

Testimony of

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Economic Consequences of Defense Sequestration**

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The Regional Economic Impact of Proposed Reductions in Defense Spending

Chairman McKeon, Ranking Member Smith, members of the Committee, thank you for the opportunity to testify on the potential economic consequences of reductions in Department of Defense spending as these impacts would affect the economies of states and regions across the United States. I have conducted research relating to this issue for the Commonwealth of Virginia that examined the economic and fiscal impacts of DOD spending. This research was undertaken in 2009 in response to early concerns regarding the Commonwealth's economic vulnerability to changing DOD spending policies. More recently I was asked by the Aerospace Industries Association to calculate the economic impacts of reductions in DOD outlays for military equipment on the U.S. economy and the states that represent the home base for major aerospace and military equipment manufacturers and suppliers. I am submitting both reports for the record as they contain findings relevant to your deliberations on this important topic.

The economic impacts that occur at the state and regional levels are similar to those that have been reported at the national level and are evident in changes in economic activity—gross regional product (GRP), changes in employment, and changes in personal earnings. Collateral impacts also may occur in the local business base as the loss of sales for single-market businesses could result in the failure of these business establishments—the nature of their business (size and product line) may make these firms more vulnerable to changes in sales due to DOD spending reductions or reductions in civilian or uniform personnel. These latter effects are particularly evident around military installations as witnessed recently here in the District of Columbia among the retail and other commercial businesses having previously served the staff of and visitors to Walter Reed prior to its closing in September. These “BRAC effects,” where installations have closed or substantially downsized, provide a good measure of the potential ranges of economic impacts that may result from reductions in DOD spending. All too often these local effects are lost in the impersonal numbers that are used to measure the economic impacts of changes in public spending patterns.

State-Level Economic Impacts of DOD Spending

One approach to understanding the potential impacts of DOD spending reductions is to examine the importance of DOD spending to a local economy. An examination of DOD spending on the Commonwealth of Virginia economy provides a good measure of what could be the impact of reductions in these spending levels.

Spending by the Department of Defense in support of its activities—defense installations, uniform and civilian personnel, retirees, and federal contractors—represents a major source of jobs and income within the Commonwealth of Virginia and generates significant direct and indirect economic activities throughout all sectors of the State’s economy. Additionally, DOD spending and the jobs and payroll this spending supports generate a significant surplus of state-level revenues relative to the demands placed on state-funded services. These economic and fiscal impacts are summarized as follows.

- In FY 2008 DOD spending in the Commonwealth of Virginia contributed \$57.4 billion to the State’s economy accounting for 15.6 percent of the total value of the goods and services produced in the State—its gross state product;
- DOD spending and its re-spending within the State’s economy supported a total of 902,985 jobs (both directly funded and supported indirectly by the re-spending of DOD funds within the State) representing 18.9 percent of the state’s total job base;
- DOD spending generated \$44.4 billion in personal earnings accounting for 17.4 percent of the total personal earnings of all workers residing within the State;
- The fiscal impacts of DOD spending and the workers it supported generated a significant net revenue benefit for the State in FY 2008. On average, for each job associated with DOD spending, the revenues generated exceeded the expenditure demand placed on the State’s budget by \$1,848.52; that is, for each \$1 in expenditure demand, \$2.85 in state revenues were collected for each employee (including military retirees) and these employees related business spending.
- The total net fiscal benefit accruing to the State from DOD-supported economic activities in the State in FY 2008 was \$1.1 billion.
- DOD spending in the Commonwealth totaled \$54.5 billion in FY 2008 and ranked first among all states on a per capita basis (\$6,713.06) representing a funding advantage of \$4.26 to \$1.00 compared to the U.S. average.

This DOD spending is an important source of economic activities, personal earnings, jobs and fiscal benefits for the State. In the absence of this spending, the economy would have been 15.6 percent smaller, it would have had 18.9 percent fewer jobs and faced a budget gap of \$1.1 billion.

Economic Impacts of DOD Spending Reductions For Military Equipment Acquisition

My recent analysis of DOD spending reductions for the acquisition of military equipment that has already been approved (BCA 1) totaling \$19.324 billion for FY 2013 and the potential additional reduction of \$25.686 billion in procurement of military equipment, also impacting FY 2013, illustrate the breadth of these effects on jobs, payroll and GDP as these effects cycle through the economy at the local level. This total reduction of \$45.01 billion in DOD spending for the acquisition of military equipment in FY 2013 would result in the following economic impacts:

- Lost sales throughout the supply chain and induce sales losses through the broader economy totaling \$164,059,027,945; that is, for each \$1 in DOD spending reductions for military equipment, an additional \$2.64 in sales losses will be experienced by other businesses;
- 71% of these lost sales would occur as a result of decreased consumer spending by workers directly and indirectly affected by these DOD spending reductions—workers having lost their jobs and/or experienced salary reductions—affecting local businesses serving local demand;
- The loss of 1,006,315 full-time, year-round equivalent jobs: 352,750 would be industry wide including 124,428 manufacturing jobs and 653,570 jobs supported by the payroll spending that would be lost; that is, 65 percent of the job losses are outside of the aerospace and military equipment industry.
- This total job loss would add 0.6 percentage points to the current U.S. unemployment rate (raising today's 9.1% rate to 9.7%);
- Wage and salary income would decrease by a total of \$59.4 billion with \$48.4 billion of these losses occurring among workers working in businesses outside of the military equipment manufacturing supply chain—retail, construction, professional and business services, health and education, leisure and hospitality construction, financial services and others;
- Lost non-wage income—spending for operations, capital investment, retained earnings, profits—would decline by \$27.05 billion with 63.4% of this lost income being experienced by non-DOD prime contractors and their suppliers; and,

- In total, the U.S. gross domestic product (GDP) growth would be \$86.456 billion less, representing an amount equal to 25% of the projected annual increase in GDP for 2013; this loss would reduce currently projected growth for 2013 from 2.3% to 1.7% (IHS Global Insight September 2011 forecast).

The State Level Impacts of DOD spending Reductions

While the economic impacts of DOD spending reductions would affect all 50 states, ten states would account for 58.5 percent of the job and income losses projected to occur in 2013 as a result from a \$45.01 billion reduction in military equipment acquisitions. In total, these spending reductions would result in employment decreases of 588,700 jobs in these ten states and generate losses of \$34.7 billion in personal income. These decreases in economic activity would reduce these states' gross state product by a total of \$50.6 billion in 2013. One-third of these impacts would occur in California, Virginia and Texas.

Summary of Findings

Reductions in DOD spending, whether it involving uniform or civilian personnel, the operations of military installations, the maintenance or acquisition of military equipment or goods and services provided by private contractors, will have wide spread impacts extending well beyond prime contractors and their direct and indirect suppliers. Each of these prime contractors and their suppliers (direct or indirect) employs large numbers of workers and also make substantial purchases of goods and services from suppliers to support their business operations. The loss of this payroll and their business purchases (largely non-manufacturing suppliers) will spread the economic pain of these cutbacks to a far larger population and business base than generally appreciated.

Each \$1 decrease in DOD equipment purchases will generate an additional \$2.64 in lost sales elsewhere in the economy with 71 percent of these losses resulting from decreased spending by workers having lost their jobs.

The employment effect is even greater, with job losses associated with only a \$45.01 billion reduction in DOD spending for military equipment acquisition generating a total loss of 1 million jobs of which 88 percent would be on "Main Street" and only 12 percent are directly within the aerospace and military equipment industry manufacturing sectors with two-thirds of the total job losses cutting across businesses totally outside of the aerospace and military equipment industry and its supply chain. This job loss would add 0.6 percentage points to the U.S. unemployment rate. Beyond the loss of jobs there is the loss of earnings and spending that further would undermine state and local tax bases.

Spending reductions have consequences and these consequences disproportionately impact workers and businesses that appear to have little connection to the target of the spending reduction. The breadth and reach of this collateral economic damage should be fully measured and assessed as decisions to reduce DOD spending are debated. Besides the impacts on the nation's military readiness and ability to respond to international crises, the impacts of any proposed DOD spending reductions on local economies, their workers, their incomes, and on local businesses need to be fully assessed and their consequences understood and minimized or mitigated.