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The US Defence Industry under Obama: Are the Good Times Over?

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The US defence industry may have had its biblical “seven fat years” and could be looking at a significant trough in defence spending. Congress may save some programmes, and US arms producers might offset declining domestic procurement with overseas sales. Both efforts may be insufficient to prevent defence industry restructuring.

PRESIDENT Obama will soon sign his first defence budget, for fiscal year (FY) 2010, which starts in a month’s time. This budget will comprise approximately US\$556 billion in base spending, along with US\$130 billion in supplemental spending, for a grand total of US\$686 billion.

For a country as small as Singapore, with a defence budget barely one-hundredth the size, these figures may seem astronomical, almost inconceivable. And yet, there are some in the United States who have argued that not only is it not enough, but that any cuts would be tantamount to exposing America to its enemies. But the cuts are coming.

The US defence budget has literally had its biblical “seven fat years”: from 2001 to 2008, it grew from US\$335.5 billion to US\$696.2 billion – an increase of 107 percent. Since 2008, the budget has tapered off slightly (although the 2010 budget request is up around 2 percent over the previous year, after taking inflation into account).

One thing that is definitely going away is the supplemental budgets for wartime operations in Iraq and Afghanistan. These totalled more than US\$882 billion between 2001 and 2009; the FY2010 budget request includes an additional US\$130 billion in supplemental spending, but this will probably be the last.

Additionally, the Office of Management and Budget (OMB) is telling the US Department of Defence (DoD) to expect only one percent real growth in subsequent years. If that holds true and if supplemental budgets are eliminated altogether, total FY2011 defence budget could be as much as 18 percent *below* FY2010.

Impact on the US Defence Industry

The US defence industry has seen lean times before. The 1990s – the time of the so-called “peace dividend” – saw military expenditures fall more than 25 percent. This forced a major restructuring and consolidation of the US defence industrial base. In particular, several large-scale mergers and acquisitions (M&As) took place, resulting in the emergence of five mega-defence companies – Boeing, Lockheed Martin, Northrop Grumman, Raytheon, and General Dynamics – greatly reducing competition in the US defence sector and concentrating armaments production in the hands of a few, very large defence firms.

These five mega-firms now control most key US military programmes and also have access to considerable DoD research and development (R&D) funding. Consequently, these firms benefited greatly when US defence spending on procurement and R&D rebounded in the 2000s. By 2007, the five largest defence companies received nearly one-third of all US defence procurement spending – and half of all military R&D funding.

At the same time, US defence firms are highly dependent on their home market. In 2007, for example, only 15 percent of Lockheed Martin’s revenues came from foreign sales. That same year, overseas markets accounted for only around 10 percent of General Dynamics’ income; for Northrop Grumman, it was less than six percent.

Consequently, when US defence spending falls, these companies are suddenly very vulnerable. In fact, the FY2010 defence budget cuts procurement spending by 1.7 percent over FY2009. More importantly, perhaps, R&D spending – which has traditionally been protected from budget cuts, even during the 1990s – will be reduced by 3.4 percent. These cuts are likely to continue, as Defence Secretary Gates emphasises fighting the current low-intensity wars in Iraq and, increasingly, Afghanistan, over long-term plans to build a military capable of taking on a more high-tech “peer competitor” in a conventional war.

The impact can already be seen. The DoD plans to cap production of the F-22 fighter at 187 planes and the C-17 transport plane at 205 planes, terminate the *Zumwalt*-class destroyer programme after building only three ships (originally the US Navy planned to acquire 32 ships in this class), and cancel the manned armoured vehicle element of the Future Combat Systems (FCS) programme. Additionally, as a growing “bow wave” of new systems – such as the F-35 Joint Strike Fighter (JSF) and the lightweight Mine-Resistant Ambush-protected (MRAP) vehicle – are poised to enter production, the DoD will have to decide which programmes to delay, cut back, or cancel outright.

Fighting Back?

To be sure, the US defence industry is not going down without a fight, and its allies in the US Congress have tried to fight the DoD’s proposed cuts. For instance, many in Congress wanted to buy additional F-22s, arguing that 187 planes are insufficient to take on, for instance, a China armed with advanced fighter jets. Eventually, the legislative branch bowed to White House pressure on terminating F-22 production; at the same time, it may yet force the DoD to buy additional C-17 transport aircraft that it did not request.

Moreover, it is likely that the US defence industry will increasingly look overseas to make up for shrinking sales at home. In this regard, US arms producers have considerable clout when it comes to international arms sales – a worldwide market worth around US\$60 billion in 2007. In addition, large domestic production runs permit them to sell systems overseas at very competitive prices, and they can also offer very attractive industrial and technological inducements (i.e., offsets and co-production rights).

As a result, Singapore and other countries in the Asia-Pacific might find it increasingly easy to buy some of the most advanced weapons system being produced by the US arms industry. Singapore and Australia are already partners on the JSF, and pressure is growing to permit the export of the F-22 fighter to Japan.

Overall, the US defence budget “gravy train” may be over, and the large US defence contractors are just going to have to adjust. This could mean another round of rationalisation, M&As, and layoffs like we saw in the 1990s, resulting in an even leaner and meaner defence industrial base. It could also mean an explosion in US arms exports – including to the Asia Pacific region.

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