

# U.S. economic collapse is behind 'arms reduction' mania in Washington

by Leo Scanlon

The *pas-de-deux* just concluded between the superpowers in Washington has been universally mischaracterized as part of an "arms control" negotiation. In reality, both superpowers have embarked on unilateral reorganizations of their military forces, and are now attempting to negotiate a new treaty for the European continent, modeled on the 1815 Treaty of Vienna which established the Alexander II's Russia as the "policeman of Europe."

Contrary to all of the propaganda statements made by U.S. military and political officials, U.S. strategy is driven by the fact that the industrial base of the U.S. economy has collapsed to such an extent that it cannot sustain a military force capable of containing the Soviets in Europe. The current defense budget was largely planned with this reality in mind—long before the revolutionary events of 1990 changed the map of Eastern Europe.

The Soviet Union, for its part, is well aware of the implications of this economic collapse, and has targeted it as the Achilles heel of the North Atlantic Treaty Organization (NATO), which since the early 1950s has served as a barrier to Soviet aggression, but which is now in turmoil in the wake of the revolutions in Eastern Europe. The now nearly completed "Ogarkov revolution" of the Soviet military structure, precisely pits Soviet strengths against this weakness, and is designed to situate them as Europe's new policeman, in spite of the Soviet Union's own catastrophic economic collapse.

## 'Free market' dogma collapsed U.S. military

The origins of the perilous military situation now facing the United States can largely be traced to the economic policies pursued by the Reagan administration and the Carter administration before it. The decision was made to abandon support for basic industrial production, in favor of more "cost-effective" speculative and usurious financial practices. The long-term weakness this built into the economy was complemented by an ideological crusade which demanded "competition" in contracting for military weapons systems.

The insane idea of forcing the most capital-intensive component of American industry to engage in the duplicative efforts necessary to compete for large military contracts, was

championed by Navy Secretary John Lehman, among others. In military-related industry it operated like the deregulation schemes in other sectors, effectively cartelizing production and wiping out a network of middle-sized engineering and production facilities. A study recently issued by the Center for Strategic and International Studies at Georgetown University in Washington, D.C., reports that of 118,489 defense firms operating in 1982, 60% were gone by 1987.

In order to sustain the cost of competing for big-ticket projects, most defense firms took on large amounts of debt during the so-called defense buildup. Debt-to-equity ratios in the aerospace and defense sector soared from the historic average of 14% to over 37%. According to figures published in *Defense News*, the aerospace firm Grumman now sports a 108% debt-to-equity burden; McDonnell Douglas 88%, Lockheed 89%, and so on.

The interest costs of this debt are enormous. Northrop's interest expense increased sevenfold, from \$17.4 million in 1985 to \$123.7 million in 1989; McDonnell Douglas went from \$95 million to \$366 million; and Grumman from \$29.4 million to \$105.3 million. At this point, the stocks of these companies are considered to be little more than "junk bonds."

## Copping out on R&D

An additional consequence of the dual-sourcing mania was that the process penalizes those companies which are most heavily invested in research and development. Once a contract is let, the Pentagon awards 60% of the work to the winner, and 40% to the loser, in order to keep vital production lines running. It didn't take long for people to figure out that the best tactic in this environment was to save the cost of R&D, lose a competition, and try to eke out a profit on the 40% of the production awarded to the loser. Former Pentagon procurement chief Robert Costello told the *Los Angeles Times*, "I don't think there was a single remarkable success in competition."

That is an understatement. The penalties against R&D expenditures which were built into the contracting schemes of the Reagan administration were compounded by the interest costs described above. The final nail in the coffin was the

frenzy of “waste, fraud, and abuse”—charges nated in the “Ill Wind” 1988.

The administrative and prosecutorial apparatus created under this rubric imposed a further burden on defense contractors. In one case, cited by the *Los Angeles Times*, the federal government spent \$300 million to audit a \$500 million contract. That figure does not include the cost borne by the contractor for hiring accountants and lawyers to oversee the government snoops. Smaller firms, faced with the choice of bearing these costs or being fined and jailed for minor accounting infractions, left the industry in droves.

But that does not mean that the remaining large contractors are fairing any better. Martin Marietta chief Norman Augustine told a recent congressional hearing that in the past two years, 47 companies have put their defense divisions up for sale, and 30 have been sold in the effort to raise cash to meet interest payments.

According to Robert Costello, the Bush administration is completely indifferent to this chaotic situation. Speaking to a seminar sponsored by the Brookings Institution in April, Costello talked about the collapse of the (virtually clandestine) efforts to protect U.S. manufacturing capabilities during the Reagan administration: “Under Reagan you could put ‘defense’ in front of it and get away with [support for manufacturing]. . . . In this administration, you can’t do it at all.” He pointed to the fact that since the departure of Defense Secretary Caspar Weinberger in November 1987, the Defense Manufacturing Board has been abolished, and the White House recently moved to fire Craig Fields, the head of the Defense Advanced Research Projects Agency, because he had attempted to use government funds to support high-tech electronic research.

### **Bush budget will finish off defense**

It is from this standpoint that the Bush defense strategy proceeds. The policy of the administration is to reduce the rate of production of big-ticket defense items, stretch out procurement where possible, and eliminate the major weapons systems which should be procured to maintain a deterrent to Soviet force in Europe. This strategy has two consequences: It saves a certain amount of money in the immediate year, but it also raises the per-unit cost of each item which is eventually produced.

For defense companies struggling with huge debt burdens, the result is catastrophic. Any hope of amortizing the R&D and interest costs accumulated in the 1980s is negated by the slowdown in production rates. The resulting increase in per-unit costs are passed on to the taxpayer, and that means that Congress will take a carving knife to whatever is left of defense spending plans. The mass layoffs which are now sweeping through the defense industry will soon be complemented by large numbers of enlisted men and officers who will be leaving the armed services as manpower levels are

drawn down, further complicating any effort to manage this restructuring.

### **Treaties become budgetary items**

In January 1990, the Congressional Budget Office produced a study which examined the possible effects of a treaty on Conventional Forces in Europe (CFE), and what potential impact it would have on military budget planning. “Based on these assumptions,” of its 18 active divisions, including 2 of the 4 $\frac{2}{3}$  divisions currently stationed in Europe and 5 divisions stationed in the United States intended as reinforcements for European forces in the event of war. As a result of these reductions, the Army would need 185,000 fewer soldiers, counting only those directly or indirectly involved with the disbanded units. If proportional reductions were also made in Army overhead, another 60,500 active-duty personnel could be demobilized. Thus, the total reduction could be as large as 246,000—leaving the Army about one-third smaller than it is today.”

In short, the options described in the Congressional Budget Office paper is the one chosen, and already partly implemented, by the Bush administration in the current defense budget. The fact that this was announced in advance of the conclusion of the current round of CFE talks would indicate that those talks have effectively been concluded on these terms.

This is exactly what Paul Wolfowitz reported to Congress on Feb. 28: “We are planning future forces based on our expectation of a CFE agreement. We have not in the past incorporated into our planning guidance an assumption of reaching an arms control agreement, *before* it was actually concluded, but we are doing so now because we expect to implement a successful agreement in the near future.”

In 1985, Georgi Arbatov, who heads Moscow’s U.S.A. and Canada Institute, bragged that the Soviets no longer feared the U.S. military, or the U.S. Strategic Defense Initiative, since the budget crisis would cripple these capabilities. A paper written by the Congressional Budget Office in 1988 added: “While NATO’s technological progress provokes a genuine fear and the invectives against it continue, what was previously a really hysterical fear about Western advanced technology has become considerably muted. Some participants [in the CBO seminar] suggested that the Soviets’ fear has abated as a result of more moderate assessments of what the West will be able to do in the next 10 to 15 years to introduce new weaponry in meaningful quantities.”

Soviet policy in the Strategic Arms Reduction Talks (START) and CFE is predicated on this reality. Moscow has demanded and received concessions on every major point advanced by the Bush administration in the START talks, and have refused to budge on conventional force issues, because they know that the Bush administration budget is Moscow’s first line of defense. Detail by detail, the administration is negotiating on behalf of the Ogarkov reorganization.