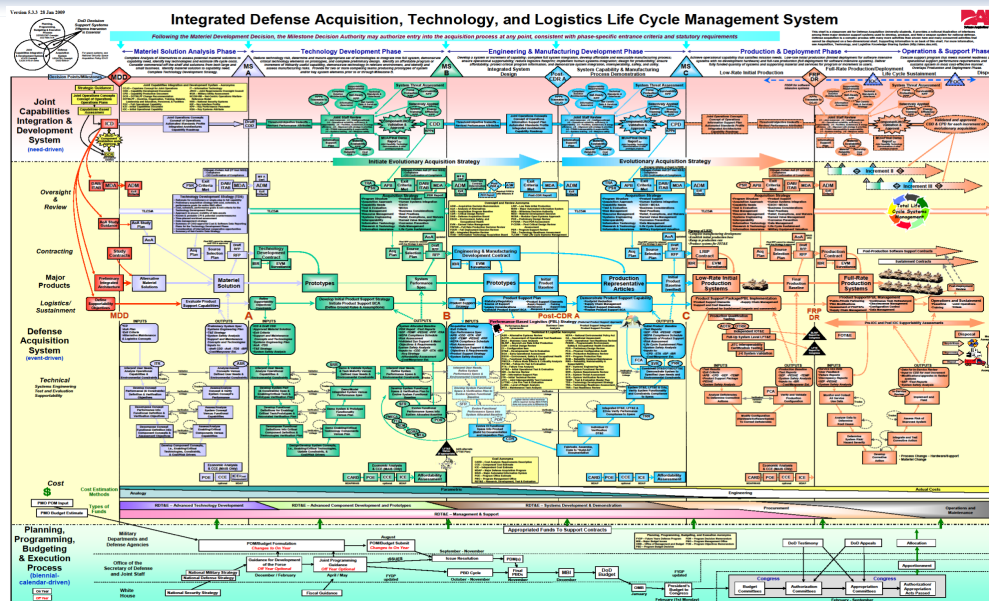
Background Defense Acquisition System: In Theory



Approved by Full Defense Business Board on April 19, 2012 8

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Background Defense Acquisition System: In Reality



NOT Linked and Streamlined

Approved by Full Defense Business Board on April 19, 2012 9

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The Defense Business Board, after a year of analysis, made eight recommendations designed to link and streamline the defense requirements, acquisition and budget processes. The recommendations in April 2012 were well received by both the senior civilian and military leaders in the building at all levels. Almost a year later, they are still “studying them.”

This is ticking time bomb #8—a broken DOD acquisition system that costs more, takes longer and produces less.

TOUGH STRATEGIC DECISIONS

Now let’s look at some of the major policy issues we face.

- What do we need our military to be ready for in the years and decades to come?

Should our military focus more on near peer competitors? homeland defense? missile defense?; counterinsurgency?; stability and reconstruction?; how about cybersecurity? All of the above? None of the above?

Secretary Gates advocated for more resources for the State Department because he knew the military cannot do it alone, and there are critical missions he did not believe our military should be doing.

In both Iraq first and now Afghanistan, we are shifting to emphasize helping friendly militaries train their forces to cope with their security problems instead of us doing it for them.

This is not the war of decisive outcomes that we fought in the past.

WARFARE/TECHNOLOGICAL CHANGES

How we fight also is changing in important ways.

Today we have net-centric warfare; asymmetric warfare; systems-of-systems; and joint and coalition operations.

Each one of these raises questions about how front-line decisions are made as the front line itself becomes harder to define.

Some people say the answer is not in superior technology. Rather, they say we have to invest in smart, adaptable people. That people will trump technology. Some say we need the right balance of both.

Because of the budget situation, we will be forced to choose. Should it be billions for weapons or billions to retain experienced mid-level officers and NCOs’.

What will be keys to success in the future?

One thing is certain, we cannot do it all, so we will have to make hard choices and avoid wasting resources on capabilities whose value is diminishing.

This is just one among the many tough strategic decisions we face as we seek greater value in a resource-constrained defense budget.

Another question we have to answer is whether the current DOD organizations and processes will deliver the decisions we need—or put in another way is the organization up to the tasks.

However if the Department and the Congress do not substantially reform the acquisition process, overhead costs and the bureaucracies—and if the personnel and benefits continue to increase at the cyclic rate—we will -- as the QDR independent panel has so forcefully pointed out-- be looking at the trade-offs of a much smaller active duty military, little or no modernization or significantly less investment in research essential to maintain our technological edge.

All of us in the national security community need to help. In particular, we need support in the Congress, which historically has led the way in pushing needed changes in the executive branch. In recent years, however, Congress has been not much more than an interested bystander and has adapted a strategy of alternating between an adding machine or a machete. Congress need to be a full partner in providing the changes in law and budgets to support the fundamental shifts that must occur.

CONCLUSION

To defuse all these ticking time bombs, the nation will need leaders with profound wisdom, courage, and determination.

Fortunately, today there are a number of such leaders in significant positions of authority, at the White House, at the Pentagon and in business, helping to lead us in the right direction.

Change will require significant sacrifices on all fronts and in all spending categories and revenue potential—mandatory and discretionary, domestic and defense. Sacrifices that are essential if we are to return to the promise of a better quality of life and more promising future for our children and grandchildren as well as the thousands upon thousands around the world who still see America as a beacon of hope in a troubled world.

It would be Pollyannaish to think these kinds of difficult choices will or should exempt the Department of Defense—the largest repository of discretionary spending which contains some of the more expensive entitlements in government. We clearly need to think smarter – not richer.

Thanks to each and every one of you here today, particularly those who wear our nation's uniform and to those who serve in government, and those who have served.

Thank you.

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NOTE: This paper is an updated version of a speech General Punaro made to the Committee for a Responsible Federal Budget and other audiences. The initial speech was made on April 22, 2011. He has continued to update and give this speech and the numbers are current as of February 1, 2013 as the text has stayed constant.

¹ The charts used in this presentation were either developed by the Author or used in a publically released task force report in July 2010 of the Defense Business Board related to reducing DOD's overhead which he chaired. Gen Punaro has chaired similar efforts for the last three Secretaries of Defense, starting with the Defense Reform Task Force for Sec. Cohen in 1997. Additional charts are taken from a publically released report of the Reserve Forces Policy Board in Dec. 2012 which Gen Punaro chaired.