The Future Affordability of U.S. National Security

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Summary of Key Points

- The United States currently devotes about 4.7 percent of gross domestic product (GDP) to national defense and another 1.5 percent to broader security efforts, including international affairs, homeland security, veterans' affairs, and intelligence.
- What share of GDP will be affordable for security over the long term depends on a variety of factors, including:
    - Public perceptions of the security threat;
    - The degree of debt-induced fiscal and economic risk policy makers are willing to run;
    - The level of taxation the public is willing to bear;
    - Whether and how much the costs of federal entitlement programs, particularly Medicare and Medicaid, can be reined in; and
    - How much money is devoted to running the rest of the federal government.
- Putting federal budgets on a sustainable path will require shifting about six percent of GDP into revenues or out of spending, relative to their likely current course, according to the Congressional Budget Office.
- Depending on how that shift is distributed among taxation, entitlement spending, defense spending, and nondefense discretionary spending, an affordable long-term level for national defense will be between 1.6 percent and 2.6 percent of GDP.
- An affordable long-term level of total security spending might thus be between 2.1 percent and 3.4 percent of GDP.

The Future Affordability of U.S. National Security

Introduction

The U.S. government faces a tough fiscal future. If taxes do not rise and federal spending continues on its current likely course, the Congressional Budget Office (CBO) finds that federal debt will rise to unsustainable levels over the coming years.[1] To avoid the stark fiscal and economic risks associated with such a path, CBO finds that policy makers must act within a few years to raise taxes, lower spending relative to anticipated levels, or both. The longer action is delayed, the higher the tax rise and the deeper the budget cuts will have to be to achieve fiscal sustainability.

Spending for national defense and security grew sharply in real terms during the past decade, but that spending is by no means the sole cause, or even the most significant cause of the nation's future fiscal problems. Nevertheless, if history is a guide, policy makers will see cutbacks to defense and security budgets as an important part of their efforts to bring deficits under control.

The Budget Control Act of 2011, signed by President Obama on 2 August 2011, calls for multiple rounds of deficit reduction. The first round would trim non-war defense and security budgets by less than ten percent in real terms, relative to 2011 levels. If the congressional supercommittee established under the Budget Control Act cannot reach a deficit reduction agreement that is satisfactory to Congress and the President, then the law's automatic "sequestration triggers" would push non-war defense spending lower; the total inflation-adjusted reduction to non-war national defense budgets relative to 2011 levels would be about 16 percent. That outcome would return non-war national defense spending in real terms to about the level it held in 2006.

The Department of Defense is already working on ways to absorb the smaller trim of the first round. Key leaders in the department and Congress strongly oppose the larger cutbacks that would ensue under the sequestration triggers, however; they argue that any reductions beyond the size imposed through the first round of the Budget Control Act would harm the nation's security.

Unfortunately, even the budget cuts brought on by the Budget Control Act's sequestration triggers would not come close to putting the federal government on a sound fiscal footing. CBO's calculations suggest that achieving fiscal sustainability would require nearly four times the amount of deficit reduction as the August law would produce. In fact, concerns about the nation's fiscal situation may well push defense and security spending significantly lower than the sequestration targets the Defense Department now holds to be untenable. If this is the likely longer-term result, then national leaders would do well to develop contingency plans now for delivering security in a significantly more austere environment than the one they now wish for.

[1] Congressional Budget Office, *CBO's 2011 Long-Term Budget Outlook*, June 2011.

The United States currently devotes about 4.7 percent of gross domestic product (GDP) to national defense.[2] This includes the costs of the wars in Iraq and Afghanistan, which today account for about one percent of GDP. Another 1.5 percent of GDP goes toward programs and activities that are closely related to national security and captured in a category designated “security” in recent federal budget summaries, bringing total security spending to about 6.2 percent of GDP.[3] In addition to national defense, the security budget includes international affairs, homeland security, veterans’ affairs, and those intelligence programs that do not figure in the defense budget.[4]

Some observers believe the nation can afford indefinitely to devote about five percent of GDP to defense, with additional sums for broader security efforts.[5] Others argue that addressing the nation’s fiscal problems and improving long-term economic prospects will require a significant reduction in the share of the economy that goes to defense and security.[6]

What share of GDP is affordable depends on a variety of factors, including public perceptions of threats to the nation’s security as well as concerns over the nation’s fiscal future. On the fiscal side, the share of GDP deemed affordable will depend upon the level of taxation the public is willing to bear, the degree of debt-induced risk the nation’s policy makers are willing to run, and choices about how much money should be devoted to other federal activities. This article explores the fiscal factors in an effort to determine how much the United States can reasonably afford to spend on defense and other aspects of security.

Using CBO’s analyses of the overall federal budget as a starting point, I find that an affordable long-term level for national defense spending is between 1.6 percent and 2.6 percent of GDP. Within that band, the affordable level will depend upon whether taxes are permitted to rise and on how the cuts in federal spending are distributed among three broad categories: mandatory programs, nondefense discretionary accounts, and national defense.[7] Assuming that the wars in Iraq and Afghanistan wind down a few years from now and are not replaced by new, expensive wars, that translates into cutting the non-war defense budget in real terms by four percent to 40 percent, relative to its 2011 level, within the coming decade.

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[2] The federal budget function designated “national defense” includes spending by the Department of Defense, the atomic energy programs that provide nuclear weapons and environmental cleanup of the nuclear weapons establishment in the Department of Energy, and smaller defense-related programs in other agencies.

[3] Author’s calculation; OMB’s mid-session review for fiscal year 2012 reports total appropriated security outlays at 5.6 percent of GDP. Mandatory outlays by the Department of Defense and the VA add another 0.6 percent.

[4] The federal budget function designated “international affairs” includes spending by the Department of State, foreign assistance spending, and money for international outreach and exchange programs. Most of the intelligence budget falls within the Defense Department’s budget.

[5] During the past decade, several former senior military officers argued that non-war defense spending should rise to a level of four percent of GDP and be held there, citing that share of the economy as both necessary for a strong defense and affordable over a long period. The same view was espoused by policy analysts at the Heritage Foundation and the American Enterprise Institute. More recently, Martin Feldstein argued that any figure short of five percent of GDP is affordable. Martin Feldstein, “America’s Challenge,” AEI Annual Dinner Address, May 3, 2011.

[6] See for example Michael Mandelbaum, *The Frugal Superpower: America’s Global Leadership in a Cash-Strapped Era* (New York, NY: Public Affairs, 2010).

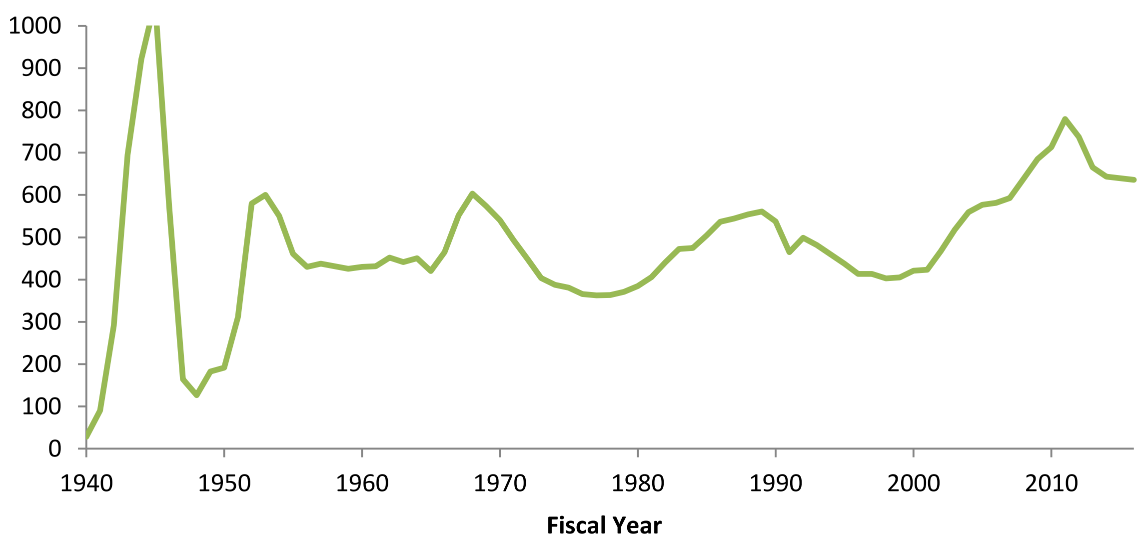
[7] Discretionary activities are those whose funding depends on appropriations each year. Mandatory programs are those whose funding is determined by extant law.

The article is organized as follows: The next section offers a look at the historical context for national defense spending and the overall federal budget. The article continues with an examination of the fiscal pressures and rising debt that loom in the future if federal spending continues to climb as anticipated and tax revenues do not rise appreciably as a share of GDP. It then focuses on how policy makers might address the fiscal problems and avert an unsustainable debt load. Finally, it turns to the implications of those choices for future defense and security budgets, and the potential consequences of lowered security spending for the economy.

The Historical Context

Typically, U.S. defense spending rises in real terms during wars and adjusts back to lower levels at war's end (see figure 1). Defense spending also rose during the Carter-Reagan military buildup of the late 1970s and early 1980s, and returned closer to pre-build-up levels with the military drawdown that began just before the Cold War ended. Beginning in 1998, defense budgets began to climb again, and the rise accelerated following 9/11. Today, spending for national defense is substantially higher in real terms than at any time since World War II.

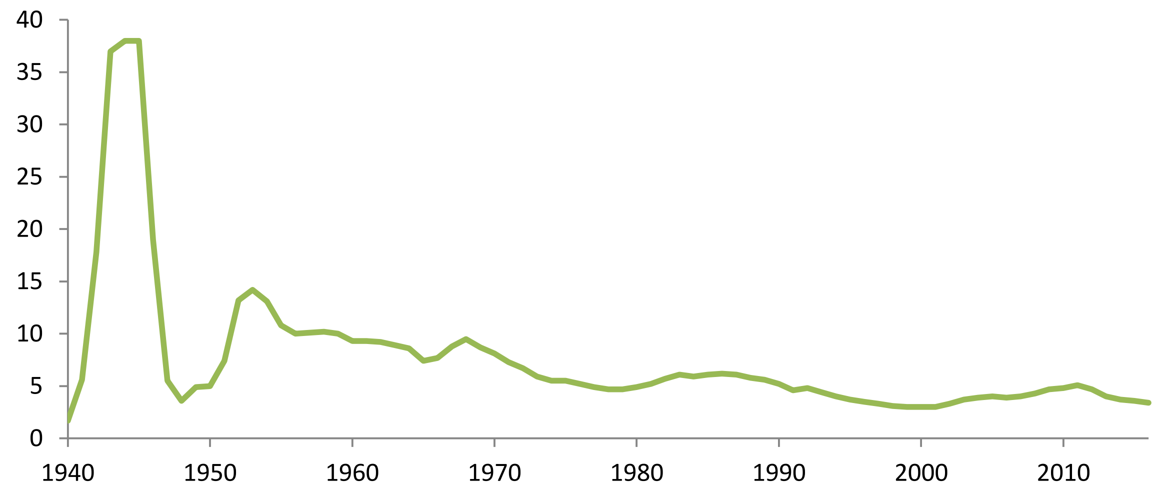
Figure 1. U.S. Outlays for National Defense
(Billions of Constant FY 2011 Dollars)



As a share of the economy, however, national defense expenditures are lower than the seven percent share of GDP the United States devoted on average to the category during the Cold War. In fact, except for relative increases during wartime and to fund the Carter-Reagan buildup, the trend for national defense spending as a share of the economy has been downward over a period of decades (see figure 2). (Federal reporting of budgets for the wider security category is quite new, so comparable historical comparisons are not available for that more inclusive category.)

It might seem that if the United States could once afford to spend seven percent of GDP on defense, establishing a five percent floor on the future allocation to defense would not be difficult. Over the course of several decades, however, the way that the nation divides its federal budget pie has changed markedly. As discussed in the next section, spending for the major entitlement programs, particularly Social Security, Medicare, and Medicaid, has grown rapidly as a share of the pie. The result can be viewed as a crowding out of defense spending that will make it extremely hard to increase defense's share in the future, short of a dire national security emergency.

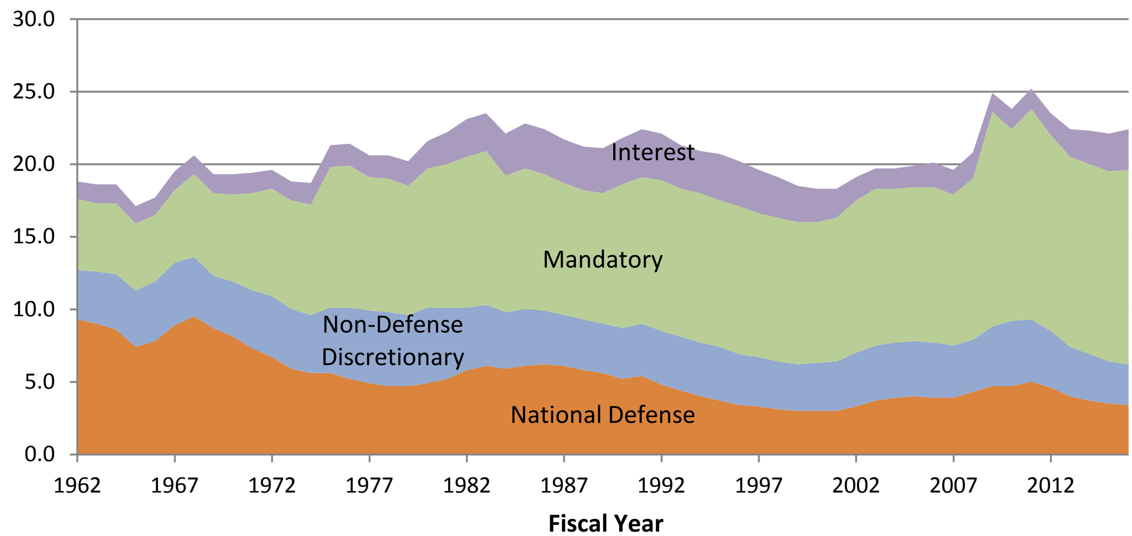
Figure 2. U.S. Outlays for National Defense (Share of GDP in Percent)



The size and allocation of the federal budget since the 1960s

Since 1962, the total federal budget (including interest payments on debt held by the public) has drawn between 17 percent and 25 percent of GDP (see figure 3). Non-interest federal spending has averaged about 18.5 percent of GDP, with interest on the public debt claiming on average another two percent. But the share of GDP devoted to mandatory programs—which include Social Security, Medicare, Medicaid, pension payments for retired service members and federal civilians, and other payments that are determined by extant law rather than by annual appropriation—has nearly tripled, from 4.9 percent of GDP in 1962 to 14.5 percent in 2011. Medicare and Medicaid, which did not exist in 1962, now claim about five percent of GDP. In fact, between 1971—the last year in which national defense spending topped seven percent of GDP—and today, federal health care expenditures more than quadrupled as a share of the economy. Social Security spending nearly doubled as the elderly population grew and benefits were expanded, climbing from 2.5 percent of GDP in 1962 to 4.9 percent today.

Figure 3. Federal Outlays as a Share of GDP (percent)



Outside of defense and the mandatory programs, generations of national leaders have vowed to "shrink the size of federal government." In actuality, they have never gained much traction in reducing the spending category associated with the running of the government. Federal activities that must be appropriated from year to year are denoted in the budget as "discretionary." Most of the defense and security budgets fall into the discretionary category.[8] Funds to run all of the government's nondefense departments and agencies—for example the Departments of Homeland Security, Transportation, Education, and State—are denoted "nondefense discretionary." During the past 50 years, as defense spending shrank from a high of 9.3 percent of GDP in 1962 to a low of three percent in 2000, the nondefense discretionary budget remained closer to its average of four percent, varying between a high of 5.2 percent in 1980 and a low of 3.2 percent of GDP in 1999. The persistence of the funding share for

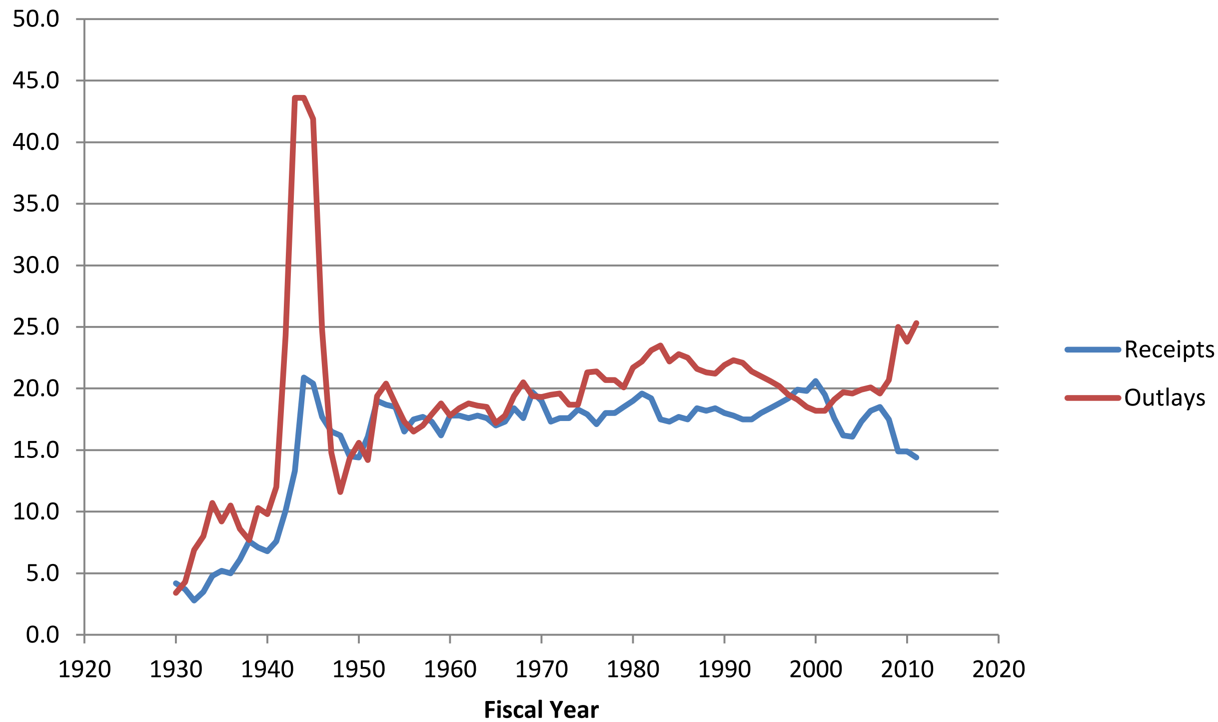
[8] VA is an exception; about one-half of veterans' funding currently falls into the mandatory category.

this category through decades of budget negotiations can make today's pledges to shrink the size of government and dramatically reduce nondefense discretionary spending ring hollow.

Revenues, deficits, and debt since the 1960s

Before the 1960s, federal leaders generally sought to balance the budget, except in times of war and economic recession.[9] Since the 1960s, however, federal revenues generally have not kept pace with spending (see figure 4). Initially during the Kennedy administration, policy makers saw lowered taxes and increased spending as mechanisms to stimulate the economy. They argued that running deficits in the near term would promote growth, which in turn would increase federal revenues and avert deficits in later years. The recipe seemed to work; the economy picked up and the budget was balanced (see figure 5).[10]

Figure 4. Outlays and Revenues as Share of GDP (Percent)



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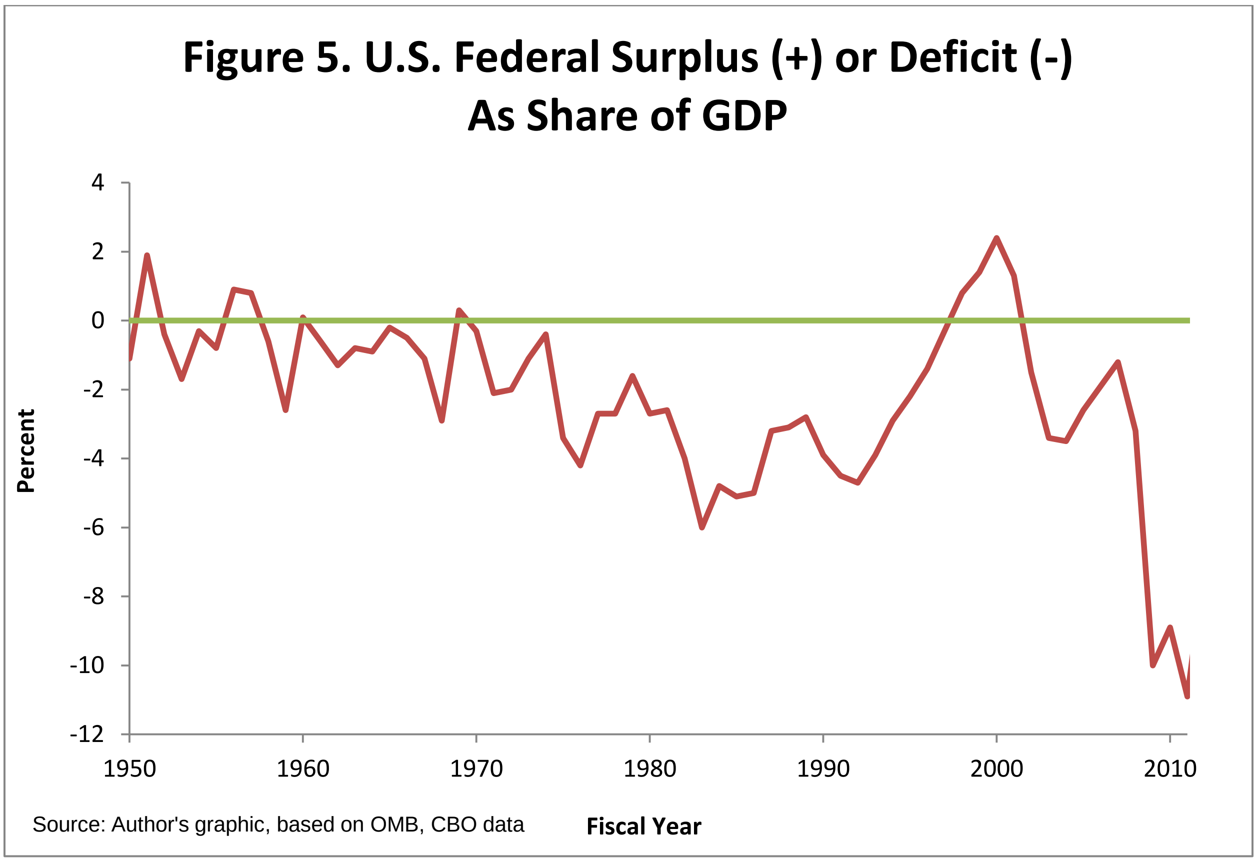
[9] Dennis Ippolito, *Why Budgets Matter: Budget Policy and American Politics* (Pennsylvania State University Press, 2003), pp. 3-4.

[10] Dennis Ippolito, *Why Budgets Matter: Budget Policy and American Politics* (Pennsylvania State University Press, 2003), pp. 5-6.

By the 1980s, however, the character of deficits changed from small, short-running and stimulative to deep, long-running, and structural—that is, they represented a structural imbalance between spending and revenue policy that would persist even if the economy operated at "optimum levels of growth and employment."[11] The result was a steep climb in debt held by the public (see figure 6).

Concerned over persistent deficits and mounting debt, Congress in 1985 passed the Gramm-Rudman-Hollings Act, which was structured to tie lawmakers' hands to balance the budget within a few years. With no agreement among policy makers regarding how deficits should be reduced—whether by raising taxes, reining in entitlements, shrinking the size of government, or cutting back on defense spending—Congress abandoned that law within a few years, and deficits deepened again.

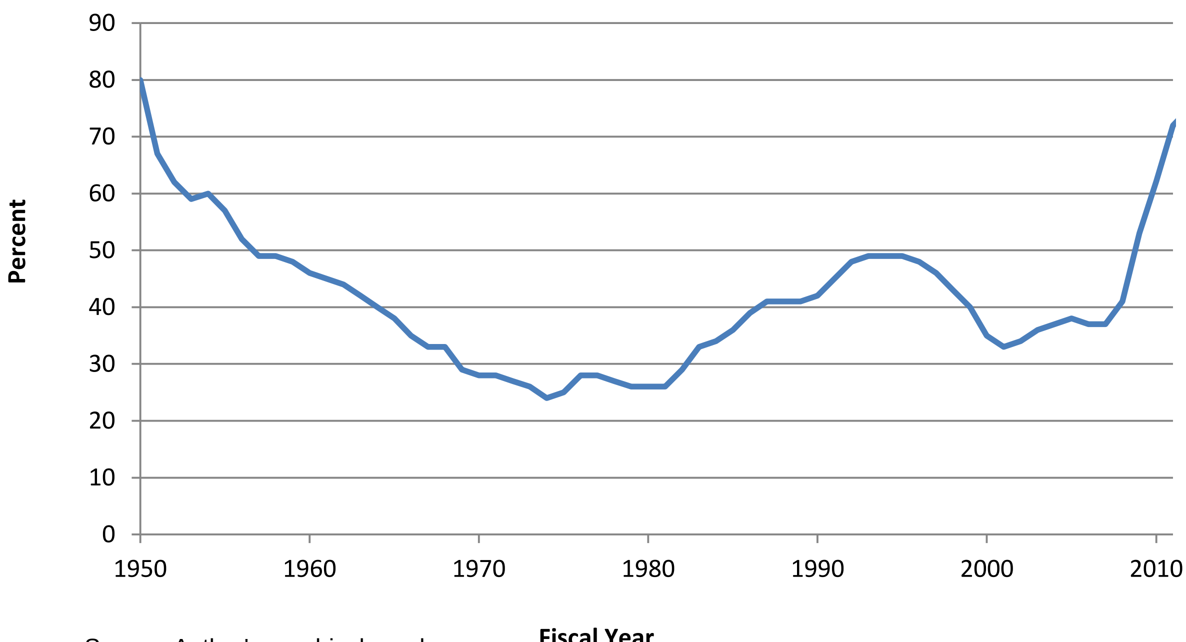


The end of the Cold War and the economic expansion of the 1990s, coupled with more workable budget control mechanisms in Congress, actually led to fiscal surpluses by the close of the twentieth century. Most of the budget cuts were drawn from the Department of Defense, which shrank in size by nearly

[11] Dennis Ippolito, *Why Budgets Matter: Budget Policy and American Politics* (Pennsylvania State University Press, 2003), p. 7.

one-third during the period. Rising tax receipts also contributed significantly. Between 1993 and 2001, revenues grew from about 16 percent to nearly 21 percent of GDP, the combined result of the economic boom and tax policy. With revenues larger as a share of GDP than they had been at any time since World War II, it was easy for the Bush administration to argue for the tax cuts that Congress adopted in 2001 and 2002. (Those tax cuts were extended for two years in 2010.) In the current anti-tax political climate, tax increases that would return revenues to the 21 percent of GDP seen at the turn of the century seem fairly unlikely.

Figure 6. U.S. Federal Debt (Share of GDP)



Source: Author's graphic, based on OMB, CBO data

Future Pressures on the Federal Budget

Absent significant reform or a major expansion of the total federal budget, the rising costs of Social Security, Medicare, and Medicaid will continue to crowd out defense spending. In the extreme, if federal budgets are held near today's levels as a share of GDP, nondefense discretionary spending is not reduced significantly, and mandatory spending is not brought under control, there will soon be no money left for defense. Clearly, the nation's leaders will need to find another path. This section highlights some of the pressures that are likely to push defense spending down in the coming years.

Health care and Social Security

Health care costs are the fastest-growing portion of the federal budget. The Congressional Budget Office projects that if current laws remain in place, federal spending for the major federal health care programs is likely to rise from about 5.6 percent of GDP today to more than 9 percent of GDP by 2035; it will continue to grow faster than the economy thereafter.[12] If payments to health care providers are not held in check as envisioned under current law, then spending for those programs will grow even more rapidly. In contrast, Social Security spending will climb from about 5 percent of GDP today to about 6 percent of GDP within 20 years, but after that can be expected to stabilize as a share of the economy.

A substantial share of the anticipated rise in the costs of federal health care programs can be attributed to the aging of the population. 2011 is the first year of Medicare eligibility for the leading edge of the baby-boom generation. Medicare costs are expected to rise annually as large numbers of baby-boomers reach retirement age each year and enter the system. Between now and 2035, CBO estimates that aging will account for about one-half of the cost growth in the federal government's major health programs.[13] Over a seventy-five-year period, however, aging will account for less than one-third of the rise in costs.[14]

The remainder of the growth in health care costs can be attributed to the rapid growth in the underlying costs of health care across the United States. Controlling the government's spending in this area would require reducing the share of individuals' medical expenses that the government pays, slowing the underlying rate of cost growth for health care, or both.

The health care reform act of 2010 is meant to accomplish both. Its provisions regarding electronic medical records are aimed in part at reducing the costs, for example by avoiding the need to undertake a second round of medical tests because an individual's doctor is unaware of the results of a previous round. The law also reduces in real terms the amount that the government will pay to health care providers for the services they render. If not overturned, that provision would save taxpayers money in the coming years. Congress has mandated such provisions in the past, however, only to overturn them in later years under pressure from the medical community and seniors' advocacy groups.

Other ways to rein in the rising cost of federal health care programs include raising the age of eligibility for Medicare, raising the size of premiums that individuals pay for coverage, or shifting Medicare from the system in which the government reimburses health care providers for services to one in which each Medicare-eligible individual receives a voucher, indexed to inflation, to pay for private-sector medical insurance. All of those mechanisms have been proposed this year in the context of the deficit reduction.

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[12] The major health care programs included in CBO's estimate are Medicare, Medicaid, the Children's Health Insurance Program (CHIP), and insurance subsidies to be provided by medical insurance exchanges that the 2010 health care reform law would create by 2014. Congressional Budget Office, *CBO's 2011 Long-Term Budget Outlook*, June 2011, p. 35.

[13] "CBO's 2011 Long-Term Budget Outlook," June 2011, p. 10.

[14] "CBO's 2011 Long-Term Budget Outlook," June 2011, p. 10.

The Medicare voucher and insurance reform proposal put forward by House Budget Committee Chairman Paul Ryan in April 2011 would hold spending for the major federal health programs close to today's level as a share of GDP for a period of decades, thus shaving about three percent of GDP from the anticipated size of future federal deficits.[15] Compared with CBO's long-term budget scenarios, however, that proposal over time would more than double the out-of-pocket costs of health care for a typical Medicare beneficiary.[16] The fierce opposition that met Chairman Ryan's proposal immediately after its release should serve as an indication that health care cuts as deep as that may not be feasible politically.

Expanding the budget pie so there is more for all

Suppose that bills in the mandatory accounts continue to mount as CBO anticipates, and that nondefense discretionary spending continues to hold onto its 50-year average share of GDP. If national defense spending remains at five percent of GDP for the next twenty-five years, then non-interest federal expenditures will top 25 percent of GDP by 2035, well above any level seen since World War II ended.

To sustain that level of non-interest spending over the long term, the nation could choose between substantially higher taxes and rapid growth of the federal debt. To hold spending at 25 percent of GDP without an expansion of the debt would require revenues of at least the same magnitude. Yet federal revenues this year come to less than 15 percent of GDP. Even at the height of World War II, they did not exceed 21 percent. Average revenues over the past half-century came to about 18 percent of GDP.

Other countries do support taxation at higher levels. OECD members on average spend nearly six percent more of their GDPs to finance their governments than the United States.[17] Unfortunately, adding six percent of GDP to U.S. federal tax hauls would bring revenues to 21 percent of GDP, not the 25 percent needed to avoid future deficits if spending is left uncontrolled. Moreover, economists worry that raising tax rates much beyond historical norms could reduce individuals' incentive to work, thus reducing the labor supply and lowering the nation's economic output.[18] Significantly higher taxes also pose the risk of reducing national savings rates.[19]

In short, it could be risky simply to expand the size of the federal budget pie to accommodate the anticipated growth of mandatory spending while keeping discretionary spending at or near current

[15] Congressional Budget Office, "Long-Term Analysis of a Budget Proposal by Chairman Ryan," April 5, 2011.
[16] Congressional Budget Office, "Long-Term Analysis of a Budget Proposal by Chairman Ryan," April 5, 2011, p.4.
[17] OECD Factbook 2010: Economic, Environmental and Social Statistics, "General government revenues as a percentage of GDP." The figure includes revenues drawn at regional and local levels as well as the national level. OECD is the Organization for Economic Cooperation and Development, which brings together the governments of 34 democratic countries with market economies.
[18] CBO outlines two offsetting arguments on the economic effects of higher tax rates, but on balance finds that a lower marginal tax rate increases the labor supply and vice versa. "CBO's 2011 Long-Term Budget Outlook," June 2011, p. 28.
[19] "CBO's 2011 Long-Term Budget Outlook," June 2011, p. 28.

levels as a share of the economy. More fundamentally, it seems highly unlikely that the American public would stand for the tax increase that would fund such a course.

CBO's estimates of future debt under two fiscal scenarios

The Congressional Budget Office explores the potential long-term fiscal and economic consequences of broad policy choices in periodic reports, the most recent of which was published in June 2011.[20] CBO examines the possible consequences of two divergent fiscal scenarios: one that adheres to the laws and policies that are in place today, and another that assumes a more realistic set of future policies. To examine the future consequences of policies in place today, CBO makes the following assumptions: First, there are virtually no changes to current laws regarding eligibility and payments under the mandatory programs. This means, for example, that payments to medical providers will drop dramatically in real terms over the next few years, as the health care reform act dictates. Second, there are virtually no changes to current tax policy. This means that the tax cuts passed in 2001 and 2002, and extended last year for a two-year period, will expire about a year from now. Third, throughout the coming decade, discretionary spending (both defense and nondefense) will rise annually consistent with inflation. After 2021, defense and nondefense discretionary spending will each retain a constant share of GDP. For national defense, the starting point in 2011 includes the costs of the wars in Iraq and Afghanistan. Under this scenario, national defense spending would fall from 4.7 percent of GDP in 2010 to 3.6 percent of GDP in 2021, and remain at that level as a share of GDP for 15 years thereafter. That 3.6 percent would be expected to cover any war costs as well as the non-war budget.

Under this so-called "extended baseline" scenario, CBO finds that debt held by the public will rise from about 69 percent of GDP today to 84 percent of GDP 25 years from now.[21] Letting the federal debt rise to that level could have negative fiscal consequences. Among other things, higher debt means higher interest payments, even if interest rates do not rise. Should interest rates climb from today's extremely low levels to a more typical three percent, interest payments alone would consume 2.5 percent of GDP, compared with 1.4 percent today. Should the larger debt cause creditors to demand an interest premium and push interest rates higher—say to five percent—then payments on the debt would rise above four percent of GDP. While that level of debt would be cause for concern, it would not likely wreck the economy. Thus, if the United States holds to its current policy course, then national defense spending at 3.6 percent of GDP might just be affordable over the long run.

Unfortunately for defense, CBO's extended baseline scenario is highly unrealistic. On the spending side, it assumes that doctors will accept the lower payments under Medicare and Medicaid that the law currently calls for. In the past, laws calling for capped or lowered payments to medical providers have been overturned before the pinch actually took place. A more likely scenario is that payment rates for physicians will stay at their current levels in real terms for another decade. This is the assumption CBO makes in its so-called "alternative fiscal scenario."

[20] "CBO's 2011 Long-Term Budget Outlook," June 2011.
[21] "CBO's 2011 Long-Term Budget Outlook," June 2011, Summary page 2.

On the tax side, CBO's extended baseline scenario assumes that tax laws in place today will sunset next year, and tax rates will revert to the levels of 2000. Moreover, it assumes that provisions like the alternative minimum tax and the income bands for the various tax rates will not be adjusted for inflation. As a result, tax revenues would rise to 23 percent of GDP by 2035, significantly higher even than during World War II. A more realistic path is that the tax cuts of 2001 and 2002 will again be extended, the alternative minimum tax will be adjusted to affect about the same share of taxpayers as in the past, and tax revenues will return to their historical share of GDP. CBO makes these assumptions in its alternative fiscal scenario. Finally, the alternative scenario makes the same assumptions about discretionary spending as the extended baseline.

CBO finds that if the alternative fiscal scenario were to unfold, debt held by the public would top 100 percent of GDP by 2021—coming close to the 109 percent that marked the highest point in U.S. history during World War II. By 2035, debt would rise to about 190 percent of GDP. Moreover, rather than leveling off or declining as it did at the end of World War II, debt would continue to build.

The consequences of rising levels of debt

Debt at that level is unsustainable from fiscal and economic points of view. Even if interest rates stayed below three or four percent—a most unlikely outcome—interest payments on the public debt would rise to 5.7 percent or 7.6 percent of GDP. That is well above the historical average of two percent and, in the latter case, about one-third of the share of GDP typically held by the total federal budget. More likely, however, interest rates would rise as creditors concerned over the possibility of default demanded higher yields.[22] Should interest rates rise to ten percent—a situation that the United States experienced in the past—then federal interest payments alone would reach 19 percent of GDP, about the same as the average size of the entire non-interest budget during the past 50 years.

In addition to pushing interest rates higher, such a sizeable debt poses a substantial risk of crowding out investment in productive activities that promote economic growth. CBO estimates that by 2035, real gross national product would be between seven and 18 percent lower under this scenario than is likely if deficits and debt are held in check.[23]

More generally, running such a large debt would limit the flexibility the nation's leaders have in dealing with economic or financial crises. If banks are on the brink of failure and the federal debt already

[22] Some analysts argue that rising debt levels are less likely to push interest rates up than in previous decades, because of the position of the U.S. dollar as the world's reserve currency and the large fraction of the public debt that now is held by foreign governments. Briefly, they hold that foreign creditors with vast holdings of dollars accumulated by selling goods and services in the United States really have no other good place to put their money. Recent problems in euro-zone economies reinforce this point of view. So does the fact that interest rates today are at a historical low point, despite the fact that U.S. federal debt is at a post-World War II high point. Nevertheless, most economists would agree that running a debt that approaches twice the size of the economy is risky business indeed.

[23] CBO's analysis does not fold this economic penalty back into its calculations of budgets and revenues each year. If the negative economic effects are included, then debt held by the public could reach 250 percent of GDP by 2035. "CBO's 2011 Long-Term Budget Outlook," June 2011.

exceeds the size of its GDP, adding to that debt to provide a bailout will be even harder than it was the last time. Getting lawmakers to agree on a stimulus package of any size to deal with a recession will not be any easier. Yet the very size of the debt could also cause creditors to lose confidence in the government's ability to pay its bills and make good on its debts, thus sparking a rapid rise in interest rates that would make borrowing unaffordable and lead to a fiscal crisis.

How to avert an unsustainable level of debt

To avoid such troubling prospects, the federal government would need to bring spending and revenues closer into alignment. CBO estimates that moving to a sustainable path would require an "immediate and permanent" shift in spending or revenues of 4.9 percent of GDP, relative to the (more realistic) alternative fiscal scenario, beginning this fiscal year.[24] That shift could come from increasing taxes, reducing budgets, or a combination of the two. To put the problem in context, this is more than three times the size of the shift called for in the Budget Control Act of 2011.

If most of the problem is deferred—as seems likely—then an even greater share of GDP will need to be cut from spending or added to revenues relative to the alternative fiscal scenario. If the changes are deferred to 2015, then CBO estimates that from that year forward, spending will have to be cut or revenues raised (or a combination of the two) by 5.9 percent of GDP—nearly four times the size of the sift called for under the Budget Control Act. If changes are deferred until 2020, then 8.1 percent of GDP will have to be moved from one side of the ledger to the other.[25]

The Consequences for National Defense Spending

CBO's extended baseline scenario assumes that national defense spending, including the costs of wars, will fall to 3.6 percent of GDP by 2021 and remain at that share for another 15 years. In other words, if the American public is willing to support a return to the tax rates of 2000, forego adjustments to the income levels at which the alternative minimum tax applies, and sharply reduce payments to doctors for services performed under federal health care programs, then 3.6 percent of GDP could be an affordable level of spending for defense for as much as 25 years.

Compared with the 4.7 percent of GDP that the United States devotes to national defense today, 3.6 percent might seem like a significant loss for the defense establishment. On the contrary, that outcome would translate into a significant rise in the non-war defense budget when measured in real terms. Assuming that the wars in Iraq and Afghanistan can be ended and are not replaced by new, expensive wars, then the full 3.6 percent of GDP allocated to national defense under this scenario would go toward the non-war budget. Today, the non-war budget captures about 3.8 percent of GDP. Thus, even when measured as a share of GDP, the reduction in base defense spending would be minimal. In real terms, this outcome would actually increase the non-war defense budget by 30 percent over the 10-year

[24] The shift is measured in comparison to the more realistic "alternative" fiscal scenario.
[25] "CBO's 2011 Long-Term Budget Outlook," June 2011, p. 16.

period between 2011 and 2021. Defense would continue to gain substantially in real terms thereafter, as its constant 3.6 percent share of GDP would keep budgets well ahead of inflation year after year.

That scenario seems highly unlikely, however—both because raising revenues to 23 percent of GDP could impose a drag on the economy and because public sentiment is strongly against a significant rise in taxes.

If decision makers do not act until 2015, then avoiding the unsustainable fiscal and economic path of the alternative fiscal scenario means cutting about six percent of GDP from spending compared with CBO's alternative fiscal scenario, or raising that much extra in revenue, every year from 2015 until 2035. Politics will decide whether and how to apportion that pain among taxes, mandatory accounts, nondefense discretionary, and defense spending.

For insight into a worst case for defense, one can look at how the national defense budget fared in the Budget Control Act of 2011. That law calls for two rounds of fiscal shifts. The first round affects only the discretionary accounts. The second round allows the congressional supercommittee to choose among and apportion specific tax increases, mandatory cuts, and discretionary cuts. If the supercommittee fails in its charge, however, then the sequestration triggers that follow will hold taxes harmless and apportion one-half of the cuts to national defense. Should such a system be devised to shift six percent of GDP from federal spending, then defense would have to cut about three percent of GDP from the outyear level of 3.6 percent that it holds in the CBO scenario. In other words, only 0.6 percent of GDP would be left for defense. Nondefense discretionary accounts would have to be cut back to 0.1 percent of GDP. This seems an extremely unlikely outcome. On the other hand, barring a military emergency, it seems unlikely that defense will be spared from absorbing some share of the needed fiscal shift.

Table 1 explores the level of revenues, spending, and debt over a period of 25 years under five scenarios: CBO's extended baseline, CBO's alternative fiscal scenario, and three fiscal paths that CBO would consider sustainable. The first scenario—CBO's extended baseline—comes close to being sustainable, in that debt held by the public rises from 69 percent to 84 percent of GDP over the 25-year period. As discussed in the previous section, however, it seems unrealistic because it requires revenues that are significantly higher than historical levels.

The second scenario—CBO's alternative fiscal scenario—is more realistic, but is unsustainable; debt would rise to almost twice the size of the GDP by 2035. Scenarios 3, 4, and 5 are devised to be sustainable under CBO's definition—that is, beginning in 2015, they shift six percent of GDP out of the deficits that accrue each year under CBO's alternative scenario, either by shaving from spending or adding to revenues or both. Specifically, Scenario 3 trims 1.5 percent of GDP from mandatory programs, 1.5 percent from nondefense discretionary, and 1.5 percent from national defense every year beginning in 2015, compared with what spending would be under CBO's alternative fiscal scenario; it raises revenues by 1.5 percent of GDP relative to the alternative fiscal scenario.

Scenarios 4 and 5 are both “no new taxes” scenarios. Scenario 4 holds revenues at the level of 18.4 percent of GDP, as envisioned in CBO’s alternative fiscal scenario. It then evenly distributes the entire six-percent shift among the three categories of spending; that is, each spending category is cut by 2 percent of GDP relative to what it would be under the CBO alternative fiscal scenario. Scenario 5 apportions the pain among the three spending categories in proportion to their shares of the total non-interest budget under CBO’s alternative fiscal scenario in 2021; that means that 4.1 percent of GDP is cut from mandatory spending, 0.9 percent from nondefense discretionary spending, and 1.0 percent from national defense spending.

Table 1. Revenues, Spending, and Debt Under Four Scenarios
Share of GDP (Percent)

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
	CBO Extended Baseline	CBO Alternative Fiscal Scenario	4-Way Even Split among Revenues and 3 spending areas	3-Way Even Split among 3 Spending Areas	3-Way Proportional Split among 3 Spending Areas
Revenues					
2011	14.8	14.8	14.8	14.8	14.8
2021	20.8	18.4	19.9	18.4	18.4
2035	23.2	18.4	19.9	18.4	18.4
Mandatory					
2011	13.6	13.6	13.6	13.6	13.6
2021	13.8	14.8	13.3	12.8	10.7
2035	16.6	18.3	16.8	16.3	14.2
Nondefense Discretionary					
2011	4.4	4.4	4.4	4.4	4.4
2021	3.1	3.1	1.6	1.1	2.2
2035	3.1	3.1	1.6	1.1	2.2
National Defense					
2011	4.7	4.7	4.7	4.7	4.7
2021	3.6	3.6	2.1	1.6	2.6
2035	3.6	3.6	2.1	1.6	2.6
Debt Held by the Public, 2035	84	187	69	69	69

As Scenario 3 suggests, if mandatory programs, nondefense discretionary, national defense, and revenues are each required to contribute one-quarter of the shift, then the long-term affordable level of defense spending is 2.1 percent of GDP. Assuming that the wars in Iraq and Afghanistan end within a few years, and that new wars do not take their place, in 2021 that represents about a 22 percent reduction in real terms to the base budget for national defense relative to the 2011 level. Scenario 3's distribution of the deficit reduction would leave the nondefense discretionary accounts with just 1.6 percent of GDP, however.[26] That figure is greatly at odds with historical spending for this category, which has remained close to constant around an average of 4 percent for decades. Thus, in the absence of major war or visibly rising external threat, policy makers may well decide that even 2.1 percent of GDP is unaffordable for defense over the long term.

Scenario 4 suggests that if revenues revert to their historical share of GDP, and if deep cuts to mandatory spending as a share of GDP are not feasible, then policy makers who want a sustainable budget should expect to spend no more than 1.6 percent of GDP on national defense and 1.1 percent on nondefense discretionary programs by 2021. For defense over the next decade, this represents a 40 percent real decline in non-war spending relative to the 2011 base budget, assuming that war costs can be brought to zero. This outcome would take defense spending lower in real terms than the post-Cold War nadir of 1998. As such, it seems politically unlikely. Reducing nondefense discretionary spending to just 1.1 percent of GDP seems even less likely.

Scenario 5 indicates that even if taxes do not rise, defense can still fare quite well under a sustainable federal budget if mandatory spending can be slashed dramatically. If mandatory spending could be cut relative to expectations by about four percent of GDP throughout the period from 2015 to 2021, then defense would be affordable at 2.6 percent of GDP—very close to the share that the base budget would hold if it is adjusted for inflation as GDP rises faster than inflation for a period of ten years. This scenario seems extremely unlikely, however, as it would require deep and nearly immediate benefit reductions even for those already enrolled in the Social Security and Medicare systems. Even the proposal put forward by Chairman Ryan, roundly rejected within days of its unveiling, takes a much slower approach to cutting mandatory programs; by 2022, it would shave just 2.3 percent of GDP from spending in the major mandatory accounts, relative to CBO's alternative fiscal scenario.[27]

Implications for Overall Security Spending

Although the White House now reports to Congress on total spending for the wider security effort, the Budget Control Act of 2011 is the first to impose caps on overall security budgets. The caps imposed on security spending affect only the first two years of deficit reduction, FY 2012 and FY 2013. Moreover, if the supercommittee process fails and sequestration is triggered under the Act, then both caps and cuts will be apportioned not to security but to national defense budgets. Thus it is harder to say how the broader security category might fare in future fiscal deliberations, or what will be deemed affordable for the international affairs, homeland security, veterans' affairs, and nondefense intelligence accounts.

[26] CBO puts the share of GDP devoted to nondefense discretionary spending between 2021 and 2035 at 3.1 percent; reducing that by 1.5 percent leaves 1.6 percent. "CBO's 2011 Long-Term Budget Outlook," June 2011, p. 60.

[27] Congressional Budget Office, "Long-Term Analysis of a Budget Proposal by Chairman Ryan," April 5, 2011, p. 16.

Broadly speaking, if defense is found to be affordable at the level of 2.1 percent of GDP, and if the other security accounts meet a proportional fate, then total security spending of 2.8 percent of GDP might be seen as affordable.

The Economic Implications of Reduced Security Spending

It has become commonplace in some circles to think of government spending as a drain on the economy. Certainly when revenues do not keep up with spending year after year—when the budget imbalances are structural—the magnitude of the resulting debt becomes a significant cause for concern.

On the other hand, the Department of Defense rightly points out that defense spending is not simply a drain on the nation's economic well-being. Rather, defense and other security spending can contribute to the economy in a variety of ways.

Like virtually all other federal expenditures, defense spending spells jobs for American workers. With some 1.5 million active-duty personnel, 850,000 paid members of the Guard and Reserve, and 700,000 civilian workers, the Department of Defense is by far the largest employer in the United States. It also pays the bills for millions of contractor employees. The Department of Homeland Security employs hundreds of thousands of workers and spends significant sums to purchase equipment built in the United States. The Department of Veterans Affairs, Department of State, and intelligence community also create jobs and spend money that creates additional jobs.

Moreover, the security sector is often at the forefront of technical innovation. The products of its research and development find their way into civilian applications. The Internet itself is a good example. Some military systems are used directly in support of civilian applications that add significantly to today's economy. For example, the Global Positioning System is used around the world to inform the navigation systems in cars, mobile phones, and other consumer products.

As the Department of Defense argues, the security sector also underpins the U.S. and global economies in important ways. The Navy and Coast Guard safeguard the freedom of the seas that underlies the free flow of commerce around the world. The Transportation Security Administration protects passengers, facilities, and the public, making travel safer and helping to avoid the sort of economic downturn that followed 9/11.

That said, it would be wrong to suppose that security spending creates more jobs than the same level of spending by another government agency. In fact, a recent analysis at the University of Massachusetts finds the opposite: Defense spending creates fewer jobs for Americans than the equivalent level of spending for education or investments in clean energy.[28] Spending money on Social Security or health care—or leaving it in the hands of taxpayers—can also lead to jobs and other economic benefits. Furthermore, it seems more likely—not less—that an equivalent level of funds devoted to civilian

[28] Robert Pollin and Heidi Garrett-Peltier, "The U.S. Employment Effects of Military and Domestic Priorities: An Updated Analysis," January 26, 2010.

research and development would lead to important breakthroughs with applications in the non-security sector. Finally, if underpinning the global economy through protection of sea lanes and air travel is the goal, it could surely be achieved through security budgets that are far smaller than today's.