Fiscal Cliff Just the Beginning for State's Defense Industries

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Defense is big business in Connecticut. So it's no surprise that the potential for sequestration has many of the state's defense contractors and suppliers on edge.

The stopgap fiscal cliff legislation passed earlier in the week put off any decision about sequestration, deep across-the-board cuts in federal defense and other spending, now set to take effect in March.

Just how big is Connecticut's defense industry? It accounts for approximately 50,000 jobs and $25 billion per year in economic activity, says Bob Ross, executive director of the state's Office of Military Affairs, an agency charged with providing economic support to the defense industry, the sub base in Groton, and the state's other military organizations.

"That's approaching about 10% of our economy. Connecticut ranks eighth in the nation as a defense contracting state and third on a per capita basis."

Panel Discussion

Given such high stakes, how does Connecticut survive in an environment where there will be less defense spending? What can be done to ensure that this critical sector of our economy tays strong?

Those were the questions at the center of a panel discussion at today's Economic Summit and Outlook in Hartford, presented by CBIA and the MetroHartford Alliance and sponsored by Webster Bank. The event was held at the Marriot Hartford Downtown and drew 500 business leaders from across the state.

The panel was moderated by MetroHartford Alliance President & CEO Oz Griebel and included Ross; Jay DeFrank, vice president of communications and government relations at Pratt & Whitney; and Collin Cooper, CEO of Whitcraft Group.

Let's Hope Churchill Was Right

According to DeFrank, the possibility that sequestration would be allowed to take effect has already had an impact through the defense industry supply chain in terms of hiring and capital investment decisions. If it happens, however, the impact will be much worse.

"In one study done for the Aerospace Industries Association, George Mason University put Connecticut among the top 10 states most at risk for the effects of sequestration," said DeFrank. "In fact, 42,000 jobs could be affected. Many of those job losses would be in small businesses in Connecticut."

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DeFrank noted that when the nearly half-trillion dollars in 2011 defense cuts are combined with a half-trillion that's at risk if sequestration goes into effect, "you can see how threatening an entire industry with a trillion dollars in cuts can quickly cascade down to states, communities, and individual businesses, costing jobs and jeopardizing capital investments at a time when we're struggling to recover from the recession."

DeFrank points out, however, that as damaging to Connecticut as sequestration could be, given the long-term U.S. fiscal picture, "it's just a harbinger of what is going to be a long and challenging trend."

He believes that trend may actually represent an opportunity for those who, "early on, take the long view and position themselves for the future."

DeFrank and Ross are optimistic about the chances for avoiding sequestration.

"I'm a believer in what Winston Churchill said, that the Americans always come to the right answer after they've exhausted every other possibility, " said DeFrank.

But, said Ross, "the sooner we can get this uncertainty resolved, the quicker we can move on."

Strategies Going Forward

What can be done to ensure that Connecticut's defense industry can thrive in a new era of federal debt reduction?

One of the keys, said DeFrank, is for the industry and state government to recognize that the budget environment we're in is long-term and challenging and that we have to adapt. "We cannot be captives of how we did things in the last century," he said.

Colin Cooper of Whitcraft believes the state legislature could help by taking a cost-benefit- analysis approach to legislation, noting that the benefits of some programs may go to one economic sector, but the cost falls on others.

"Manufacturing sometimes feels that companies are looked at as revenue streams for government programs. So, really, a cost-benefit approach to things [is what's needed], he said."

DeFrank recommends that the state take several actions, including partnering with industry to retrain displaced workers to provide them with the skills needed for the complex, high-tech work that is Connecticut's hallmark.

He also called for long-term predictability and stability in areas of government such as the tax code, in particular, the administration of tax credits.

Ross also advocated greater predictability and stability when it comes to government programs. "If you have a program in place, keep it in place. If you change the rules, even for the best of motives, it just frustrates… everybody," he said.

Connecticut's Strengths

Fortunately Connecticut has several advantages that will help companies here adjust to the new reality of scaled-back federal defense spending.

"The good news is that the defense businesses in Connecticut are some of the most competitive in the nation and the world," says DeFrank. "We have to be. It's the only way you can continue to operate profitably in such a high-cost environment. And we have that critical mass that fosters innovation here. High-tech manufacturing companies, world-class educational institutions, and a highly skilled, highly trained workforce."

In addition, Connecticut is not likely to see cuts as severe as in other defense-heavy states. "I expect that over the next five or 10 years, we're going to see about a 10% cut in defense contracting in the state," said Ross. "That sounds like bad news, but relative to other states, it's good news."

Other states in the top ten for defense manufacturing will see closer to a 20% reduction, and Florida and Pennsylvania are looking at 30% to 35% cuts in defense contracting.

Why is Connecticut so lucky, relatively speaking? "The reason is that we're building the right things at the right time in history," said Ross, noting that the Pentagon's national defense strategy calls for the things that Connecticut manufactures—jet engines, helicopters, attack submarines, and ballistic missile submarines.

"We should feel very good about where we are and what the future looks like relative to everybody else," said Ross, but with one caveat: "unless sequestration is applied."

In other highlights from the conference:

We may not have driven off the fiscal cliff, but watch out for the potholes ahead.

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The potholes, said Webster Bank economic advisor Nick Perna and Travelers Institute President Joan Woodward at the Economic Summit & Outlook in Hartford this morning, are due to three major fiscal events that Congress has to resolve by the end of March:

1. What to do about the nation's $16.394 debt ceiling--which we have already hit.
2. What to do about the automatic cuts in federal spending ($1.2 trillion over 10 years)--that would, said the White House, "have a devastating impact on important defense and nondefense programs." In a defense-industry-heavy state like Connecticut, a huge issue.
3. What to do about the continuing budget resolution--that expires on March 27—to avoid another temporary shutdown of at least some government functions.

It's going to be a messy political situation over the next two months, said Woodward [pictured above], executive vice president, public policy, for Travelers, so "turn your TV off until February 25th. The deals will be cut in the last three days in February."

Better yet, said Perna, "leave the country" for a while, because it should be another raucous battle of sound, fury and no progress until the last possible moment.

While America's debt problem may seem new to observers who are exhausted after the fiscal cliff drama, Woodward said that the Travelers Institute has been warning people about it for three years.

"This is the single-most important issue of our times," she said. "We care very deeply about the future of our children … who will be facing this."

So three years ago, Travelers launched a public awareness effort with public television that culminated in a riveting movie called *Overdraft*.

If what we just experienced is a fiscal cliff, *Overdraft* shows that we as a nation are on the edge of an abyss—trillions in debt and no credible plan to pay it back yet.

For example, by 2020, our collective debt for Social Security, Medicare and Medicaid alone will overtake the nation's total revenues for the just-completed fiscal year 2012 ($2.4 trillion).

And with 10,000 baby boomers now retiring every day, and fewer active workers paying into Social Security, said Woodward, the pressure on those accounts is enormous.

Once again, Congress has kicked the can down the road a little bit, but time is running out. The fiscal cliff deal was a frustratingly unfinished work.

"Any deal without dealing with the debt ceiling," said Perna, "is not a deal."

Perna said the ratings agencies downgraded the U.S. after the previous deal in 2011 "not because of our indebtedness, but because Congress showed no willingness to pay what we owe."

That message is reinforced in the *Overdraft* movie by just-retired Senator Kent Conrad (D-North Dakota).

"There is enormous denial in this town [Washington D.C.] on both the left and the right," said Conrad.

Still, Woodward is optimistic that deals will be struck and that "budget sanity" will prevail.

The 2013 Economic Summit & Outlook was presented by CBIA and the MetroHartford Alliance, and sponsored by Webster Bank.