

October 22, 1993

## **SUPPORTING THE FORCE: THE INDUSTRIAL BASE AND DEFENSE CONVERSION**

### **INTRODUCTION**

“Our new security strategy will...ensure our defense industry can supply the weapons and technologies America may need in the future.” So promised then-candidate Bill Clinton in an August 13, 1992, speech before the World Affairs Council of Los Angeles. But just a few moments later in the speech, Clinton charged that: “There is today no plan to help our defense workers and military personnel make a transition to a civilian economy. I have such a plan.” Candidate Clinton thus promised to preserve America’s military industrial base while at the same time converting it to civilian production. Therein lies a serious contradiction. The weapons and technologies America may need in the future cannot be made if too many defense industries are converted to manufacture gas-saving automobiles, for example, instead of tanks and armored personnel carriers.

President Clinton’s defense industrial policy has been marked by two initiatives. On March 11, during a speech outside Baltimore, he announced a \$20 billion defense conversion program. Two weeks later, he took a step that was tantamount to abandoning the defense industrial base: he proposed reducing defense budget authority by over 3.5 percent per year over the next five years.<sup>1</sup> This budget proposal doubles the \$60 billion cut Clinton promised during the campaign. The largest decreases in the fiscal 1994 defense budget will come in accounts for the procurement of weapons and equipment. Not having these funds will especially weaken the defense industrial base because they are the main fuel for industrial production. The budget authority for procurement spending will dimin-

**1** This figure is calculated in so-called real terms, accounting for the expected rise in inflation. Department of Defense, “FY 1994 Defense Budget Begins New Era,” News Release No. 126-93, March 27, 1993. The news release is accompanied by a package of supporting materials that provides total defense budget figures for the period covering fiscal years 1994 through 1998 and detailed information on the fiscal 1994 defense budget request.

ish by over \$8 billion, or 17 percent in real terms, from the 1993 level to \$45.5 billion in 1994.<sup>2</sup> Reductions of this magnitude will make it impossible for the defense industry to produce an adequate supply of weapons and technologies for America's defense needs.

For Clinton to avoid devastating the military industrial base and the nation's military posture, he must reverse course. He should:

- ✓ **Concentrate** his long-range defense planning above all on the industrial needs of the armed forces, and not on converting the defense industrial base to civilian production.
- ✓ **Eliminate** the \$20 billion defense conversion program.
- ✓ **Focus** defense planning on the building and buying of the next generation of weapons.
- ✓ **Give** governmental support to specific defense industries only as a last resort. There may be times when the government will have to support a particular defense industry—one which manufactures submarines, for example—which may not appear to be needed in the short run, but which may be needed to meet some future threat.

## CLINTON'S DEFENSE CONVERSION POLICY

The Clinton defense conversion plan was developed during the 1992 presidential campaign and the first months of his Administration. The policy was announced on March 11 in a speech by the President to the employees of Westinghouse Electronics Systems, outside Baltimore. The \$20 billion program is based on four principles:

**Principle #1: America's so-called defense economy needs to be converted to civilian production.** Clinton believes that the Cold War produced a U.S. economy heavily burdened by defense expenditures. Supposedly all this spending on defense deprives the economy and the government of funds for domestic programs. Also it supposedly distorts the economy toward non-productive purposes.

**Principle #2: The federal government should play a central role in managing defense conversion.** Of the \$20 billion that the Clinton Administration proposes to spend over a five-year period on defense conversion, \$10 billion will go to so-called investments in government-selected civilian technologies. This is predicated on the notion that the government knows better than the businesses already operating in the market which civilian technologies will sell. Another \$4 billion of Clinton's program will go to government-sponsored retraining programs for displaced defense workers. And \$1 billion will provide federal assistance to local communities hurt by defense cut-backs. Only one-fourth of the funds, about \$5 billion, will be spent on pro-

---

2 *Ibid.*

grams that have potential military utility. These funds will go to developing “dual-use” technologies, meaning those that have both military and civilian applications.

**Principle #3: The primary purpose of the defense conversion is to preserve defense production capabilities for the civilian economy.** In making his announcement at the Westinghouse facility, Clinton extolled the facility’s effort to increase civilian production from 16 percent of total output in 1986 to a projected level of 50 percent by 1995. He hopes to encourage this type of conversion around the country. As the President said in his Westinghouse speech: “What you have done here [at Westinghouse] is what I wish to do nationally—take the most talented people in the world who’ve produced some of the most sophisticated military technology and put that to work in the civilian economy.”

**Principle #4: The impact of defense conversion on national security will be marginal.** Clinton says: “With the dwindling Soviet threat, we can cut defense spending over a third by 1997.” The President clearly believes that these levels of defense cuts can be made without weakening national security. By the same token, Secretary of Defense Les Aspin argues that poor economic performance—supposedly caused partly by too much defense spending—is itself a national security threat. “The danger here,” says Aspin, “is the failure to see our national security interests in a way that includes our economic success. Economic well-being is vital to our security.” Seen in this way, spending on domestic programs can be said to have some bearing on national security.

## CLINTON’S DEFENSE DRAWDOWN IN PERSPECTIVE

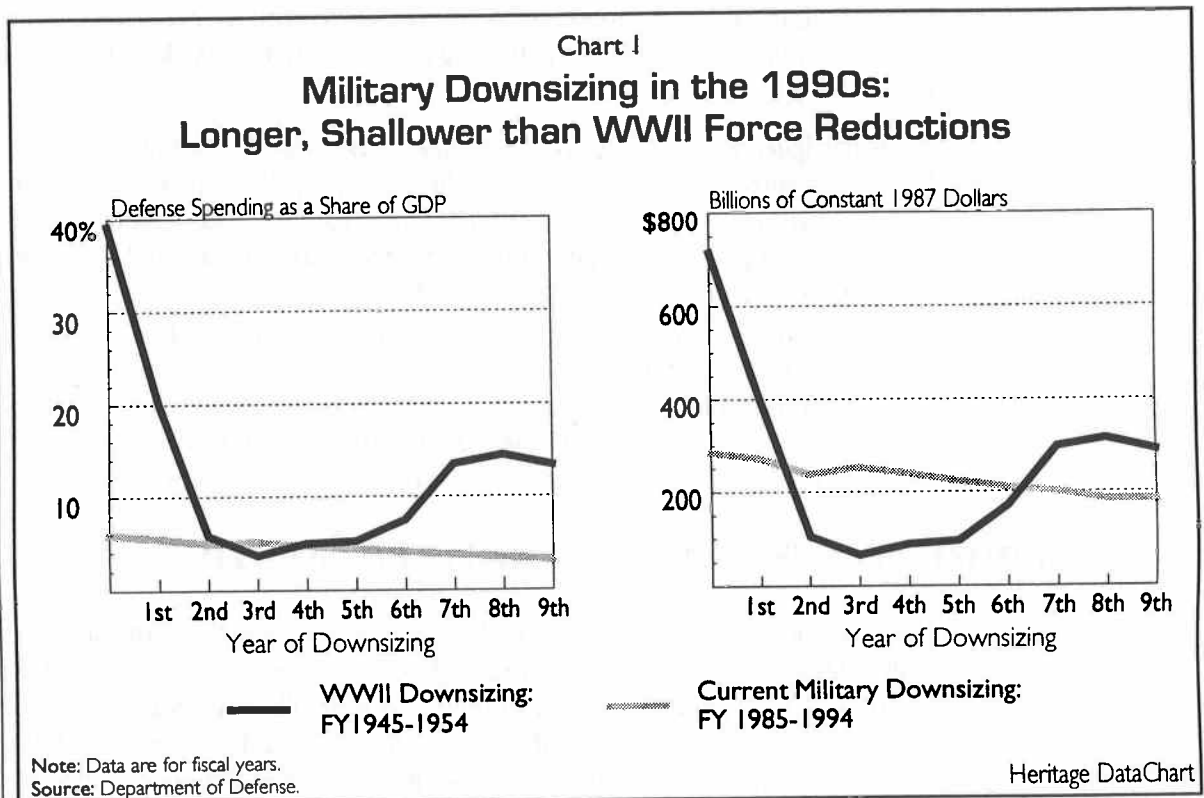
The defense budget began declining well before the end of the Persian Gulf War and the election of Bill Clinton. In fact, defense budget authority in real terms peaked in fiscal 1985, well before the end of the Cold War. This downturn in defense spending has been gradual. But critics of the armed forces, including President Clinton, argue that the American economy is suffering from massive dislocations because of a rapid “demilitarization” of the economy. While some communities are suffering severe economic problems as a result of the defense drawdown, the economy as a whole has not been greatly damaged as a result of the defense cuts. This is because defense is not a large segment of the economy and because defense expenditures impose only a modest burden on the economy.

President Clinton, though, is trapped by his belief that he inherited what he terms a “defense economy.” He is wrong. The money the government will actually spend on defense in 1993—so-called outlays—will constitute only 4.7 percent of gross domestic product (GDP). Clinton’s budget will reduce that burden to around 3 percent by 1998. By focusing on the marginal improvements to the economy that may be obtained by “making a transition to a civilian economy,” Clinton ignores the impact of his decision on the U.S. military posture. While the Clinton defense reductions affect only 1.7 percent of GDP over a five-year period, they will result in a defense budget reduction of 18 percent and reductions of perhaps 50 percent by 1998 in the amount the Pentagon spends on weapons and equipment.<sup>3</sup> When coupled with budget reductions already imposed under Ronald

Reagan and George Bush, the defense spending trend under Clinton is even more disturbing. After accounting for inflation, the fiscal 1993 procurement budget is only 43 percent of what it was at its peak in 1985.<sup>4</sup>

### The Defense Drawdown After World War II

During World War II, the nation truly had a defense economy. In the war's last year, 1945, over 39 percent of the nation's GDP was devoted to defense. By 1948, less than 4 percent of GDP was spent on defense.<sup>5</sup> Defense spending in 1945 was \$714 billion in 1987 dollars; by 1948, it was under \$65 billion. Thus, in only three years, defense spending had fallen by 90 percent.<sup>6</sup>



By contrast, defense accounted for just 6.5 percent of GDP in 1986. Today it is 4.7 percent.<sup>7</sup> Current projections are that around 3 percent of GDP will go for defense in 1998.<sup>8</sup> Defense spending peaked in 1989 at \$285.9 billion (in 1987 dollars), and under the Clinton budget will fall to about \$185 billion (also in 1987 dollars) in 1998.<sup>9</sup> Thus, the gov-

3 The Clinton Administration has not released defense procurement budget figures for the years beyond fiscal 1994.  
 4 Department of Defense, *National Defense Budget Estimates for FY 1994* (Washington, D.C.: Department of Defense, 1993), p. 80.  
 5 *Ibid.*, p. 140.  
 6 *Ibid.*, p. 128.  
 7 *Ibid.*, p. 141.  
 8 Department of Defense, *National Defense Budget Estimates for FY 1994* (Washington, D.C.: Department of Defense, 1993), p. 141; and Department of Defense, "FY 1994 Defense Budget Begins New Era," News Release No. 126-93, March 27, 1993.

ernment will spend 35 percent less in 1998 than in 1989. Compared with the post-World War II drawdown, the current decline in the defense budget will result in nowhere near the level of the economic dislocations seen the late 1940s.

### The Impact on the Armed Forces

The true measure of whether a defense policy protects national security adequately is not how much is spent on defense, but rather whether the armed forces will have the means to fight and win when conflict arises. From this perspective, Clinton's approach is alarming. The Bush Administration by February 1992 had already recommended terminating over 100 weapons programs in fiscal years 1991 and 1992. For fiscal 1993, it identified another seventeen programs for termination.<sup>10</sup> While it is impossible to quantify precisely the combat value that has been lost by ending these programs, the Navy faces the likelihood of not having an all-weather attack aircraft to replace the aging A-6 *Intruder*. The Clinton Administration has not yet announced a complete hit list of programs beyond those announced by the Bush Administration, but it will include the A/F-X fighter, the Multi-Role Fighter (MRF) aircraft and the F-16 *Falcon* fighter.<sup>11</sup>

### The Macroeconomic Impact

What will be the impact of Clinton's defense cuts on the economy as a whole? What will be the effect on economic growth and employment? The short answer to these questions is very little.

On the spending side, government social spending is a far greater burden than defense spending. Social and economic spending has jumped in recent years and is likely to continue to explode. Federal social and economic spending in fiscal 1993 will amount to \$945.8 billion (current dollars) and absorb over 15 percent of GDP (see Chart 2 on following page).<sup>12</sup> By these standards, the most important conversion problem the Clinton Administration faces is not from a defense economy to a civilian economy, but from a public-sector welfare economy to one based on private-sector production.

#### Defense Department FY 1993 Planned Program Cuts

TOW Sight Improvement Program  
LAMP-H (Landing Craft)  
HARM Missile  
Supersonic Low Altitude Target  
Closed Cycle ADCAP Propulsion System  
SQY-1 ASW Combat System  
Mk-50 Vertical launch ASROC  
SH-2 SLEP  
ARS-Class Salvage Ship  
E-2C Early Warning Aircraft  
LSD-41 Amphibious Ship  
Peacekeeper Rail Garrison  
SRAM II Strategic Missile  
SRAM-T Tactical Missile  
Mobile Small ICBM (Launcher)  
Space-Based Wide Area Surveillance  
KC-135 Reengining

Source: Department of Defense.

- 9 The figure for 1989 was obtained from Department of Defense, *National Defense Budget Estimates for FY 1994* (Washington, D.C.: Department of Defense, 1993), p. 129. The 1998 figure was calculated by taking the 1998 outlay figure for defense provided by the Department of Defense and deflating it according to the Department's own deflators.
- 10 Department of Defense, "Complete Set of Briefing Charts on the FY 1993 Budget," 1992.
- 11 Secretary of Defense Aspin announced these program terminations when he announced the findings of the "Bottom-Up Review" on September 1, 1993, at the Pentagon.
- 12 Department of Defense, *National Defense Budget Estimates for FY 1994* (Washington, D.C.: Department of Defense, 1993), p. 127.

Reductions in defense-sector jobs are likely to be offset by growth in those in the civilian economy. A study by the Defense Budget Project estimates that the defense drawdown could eliminate as many as 1.791 million defense sector jobs, both private and public, during the period from fiscal 1992 through fiscal 1998.<sup>13</sup> This higher estimate constitutes about 1.5 percent of all the jobs in the U.S. as of 1992. But since some of this job loss will result from retirement

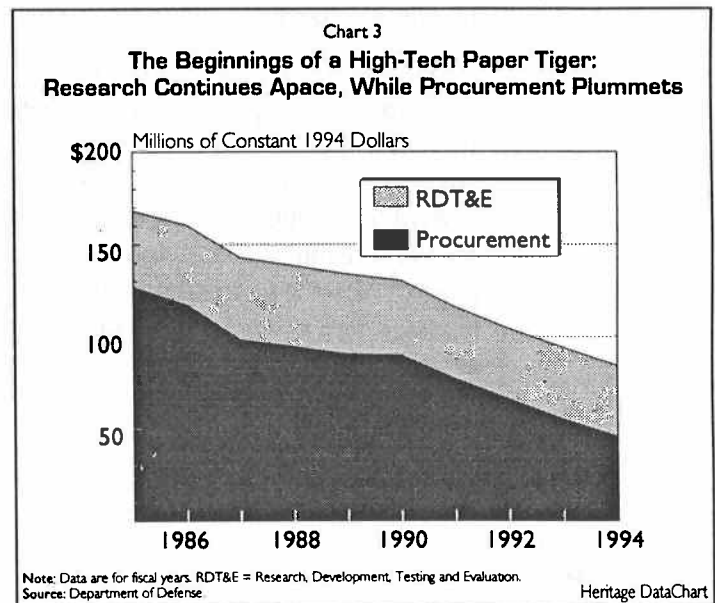
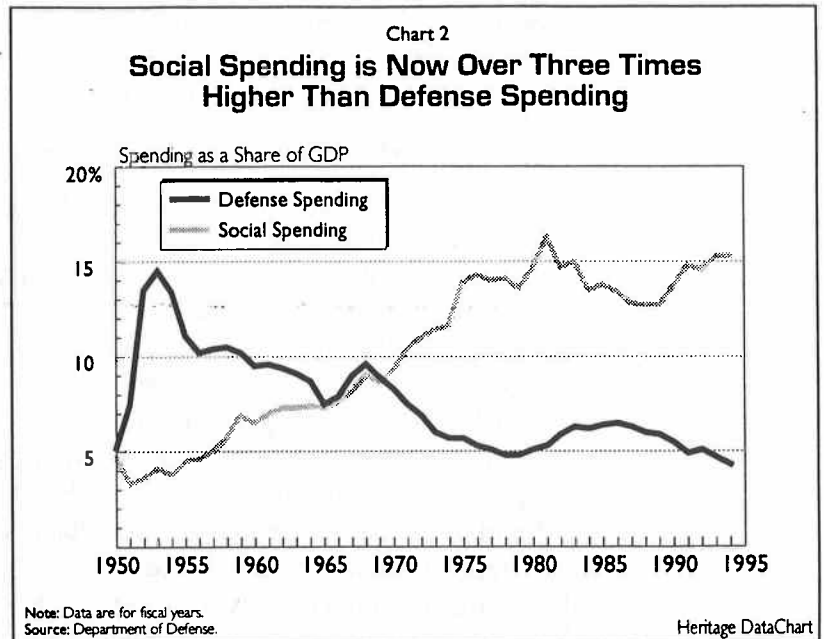
and normal attrition, other sectors of the economy will not have to absorb all these positions to avoid higher unemployment throughout the entire economy.

In terms of growth, the Congressional Budget Office has estimated that defense cuts smaller than those envisioned by Clinton could encourage growth after the turn of the decade. As a result, by 2002 the annual gross national product (GNP) could be only 0.6 percent higher than it otherwise might be.<sup>14</sup>

The upshot is clear: Clinton is wrong to assert that defense is an unacceptable burden on the U.S. economy. His defense conversion program thus becomes little more than a thinly veiled attempt to craft a government industrial policy.

### The Impact on the Military Industrial Economy

While the curtailment of defense spending will have only a marginal impact on the economy as a whole, its impact on the defense industrial sector will be se-



13 Richard A. Bitzinger and Steven Kosiak, *Potential Impact of Defense Spending Reductions on the Defense Related Labor Force By State* (Washington, D.C.: Defense Budget Project, 1993), p. 3.

14 Congressional Budget Office, "The Economic Effects of Reduced Defense Spending," February 1992, pp. 13-14.

vere. In addition to the procurement cuts, Clinton plans to lower the research and development account to \$38.6 billion in 1994 (1994 dollars) from a 1985 high of \$41.5 billion (also 1994 dollars).<sup>15</sup> In all, procurement and research and development under the 1994 Clinton budget will be only 45 percent in real terms of what it was in 1985 (see Chart 3).

As a result of these cuts, U.S. defense industries could lose as many as 1.052 million people in the period 1992 through 1998 because of the drawdown.<sup>16</sup> In 1992, these industries employed 2.761 million people.<sup>17</sup> Thus, employment in defense industries could fall by as much as 48 percent during this period.

## **PRESERVING AMERICA'S MILITARY INDUSTRIAL BASE**

Maintaining America's military strength requires a strong military industrial base that can produce a sufficient number of modern weapons to sustain the U.S. armed forces during combat. The Clinton Administration risks undermining the industrial base through defense budget reductions that not only are too deep, but too focused on decreasing the procurement budget for the purchase of weapons and equipment. America's soldiers, sailors, and airmen will pay a steep price in future conflicts as result of this policy. A more sensible policy would be to:

- ✓ **Concentrate long-range defense planning above all on the industrial needs of the armed forces and not on converting the defense industrial base to civilian production.**

The best measure of whether the nation is managing its military industrial base appropriately is whether its armed forces receive the latest in technology. Reagan's emphasis on the technological modernization of the armed forces led directly to the quick victory and low casualties in the Persian Gulf War.

The Clinton Administration should focus on producing weapons that are now in research and development and represent the next generation of weapons capability. Some of these are the CVN-76 aircraft carrier, the V-22 *Osprey* transport aircraft, the F-22 advanced tactical fighter, the Light-weight Exoatmospheric Projectile (LEAP) anti-missile interceptor, the Theater High Altitude Area Defense (THAAD) missile system, the *Brilliant Eyes* sensor satellite, and the dual-use Single-Stage Rocket Technology (SSRT) space launch system. These cutting-edge systems may provide the margin of victory needed in America's next war. Redirecting the funding in this way will help fund a new generation of weapons to be put in the hands of America's soldiers, sailors, and airmen, while at the same time maintaining the military industrial base.

---

15 *Ibid.*

16 Richard A. Bitzinger and Steven Kosiak, *Potential Impact of Defense Spending Reductions on the Defense Related Labor Force By State* (Washington, D.C.: Defense Budget Project, 1993), p. 3.

17 *Ibid.*

✓ **Eliminate the \$20 billion defense conversion program.**

The Clinton defense conversion program offers \$20 billion in financial incentives to individuals, businesses, and local governments that are adversely affected by defense budget reductions. This approach will cause inestimable damage to the defense sector of the economy by encouraging defense firms to abandon defense production.

This \$20 billion can be put to better use. It can be recycled into the procurement account of the defense budget to build new weapons and equipment, thereby improving the combat capability of the U.S. armed forces.

Even on its own terms, the Clinton defense conversion program is likely to be a failure. Its central goal is to induce defense contractors to diversify into non-defense fields. But many defense companies are already diversified. Further diversification is not always the best solution for defense companies seeking to adjust to a reduced defense market. Some defense companies are not well positioned to penetrate an already saturated consumer market. Others have invested heavily in products that are unique to defense, and if forced from the defense business, will lose their investments. Defense companies should seek solutions that best suit their needs. The government has no way of knowing what these needs are.

## THE IMPACT ON THE DEFENSE FIRMS

How are defense industries reacting to the shrinking the defense market? Firms have adopted one of three alternative approaches. They are:

**1) Getting out of the defense business.** Many firms are simply leaving the defense market. Those doing so are mainly ones that already are pursuing other lines of business. Most of these are selling off their defense companies. For example, General Electric Corporation, a broadly diversified company, has sold its aerospace division to Martin Marietta Corporation.

**2) Entrenching themselves in the defense market.** Many companies, of course, are remaining in the defense industry. Those doing so are mainly ones whose main business is defense products. Their aim is to take advantage of the turbulence in the defense industry. The Martin Marietta Corporation's decision to purchase General Electric's aerospace division is a good example.

**3) Branching out into non-defense production.** The third option for defense companies is to diversify their production to include consumer electronics, civil aviation products, and industrial machinery. Diversification is not new to the industry; a recent study of 228 defense enterprises shows that 140, or 60 percent, have "low dependency" on the defense market.<sup>1</sup> Low dependency is defined as when less than 25 percent of the firm's total revenue is derived from the sales of arms and equipment to the government. The same study shows that only 49 such enterprises are "highly dependent" on the defense market. This is defined as more than 50 percent of revenue is obtained from government sales. Of these 49 enterprises, only seven had sales in 1991 exceeding \$3 billion.

<sup>1</sup> Richard A. Bitzinger, *Adjusting to the Drawdown: The Transition in the Defense Industry* (Washington, D.C.: The Defense Budget Project, 1993), p. 8.



✓ **Focus defense planning on the building and buying of the next generation of weapons.**

Implicit in Clinton's defense plan is the assumption that a high technology force can be maintained through research and development alone, without actually buying the weapons systems. This is deceptive, for three reasons:

- 1) **Not all advances in weapons technology are derived from research and development.** Many breakthroughs are realized through the production and deployment cycles, particularly those related to efficient and reliable production. For example, fighter aircraft produced at the end of a production run are frequently more reliable and cheaper because of what has been learned by the manufacturer in the course of production.
- 2) **Weapons systems that are in the development stage cannot be used effectively in combat.** For example, a prototype tank may represent the cutting edge in armored technology, but it is of little use if not enough have been produced for use in combat and if it has not been available to troops for training.
- 3) **A policy that emphasizes research and development at the expense of procurement will undermine production capabilities and the industrial base.** The sustained production capability needed to turn out large numbers of a weapons system cannot be maintained if the Pentagon has only prototype models. For example, the C-17 transport aircraft prototype cost over \$1 billion to produce. The production models will cost about \$300 million each, depending on the number purchased. Given the unpredictable nature of regional crises, which will be the primary concern of the U.S. military in the future, weapons that are not already in production cannot be manufactured in large enough numbers to support large combat operations.

Furthermore, sharp cuts in procurement funding will adversely affect the production of existing weapons systems. For example, tight budgets raise the question of whether to upgrade existing weapons, such as the F-14 *Tomcat* fighter aircraft, or to build new systems, such as the AFX aircraft now in development. Moreover, budget pressures are forcing decisions to curtail the procurement of existing weapons systems. The Multiple Launch Rocket System (MLRS) and the F-16 *Falcon* fighter jet are two such systems. But ending production prematurely may result in a gap in military capabilities as older systems are retired before the new systems are ready. Besides, once a decision is made to stop the production of a weapon, the capability to produce it quickly atrophies. Production line employees are laid off, the tooling is discarded, and managers are assigned to new tasks.

The most disturbing problem associated with sharp reductions in procurement funding, however, is that it may force the Pentagon to cancel new weapons programs altogether. The Clinton Administration has not yet announced a complete list of the new programs it plans to terminate. The casualty list is likely to be long and is certain to include the A/F-X aircraft and the Multi-Role Fighter (MRF) aircraft now in development. As assaults on the procurement budget force decisions to withhold the production of new weapons, the industrial base is weakened. The effort to maintain a modern military is likewise weakened. This is why money restored to the defense budget from defense conversion should be targeted to the procurement account.

✓ Give governmental support to specific defense industries only as a last resort.

Even if all of the \$20 billion Clinton has earmarked for defense conversion is returned to military modernization programs, some vital defense sectors—nuclear shipbuilding, for example—may be in danger of disappearing. This result is predictable for areas where the perceived threat is limited for the near term. But because the near-term threat is diminished, it does not mean that the military capability to counter that threat will never again be needed. For example, the primary mission for Navy attack submarines during the Cold War was defending against Soviet submarines armed with submarine-launched ballistic missiles (SLBMs). That mission is less important today. However, as hostile Third World countries capable of challenging vital American interests obtain their own submarines, the U.S. will have to retain a submarine force to deal with this new threat. For example, Iran has taken delivery of two submarines from Russia and could challenge U.S. access to Middle East oil. Given poor planning and reduced defense budgets, however, there may be no nuclear submarine manufacturers in business when the Navy needs to replace its aging fleet of attack submarines.

Thus the Navy should continue building a third *Seawolf* submarine, even though there is little near-term military justification for doing so. The reason: to keep the shipbuilding capability intact until the Navy is ready to build its new submarine *Centurion*.

## CONCLUSION

The nation's military industrial base does not exist to bolster the nation's economy. Nor does it exist to expand employment opportunities. Its purpose is to provide the U.S. with the world's strongest, most well-armed military.

President Clinton should remember these truths when formulating his defense plans. Clinton's defense conversion plan will decimate the defense industrial base of this country. A strong military industrial base is built carefully over a long period of time. While it can be dismantled quickly, it is not easily rebuilt. Ultimately, the price will be paid when President Clinton, or more likely a future President, is required to order the American military into battle without the most modern technology or without an adequate number of weapons and equipment. The nation learned a grim lesson when it disarmed too quickly after World Wars I and II. American forces thus were unprepared for World War II and the Korean War and as a result, many American lives were needlessly lost.

This is a lesson that Clinton should remember not only the next time he visits Arlington Cemetery, but the next time he makes a decision affecting the industrial base of this country.

Baker Spring  
Senior Policy Analyst

All Heritage Foundation papers are now available electronically to subscribers of "Town Hall," the conservative meeting place, and "NEXIS," the on-line data retrieval service. For information about Town Hall services, please call (800) 441-4142. On Nexis, The Heritage Foundation's Reports (HFRPTS) can be found in the OMNI, CURRNT, NWLTRS, and GVI group files of the NEXIS library and in the GOVT and OMNI group files of the GOVNS library.