

# How to Improve DOD's Management of Inflation

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## KEY TAKEAWAYS

As long as inflation persists at its current level, it will have a substantial impact on the Pentagon and its management of the armed forces.

Congress can give DOD improved reprogramming authorities and apply targeted changes to the President's budget request to ameliorate inflation's impacts.

These changes will not diminish the need for a fully resourced defense budget, but they can help Congress and the Pentagon to deal with the effects of inflation.

Less than two months after the President's budget request was unveiled, the Biden Administration was talking about wanting a defense supplemental to address the effect of sky-rocketing national inflation on Department of Defense (DOD) purchasing power.<sup>1</sup> In a discussion of the defense budget request and the National Defense Strategy, Deputy Secretary of Defense Kathleen Hicks acknowledged that inflation will have to be addressed both in fiscal year (FY) 2022 and in FY 2023.<sup>2</sup>

As long as inflation persists at its current elevated level, it will have a substantial impact on the Pentagon and its management of the armed forces. Further, as a recent McKinsey & Company report shows, defense inflation historically has run higher than the consumer price index for urban workers.<sup>3</sup>

This paper, in its entirety, can be found at <http://report.heritage.org/ib5274>

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However, Congress can help. It can provide the DOD with improved reprogramming authorities and apply targeted changes to the President's budget request to ameliorate its impacts. These changes will neither erase the impacts of inflation nor diminish the imperative for a fully resourced defense budget, but they can help Congress and the Pentagon to navigate the choppy waters that are created by inflation.

The President's budget request for defense was released on March 28, 2022, with an outdated inflation projection, pegging it at 2.3 percent.<sup>4</sup> The Biden Administration explained it as being the forecasted assumption back on November 10, 2021.<sup>5</sup> However, even then, the Pentagon's inflation assumption was not aligned with the GDP Price Index, which was already at 6.1 percent for government consumption in the third quarter of 2021.<sup>6</sup> By underestimating the level of inflation, the Biden Administration failed to capture what is certain to be its significant impact on the department.

John Ferrari, a visiting fellow at the American Enterprise Institute, has aptly described the Administration's changing stance on inflation at the Pentagon: "From first denying there was rampant inflation early last year, to insisting it was simply transitory, then claiming it really would not affect the Pentagon, the administration is seriously misguiding Congress and the public."<sup>7</sup>

Despite these efforts by the Administration to downplay the issue, Members of Congress have seen through these subterfuges and expressed their discontent with a defense budget that barely acknowledges, let alone mitigates, the impact of inflation.

Senate Armed Services Committee Ranking Member James Inhofe put it succinctly: "Most problematic is that this budget neglects to sufficiently account for historic inflation."<sup>8</sup> Further, the Senator and his House counterpart, Representative Mike Rogers, sent a letter asking for clarification with respect to "the observed and anticipated effects [of] inflation on the department's budget, both in the recent past and the near future."<sup>9</sup>

The DOD's response was underwhelming. It provides some interesting and actionable information on the process but is far from clarifying exactly how inflation affects the Pentagon.<sup>10</sup> The letter provides quantifiable data on how inflation affects different accounts, such as Army procurement and defense-wide research and development, but without much clarity as to how it was calculated. It also stresses that much of the impact of inflation is still unknown and will be seen in the department's execution of appropriated resources. The DOD response should be viewed as a source of more questions rather than as a definitive answer.

Inflation both affects the planning process by changing projected prices and affects the execution of funds when prices of goods and services are different than projected. However, because of the current DOD financial management structure, there will necessarily be a lag between the time when Congress appropriates resources and the time when the budget is implemented and the effect of inflation is felt.<sup>11</sup> Because of this lag, the DOD's budget request and Congress's appropriations and authorization bills will have to reflect informed guesses on the effect of inflation.

## What Congress Should Do

The inflationary level used by the Biden Administration to create its defense budget request was clearly detached from reality. It is now up to Congress to use a more realistic inflation level and create solutions and tools to blunt the impact of inflation through the execution of funds in the coming fiscal year. To blunt some of the effects of inflation on our armed forces, Congress should:

- **Exempt inflation-related reprogrammings from the reprogramming cap.** In its May 2 letter, the DOD indicated that it would leverage reprogramming actions to offset pricing changes caused by inflation.<sup>12</sup> However, Congress in recent years has set a low limit on reprogramming actions for the department that ranges from \$6 billion to \$8 billion.<sup>13</sup> If one considers that the Pentagon “has been forced to raise fuel prices by a total of \$3.4 billion in FY 2022 to reflect current market prices,”<sup>14</sup> this authority will evaporate rapidly. Congress should exempt reprogramming actions that can be tied directly to inflationary effects from the general reprogramming limits. This would serve to blunt some inflationary effects while maintaining some reprogramming flexibility. It also would make it easier to quantify the effects of inflation throughout the year.
- **Pilot fast-tracking reprogramming requests.** The reprogramming process itself has many challenges that make it both ineffective and slow, from the many layers of Pentagon approval to the process for transmittal to Congress.<sup>15</sup> Congress should create a pilot program that includes an expedited approval process for reprogramming requests that meet specific criteria, which should be tied to economic price adjustments and other mechanisms used by the Pentagon to address inflationary impacts.<sup>16</sup>

- **Focus on multi-year appropriations in key programs.** The May 2 letter provides some initial details on how the department's inflation assumptions change for different accounts within each appropriation title.<sup>17</sup> It also quantifies the effects for different portions of the budget. However, those numbers and their inflationary effects are based on the lower inflation assumption of the President's budget and, in many cases, are artificially deflected by lower procurement quantities. Congress should determine precisely how the different inflationary impacts were calculated.

Once Congress has developed the relevant information on the inflation assumptions used in each of the categories, it should use this information to allocate more resources to key programs, giving preference to multi-year appropriations such as procurement and research and development. Shipbuilding would be a prime candidate for the incorporation of a built-in cushion, which would signal the industry that Congress is willing to increase the size of the Navy and that funding could be applied in multiple fiscal years.

- **Trim ineffective programs and misguided spending.** One way to cope with inflation is to reduce unnecessary purchases. In the case of the DOD, many programs would generate savings, from a new round of base closures to changing the authorization for the basic allowance for housing. Heritage's Budget Blueprint includes more than \$12 billion of possible savings for the Pentagon.<sup>18</sup> Further, the Biden Administration has requested funding for ineffective programs that should not be funded, among them \$3 billion dedicated to combating climate change and millions that are dedicated to promoting divisive equity-based trainings.<sup>19</sup>

Any federal budget deserves and requires careful analysis and consideration. When high levels of inflation are being driven by poorly crafted federal government policies, effective and targeted congressional oversight becomes even more important.

Beyond specific measures to deal with inflation in the coming fiscal year, the challenges that the Pentagon will face in dealing with inflation highlight the shortcomings of its current financial management process; its Planning, Programming, Budgeting and Execution (PPBE) processes; and its extremely lengthy timelines that are based on predictive capabilities. An

ongoing congressional commission will recommend changes and reforms in the process.<sup>20</sup> The commission should pay close attention to how the DOD's financial management community adapts to inflation and how its adaptations can be incorporated into a more agile and responsive financial management system for the department.

## Conclusion

At its core, inflation is a problem that extends to the whole economy and that cannot be fully mitigated at the Department of Defense. The federal government itself has tools to change the course of inflation, and it should stop adding to the problem so that we can get back to a well-functioning economy.<sup>21</sup> The first step is to stop spending and borrowing money and adding to the budget deficit.<sup>22</sup> After that, the federal government should begin to roll back policies that drive up prices, from increased taxation to burdensome regulations and trade barriers.<sup>23</sup>

As defense inflation historically has run higher than the consumer price index for urban workers, the development of new tools and processes to tackle inflation at the DOD would be especially desirable.<sup>24</sup> Both Congress and the Department of Defense have shown a willingness to adapt the processes to account for inflationary effects. Implementing the recommendations proposed in this *Issue Brief* would help them to fight inflation more effectively.

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## Endnotes

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