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IRAQ WAR SPURS GROWTH IN VEHICLE MANUFACTURING AND FUEL SUPPLY CONTRACTS: BUDGETARY PRESSURE ON BIG TICKET SYSTEMS LIKELY TO INCREASE

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INTRODUCTION

The ongoing wars in Iraq and Afghanistan have spurred strong growth in Pentagon prime contract awards to companies involved in armored vehicle production and fuel supply. In the mean time, major arms makers like Lockheed Martin and Northrop Grumman have experienced much more modest growth rates.

ARMORED VEHICLE MAKERS BENEFIT MOST

A New America Foundation analysis of the Department of Defense's top ten contractors for FY 2007 found that the greatest increase by far from the prior year was posted by BAE Systems, which purchased Armor Holdings Inc., producer of the Mine-Resistant Ambush Protected vehicle (MRAP), in July of 2007. BAE's Pentagon awards grew from \$4.7 billion in FY 2006 to \$9.8 billion in FY 2007, an increase of over 87 percent. For General Dynamics, another top gainer, tracked combat vehicles like tanks accounted for more than half of the company's 39 percent increase (\$4.1 billion).

By contrast, gains for the top three contractors were less dramatic. Lockheed Martin's Pentagon prime contracts increased by 4.5 percent, from \$26.6 billion to \$27.9 billion; Boeing's awards grew by 11.3 percent, from \$20.3 billion to \$22.5 billion; and Northrop Grumman's contracts increased by 4.2 percent, from \$16.6 billion to \$16.8 billion (see Table I).

TABLE I: TOP TEN PENTAGON CONTRACTORS, FY 2007

<u>Company</u>	<u>Prime Contracts, FY 2007</u>	<u>Amount and % Change from FY 2006</u>
Lockheed Martin	\$27.9 billion	\$1.3 billion (4.5%)
Boeing	\$22.5 billion	\$2.2 billion (11.3%)
Northrop Grumman*	\$17.3 billion	\$700 million (4.2%)
General Dynamics	\$14.6 billion	\$4.1 billion (39%)
Raytheon	\$11.2 billion	\$1.1 billion (10.9%)
BAE Systems**	\$9.8 billion	\$5.1 billion (108.5%)
L-3Communications	\$6.0 billion	\$1.3 billion (27.7%)
United Technologies	\$5.3 billion	\$800 million (17.7%)
KBR, Inc.	\$4.9 billion	-\$1.4 billion (-27.6%)
SAIC, Inc.	\$3.6 billion	\$300 million (9.3%)

SOURCE: *USAspending.gov*

* Includes Northrop Grumman subsidiaries Newport News Shipbuilding and Northrop Grumman Systems Corporation.

** Includes BAE subsidiary BAE Systems Land and Armaments Inc.

Overall Pentagon awards grew by 4.3 percent from FY 2006 to FY 2007, from \$298.5 billion to \$312 billion. This was less than half the growth rate of 10.7 percent posted between FY 2005 and FY 2006—another sign that the Bush administration’s record post-World War II military buildup may be starting to wind down, despite the ongoing costs of Iraq and Afghanistan.

IRAQ AND AFGHANISTAN TRANSFORM CONTRACTING

Statistics from the Federal Procurement Data System provide a stark demonstration of the degree to which the Iraq and Afghan conflicts have transformed the Pentagon’s buying habits. A look at contract spending broken down by services shows that the Army has been the big winner, nearly doubling from FY 2003 to FY 2007, from \$56.8 billion to \$111.3 billion; the Navy was next in line, growing by 55.5 percent over the same time period, from \$53.9 billion to \$83.6 billion; while the Air Force was last with an increase of 30.8 percent from FY 2003 to FY 2007, from \$51.5 billion to \$68 billion.

A breakdown by products purchased is even more revealing, with contracts for “Liquid propellants and fuels, petroleum base” tripling between FY 2003 and FY 2007, from \$3.7 billion to \$11.1 billion. Major fuel contractors during FY 2007 included Royal Dutch Shell (\$2.1 billion); Valero Energy Corporation, \$1.0 billion; BP (\$963.7 million); Exxon Mobil (\$949.2 million); and Conoco Phillips (\$267.2 million).

“Combat, Assault and Tactical Vehicles, Tracked” were among the top 5 products and services purchased by the Pentagon in FY 2007, at \$8.9 billion, as were “Trucks and Tractors, Wheeled” at \$8.1 billion. In addition to BAE Systems and General Dynamics, cited above, major vehicle producers receiving Pentagon prime contract awards during FY 2007 included McAndrews and Forbes Holdings (owner of AM General, the maker of the Humvee), \$3.6 billion; and Oshkosh Truck Corporation, \$2.3 billion.

A THREAT TO BIG TICKET WEAPONS SYSTEMS?

The “perfect storm” of rising fuel prices, an economic downturn, continuing needs for land equipment in Iraq, and growing calls for increasing the size of the Army and the Marines will place heavy budgetary pressure on expensive next generation items like the Lockheed Martin F-35 Joint Strike Fighter and the Army’s Future Combat System. Current combat needs and tightening budgets are likely to result in cutbacks or “stretch outs” of these kinds of projects.

SOURCES FOR THIS REPORT:

USAspending.gov; U.S. Department of Defense Top 100 contractors series, FY 2006 edition; Tony Capaccio, “L-3 Rises, KBR Falls Among Top Defense Contractors,” Bloomberg.com, May 30, 2008; Business Wire, “BAE Systems Completes Acquisition of Armor Holdings Inc.,” July 31, 2007; Charlie Savage, “Senator Warns of a ‘Crisis’ In Pentagon Cost Overruns,” *New York Times*, June 4, 2008.

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