



The Impact of Globalization and Shifting Defense Priorities on the Defense Industrial Base

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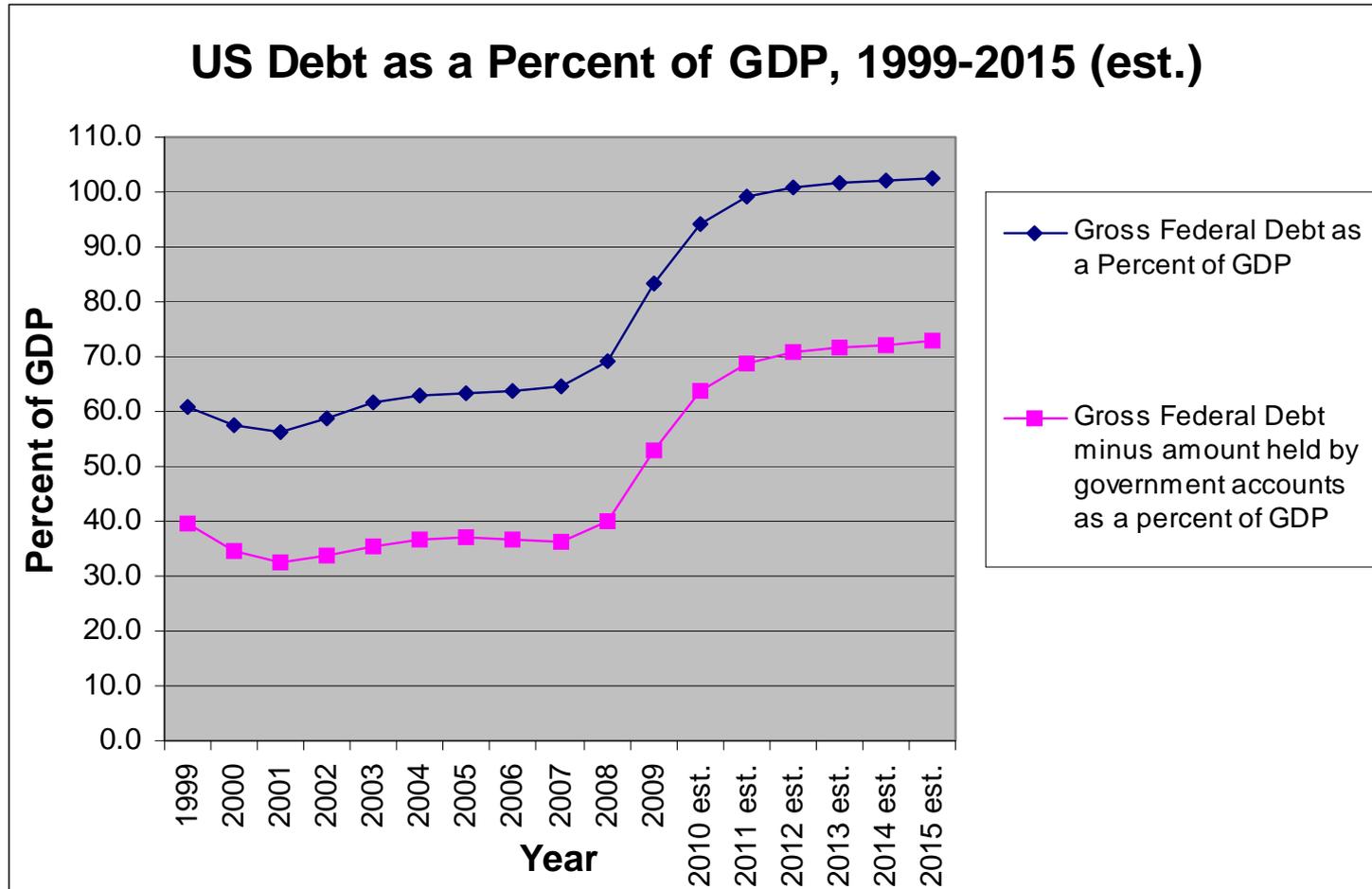


Evolution of the Defense Industrial Base

- The defense industrial base in the US has witnessed many changes over the past twenty years.
- Presentation focuses on
 - The impact of macroeconomic conditions (the labor market, the federal budget) and shifting defense priorities on the defense industrial base
 - The evolution of the defense industrial base in response to the shift in priorities
 - The continuing global nature of the defense marketplace



US Debt as a Percent of GDP



Underlying raw data from Office of Management and Budget (OMB)

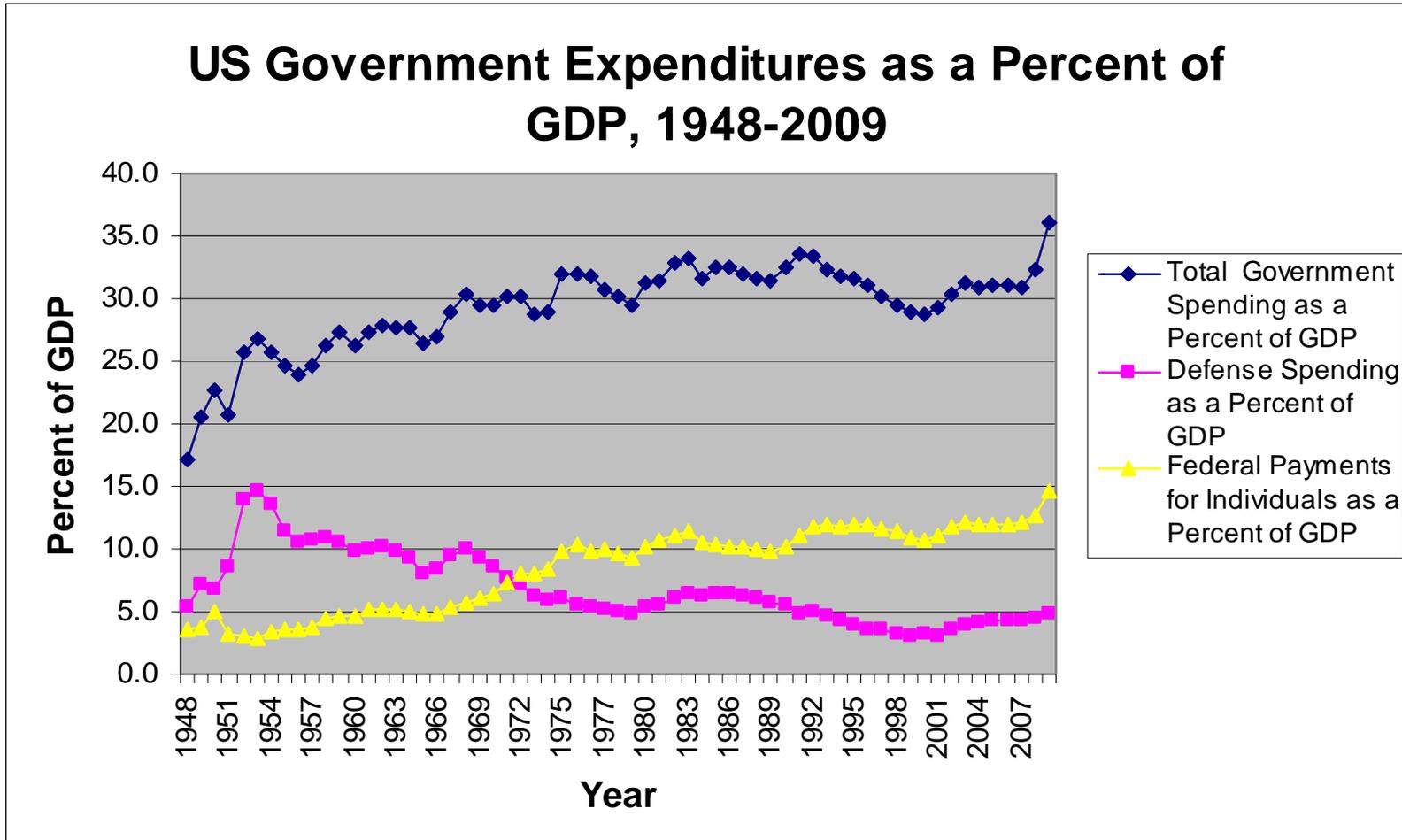


Size of the US Debt and Deficit

- The ratio of gross federal debt to GDP rose from 57.3% in 2000 to 69.2% in 2008 to 83.4% in 2009. Projections suggest that it will continue to rise.
- The US deficit for FY 2009 was \$1.4 trillion, which was 9.9% of GDP.
 - President Obama's budget, submitted to Congress in early February, 2010, would result in a \$1.56 trillion deficit, which is the highest level in history.
 - The deficit has only climbed to 5% or more of GDP four times since the end of World War II.
- Projected deficits between 2011 and 2020 would add \$8.5 trillion to the national debt.



US Government Expenditures as a Percent of GDP, 1948-2009



Underlying raw data from Office of Management and Budget (OMB)

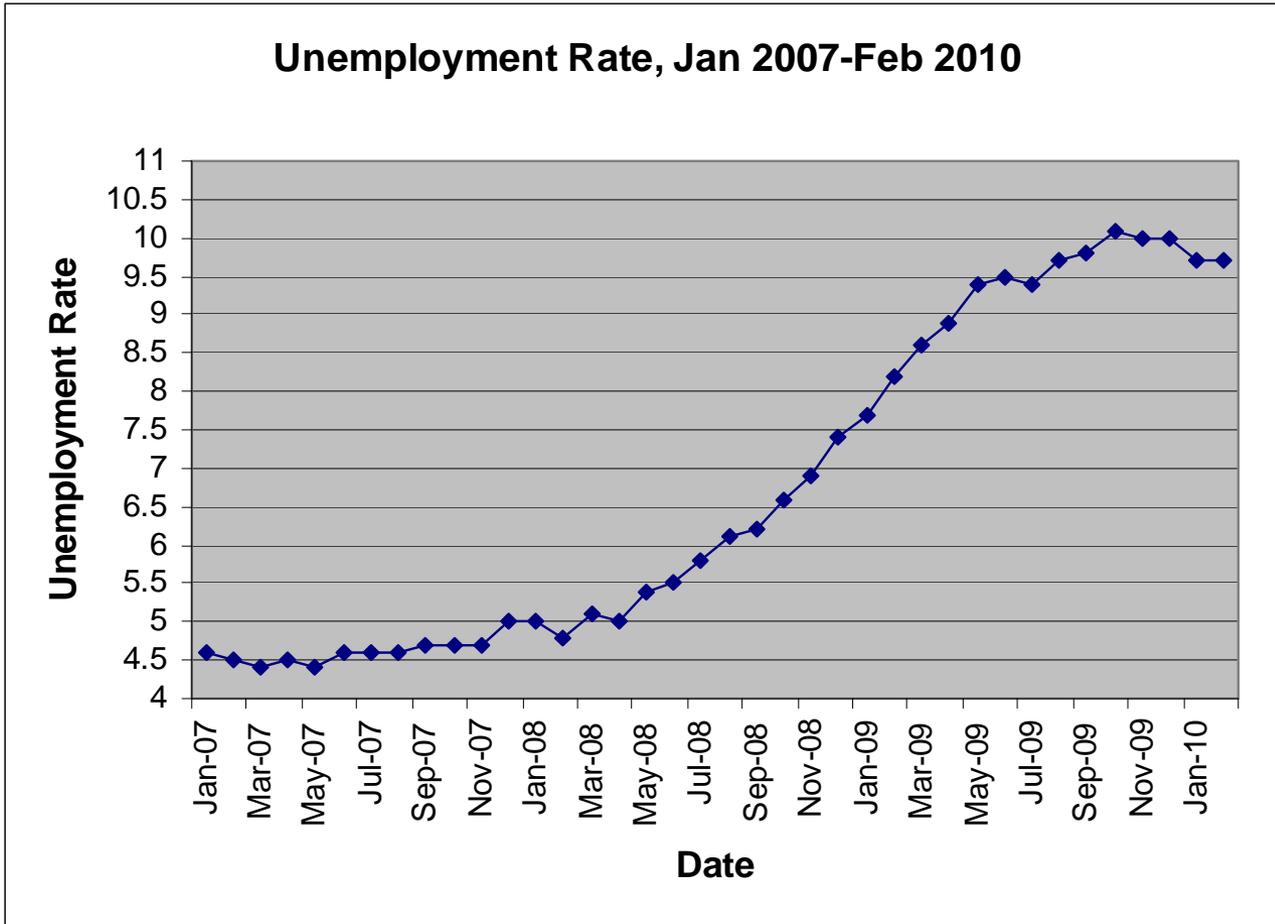


The Defense Budget and the Shift in Priorities

- Shift in defense priorities toward combating insurgent foes through irregular warfare, rather than engaging in combat against more traditional, superpower foes
- The Obama administration is seeking \$708 billion in fiscal 2011 for DoD which reflects these shifting priorities.
 - Greater funding for types of weapons systems which support irregular warfare
 - Reduction in more high-tech weapons systems for conventional warfare
 - More emphasis on controlling cost growth



Unemployment Rate



Source of underlying raw data: Bureau of Labor Statistics



Impact of Unemployment on Congressional Reactions to Changes in Defense Programs

- Although 2009 defense spending was only 4.9% of GDP, the defense presence in regional economies has strong spillover effects.
- In the context of rising unemployment, Congressional representatives have become increasingly concerned about the labor market impacts of reducing certain defense programs, depending on the region of the country.



The Impact of Shifting Defense Priorities on the Defense Industrial Base

- Concerns that a gap in work from termination of certain types of defense programs could lead to atrophy of a specialized skills base, which, in the absence of defense work, would not be able to grow with commercial sector demand.
- Although current profits may be good in particular sub-sectors due to orders of existing models, reduced demand for next generation Pentagon programs can hinder the strength of the sector in developing future systems.
 - Various examples
- Shift in defense priorities can lead to the development of new sectors
 - Various examples



The Defense Sector as a Global Industry

- Defense Secretary Robert Gates stated that “defense manufacturing is a global business.”
- Ashton Carter, Undersecretary of Defense (AT&L), has noted that European products are “part of a ‘global industrial base’ that deserve consideration, especially if these designs can be purchased at a lower cost.”



Interdependency within the global defense industrial base

- Although many US weapons systems do not have foreign contractors as the primary contractor, the US is involved with the defense industrial bases of other countries through global supply chain arrangements.
- Overseas sales can bolster our domestic defense industrial base even as our priorities change.
 - Demand from other countries for conventional weapons systems augments sales of US defense contractors



Conclusions

- The rising US debt and deficit may increasingly put pressure over time on other segments of the budget, including defense, as more funding becomes needed for additional areas.
- Both with the shift in defense priorities and potentially greater fiscal austerity, there will be a greater emphasis on cost-effective weapons for the current threats.
- Shift toward irregular warfare and away from conventional warfare may lead to attenuation of certain aspects of the defense industrial base, but also to increased growth in other sectors



Conclusions

- The defense industrial base is global in scope and there is an increasing trend toward global supply chains to share innovation and risk, and to develop interoperable equipment.
- If sales of domestic defense manufacturers flag, there is still substantive demand from overseas for weapons systems.
- The defense sector continues to be a significant contributor to the US and global economies. The evolving fiscal environment and the types of military threats will hopefully contribute to the development of a more cost-effective and transparent landscape.