

TESTIMONY on the “Budget for All” Resolutions S. 1750 and H. 3211

Massachusetts State Legislature

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Good Morning, and thank you for inviting me to speak here today.

My name is Linda Bilmes, and I am the Daniel Patrick Moynihan Senior Lecturer in Public Policy and Public Finance at the Harvard Kennedy School of Government at Harvard University.

Last fall, voters in Massachusetts passed the "Budget for All" resolution in every one of the 91 towns where it was on the ballot. One of the four points in the resolution is that the US should shift resources away from military spending and toward domestic priorities. Many of us who support a strong military may question whether cutting the defense budget is realistic. I will focus my testimony today specifically on the issue of whether it is feasible to reduce spending on the Pentagon without endangering overall national security.

My comments are the result of extensive study. I have researched and written about the defense budget for many years, particularly the cost of the Iraq and Afghanistan wars, the long-term costs of providing medical and disability benefits to veterans, the TRICARE system, procurement costs, and structural issues related to the Base Closure and Realignment Commission (BRAC). I am co-author, with Nobel laureate Joseph Stiglitz, of the best-selling book *The Three Trillion Dollar War: The True Cost of the Iraq Conflict*, as well as dozens of book chapters, articles, papers, journal monographs and other publications. I am the daughter of a World War II veteran, the daughter-in-law of an RAF pilot, and a peer reviewer for the National Institute of Medicine. I serve on the Board of Directors of the Institute for Veterans and Military Families at Syracuse University and on the US Department of Labor Veterans Employment Board. I have testified on many occasions to the Veterans Affairs Committees and subcommittees of the US House of Representatives and US Senate.

There are four points I'd like to make today:

- 1. We are spending far more than necessary on the defense budget because of excessive spending on overheads, indirect costs, obsolete weapons programs, cost overruns, and extremely poor oversight on how we make purchases and keep track of costs. This spending pattern means that we are spending more, but getting less for our defense dollars.***

One out of five dollars spent by the federal government goes to the military. Since 2001, the size of the annual military budget has grown by nearly \$1 trillion, *not including* the wars in Iraq and Afghanistan. Over the last five years, we've spent more money on the military, in inflation-adjusted dollars— than at any other time since World War II. Despite this influx of cash, our Air Force and Navy fleets and forces are older and smaller than they were 10 years ago. The Air Force now has 2500 fewer aircraft, and the Navy has fewer than half the number of ships, as before the war. Air force pilots receive only half as many hours of training as they did a decade ago. Where does all the money go?

Unfortunately, a great deal of military spending is highly inefficient and wasteful. The defense budget is filled with items left over from the cold war -- for example, funding for annual reports that no one reads and spare parts for weapons that we no longer use. Congress continues to appropriate money for obsolete, redundant and underperforming programs and facilities because they are located in key congressional districts.

The cost of new weapons programs is growing uncontrollably. Military contractors routinely underbid and then subsequently jack up prices. The costs are filled with layers of indirect costs, overheads and extras. Former Secretary Gates estimated that some 30% of the budget is consumed by overhead costs. With these overheads buried among thousands of individual line-items expenditures, the current system makes it impossible for the department to monitor and control costs.

Let me offer just one example - the F-35 joint strike fighter. In 2001, the F-35 was supposed to cost \$81 billion per aircraft. According to the Comptroller of the Department of Defense, the costs have escalated and production has been delayed, to the point where the F-35s are now ranging from \$190 billion for the Air force model to \$277.9 billion for the Navy version, with some \$40 billion for each aircraft being attributed to "procurement" costs alone.

The direct result of this breakdown in cost control is that the US will be able to purchase far fewer of them - actually reducing our military capacity. And in the meantime, as my colleague Winslow Wheeler of the CDI has pointed out, the US will incur billions of dollars in additional expense to extend the lifespan of the current generation of aircraft such as the F-16s, F-15s, and others until the F-35s become operational.

Another issue is the growth of civilian personnel. In total, personnel costs now comprise 1/3 of Pentagon spending. During the past decade, the number of civilians working for the Pentagon has grown by more than 100,000 to nearly 778,000 in total, at the same time that the department has vastly increased the number of contractors. According to former Undersecretary for Policy Michele Flournoy, the overhead staff in the defense agencies and headquarters has "grown like weeds". She argues in the *Wall Street Journal* that the private sector typically enjoys cost savings of 15-20% as well as improved performance by delayering headquarters staff, but that senior Pentagon leaders have not been given the authorities to reshape the workforce for the 21st century.

The bottom line is that we are not spending defense dollars strategically to meet fundamental national security needs. Spending is being allocated based on historical patterns, regardless of whether the item in question is necessary, cost-effective, performing well, or overrunning its budget.

2. *The Pentagon has flunked its financial audit every year for the past twenty years. We should not be appropriating more money to the Department of Defense until it institutes responsible financial management and controls.*

Congress enacted the Chief Financial Officers (CFO) Act more than 20 years ago. The purpose of this law is to make sure that every dollar of taxpayer money is spent properly. Just like companies in the private sector, Federal agencies must undergo audits each year to ensure that they are practicing sound financial management. Twenty-three of the twenty-four federal agencies have now obtained a clean opinion from the independent auditors on their financial statements.

The *only* department that has not produced an auditable financial statement is the department of Defense. The financial systems for the Pentagon are so inadequate that the auditors cannot even begin to audit them. This failure is not just about numbers on a ledger. It is a failure to handle taxpayer money responsibly and a failure to institute the proper controls, practices, and safeguards on expenditures.

Given the kind of multi-year, long-term capital spending that the military requires, the Pentagon should be using a cost-accounting system, and it should produce a capital budget. But it doesn't have these basic controls in place either. The department's accounting systems provide little management information and are completely unsuited to tracing costs by activity or making decisions based on efficiency. The result is that we cannot track where much of the defense budget is spent, much less figure out how well different programs are performing.

This breakdown in financial accountability has made it extremely difficult to track war spending over the past decade. All the major government oversight agencies - including the GAO, the CBO, the Congressional Research Service, the Special Inspector Generals for Iraqi Reconstruction and for Afghanistan - have criticized the Pentagon for its inability to separate war appropriations from non-war funding. Money that was intended to be spent on core military functions has been diverted to Iraq and Afghanistan, and funds for the wars have been used for other purposes. No one has a complete grasp on what happened. The Pentagon admits that it has "lost visibility" on tens of billions of dollars in spending. Unsurprisingly, the department has been investigating numerous cases of fraud, corruption and racketeering, which have been uncovered by its own Inspector Generals.

Let me provide you with just a couple of examples from my research.

Many of the Pentagon's core databases for tracking contracts are dysfunctional. The Synchronized Pre-deployment Operational Track (SPOT) system is supposed to track information on contracts and personnel. In 2010 the system reported \$22.7 billion on contracts, but the GAO found it had missed out at least \$4 billion due to double-counting, undercounting, and over counting. Another malfunctioning database is the CENTCOM tracking system that is supposed to vet non-US vendors to prevent money falling into the hands of insurgents. It's supposed to vet all non-US vendors who receive more than \$100,000, but the system is not effective because 74% of the vendors receive *less than* \$100,000 – in some cases, just a few dollars less.

Perhaps most disturbing is that at least \$40 billion (at a very conservative estimate) has been spent on a category called "Miscellaneous Foreign Contractors". After Lockheed Martin and Boeing, "Miscellaneous Foreign Contractors" comprise the third largest contractor over the last 10 years, yet these are contractors on which there is no information at all.

There is strong support in this country for a well-funded military that protects our security. But as taxpayers, we also are entitled to financial accountability. With the exception of military salaries and other critical expenses, it would be advisable to reduce funding for the core defense budget, particularly the procurement budget, until the Pentagon can produce auditable financial records.

3. *The wars in Iraq and Afghanistan will cost between \$4 to \$6 trillion -- but most of this amount has not yet been paid. Rather than continuing to borrow billions of dollars every month to fund ongoing war operations, we should be reducing our troop presence in Afghanistan and refocusing on the care of service members who have been deployed during the past decade and funding for diplomacy.*

The wars in Iraq and Afghanistan have been extremely expensive in blood and treasure. The visible price tag for the wars is \$2 trillion so far, including combat operations, fuel, transportation, equipment, weaponry, medical care for those in the field, and other current costs.

At this point, I usually remind myself to think about the difference between a billion and a trillion:

- A million thousand-dollar bills stacked up would be about 4 inches high
- A billion would be about 360 feet – about half the height of the John Hancock tower
- A trillion is 67.9 MILES high

Much of this money has been spent on contracted services, which has received a great deal of attention. The major war activities involving contracted support were: construction and operation of over 500 bases in Iraq; land and air transportation; training of the Iraq and Afghan police and military; infrastructure to support US military presence; reconstruction of water, roads and utilities in Iraq and Afghanistan; environmental cleanup; production of armed vehicles, Humvees and M-RAPS; and security services. The firms that were involved directly in these activities were the primary beneficiaries of government war expenditures.

However, at this point we should be focused on the future hidden accrued costs that have *not yet been paid*, including the cost of replacing used-up equipment, replenishing ready stocks and troop regiments, and providing medical care, disability and other benefits to veterans and their families. These costs will add an additional \$1.5-\$2 trillion to the full cost of the war.

In addition, the wars have been financed entirely through borrowing. This money, which has added at least \$2 trillion to the national debt, will have to be repaid with interest, by our children.

The human costs of the wars are sobering. Since 2001, the US has deployed 2.2 million young men and women to the Iraq and Afghanistan theatres. As of July 3rd, 2013, there were 6729 young Americans who had died in these conflicts. But the wars have been fought by a small percentage of the population, who have endured long and in many cases repeated tours of duty. The high survivor rate and the nature of the conflicts has produced an unprecedented number of casualties. The number of Iraq and Afghanistan veterans receiving government medical care has grown to more than 800,000 – most of whom have applied for permanent disability benefits from the Department of Veterans Affairs. Nearly half of the service members who have been

discharged from the military have already been approved to receive disability benefits for the rest of their lives.

The US has rightly boosted veteran's benefits, invested in additional staff and technology, expanded mental health care and made it easier to qualify for disability pay, but even so, the number of claims keeping climbing, and the VA is struggling to cope with an enormous backlog. The VA's annual budget will exceed \$140 billion this year, up from just \$50 billion in 2001.

In previous wars, the bill for paying veterans benefits came due decades later - for example, the peak year for paying WWI benefits was in 1969. This time around, with higher survival and claim rates, more generous benefits, and new medical treatments, the eventual costs of caring for these troops will exceed one trillion dollars. This does not include the costs of paying for TRICARE health care for those who are still serving, their families and military retirees.

The war in Afghanistan is costing us \$7 billion every month that it continues. The single biggest monthly bill is for fuel -- given the complex logistics involved in transporting troops and supplies into and out of Afghanistan's mountainous terrain. Another \$90 billion has been devoted to "reconstruction" aid in Afghanistan -- the largest amount spent by the US since the Marshall Plan. Endemic corruption among local contractors and officials has constantly drained money from the budget.

We currently have 68,000 US troops deployed Afghanistan. About half that number is scheduled to return home in 2014, when our combat role is scheduled to end. Our mission in that country has been multifaceted, including efforts to defeat the Taliban, to protect civilians, to train Afghan police and armed forces, and to prevent the country from becoming a "safe haven" for Al-Qaeda.

The worst casualties of the entire post 2001 period have occurred during the Afghanistan surge. The Walter Reed National Military Medical Center in Bethesda, Maryland hospital is treating hundreds of amputees and severe casualties from the past two years alone. Despite widespread corruption in the Afghanistan government, the US and NATO have committed to provide support to Afghanistan for the next decade, likely in the range of 8000 to 12,000 troops. It is unclear whether this will be sufficient to achieve any of our goals.

I believe that in supporting the "Budget for All", the voters of Massachusetts are questioning whether we can afford to continue these expensive operations in Afghanistan, given our limited resources, our other obligations around the world, and our responsibilities to those who have already returned. Although we have already accrued trillions of dollars in future veterans and weapons replacement costs, we would still save billions per month in operating costs if we brought our troops home sooner. If we invest a fraction of the money saved in helping to improve the veterans disability claims system, and in funding instruments of "soft" influence such as diplomatic initiatives at the State Department, we would strengthen our country while still saving money.

4. The current trajectory of the Pentagon's health-care and entitlement spending is unsustainable and is shifting costs away from the private sector onto government.

Most Americans support the idea that we should subsidize medical care for the military and their families. But in the past decade, the amount of the subsidy has skyrocketed.

The fastest rising costs in the Pentagon are related to non-military spending, primarily health care, retirement and other military entitlement spending. Pentagon spending on health care (not including veterans care) has more than doubled since 2001 and now accounts for nearly 10 percent of the total defense budget. TRICARE is growing much faster than any other federal health-care program at 11.4% per year –compared with 9.1% for the Veterans Administration, 8.4% for Medicare and 7.8% for Medicaid. Overall national health care spending is growing at 6.5%¹.

Over the past decade, the gap between the cost of purchasing care in the private sector compared with TRICARE increased from 3 to 1 to 9 to 1. Families can purchase health insurance in TRICARE for a tiny fraction of the private sector rate, about \$460 per year for a family of four. Unsurprisingly, people who are eligible for TRICARE as well as private health plans have shifted out of their private plans and into TRICARE –shifting the burden away from private companies and onto the government. The participation rate (and the cost) will increase further as President Obama’s healthcare reforms push everyone into buying a medical plan – with TRICARE by far the cheapest option for those able to take advantage.

I want to emphasize that this system I am describing is for active-duty military, families and retirees. Most of the Iraq and Afghanistan veterans –about 87% - will leave military service long before the 20 years that is needed for retirement, so they will not qualify for this system once they become veterans.

Why is the TRICARE system so expensive? One reason is that unlike Medicare, TRICARE can negotiate its rates directly with providers, without maintaining the caps set by Congress. But a more fundamental reason is that that the system has grown during a period of budget largesse to the military, without seriously focusing on cost control.

Conclusions

In conclusion, I believe that it is realistic, feasible and advantageous to reduce spending on the military.

However, this needs to be undertaken wisely. The across-the-board cuts in the sequester are the wrong approach. The sequester will force defense and other government agencies to cut the most visible, easily understood programs – it won’t do anything to root out overheads, duplication and inefficiencies. It will delay routine equipment maintenance leading to higher costs in the future. It undermines morale, retention, hiring and training.

However, the seemingly limitless ability to raise federal debt means it has been easier to open the federal checkbook rather than work out how to get better value for what we already spend. The Pentagon has been especially lax due to the extra money that has been coming in for the wars over the past decade.

The good news is that solutions are not rocket science. The private sector and many state and local governments have already implemented systems that provide much greater transparency over expenses, costs and overheads. There are concrete steps we can take to give us better control over defense spending.

¹ Bilmes, Linda. The Financial Legacy of Iraq and Afghanistan: How Wartime Spending Decisions Will Constrain Future National Security Budgets (March 26, 2013). HKS Working Paper No. RWP13-006. Available at SSRN: <http://ssrn.com/abstract=2281275> or <http://dx.doi.org/10.2139/ssrn.2281275>

First, we should invest in developing the systems to better understand indirect costs and target spending wisely, and adopt better budgeting frameworks, including activity-based budgeting and capital budgeting.

Second, we should subject defense spending— including programs, facilities, personnel, and entitlements - to rigorous standards of financial and performance accountability.

Third, we should expedite our withdrawal from Afghanistan.

Fourth, we should bear in mind that the most critical requirement for national security is a strong national economy, and that by bringing military spending under control, we will be helping to reduce strain on the federal budget.

By taking these steps, we will be fulfilling the spirit of the resolution passed overwhelmingly by voters in Massachusetts, and strengthening the national security of the United States.

Thank you.