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Defense Sector Sees Delayed Outlay Cuts

By ANDY PASZTOR IN PARIS AND NATHAN HODGE IN WASHINGTON

U.S. defense contractors are girding for inevitable budget cuts, but senior Pentagon and industry officials increasingly see a silver lining: They expect only marginal spending reductions over the next two or three years.

That is the sentiment emerging as makers and buyers of weapons from around the world gathered at the Paris Air Show this week to discuss deals, though much of the talk is about shrinking military-acquisition accounts in the U.S. and across Europe.

Behind some of the gloomy longer-term forecasts, however, is a growing realization that the most painful defense cuts probably will be delayed, at least until a new team of Pentagon leaders—including incoming U.S. Defense Secretary Leon Panetta, whom the Senate confirmed on Tuesday—finishes a strategic review and reassesses spending plans. In the meantime, many big-ticket weapons programs appear insulated from swift or dramatic reductions, according to industry and Pentagon leaders.

On Tuesday at the show, David Van Buren, the U.S. Air Force's chief acquisition official, said this time the Pentagon is likely to avoid the kind of broad cuts that decimated funding for weapons development and acquisition at the end of the Cold War. Unlike two decades ago, when some acquisition accounts were slashed by 50% and major defense contractors suffered a massive brain drain, Mr. Van Buren told an industry gathering at the air show "there is no question our budget is going down a little bit" for the time being.

"Production efficiencies will not be enough" to satisfy deficit-reduction goals, Mr. Van Buren said in an interview, because today's weapons "are more sophisticated and the unit costs are higher" than they were during the previous spending downturn. But the architects of those earlier cuts, he said, "ended up disappointed by the results" because acquisition was hit disproportionately while manufacturing assets and services to the Pentagon weren't cut as deeply.

Despite growing public and political pressure in Washington for lower Pentagon budgets, and President Barack Obama's vague pledge to cut $400 billion from national-security spending by 2023, companies such as Boeing Co. and Lockheed Martin Corp. appear to be preparing for an initial period of relatively stable funding.

Chris Raymond, head of business development for Boeing's defense and space unit, said "that's our baseline view of the world," but he added that company officials also are drafting contingency plans "if things happen a little deeper and a little faster."

According to Mr. Raymond, one big difference from the 1990s is that the military's basic equipment has come through a decade of two wars, and experienced wear and tear at a "higher level than anyone would have planned."

With this partly in mind, the House Armed Services Committee recently approved a $553 billion base budget for the Department of Defense, in line with the White House's proposed spending blueprint for 2012. The Senate version of the defense-authorization bill came in $5.9 billion below that request.

"If you expect defense budgets to be flat at best, then the new game becomes exports," said Damien Lasou, a senior aerospace consultant at Accenture. Until recently, he said, major U.S. defense contractors didn't pay particular attention to exports "because the domestic market was so big."

Winslow Wheeler, director of the Straus Military Reform Project at the Center for Defense Information, said the administration's $400 billion target was actually a "modest" proposal that wouldn't hit the Pentagon as squarely in the pocketbook as once thought. He said that figure also envisions cuts to "security" spending, which covers the Homeland Security and State departments as well as veterans' programs.

What's more, Mr. Wheeler said, the White House's proposed cuts are much less drastic than those floated last year, such as the nearly $1 trillion in cuts to the Pentagon's budget during the next 10 years recommended by a deficit-reduction panel commissioned by Rep. Barney Frank (D., Mass.). "It's not the kind of magnitude that everybody was talking about last December," Mr. Wheeler said. "Everybody was talking about far more significant cuts if defense was on the table."

Outgoing Defense Secretary Robert Gates already has offered up a variety of early savings and projected cutbacks, sacrificing some programs in order to stave off deeper spending declines under discussion on Capitol Hill.

Benjamin Friedman, a defense-policy expert at the libertarian Cato Institute, said that "war weariness" has become a factor in debates over defense spending. But he also said that "status quo forces" were at work to preserve the Pentagon budget, which has doubled in real terms since the terrorist attacks of Sept. 11, 2001.

Given the focus on saving money, some contractors face stepped-up scrutiny and greater consequences as a a result of performance lapses. The Air Force, for example, recently punished Lockheed Martin by withholding part of the company's fee for botching work on a Pentagon communications-satellite propulsion system. The problem means the satellite will reach orbit months later than planned.

Speaking generally about contract enforcement issues, Mr. Van Buren said that in three years on the job, he hasn't seen any company bring a project in under cost projections. "With every contract, we put an under-run [and] an overrun scheme" into place. "I'd like to see some companies under-run" their contracts, Mr. Van Buren said, which could save taxpayers money but also assure contractors greater profits.