Pentagon: No more big defense mergers

By Yochi J. Dreazen *National Journal* June 15, 2011

The Defense Department will try to stop consolidation among the nation's biggest weapons contractors, who are bracing for potentially far-reaching cuts in defense spending because of the nation's yawning budget deficit, a top Pentagon official said in an interview.

Ashton Carter, the Pentagon's top acquisitions official, said he expected the defense industry to go through a period of profound change as it adjusts to a new era of austerity. But he cautioned that the department would take steps to prevent mergers and acquisitions within the ranks of major defense contractors like Raytheon and Boeing, whose numbers have fallen sharply since the end of the Cold War.

"We would not allow any further mergers of the big ones," Carter, the Pentagon's undersecretary of Defense for acquisition, technology, and logistics, told *National Journal*. "On occasion we will intervene by blocking a transaction if we thought it was excessively short-term focused and had done a poor long-term risk analysis."

In 1993, during a very different era for defense contracting, Carter was one of the participants at what came to be known as the "Last Supper."

Then-Defense Secretary Les Aspin summoned the chief executive officers of the nation's 15 biggest defense contractors to the Pentagon and bluntly told them they needed to start consolidating.

Carter, who served as an assistant secretary of Defense during the Clinton administration, noted that the industry had roughly 40 major players during its Cold War peak. Within a few years of the Last Supper, the industry had shrunk to barely a half-dozen large companies players.

In the interview, Carter said the number of major defense firms shouldn't be allowed to fall any further, particularly since the coming cuts won't be as pronounced as had been the case after the end of the Cold War.

"It won't be like in the 1990s," he said. "I don't expect [the industry] to contract any further."

Still, Carter said it could no longer be business as usual at the Pentagon. The Defense Department's base budget has nearly doubled since 2001, but the Obama administration and Congress have made clear in recent months that the Pentagon budget will be held steady - and possibly even cut - in the years ahead. On Monday, for instance, the House Armed Services Committee recommended cutting $9 billion from the department's fiscal 2012 request.

In the interview, Carter said the department will work to reduce the $200 billion it spends each year on logistics and maintenance by about 5 percent, savings he described as "real money." He estimated that such efficiencies could save the department as much as $100 billion in coming years.

One weapon the Pentagon will use in its fight to rein in runaway spending is what Carter refers to as a "share line," an agreement allowing contractors who bring their projects in below budget to keep some of the savings. If an aerospace firm manufacturer delivered a next-generation drone for $200 million less than had been projected, for instance, it might be allowed to keep $100 million for itself. The government would keep the rest.

"Businesses all over the country are constantly, ruthlessly routing out unnecessary costs and making themselves leaner," Carter said. "We have to provide incentives for [defense contractors] to do that. "

In the end, though, Carter said major defense firms will have to find ways of delivering their products for less money for the simple reason that there is less money to go around.

"The alternative to adaptation is just canceling programs," he said in the interview. "The programs that survive will survive in part because they are being economically managed. And if you're a poorly-run program and you're not performing, that ipso facto puts you on the potential cut list."