

Managing the Transition: Defining Government's Role in the Defense Conversion

by Jeffrey Li

The sheer military/industrial capacity of this nation shames any historical comparison. For a stretch of forty years, America allocated trillions of dollars to confront the Soviet threat, building five complete branches of the military, as well as their supporting research and industrial bases. Today, the "military-industrial complex" stands as the largest agglomeration of capital and industrial labor resources in America. It saps 15 percent of America's scientific brain power, employs three million people, and funds 32,000 prime contractors and 100,000 subordinated facilities. One million civilians and 1.9 million in uniform work under the Pentagon (Melman 11). Nevertheless, the bipolar world and concomitant arms race has dissolved. The Cold War is a tepid artifact and defense expenditures on a Herculean scale can no longer be justified. These days politicians, columnists, and economists are buzzing about a "once-in-a-lifetime" peace dividend. They argue for a comprehensive conversion of the national military-industrial base, where the resources exploited for defense purposes are redirected toward civilian ambitions.

So goes the popular concept of defense conversion or whatever you call it (diversification, economic adjustment, military transition, defense reinvestment...). The central tenet of conversion asserts that companies which produce goods for the defense market can be guided, with a little effort, toward a successful civilian market. The benefits to the country could be immense. Labor and machinery reserved for defense could be retrained and retooled for civilian use. Rebuilding the infrastructure, developing civilian technologies, and

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shoring-up the nation's economic competitive edge are all plausible options.

However, those grandiose designs of a new civilian economy are not the reasons why conversion is a favorite in Washington. The real motive for conversion is jobs. Defense cutbacks will have a crippling effect on private industry. Everyone knows that the Department of Defense (DoD) is a tremendous stimulant to the economy. Along with the Pentagon, it practices a de facto industrial policy, subsidizing key technologies and investing in basic and applied research and development (R & D). This high-tech research is spun-off, giving the products of civilian firms a competitive boost over foreign products. But as defense funds begin to taper off, bases will close, military personnel dismissed, and defense contractors starved for income, triggering a new wave of unemployment. Worse, defense downsizing generates a ripple-effect—three subcontracting jobs are lost for every one

prime contracting job (Elli estimates place national jobs lost at 10 million).

Higher unemployment with short-term industrial; particularly at a parochial level, leads into extended lackadaisical growth. Thus, defense conversion is an integral and defining component of President Clinton's administration.

Here are the basic numbers: Clinton budget allocates \$246 billion for national defense in fiscal year 1997. From FY1993 to FY1997, funds are projected to lower from \$273 billion (Dept. of Defense.) V newly liberated funds, Clinton announced a \$1.7 billion conversion package, already appropriated by Congress, and wants to spend \$1.7 billion over five years for retraining, helping contractors switch to civilian products, and other defense conversion programs.

The President has projected use the funds to clean-up the environment, retire, retrain, or find new private-sector workers and military personnel, and assist in community development where bases close. Most notably, the funds will be strategically targeted to enhance US competitiveness by 1) integrating the military and civilian technology base, 2) speeding the transition for defense contractors, and 3) shifting R & D efforts.

White House officials take a new approach as a cornerstone of a broad, revolutionary "technology j



Cartoon (y Oleg Vinnitski/

live." What does this approach acknowledge? First, civilian technologies are advancing faster than the military's. Secondly, sustaining a world-class industrial base starts with a sizable investment in R & D, and thirdly, US non-defense R & D, as a percentage of national product, lags substantially behind that of Japan's or Germany's.

Clinton's conversion plan now operates within the context of these three realities. Billions of dollars will be shifted from defense to civilian R & D. The government will also endeavor to fuse the defense manufacturing establishment and its commercial counterpart to pro-

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duce dual-use technologies, products that have both defense and non-defense applications. More investments via the Advance Research Projects Agency (ARPA) will be made in information and process technologies, advanced materials, and microelectronics. ARPA—America's answer to Japan's Ministry of International Trade and Industry—will cultivate a government/industry partnership and aggressively push dual-use and defense conversion initiatives to dampen the shock when the DoD's contractors switch to commercial-oriented goods and services.

The idea is credible—aiding the conversion of defense firms, fostering technologies and incorporating them into commercial products. If conversion is successful, when the downsizing is complete, jobs will be saved, communities will rebound, and American business will be lean and mean.

But will defense conversion work? Past performance would indicate "no." The economy naturally contracted and entered a prolonged slump after World War II, Korea, and Vietnam. Each time the military cuts came, defense contractors, even the biggest and most respected, attempted to diversify in commercial markets. Boeing and Grumman tried their hand in the urban-transportation market by building electric trains and buses—a flaming catastrophe. The maker of the F-15, McDonnell Douglas,

went on a short and (disastrous) escapade into the civilian sector by manufacturing medical systems and microelectronics controls. General Dynamics was eaten alive by commercial firms when it dived into telecommunications (Lundquist). The truth is, most defense contractors have a woeful record when it comes to conversion.

Indeed, the euphoria over converting legions a defense firms is short-lived. There is a realistic, sobering side to the defense transition, and it is imperative that federal policies reflect that. In confronting the economic validity of conversion, we need to avow the gaping cultural dichotomy between the commercial and defense sectors. It's a whole, new ball game.

Successful conversion will be difficult because of two factors: government procurement practices and the business culture of the commercial market.

Simply put, the DoD procures products differently from their contractors than we civilians do from ours. These acquisition standards along with regulatory barriers result in a type of product that only has utility in a defense market and cannot be directly applied in commercial fields or easily utilized by commercial consumers.

Military buyers tell defense contractors what they need and how it is to be manufactured with exacting standards. Furthermore, these specifications are frequently inordinate relative to commercial standards. For example, military equipment must operate in severe (however unrealistic) environmental conditions, such as in a thermonuclear explosion. Pushing such standards involves a bureaucratic army of acquisition personnel and volumes of procurement laws and regulations. These standards, cost-accounting problems, and incessant acquisition reviews are also the key barriers to developing dual-use technologies. Moreover, defense procurement emphasizes optimum performance at whatever expense. So the Pentagon will dole out exclusive contractors and cost-overrun guarantees in search of state-of-the-art technology, even if there is the smallest incremental rise in performance (Leopold 4).

Ironically, the same factors that produce success in the defense industry, engender failure in the commercial sector. What we get are fat, inflexible companies that are shielded from market place operations and cutthroat competi-

tion. We get a different corporate strategy, one that de-emphasizes cost-efficiency, quantity-quality trade-offs, and market adaptability. The overhead onus and inefficient processes that are the legacy of present procurement practices make entry into the commercial market precarious.

And what of this market? It is a market obeying different rules and operating under a different culture. The environment is proactive, not reactive. The consumer doesn't give the firm a recipe to follow, the firm makes up the recipe and lets the consumer pick the cheapest one. Commercial companies are entrepreneurial, excessively competitive, and prefer to manufacture not the most advanced product, but the most cost-effective. Although technology is important, distribution channels and just plain business savvy will be the decisive factors.

A good reason for why converting is so hard, is that defense companies are ignorant of how the commercial marketplace functions. They are sorely lacking of such rudimentary business skills as marketing, strategic planning, market research, and management and product development. They need marketing staffs and sales staffs, their accounting systems need to be overhauled (Lundquist). In short, they have no idea what they are getting into.

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One vital fact should not be overlooked: most markets are already filled. Today's defense industry, and hence its products, is becoming increasingly divergent from the commercial industry. For instance, what civilian needs stealth technology? Even if a convertible technology such as night-vision optics does find a way into the market, consumer demand will be trivial in contrast with the DoD's former needs. Many contractors will decide conversion is simply not worth it. It is better to tailor to one, predictable five-sided cus-

tomers than millions of civilians that are more volatile and less distinct.

Thus, beating swords into profitable plowshares is at best problematic. And therefore the question which ineluctably follows is: "Is a sweeping conversion initiative in the country's best interest?"

The Bush Administration argued that it was not. Granted, defense downsizing would close factories and

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bases, and the economic impact would be severe, even crippling, to some areas, but the pain would be localized and not likely to be widespread. After all, the defense industry now comprises a smaller share of the national economy, a \$6 trillion economy that can readily absorb \$50 billion in defense cutbacks.

We also should not forget that the US financed the military/industrial complex on borrowed money. With deficits so titanic, it makes sense to use the peace dividend to pay our dues, not waste it on government conversion programs.

And why is it that there exists programs that give special treatment to defense workers while none existed for others when their industries faltered? Defense conversion smacks of industrial policy. The whole idea of playing favorites is unfair and many times inefficient, for the government is inept at picking winning technologies and has a propensity to prop up decaying industries. The party is over. Defense firms and their employees got rich from the government, so why should the government throw in more tax money and intervene as they restructure and relocate? Let market forces, however ruth-

less, run their course, and ultimately the right resources will be shifted to the most sensible areas.

Of course, we need to be realistic. Although Americans cringe at the thought of more government, they refuse to follow a strict laissez-faire prescription, especially when jobs at home are at stake. And with a liberal ideological slant, the Democratic Administration will be too accommodating. SHU history makes abundantly clear that an unfettered market system will outperform any socialist agenda.

So which brand of economics should our country's policies reflect? More specifically, what should be the government's role during the defense transition, and what would private-sector contractors do to help themselves?

These questions will define the conversion debate, but before they are answered, we need to list the objectives of our conversion/economic adjustment policies: To keep people and communities working, to improve the global competitiveness of US industry, and to preserve the most essential elements of the defense industrial base.

Achieving all three objectives would imply a successful conversion effort. Unfortunately, the doctrine of laissez-faire accepts the inevitability of major job loss and iron-handed industrial contraction when supply and demand forces strive for equilibrium. Thus, each goal would be severely jeopardized, barring any government "meddling."

This warrants at least a limited form of government intervention. To begin, it makes sense for the government to cultivate an economic climate favorable for conversion and military-commercial integration. Federal policy could extend targeted incentives to the defense industry to pursue new markets and provide civilian R & D tax credits. But by far, the best approach is simply to ensure a growing, robust economy, where new markets and opportunities can emerge for the defense firms.

Military-commercial integration and dual-use technologies offer an unprecedented chance to promote long-term economic growth and unrivaled US competitiveness. Merging with civilian technologies, which are becoming more advanced and less expensive than military counterparts, would maintain the viability of the defense industrial base and make it more cost-effective. Therefore, it is imperative that the DoD encourage the flow of technologies,

products, and processes **commercial** and defense **revamp** or rescind procureur regulations that obstruct this. This includes streamlining acquisition practices and acquisition procedures, information disclosure requirements, and discarding excessive process specifications (Leopold 29).

The objective of a healthy defense production deserves special attention. It is unwise to leave this critical sector to market forces, since there is no guarantee that an adequate defense industrial base will remain. The challenge is to restructure and downsize while ensuring that defense manufacturing establishments retain sufficient industrial capacity to ensure our national security.

After World War I, the defense industry was downsized with such impetuosity that it was left ruefully unprepared. It took years to reconstitute military production capability. Beating swords into plowshares is not a new idea. The DoD should activate a policy of continuous improvement, extend production delivery schedules, and support foreign military sales, and whatever capital is needed in a military maintenance, research, and development, and manufacturing capabilities do not disappear. Military-commercial integration and consolidation would be instrumental in protecting the defense industry. Contractors need unnecessary defense orders

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in business and will retain the plant equipment, and resources that national security is contingent upon.

Howbeit, preserving the defense industrial base is not the only thing as direct assistance to troubled contractors. Although federal funds soothe the transition, firms must ultimately learn to turn to themselves for help.

What can the contractors do? There are typically four corporate strategies for survival during a transition: consolidation, diversification, selling to other government markets, or selling overseas (Dept. of Defense.)

Consolidation, restructuring to stay in or get of the defense business, involves reducing employment and cutting R & D and capital expenditures. Diversification occurs through conversion or acquisition of other business divisions. Both are the dominant strategies. Selling products overseas or to other government agencies such as NASA, the Federal Aviation Administration, and the Drug Enforcement Administration offers some respite from the defense build-down but revenues are meager compared to the DoD's former contracts.

The US defense industry is a heterogeneous amalgam of different sized contractors manufacturing different products. Due to flexibility, small defense companies generally convert better than big, ones, yet they lack the resources to exploit new-found opportunities. The larger contractors will set modest goals for diversification. But for the rest, the best option may be to ride out the transition and stay in the lucrative defense business, despite reduced profits and layoffs.

Whatever the government does to intervene, contractors must concede the imminent and painful process of shrinking, restructuring, and shedding thousands of jobs. There is no escape, for the fate of the defense industry is ultimately for market forces to decide. Yet, there is opportunity for a judicious government role in the transition by providing short-term assistance and promoting long-term economic growth.

The aforementioned policies of

preserving key elements in the defense industrial base mandate some form of direct government intervention. These policies are not to be applied to defense contractors when national security is not directly at stake—which is most of the time.

So what is needed is concerned but detached government, a government which merely ensures an economic climate favorable for conversion, but does not actually manage a firm's conversion itself. It is wrong and unfair for legislators to turn the peace dividend into a jobs program. Outright grants or direct subsidies that rescue firms and back conversion ventures is wasteful. Conversion policy should remove barriers to allow companies to help themselves. For example, Congress should rescind antitrust laws that prevent companies from merging to survive. Government can encourage firms through incentives to explore integration and dual-used, and it can identify, not "pick" and develop, key technologies. A new emphasis on civilian R & D is not a bad idea too.

Clinton's sweeping conversion initiative has merit, but it must be based on the rational assessment that conversion offers limited success. It simply is not feasible for Lockheed to manufacture basketballs and soft-drinks. But clearly, government action can help. Funding programs that assist dislocated workers and aid communities disproportionately hurt is tantamount to disaster relief and should be done. Policies that help defense firms acquire the flexibility to

survive the transition also make sense.

Great military powers tend to spend excessively on armaments. However, this diverts resources from other sectors of the national economy, and results in the general decline of a nation's commercial competitive advantage. It would be tragic if the US did not seize the opportunity to reverse this trend. But it would be equally tragic if we wasted the spoils of victory on ill-conceived and misguided conversion efforts.

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