



Rising Inflation Is Beginning to Worry Pentagon Leaders

Description

USA: The biggest inflation spike in three decades has the Pentagon bracing for salary increases and more expensive weapons, according to current and former defense officials.

Their warnings arrive as Congress is more than a month late in passing the Pentagon's annual budget, meaning spending is frozen at the prior year's level.

"It's certainly a concern that we have right now, but...there's a bit of a speculative part to it as well," Pentagon Comptroller Mike McCord said Monday.

Last week, the government said the consumer price index rose 6.2 percent in the past year, the [highest increase](#) in more than 30 years. Americans are paying more for everything from cars to furniture.

Defense companies, already [dealing with a supply-chain crisis](#) sparked by the coronavirus pandemic, are now warning that inflation could drive up the cost of weapons under some current and future contracts.

"Global tax and inflationary environment are also a concern as we think about next year," Raytheon Technologies CEO Greg Hayes said in a quarterly earnings call last month.

Inflation's effect on weapons projects will not happen overnight.

"This is going to play out over not only months, possibly years," McCord said.

Hayes said his company has long-term agreements "for the vast majority" of raw materials it needs to build weapons, but warned, "If these prices persist long-term, then we will see an impact."

Another area where the Pentagon could pay more: salaries. Defense officials [have long said](#) that pay and benefits for troops and civil servants typically grow at a rate higher than inflation. Last week, the Labor Department released data is an earlier indicator that the civilian pay raise in fiscal 2023 [could be 4.6 percent](#)

“I would bet anything they were not planning on a pay raise that large,” said Todd Harrison, who leads defense budget analysis at the Center for Strategic and International Studies. “So here they are in the final stages of the budget process [and] they’ve got to go back and find the money to pay for that.”

Defense officials are currently building the Pentagon’s fiscal 2023 spending request, which the Biden administration is expected to send to Congress in February. McCord said Monday that the Pentagon has not yet received pay-raise figures from the White House Office of Management and Budget.

“It’s gonna be hard to come up with that money,” Harrison said. “They’re gonna either have to ask for a higher top line, or they’re gonna have to go back and take it out of acquisition programs.”

The Pentagon’s fiscal 2022 budget proposal, which Congress has yet to pass, included a 2.7-percent pay raise for both military and civilian personnel.

There are many factors that could determine whether weapon costs go up. If the Pentagon has a fixed-price contract for a weapon, be it a fighter jet or tank, the price is likely locked and the extra cost could be borne by the manufacturer. But if there’s a cost-sharing contract, the Pentagon will likely end up paying more.

“When I look over a longer-term period as trends like labor market issues that may drive labor rates up or inflation, we have in the industry one of the highest levels of cost-plus work, so those costs get passed on and shared with our customer,” Northrop Grumman CEO Kathy Warden said on a quarterly earnings call last month. “Now I do want to emphasize that we in no way want to pass those costs on to our customers and we are working to minimize those impacts for their benefit, but our shareholders are not carrying that exposure.”

Higher inflation will likely lead contractors to pay their workers higher salaries, which will likely mean higher costs for weapons, Robert Hale, who served as Pentagon comptroller for more than five years during the Obama administration, said Monday.

“We have yet to see the wage inflation, but we are being thoughtful about that,” Leidos CEO Roger Krone said earlier this month during the company’s quarterly earnings call.

The Senate Appropriations Committee, at the Pentagon’s request, added money to account for inflation in its review of the Defense Department’s 2022 request, McCord said.

“Congress could fix this if the numbers aren’t too large in the final appropriations,” Hale said.

The Pentagon, in its 2022 request, asked for [billions of dollars for the Afghan security forces](#), which were toppled by the Taliban last summer. Congress could divert the money to Pentagon spending accounts that are expected to get hit by inflation.

The White House could tell the Pentagon to eat the cost increases, by ordering it to buy less of something. If the inflation costs are high, the Pentagon could ask Congress for emergency funding, something it typically does to pay for unanticipated war costs.

“Administrations never like to do that because it’s a must-pay kind of bill and therefore it becomes flypaper for all kinds of political add-ons,” Hale said.

Tara Copp contributed to this report.

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Date Created
11/19/2021