

## October 10, 2008 - Defense Industry Worries About Cutbacks

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### Defense Industry Worries About Cutbacks

Financial-Industry Bailout Could Prompt Congress To Trim Costly Pentagon Programs, Executives Say

By August Cole, WSJ

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Defense-industry executives are starting to worry that the costs of rescuing the financial industry will be taken in part out of the Pentagon's programs, and that could have a big impact on their companies.

As recently as a few weeks ago, the executives were relatively bullish about the long-term prospects for defense spending, regardless of which party wins the White House in November. But as the financial turmoil on Wall Street has spiraled into an international crisis, that optimism is fading.

In a note last week to employees, Boeing Co. Chief Executive Jim McNerney wrote that the world's biggest aerospace company by sales is "well positioned" to weather the financial turbulence because it has a solid credit rating and a big backlog of commercial airplane orders.

But addressing how the government's financial-industry bailout might affect Boeing's more than \$30-billion-a-year defense business, Mr. McNerney said: "No one really yet knows when or to what extent defense spending could be affected, but it's unrealistic to think there won't be some measure of impact."

Howard Lance, chief executive of Harris Corp., which specializes in defense communications and is expanding into the intelligence market, said in an interview this week that there is a sense in the industry that "everything is going to be subject to reconsideration," particularly big-ticket programs such as fighter jets, tanks and ships.

It could be months before any specific programs come under pressure. The defense budget for fiscal 2009, which started Oct. 1, is set, and Pentagon officials are well into planning the 2010 budget. The Pentagon's regular budget for fiscal 2009, not including special funding for Iraq and Afghanistan, stands at more than \$540 billion. That figure, up about 5.5% from fiscal 2008, is at a record level.

In the wake of Congress's emergency action to rescue the nation's financial system, some top leaders have made it clear that they must find ways to pay for it. Rep. John Murtha (D., Pa.), chairman of the House Appropriations Committee's defense subcommittee, warned that the bailout will only increase the pressure on Pentagon officials to find ways to balance their needs for new programs with paying for ongoing military operations in Iraq and Afghanistan.

"No matter who wins the White House, the next president is going to be forced to decrease defense spending in order to respond to neglected domestic priorities," Mr. Murtha said. "Because of this, the Defense Department is going to have to make tough budget decisions involving trade-offs between personnel, procurement and future weapons spending."

Boeing has some big programs on the line: the Army's more-than-\$160-billion modernization effort called Future Combat Systems, the C-17 Globemaster transport plane, a shot at a \$40 billion Air Force refueling jet contract, and work on Lockheed Martin Corp.'s F-22 Raptor fighter.

Other sophisticated weapons that will likely be scrutinized for their need are the Navy's \$3 billion DDG-1000 Zumwalt-class destroyer, which is being built by Northrop Grumman Corp., General Dynamics Corp. and Raytheon Co. Closer look also may be given to the almost \$300 billion F-35 Lightning II Joint Strike Fighter, a multinational effort to produce thousands of cutting-edge jets. Lockheed is also the lead contractor on that program.

Defense Secretary Robert Gates had already been pressuring the armed services over the F-22 and Future Combat Systems, saying that neither program is relevant to current operations in Iraq and Afghanistan. The 2009 defense budget postponed until the next administration tough decisions that could lead to shutting down production lines that make the F-22, as well as Boeing's C-17.

Political leaders will have to tread carefully. Cutting defense dollars can be perilous, particularly for Democrats eager to be seen as strong on defense issues and when the reductions come during a downturn, since such jobs are seen as one of the mainstays of the economy.

Even before the bailout, fiscal pressure was growing on the government. The U.S. ran a deficit of \$438 billion in fiscal 2008, some \$276 billion wider than the prior year, the Congressional Budget Office said this week. Yet some defense executives still believe that a variety of threats to U.S. national security, such as Russia's invasion of neighboring Georgia, would support strong defense spending.

Programs deemed to be technological boondoggles or irrelevant to operations in Iraq or Afghanistan may get postponed or pared back to pay for more pressing military needs. The Aerospace Industries Association, an industry trade group, said that even before the Wall Street financial crisis, plans to increase ground forces by tens of thousands of enlisted personnel were already threatening funding for longer-term programs to modernize or develop new weapons.