Defense Expenditures In Hampton Roads: Digging Deeper
DEFENSE EXPENDITURES IN HAMPTON ROADS: DIGGING DEEPER

We know that Hampton Roads is heavily dependent upon defense spending – approximately 39 percent of the value of our economic activity is directly or indirectly related to defense spending. This is a big number, but disguises some important information: for example, how that activity is distributed among the cities and counties of our region and which companies are involved. Let’s now take a closer look in order to supply some answers.

There are two major conduits for Department of Defense (DOD) funds that come to Hampton Roads: (1) expenditures made on personnel; and (2) expenditures made via contracts negotiated by the DOD with private firms or other governmental units for construction, equipment, supplies, services, etc. In the introductory chapter of this report, we examined total DOD personnel expenditures in our region and found that between 2010 and 2013, such expenditures declined by 6.9 percent. To put this number in context, total federal civilian expenditures on personnel increased by 4.2 percent in Hampton Roads during the same time period, while comparable total private, nonfarm personnel expenditures increased 9.3 percent.

DOD contracts in our region usually are less visible than personnel expenditures. Exceptions include the large DOD contracts with Huntington Ingalls relating to the construction or rehabilitation of aircraft carriers. These events justifiably garner lots of attention, but most other DOD contracts merit nothing more than a sentence in the business section of local publications. However, as Graph 1 discloses, these “other” contracts are significant in number, not the least because after they are signed, the contracts frequently are modified and extended. Such events, termed “transactions,” are commonplace. Despite their frequency and ultimate economic impact when considered as a whole, DOD transactions in Hampton Roads seldom capture the public’s attention. In any case, Virginia Beach and Norfolk record far more DOD transactions than any other cities or counties in our region.

The total value of the DOD procurement contracts in Hampton Roads only roughly mirrors the number of transactions. Graph 2 informs us that in FY 2015, the value of DOD contracts exceeded $1.13 billion in Newport News, $838 million in Virginia Beach and $774 million in Norfolk.

The lesson of Graph 2, however, is that virtually every city and county in our region has a stake in DOD contractual procurement spending. We rise and fall as a group when DOD spending changes. This was very good for us, economically speaking, in the previous decade when defense spending was increasing rapidly. Conditions were less salubrious for us in 2015 when defense spending was stagnant or declining in most categories.
GRAPH 1

DOD CONTRACTUAL TRANSACTIONS IN HAMPTON ROADS’ LARGEST JURISDICTIONS, FY 2015

Source: www.usaspending.gov
GRAPH 2

DOD CONTRACTS AWARDED BY RECIPIENT CITY, FY 2015 (MILLIONS OF DOLLARS)

Source: www.usaspending.gov
Who Receives DOD Contracts In Hampton Roads?

Which companies and firms are receiving the DOD contracts? Graph 3 supplies FY 2015 data for Hampton Roads. While Huntington Ingalls easily is the largest DOD contract recipient, not all of the $1.132 billion of activity noted for the company in FY 2015 actually relates to Newport News, the company’s headquarters. We were unable to separate Newport News from other locations where Huntington Ingalls contracts are concerned.

We were, however, able to record DOD contract locations for No. 2-ranked Atlantic Diving Supply, which is headquartered in Virginia Beach. Atlantic Diving scored $206.04 million overall in DOD contracts in FY 2015, although only $92.62 million of these contracts could be directly connected to its headquarters in Virginia Beach.

We hasten to point out that even when a DOD contract is located in a specific city, say Portsmouth, this does not guarantee that the money from the contract actually will be spent there. The money received by a firm headquartered in one city or county may be spent in another city or county, or even in another state. Further, since slightly more than 65 percent of all employed residents of Hampton Roads cross city or county lines when they commute to their jobs, DOD contractual spending tends to diffuse broadly across the region. For example, more than 33,000 people living in Virginia Beach commute into Norfolk to work each day. A significant portion of the incomes they earn will end up being spent in Virginia Beach rather than Norfolk.¹

GRAPH 3
LARGEST RECIPIENTS OF DOD CONTRACTS IN HAMPTON ROADS, FY 2015
(MILLIONS OF DOLLARS)

Source: www.usaspending.gov
Can We Detect Any Trends?

Graph 4 illustrates the ups and downs that have occurred in DOD contracts awarded to firms and organizations in Hampton Roads between 2007 and 2014 (calendar year data). The variations reflect two major influences: (1) the overall downward trend in total DOD spending in our region; and (2) the timing of large contracts at firms such as Huntington Ingalls. In June 2015, for example, Huntington Ingalls announced that it had received a $3.35 billion contract for future work on the detail, design and construction of the nuclear-powered aircraft carrier John F. Kennedy (CVN 79), upon which it already was working. The company also received a $941 million contract for modifications to existing construction on the ship. Work on the 100,000-ton vessel began in 2011; it is scheduled to join the U.S. fleet in 2017.
Shipbuilding And Repair Employment

The fluctuating overall levels of DOD contracts received by firms and organizations in Hampton Roads mask both the importance of and growth in employment that has occurred in the shipbuilding and repair industry (SIC 3366), as defined by the Department of Commerce’s Bureau of Economic Analysis. Contrary to expectations, such employment rose more than 26 percent between 2005 and 2014. This directly reflects the comparatively high level of activity at Huntington Ingalls, which has overcome declines in ship repair contracting that have occurred at several major regional firms.

Sources: www.bea.gov, Local Area Personal Income (CA5) and www.usaspending.gov
Shipbuilding And Repair Employment

The fluctuating overall levels of DOD contracts received by firms and organizations in Hampton Roads mask both the importance of and growth in employment that has occurred in the shipbuilding and repair industry (SIC 3366), as defined by the Department of Commerce’s Bureau of Economic Analysis. Graph 5 shows that contrary to expectations, such employment rose more than 26 percent between 2005 and 2014. This directly reflects the comparatively high level of activity at Huntington Ingalls, which has overcome declines in ship repair contracting that have occurred at several major regional firms.
The aircraft carrier Gerald R. Ford (CVN 78), which also is a Huntington Ingalls project and will join the fleet in 2016, will cost $13.7 billion. Its crew will number 4,500, about 1,000 fewer than existing carriers. This underscores a distinct trend in defense spending – increasingly expensive assets, such as aircraft carriers, translate into a reduced ability to employ and support personnel. The tradeoff is straightforward: As the DOD expends increasing proportions of its budget on expensive ships, airplanes and technology, it inevitably finds that it cannot hire as many people. This means that the number of active-duty military personnel and DOD civilian employees must decline. And, this is what has occurred. The DOD today has fewer dollars available to hire people. This is a motivating reason why the number of active-duty military declined from 2.04 million in 1990 to only 1.35 million in 2014. Active-duty personnel in the U.S. Navy in 2014 were only about one-half the number in 1990.

In Hampton Roads, the most recent peak in the number of active-duty military personnel occurred in 2003, when 113,400 individuals were deployed here. This number has declined every year since then, and had dropped to 86,500 in 2013.

Source: www.bls.gov, Quarterly Census of Employment and Wages (QCEW)

Source: www.bls.gov, Quarterly Census of Employment and Wages (QCEW)


The Impact Of DOD Contract Spending On Personnel

The aircraft carrier Gerald R. Ford (CVN 78), which also is a Huntington Ingalls project and will join the fleet in 2016, will cost $13.7 billion. Its crew will number 4,500, about 1,000 fewer than existing carriers.\(^2\) This underscores a distinct trend in defense spending – increasingly expensive assets, such as aircraft carriers, translate into a reduced ability to employ and support personnel. The tradeoff is straightforward: As the DOD expends increasing proportions of its budget on expensive ships, airplanes and technology, it inevitably finds that it cannot hire as many people. This means that the number of active-duty military personnel and DOD civilian employees must decline.

And, this is what has occurred. The DOD today has fewer dollars available to hire people. This is a motivating reason why the number of active-duty military declined from 2.04 million in 1990 to only 1.35 million in 2014. Active-duty personnel in the U.S. Navy in 2014 were only about one-half the number in 1990.\(^3\) In Hampton Roads, the most recent peak in the number of active-duty military personnel occurred in 2003, when 113,400 individuals were deployed here. This number has declined every year since then, and had dropped to 86,500 in 2013.

In some cases, the deployment of technology results in smaller numbers of individuals being needed to accomplish necessary tasks. As already noted, the crew of the Gerald R. Ford will number 1,000 fewer individuals than the crews of predecessor aircraft carriers.

Here is the rub for Hampton Roads. More expensive carriers will result in fewer active-duty personnel at Naval Station Norfolk. More expensive aircraft at Oceana Naval Air Station eventually will mean fewer active-duty personnel there. The same DOD dollar cannot be spent in two places.

The expense-driven assets-versus-people analysis just described is independent of other potentially negative influences on defense spending in our region, which include: (1) rising DOD personnel costs, especially those relating to health care and pensions; (2) the refocusing of U.S. defense attention toward the Pacific Rim; (3) risk factors associated with homeporting so many carriers in a single location; (4) questions as to whether aircraft carriers really are the most effective defense assets to deploy in a variety of combustible, confined naval situations around the world; and (5) rising sea levels that could make Hampton Roads a comparatively less attractive location for the U.S. Navy.

The F-35 fighter jet is billed as the fighter of the future for the United States. Each new F-35 will cost more than $300 million. Contrast this to the approximate $50,000 cost of a single P-51 Mustang, the state-of-the-art conventionally powered fighter airplane in 1945. This corresponds to about $660,000 in current prices. More than 15,000 P-51s were built. Production of the much more expensive F-35 will number in the hundreds.

Summing It Up

One area leader, upon reviewing the list of the largest DOD contract recipients provided in Graph 3, exclaimed, “I’ve never heard of half of these companies.” He’s not the only one. Defense contracting is very big business in Hampton Roads, but much of it occurs outside the public and media spotlights.

While sequestration and DOD expenditure caps have adversely affected the volume of DOD contracting in Hampton Roads, our regional numbers are quite sensitive to the periodic awarding of large contracts to Huntington Ingalls for shipbuilding and rehabilitation. Recent contract awards ensure that this particular source of economic energy for Hampton Roads is not likely to decline dramatically in the next few years.

The same cannot be said for DOD compensation of its active-duty personnel and civilian employees. It seems likely that the roster of such individuals will continue to decline in our region, at least partially because the prices of major defense assets, such as aircraft carriers, submarines and airplanes, continue to increase significantly. The DOD simply does not have sufficient funds to purchase these expensive assets and to attract and retain existing levels of personnel. This helps explain why the number of active-duty military personnel in Hampton Roads has declined more than 20 percent since 2003.