

**Congressional Testimony**  
**Before the House Armed Services Committee**  
**(as presented for the record)**

***The Impact of Sequestration on the U.S. Aerospace and  
Defense Industry***

**By the Honorable Sean O’Keefe**  
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Mr. Chairman, Ranking Member Smith and distinguished members of the Committee. Thank you for the invitation to be with you today, and to join my colleagues in the aerospace and defense industry.

My prior public service experience gives me some insight into the challenges which have prompted you to call this hearing. However, it is in my current capacity as Chairman and CEO of EADS North America and Chairman of the National Defense Industrial Association, representing nearly 90,000 corporate and individual members, that I speak with you today.

This hearing is particularly well timed. And I express my appreciation to you, Mr. Chairman, for your foresight and tenacity in tirelessly drawing attention to the impending “perfect fiscal storm” of sequestration.

Many in Washington believe that the disastrous impact of sequestration is a distant threat since it would not be implemented until January 2013. But as you, and your fellow committee members know well, the fiscal challenges of sequestration are already upon us. Industry shares your concerns—and our experience to date validates your alarm.

The question is not how we got in this position, but rather how we steer through the storm. As your defense industrial partners, we recognize that reconciling federal spending to revenues is absolutely essential in securing lasting economic stability and national security. But we fear that the government's reluctance to make difficult choices and apply a well-aimed fiscal razor will mean that the federal budget, and particularly defense, will get the equivalent of a shave with a chain saw.

Cuts will be made – but they will be imprecise and without regard to priority. The mechanistic implementation formula as prescribed in law treats the contract for protective armor and the cost to cut the grass on military bases to be of equal priority. These cuts, and the process used to derive them, also will have a significantly negative impact on hundreds of thousands of men and women in uniform, and millions of employees and their families that our industry supports.

Industry is very familiar with cyclical down-turns and the need to periodically adjust defense spending to meet new fiscal realities. But unlike the “peace dividends” of the past, the next round of cuts will not be driven by positive, external strategic factors like the collapse of the Soviet Union, the fall of the Berlin Wall, or the end of the Vietnam War. Rather, the impending sequestration cuts, if they are allowed to happen, will be driven by our collective inability to make hard choices. In effect, this is a self-inflicted wound.

Every echelon of the defense industry will be impacted. Let me speak specifically for EADS, and its U.S. subsidiary, EADS North America. As you know, EADS is one of the largest aerospace and defense companies in the world with brands you recognize, including Airbus, Eurocopter, Astrium and Cassidian.

As what some refer to as a “non-heritage” defense company, EADS North America has been on a significant growth path in the U.S.: investing in facilities, creating jobs, delivering systems like the UH-72A Lakota and competing for programs like the Air Force refueling tanker, all of which has brought positive return to the American taxpayer and warfighter. In fact just two weeks ago we announced the

establishment of an Airbus aircraft manufacturing center in Mobile, Alabama. This \$600 million investment will create several thousand construction jobs in the near term, and sustain nearly 1,000 aerospace jobs in the greater Mobile community alone.

In addition to our direct investment and employment, the United States is the largest supplier nation in the world to our corporation. Last year EADS purchased nearly \$15 billion in goods and services from American aerospace suppliers. That's more than any other company outside the US. In fact that's more than any country in the world. And our sourcing activities support approximately 250,000 American jobs.

The threat of sequestration raises a number of troubling issues for EADS. All are important, but two jump out:

1. I have already advised the Governors and Congressional delegations in the states and districts where we operate that we are wrestling with how to meet our obligations under the WARN Act. In the absence of definitive guidance from DoD, OMB and the Defense Contract Management Agency, we feel compelled to act in the spirit of this law and in all likelihood will issue WARN notices to those employees engaged in ongoing federal contract activities. It's not something we want to do. But it appears the law requires us to do it. Clearly the intent of the Act is to provide employees with time to prepare for known events that may impact their employment. Without a doubt sequestration could be just that kind of event.
2. We are very concerned about the affect of sequestration on our extended supplier base. EADS buys in the U.S. because of the high quality, innovation

and reliability of our vast American supplier network. We believe sequestration will negatively impact many of these suppliers, including driving some out of the market. Again, in the absence of guidance, we and our suppliers are left to wonder how and if our businesses will be disrupted as a result of sequestration, not only in the defense sector, but commercial activity as well.

The most vulnerable of these aerospace and defense suppliers are the vast number of small to mid-cap businesses that sustain millions of jobs, drive technology and create the innovation that is the hallmark of American aerospace. While larger companies have the capacity to more successfully weather the impending fiscal storm, small businesses do not.

In preparing for my testimony today, the National Defense Industrial Association reached out to a number of our small business members.

Their responses were both illuminating and alarming.

Small business suppliers tell us that they are already preparing to trim payrolls, that they are not creating new jobs because of the anticipation of sequestration and that many are gearing up to leave the federal and defense market space all together.

Here are three examples of our member companies:

1. An eight year old small electronics contract manufacturer, with less than 20 employees and revenues of less than \$10M. A five year contract for electronic parts was pulled back by Tier 1 supplier, because of uncertainty of whether that

particular program would survive post-sequestration. The small supplier had a cash flow crunch, forcing them to delay new hires and even downsize slightly.

2. A three year old aerospace parts manufacturer, with less than 25 employees and revenues less than \$10M. A two year contract for aircraft parts was placed on hold, because the platform was one of those targeted for cuts for Budget Control Act and sequestration. The small manufacturer pulled back on a proposed capital investment and new hires, instead using the cash to cover payroll while looking for new business.

3. A six year old aerospace components manufacturer, with less than 30 employees and revenues of less than \$15M. A three year contract for aircraft components was suspended, because several of the platforms were mentioned as potential sequestration targets. The company shelved a facility expansion plan, put a hold on new hires, and had several employees switch to reduced work hours until the business outlook was more definitive.

These company experiences are particularly disappointing because over the years this Committee has led the effort to bring small businesses into the DoD supply chain. I fear those successes will be significantly curtailed or reversed.

But even in this difficult fiscal environment, I believe there are opportunities and paths we could follow that would produce positive results, leading to more efficient government management of the defense acquisition process, and an equally more efficient industry supporting it.

The first steps in my view would be to set a realistic Defense budget reduction target, repeal the across-the-board sequester, and delegate the creation of a spending reduction plan to the Secretary of Defense. Working with a select group of Congressional national security leaders, the Secretary could produce a difficult, but acceptable, plan to meet necessary budget targets.

Such a plan shouldn't be restricted to just program choices. Rather, it must include an opportunity for "economic stimulus" by removing some of the self-imposed administrative impediments that blunt market activity. The administration has done a decent job of starting to make export control rules less rigid. But more can be done to truncate prolonged reviews by multiple agencies that discourage U.S. industry from seeking overseas markets. At the same time, Congress can help by streamlining current export control laws that negatively impact trade.

This same approach can be applied to domestic programs. The cost of doing business with the government can add more than 20% to the price of goods. This is especially true when it comes to defense. The extensive array of regulations that push up prices and drive out potential competitors could be suspended by executive order. In the mid-1990s, the Clinton administration pursued a "procurement holiday" to reduce defense spending. Introducing a "regulatory holiday" would create immediate and long-term economic benefits.

Under such a regulatory holiday as recommended by the Defense Business Board, all administrative rules and regulations would be suspended, unless reinstated by the Secretary of Defense. I believe we would see broader competition, greater

savings and retention of second- and third-tier suppliers—even in the face of budget reductions.

There also are regulatory challenges that could be addressed that impact companies like EADS North America and our ability to offer competitive choices in the U.S. market. For example, many of the new aviation contracts with DoD require FAA certification. While the European Aviation Safety Agency (EASA) standards are considered comparable to the FAA certification standards, there is no DoD process for considering and accepting EASA certified aviation standards. Therefore, the financial and schedule burdens required to convert these comparable aviation standards in order to compete for DoD programs must ultimately be priced into our offers, which increases the cost of doing business with the U.S. government.

Most immediately, the administration must communicate today its sequestration implementation plan to the public, our armed forces and to industry. The current uncertainty has effectively put sequestration and its consequences in motion. In the absence of any guidance, industry is already holding back investments, questioning the fairness of ongoing competitions, doubting the viability of existing contracts and starting to trim capacity.

During my government service I experienced first-hand the challenges of budget reductions. Program managers, analysts and budget officers will burn the midnight oil trying to shelter programs, missions and capabilities from the looming disaster.

Without guidance, I fear their cuts will be random, inwardly focused and not always driven by national security priorities. In addition, the Department will potentially be overwhelmed with renegotiating contracts, dealing with unobligated balances from

previous years and addressing unexpected Nunn-McCurdy breaches. Savings for businesses and the government under multi-year procurement contracts could be lost, fixed-price contracts will almost certainly be challenged, as well as many others terminated due to unplanned costs and liabilities.

This is a recipe for endless argument, litigation and gridlock. And it will ultimately drive up costs to the point that they exceed the savings that sequestration was enacted to produce.

But lost in the debate about this budget reduction mechanism is the larger impact of this action. This is not about the bottom line, the corporate balance sheet, share prices and market analyst reports. And it is less about preserving the industrial base, maintaining production capacity, or impacting competitiveness. The impact is on our national security. It's about diminishing the ability of our men and women in uniform who have volunteered to defend us and represent our national interests around the globe. All that we are discussing today is about industry's ability to support them. In the greater context, this is but one element of a wider range of dangerous consequences that this fiscal mechanism will create to erode our national security.

Mr. Chairman and members of the Committee, we in the industry stand ready to support your important efforts. We are prepared to make difficult decisions. But we need guidance, direction and rationality in the process. And we need it now.

Thank you for the opportunity to address the Committee. I look forward to your questions.