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Analyst Projects 30 Percent Drop in Defense Spending



The Obama administration's [military strategy](#) is predicated on avoiding wars like Iraq and Afghanistan. Beyond that, it says little about how the U.S. armed services should size forces and make investments for a future of shrinking budgets.

This creates a big problem for the defense industry as executives ponder possible actions to cope with the downturn, said Steven Grundman, a former Pentagon official and now an industry consultant.

He estimated that the most likely scenario is for defense spending to drop by one-third from its 2010 peak sometime over the next decade. The high point in 2010 was \$730 billion in 2013 dollars (including both base and war budgets). His worst-case scenario would be a budget of between \$450 billion and \$500 billion in 2013 dollars, Grundman said Feb. 16 at an industry conference organized by Aviation Week &

Space Technology.

As to when the plunge will occur, he said it could happen as early as in two years, if the so-called sequestration cuts of \$500 billion are enforced. But he believes that, most likely, the dreaded guillotine will not fall that soon, and the bulk of the cuts will happen in the next five years. "I still don't believe the reductions will be as deep as they would be with sequestration," Grundman said.

He said the administration's apocalyptic rhetoric about defense cutbacks is not helpful. During the [rollout of the 2013-2017 budget proposal this week](#), officials have insisted that any reductions beyond the \$259 billion already proposed for the five-year plan would be catastrophic and would devastate the Defense Department.

"I don't think that's yet convincing," Grundman said.

A smarter approach would be to "define the floor," he said. Grundman said the Pentagon needs the equivalent of Colin Powell's "base force" study. In 1989, then Chairman of the Joint Chiefs of Staff Gen. Colin Powell sought to define the base force as the minimum that the United States would need in order to remain a superpower following the end of the Cold War. Although Powell's effort was superseded by President Bill Clinton's bottom-up review in 1993, the idea that the Pentagon should outline a base force is relevant today, said Grundman. "Powell decided that if we don't define the floor, there is no floor."

In the current environment, it would be helpful for the administration to explain how the military would operate with a \$400 billion, or a \$500 billion budget, he said. "There's no meaningful difference if someone doesn't define the floor."

The alternative is to allow the political winds to blow freely, he added. "The country has other priorities and expectations of what the peace dividend means if we don't define a floor."

It will be a repeat of what Powell faced, he said. "I think we're there again. The country doesn't know what the floor is. The defense establishment hasn't yet informed the answer to that question."

The good news for Pentagon contractors is that the United States, even if the budget plunges by 30 percent, will still remain highly militarized, said Grundman. The president's Jan. 5 strategic guidance doesn't specify what the role of U.S. leadership in the world will be, but the odds are that whatever it is, "it will have a big dose of military power."

The desire to influence the world via military superiority is not going away, he said.

Industry, however, is in for a rough ride, Grundman warned.

Not only will there be less money for new weapon systems, but contractors will have to contend with an [unfriendly business climate](#). Most companies have not yet figured out how to adjust to an environment where they are treated as bad guys, he said. "I don't see a coherent corporate strategy to the pretty direct dissatisfaction that this customer has with this industry."

The recent termination of the Global Hawk Block 30 unmanned aircraft is a good case in point, he said. The Pentagon is holding the program as a "good example of the way we need to pay attention to cost and performance with the budget we have."

Although unmanned drones remain a "sweet spot" in the defense market, Pentagon procurement officials signaled with the [Global Hawk decision](#) that they have lost tolerance for programs that are over budget and behind schedule, Grundman said.

"That's the fate of things that become too expensive," he said. "There are not a lot of companies in this industry that know how to solve this problem: Integrate a complex system on schedule and on cost," Grundman said. "The ones that can't are going to lose regardless of who's in charge at the Defense Department. The ones who can are going to win."

The preferred survival strategy that many firms adopted in the 1990s — bulk up by acquiring other companies — might not work this time, he said. Executives should be open to all options, including selling off their defense businesses. "The reflex that I hear, 'Let's do what we did in the mid-'90s,' does not make sense to me in this environment."

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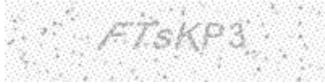
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