Good times over for US arms producers?

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President Barack Obama will soon sign his first defence budget, for fiscal year (FY) 2010 which starts in a month's time. This budget will comprise approximately US$556 billion (S$794 billion) in base spending, along with US$130 billion in supplemental spending, for a grand total of US$686 billion.

For a country as small as Singapore, with a defence budget barely one-hundredth the size, these figures may seem astronomical. And yet, there are some in the United States who have argued that not only is it not enough, but also that any cuts would be tantamount to exposing America to its enemies.

But the cuts are coming. Defence Secretary Robert Gates has already stressed fighting the current low-intensity wars in Iraq and, increasingly, Afghanistan, over long-term plans to build a military capable of taking on a more high-tech 'peer competitor' in a conventional war.

The US defence budget has literally had its biblical 'seven fat years': From 2001 to last year, it has more than doubled, from US$335.5 billion to US$696.2 billion. Since last year, the budget has tapered off slightly (although the 2010 budget request is up around 2 per cent over the previous year, after taking inflation into account).

One thing that is definitely going away is the supplemental budgets for wartime operations in Iraq and Afghanistan. These totalled more than US$882 billion between 2001 and this year; the FY2010 budget request includes an additional US$130 billion in supplemental spending, but this will probably be the last.

Additionally, the Office of Management and Budget (OMB) is telling the US Department of Defence (DoD) to expect only 1 per cent real growth in subsequent years. If that holds true and if supplemental budgets are eliminated altogether, the FY2011 defence budget could be as much as 18 per cent below FY2010's.

The US defence industry has seen lean times before. The 1990s - the decade of the so-called 'peace dividend' - saw military expenditures fall more than 25 per cent. This forced a major restructuring and consolidation of the US defence industrial base. In particular, several large-scale mergers and acquisitions (M&As) took place, resulting in the emergence of five mega-defence companies - Boeing, Lockheed Martin, Northrop Grumman, Raytheon and General Dynamics. This greatly reduced competition in the US defence sector.

These five mega-firms now control most key US military programmes and also have access to considerable DoD research and development (R&D) funding. Consequently, these firms benefited greatly when US defence spending on procurement and R&D rebounded in the 2000s. By 2007, the five largest defence companies received nearly one-third of all US defence procurement spending - and half of all military R&D funding.

At the same time, US defence firms are highly dependent on their home market. In 2007, for example, only 15 per cent of Lockheed Martin's revenues came from foreign sales. That same year, overseas markets accounted for only around 10 per

cent of General Dynamics' income and less than 6 per cent for Northrop Grumman.

Consequently, when US defence spending falls, these companies are suddenly very vulnerable. The impact can already be seen. The DoD plans to cap production of the F-22 fighter at 187 planes and the C-17 transport plane at 205 planes, terminate the Zumwalt-class destroyer programme after building only three ships (originally the US Navy planned to acquire 32 ships in this class), and cancel the manned armoured vehicle element of the Future Combat Systems (FCS) programme.

To be sure, the US defence industry and its allies in Congress are not going down without a fight. For instance, many in Congress wanted to buy additional F-22s, arguing that 187 planes are insufficient to take on, for instance, a China armed with advanced fighter jets. Eventually, the legislative branch bowed to White House pressure on terminating F-22 production; at the same time, it may yet force the DoD to buy additional C-17 transport aircraft that it did not request.

Moreover, it is likely that the US defence industry will increasingly look overseas to a worldwide arms market - worth more than US$55 billion last year - to make up for shrinking sales at home. This may be already happening. Last year, US weapons manufacturers signed arms export agreements worth almost US$38 billion, up 48 per cent over 2007. Large domestic production runs permit them to sell systems overseas at very competitive prices and they can also offer very attractive industrial and technological inducements.

As a result, Singapore and other countries in the Asia-Pacific region might find it easier to buy some of the most advanced weapons system being produced by the US arms industry. Singapore and Australia are already partners on the Joint Strike Fighter programme, and pressure is growing to permit the export of the F-22 fighter to Japan.

Overall, the US defence budget 'gravy train' may be over, and the large US defence contractors will have to adjust. This could mean another round of rationalisation, M&As and layoffs like we saw in the 1990s, resulting in an even leaner and meaner defence industrial base. On the flip side, this could also mean an explosion in US arms exports - including to the Asia-Pacific region.

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