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Defense Acquisition Trends 2019: A Preliminary Look

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Abstract

This paper presents a preliminary look at the Fiscal Year (FY) 2018 Department of Defense (DoD) contracting trends available in the Federal Procurement Data System (FPDS). This year's study focuses on the defense acquisition's systems response to the 2018 National Defense Strategy's emphasis on peer and near-peer competition, forging a new relationship between the DoD and the National Security Innovation Base, and the need for increased investment in emerging technologies. In particular, this report looks at whether there has been a significant shift in the DoD's investment posture between equipment (Products) and research and development. Additionally, this report includes analysis of the topline DoD contracting trends.

Introduction

This paper presents a preliminary look at the Fiscal Year (FY) 2018 Department of Defense (DoD) contracting trends available in the Federal Procurement Data System (FPDS). The FY 2018 DoD contract data provides critical insights into the defense acquisition system's response to the 2018 National Defense Strategy and new administration priorities (DoD, 2018). Last year, the FY 2017 DoD contract data show that although DoD contract spending has rebounded between FY 2015 and FY 2017, the growth has been largely concentrated amongst existing product lines over research and development or services. Given previous NPS-funded research showing that it often takes two years for the contract data to reflect acquisition reforms or changes in priorities, the FY 2018 contract data can illuminate whether the administration's priorities are better reflected in its second year (McCormick et al., 2015).

This report uses the methodology used in Center for Strategic and International Studies (CSIS) reports on federal contracting. For over a decade, the Defense-Industrial Initiatives Group (DIIG) has issued a series of analytical reports on federal contract

spending for national security by the government. These reports are built on FPDS data, which is downloaded in bulk from USAspending.gov. DIIG now maintains its own database of federal spending that includes data from 1990–2018. This database is a composite of FPDS and DD350 data. For this report, the study team relied on FY 2000–FY 2018 data. All dollar figures are in constant FY 2019 dollars, using the latest Office of Management and Budget (OMB) deflators. For additional information about the CSIS contracting data analysis methodology, see https://github.com/CSISdefense/Lookup-Tables.

For this paper, CSIS focused on the following research questions:

- Area: Has there been a significant shift in the DoD's investment between products, services, and research and development (R&D) to reflect the 2018 National Defense Strategy priorities?
- Platform Portfolio: Have there been significant changes across the different sectors of the defense industrial base?
- R&D: Has the DoD started to recover from its trough in the development pipeline for major weapon systems?
- Composition of the Industrial Base: What has the defense contracting rebound meant for the composition of the defense industrial base? What has it meant for vendors of different sizes? Has the number of prime vendors and new entrants doing business with the DoD continued to decline?
- Other Transaction Authorities (OTA): What are the significant trends in OTA usage across the DoD?
- Components: Have there been significant shifts in defense contracting trends between the major DoD components?

DoD Contract Spending in a Budgetary Context

The defense contracting rebound that began in FY 2016 continued into FY 2018. As shown in Figure 1, total defense contract obligations increased from $331.1 billion in FY 2017 to $364.5 billion in FY 2018, a 10% increase. Over the last three years, defense contract obligations grew 25% between FY 2015 and FY 2018.

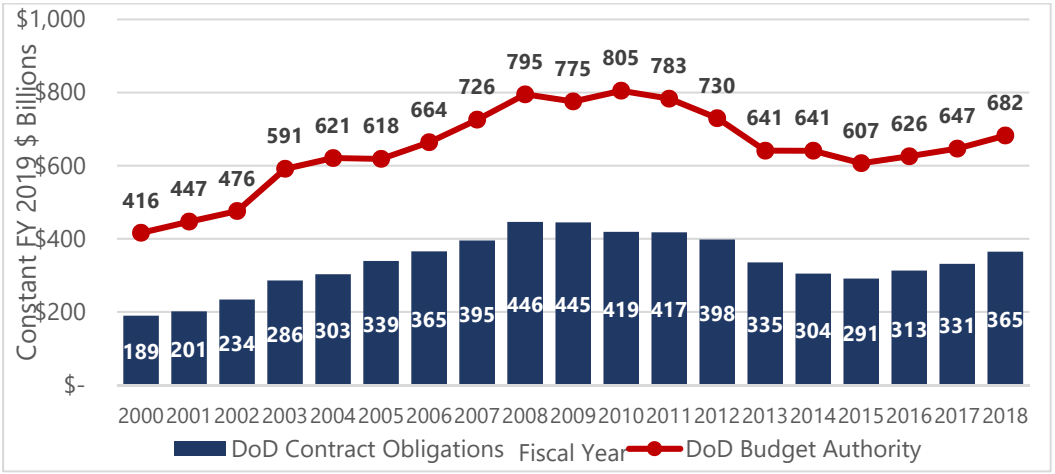

Figure 1. Defense Contract Obligations vs. Budget Authority, 2000–2018

Note. Sources: FPDS; DoD, *National Defense Budget Estimates for Fiscal Year 2019 (Green Book)*, Office of the Under Secretary of Defense (Comptroller), April 2018; DoD, *Defense Budget Overview: United States Department of Defense Fiscal Year 2020 Budget Request*, Office of the Under Secretary of Defense (Comptroller/Chief Financial Officer) (March 2019); CSIS analysis.

What Is the DoD Buying?

Despite the 2018 National Defense Strategy (NDS) emphasizing modernization priorities, there has not yet been a significant shift toward NDS-related technology in the DoD's investment posture. During the first two years of the defense contracting rebound, defense contract obligations for products significantly outpaced both services and R&D. In FY 2018, services caught up to products, as defense services and products contract obligations increased 10% and 11%, respectively, a rate in-line with total defense contract obligations growth. Meanwhile, defense R&D contract obligations only increased 4%, well below the 10% increase in total defense contract obligations. As a result, R&D fell to its lowest share of defense contract obligations this century.

Looking at total growth over the course of the defense contracting rebound, defense products contract obligations are up 35% over the last three years. Comparatively, defense services contract obligations increased 17% between FY 2015 and FY 2018, while R&D contract obligations increased just 10% over that same period.

Figure 2 shows defense contract obligations by area from FY 2000 to FY 2018.

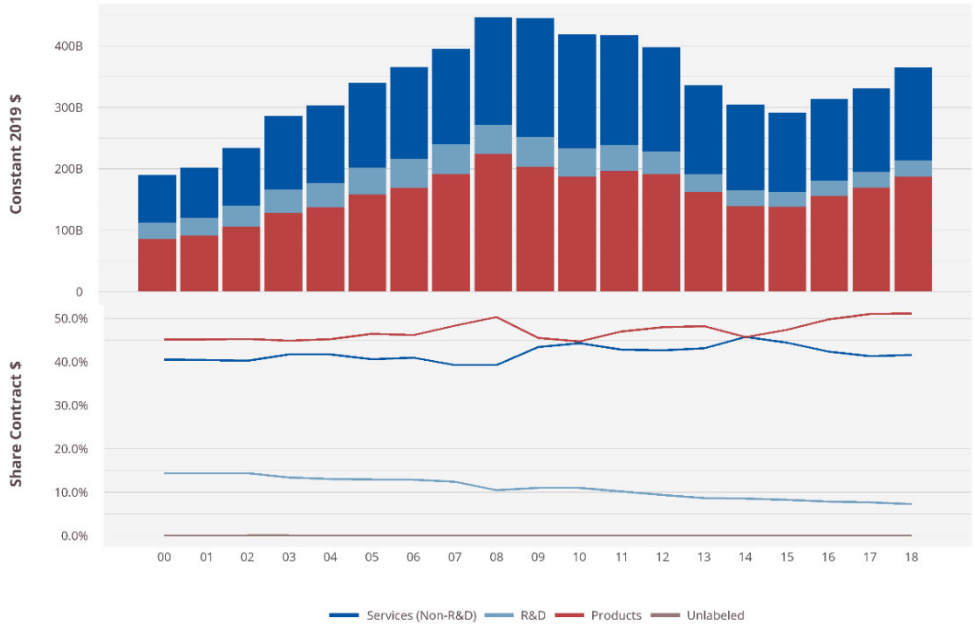

Figure 2. Defense Contract Obligations by Area, 2000–2018
(Source: FPDS; CSIS analysis)

Defense Contract Obligations by Platform Portfolio

While there have not been significant shifts in the DoD's investment between products, services, and R&D, there were more significant changes at the sector level in FY 2018.

Aircraft contract obligations increased the most amongst the eleven platform portfolios during the first year two years of the defense contracting rebound but declined in FY 2018. Between FY 2015 and FY 2017, Aircraft obligations increased 34% (McCormick et al., 2018, p. 9). However, in FY 2018, Aircraft defense contract obligations fell from $88.6 billion in FY 2017 to $84.6 billion, a 5% decline. This decline is not outside the norm, as the Aircraft sector, as previously shown during sequestration and the defense drawdown, has

been known to whipsaw between growth and declines (McCormick, Hunter, & Sanders, 2017, p. 23). In total over the course of the defense contracting rebound, Aircraft defense contract obligations have increased 29% since FY 2015, a rate slightly higher than topline growth (25%).

Air & Missile Defense contract obligations increased 53% in FY 2018, continuing the whipsaw this sector has seen throughout the defense contracting rebound (McCormick et al., 2018). Over the last four years, Air & Missile Defense contract obligations rose from $9.97 billion in FY 2015 to $10.49 billion in FY 2016 and fell to $8.92 billion in FY 2017, before rising again to $13.65 billion in FY 2018. Despite the whipsaw, total Air & Missile Defense contract obligations are up 37% since FY 2015.

After several years of declining contracting obligations, the Facilities & Construction sector experienced a large up-tick in FY 2018. Facilities & Construction defense contract obligations increased from $39.5 billion in FY 2017 to $47.3 billion in FY 2018, a 20% increase.

Land Vehicles, the sector heaviest hit by sequestration and the defense drawdown, continued rebounding in FY 2018 (McCormick et al., 2017). Land Vehicles defense contract obligations totaled $12.9 billion in FY 2018, a 51% increase from the $8.5 billion obligated in FY 2017. Between FY 2015 and FY 2018, Land Vehicles defense contract obligations have risen from $7.95 billion to $12.9 billion, a 62% increase.

The Ordnance & Missiles continued to steadily grow in FY 2018, a trend that has been ongoing through the course of the defense contracting rebound. Ordnance & Missiles contract obligations increased 17% in FY 2018, rising from $18.9 billion to $22.2 billion. Since FY 2015, Ordnance & Missiles contract obligations have increased 56%.

Figure 3 shows defense contract obligations by platform portfolio from FY 2000 to FY 2018.

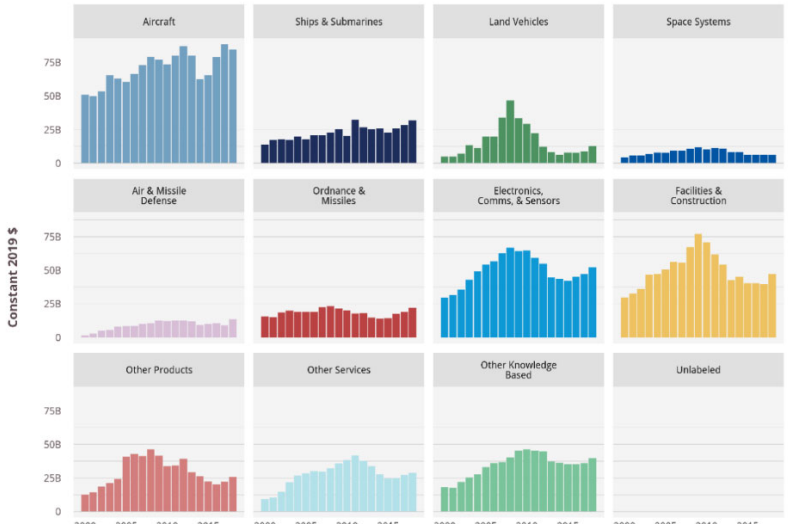

Figure 3. Defense Contract Obligations by Platform Portfolio, 2000–2018
(Source: FPDS; CSIS analysis)

Defense Contract Obligations by Stage of R&D

Previous CSIS research showed that in FY 2017, the "seven-year trough in major weapon systems development pipeline appeared to have bottomed out but does still exist in some stages of R&D and it will still be some time before DoD fully recovers" (McCormick et

al., 2018, p. 11). The FY 2018 data show that while this largely still holds true, there are notable differences across the different R&D activities.

Figure 4 shows defense contract obligations by stage of R&D from FY 2000 to FY 2018.

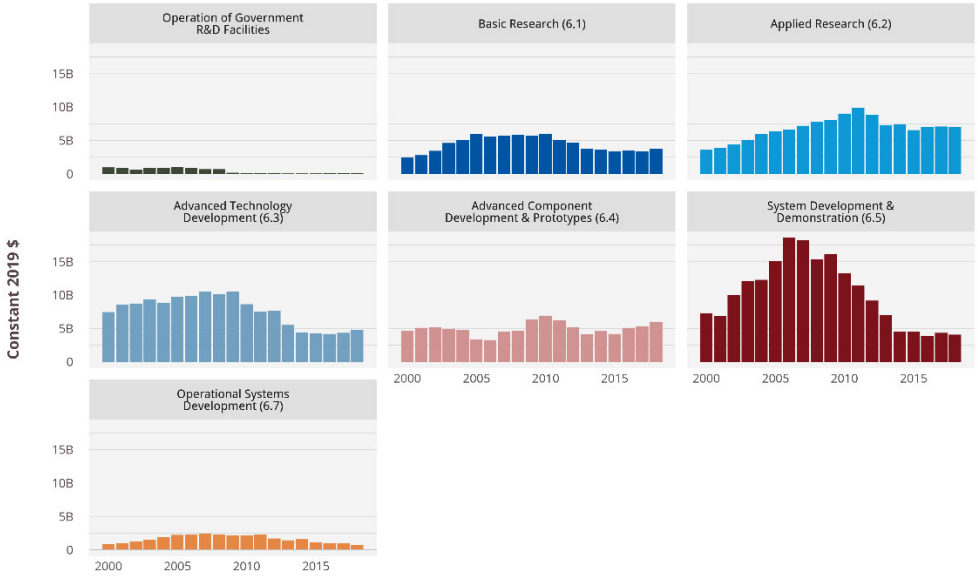

Figure 4. Defense R&D Contract Obligations, 2000–2018
(Source: FPDS; CSIS analysis)

The data show that the two earliest stages of R&D, Basic Research (6.1) and Applied Research (6.2), experienced significantly different trends in FY 2018. Defense Basic Research contract obligations increased 11% in FY 2017, a rate nearly three times the rate of the overall growth in defense R&D contract obligations, while Applied Research defense contract obligations declined 1%.

Both the two mid-stage R&D activities, Advanced Technology Development (6.3) and Advanced Component Development & Prototypes (6.4), grew at rates notably above the overall growth in defense R&D contract in FY 2018. Advanced Technology Development defense contract obligations increased from $4.3 billion to $4.8 billion, an 11% increase. Advanced Component Development & Prototypes defense contract obligations increased 14%, rising from $5.3 billion in FY 2017 to $6.0 billion in FY 2018. Of note, as the DoD pushes for increased usage of experimentation and prototyping in the acquisition process, Advanced Component Development & Prototypes accounted for 23% of total defense R&D contract obligations in FY 2018, well above its 14% historical average (McCormick et al., 2019).

After System Development & Demonstration (6.5) contract obligations declined in FY 2018 after having increased in FY 2017, the first year-to-year increase in System Development & Demonstration contract spending since FY 2005. Defense System Development & Demonstration contract obligations fell from $4.33 billion in FY 2017 to $4.06 billion, a 6%. As a share of total defense R&D contract obligations, System Development & Demonstration fell from 17% in FY 2017 to 15% in FY 2018, well below the historical average of 27%.

OTA Usage Across the DoD

OTAs have had a recent resurgence in the DoD thanks in large part to recent legislative changes aimed at incentivizing their usage and the emphasis of acquisition officials in this administration. Previous CSIS research has shown that DoD OTA obligations increased 195% between FY 2015 and FY 2017 (McCormick et al., 2018, p. 14). DoD OTA obligations continued rising in FY 2018, increasing 81% from FY 2017. In total, DoD OTA obligations have increased 352% over the last three years.

As shown in Figure 5, the base and all options (total potential value) of OTA agreements signed in the last few years is increasing at a rate quicker rate than actual OTA obligations. This last year, the total potential value of OTA agreements increased from $11.1 billion in FY 2017 to $26.8 billion in FY 2018, a 138% increase. Since FY 2015, total value of OTA agreements has increased 758% compared to the 352% growth in OTA obligations. Although the DoD will not ultimately exercise all the options contained in these recently signed OTA awards, nor necessarily obligate 100% of the value of even those options that are exercised, there is clearly a widely based increase in the potential scope of OTAs, suggesting that OTA obligations are likely to continue rising in the coming years as these OTAs are executed.

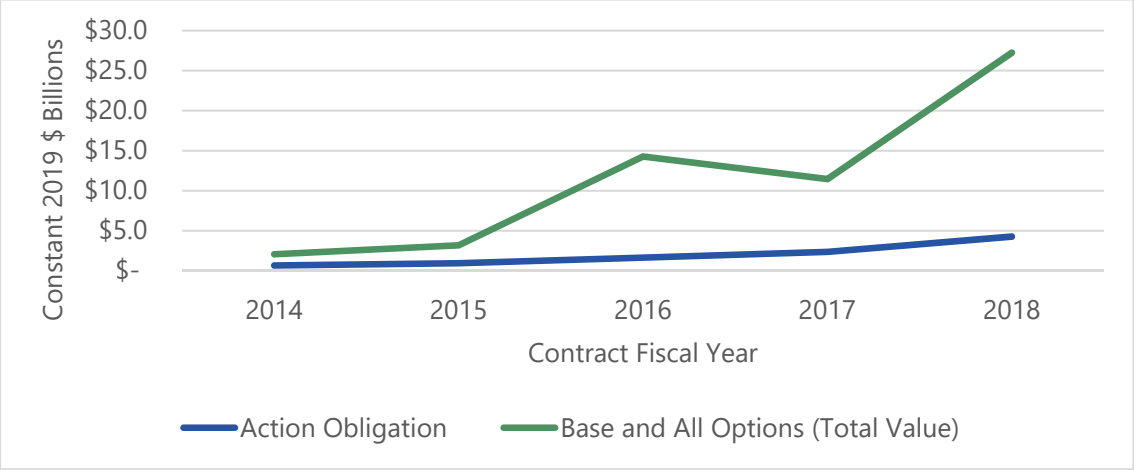

Figure 5. Defense OTA Obligations vs. Total Value, 2014–2018
(Source: FPDS; CSIS analysis)

Figure 6 shows defense OTA obligations by customer from FY 2014 to FY 2018.

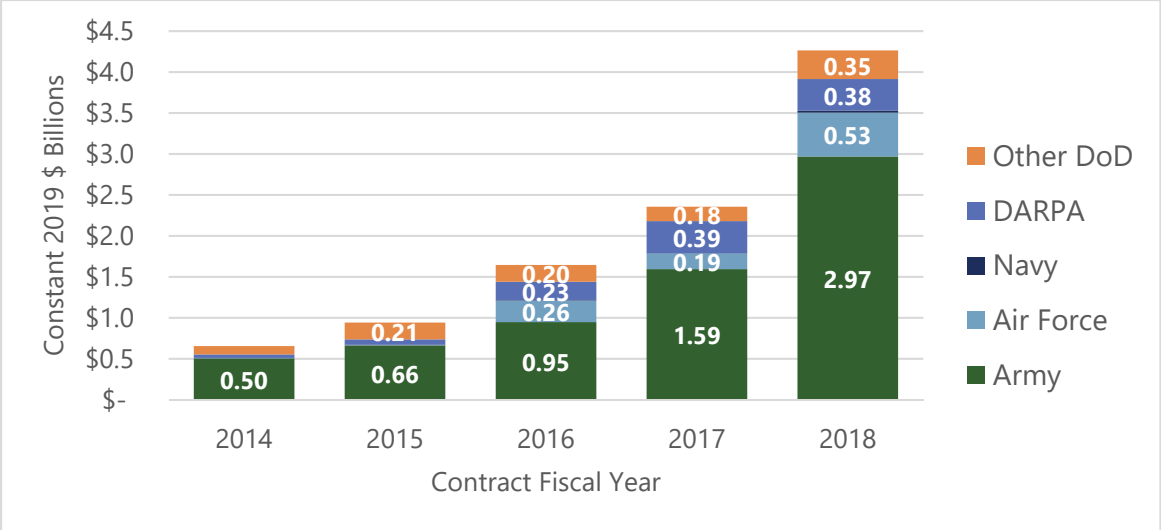

Figure 6. Defense OTA Obligations by Customer, 2014–2018
(Source: FPDS; CSIS analysis)

Across the DoD, the Army has been at the forefront of the DoD's OTA resurgence, largely due to its OTA Center of Excellence located at Army Contracting Command New Jersey (ACC-NJ) at Picatinny Arsenal, but over the last year most of the other DoD components substantially increased their usage of OTAs (McCormick et al., 2019, pp. 77–78).

Army OTA obligations increased 86% in FY 2018 and rose as a share of total defense OTA obligations from 68% in FY 2017 to 70%. Over the last three years, Army OTA obligations have increased 348% between FY 2015 and FY 2018.

Prior to the recent legislative changes, the Air Force made some limited use of OTAs, but the service has significantly increased their usage in recent years, particularly this last year. Air Force OTA obligations rose from approximately $0.19 billion in FY 2017 to $0.53 billion in FY 2018, a 176%. Air Force OTA obligations have grown 9982% since FY 2015.

Prior to FY 2018, the Navy accounted for less than 1% of total defense OTA obligations between FY 2015 and FY 2017. While the Navy still makes very limited use of OTAs, it started to make greater usage of them in FY 2018, spending $24.96 million in OTAs in FY 2018 compared to the $7.3 million the service spent in total from FY 2015 to FY 2017.

Composition of the Defense Industry

Defense Contract Obligations by Vendor Size

During the initial two years of the defense contracting rebound, the Big Five fared the best amongst the four vendor size categories, followed by Small and Medium-sized vendors, who grew at rates slightly below the topline growth, while Large vendors fared the worst,

declining 1%.[1] However, these trends did not hold true in FY 2018, as the Big Five declined slightly while the other three vendor size categories grew at roughly equal rates.

Defense contract obligations awarded to the Big Five fell from $115.9 billion in FY 2017 to $114.8 billion in FY 2018, a 1% decline. As a share of total defense contract obligations, the Big Five went from 35% in FY 2017 to 32% in FY 2018. In total over the course of the defense contacting rebound, defense contract obligations awarded to the Big Five increased 32% from FY 2015 to FY 2018.

Large vendors initially fared the worst during the initial two years of the rebound, declining 1% between FY 2015 and FY 2017, but experienced their own rebound in FY 2018. Defense contract obligations awarded to Large vendors totaled $102.4 billion in FY 2018, a 14% increase from FY 2017's $89.9 billion. However, Large vendors have yet to recover as a share of total defense contract obligations, accounting for only 28% of total defense contract obligations in FY 2018 as opposed to their 31% market share in FY 2015.

Small and Medium vendors both continued to benefit from the defense contracting rebound. In FY 2018, defense contract obligations awarded to Small and Medium vendors increased 16% and 18%, respectively. Between FY 2017 and FY 2018, the share of total defense contract obligations awarded to Medium size vendors rose from 19% to 21%, while Small vendors rose from 19% to 20%.

Figure 7 shows defense contract obligations by vendor size from FY 2000 to FY 2018.

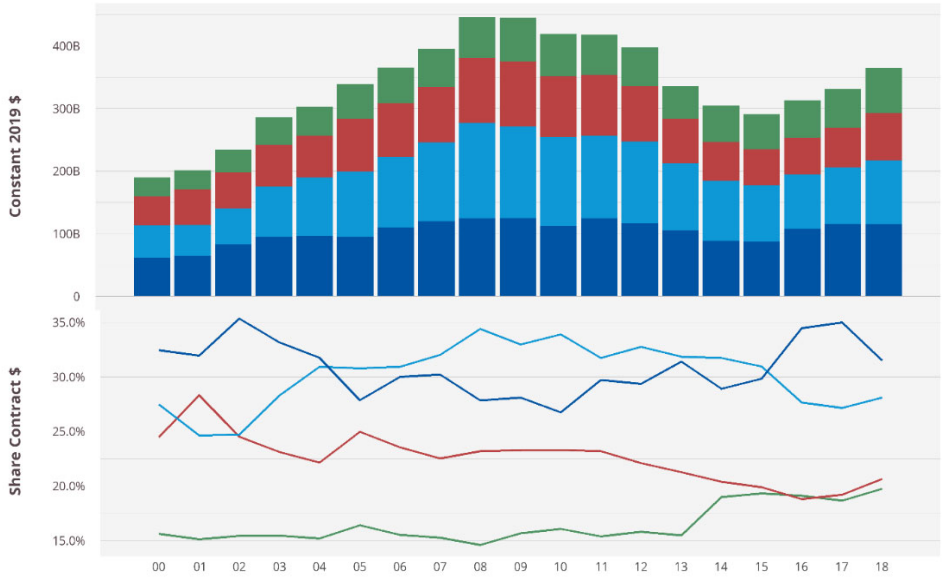

Figure 7. Defense Contract Obligations by Vendor Size, 2000–2018
(Source: FPDS; CSIS analysis)

[1] The Big Five are the five largest defense contractors as measured by total defense contract obligations: Lockheed Martin, Boeing, Northrup Grumman, Raytheon, and General Dynamics.

Vendor Count

Previous CSIS research showed that both the total number of prime vendors doing business with the DoD and the number of new prime entrants to the defense market had been declining in recent years (McCormick et al., 2017; Cohen et al., 2018). As shown in Figure 8, both of these trends continued in FY 2018. The data show that in FY 2018, the number of total prime vendors doing business with the DoD declined 9%, while the number of new prime vendors declined 7%. Since FY 2015, the total number of prime vendors doing business with the DoD has fallen 15%, while the number of new prime vendors has declined 16%. These trends, particularly the continued decline in the number of new entrants, is troublesome as the DoD emphasizes the National Security Innovation Base and tries to attract non-traditional defense companies to do business with the DoD.

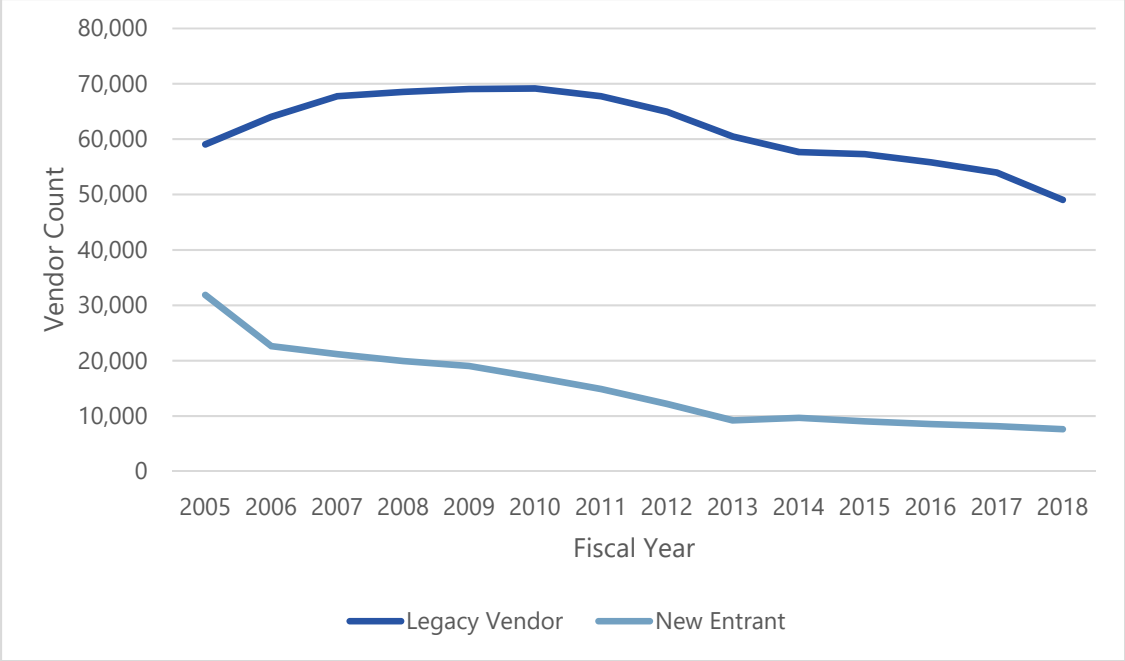

Figure 8. DoD Vendor Count, 2005–2018
(Source: FPDS; CSIS analysis)

Defense Components

Navy contract obligations grew 25% between FY 2015 and FY 2017, the most of any component, but fell in FY 2018. Navy contract obligations decreased from $113.1 billion in FY 2017 to $109.7 billion in FY 2018, a 3% decline. As a share of total defense contract obligations, the Navy fell from 34% to 30%, a market share more in line with historical averages.

The Air Force continued its year-to-year whipsaw in FY 2017, as Air Force contract obligations increased 15% last year. Air Force contract obligations are up 30% from FY 2015, but the year-to-year data shows the volatility of Air Force contracting trends in recent years. Over the last four years, Air Force contract obligations have gone from $56.2 billion in FY 2015 to $68.4 billion in FY 2016 before declining to $63.1 billion in FY 2017 and then increasing again in FY 2018 to $72.8 billion.

The Army had been growing at a slow but steady rate over the last two years after being the large bill-payer during sequestration and the defense drawdown, and saw a large

upswing in FY 2018 (McCormick et al., 2018). Army contract obligations increased 15% in FY 2018, going from $80.97 billion to $93.17 billion.

Both the Defense Logistics Agency (DLA) and the Missile Defense Agency (MDA) grew at rates significantly above the defense topline in FY 2018. In FY 2018, DLA and MDA contracting obligations reached near-historic levels, increasing 26% and 51%, respectively.

Figure 9 shows defense contract obligations by component from FY 2000 to FY 2018.

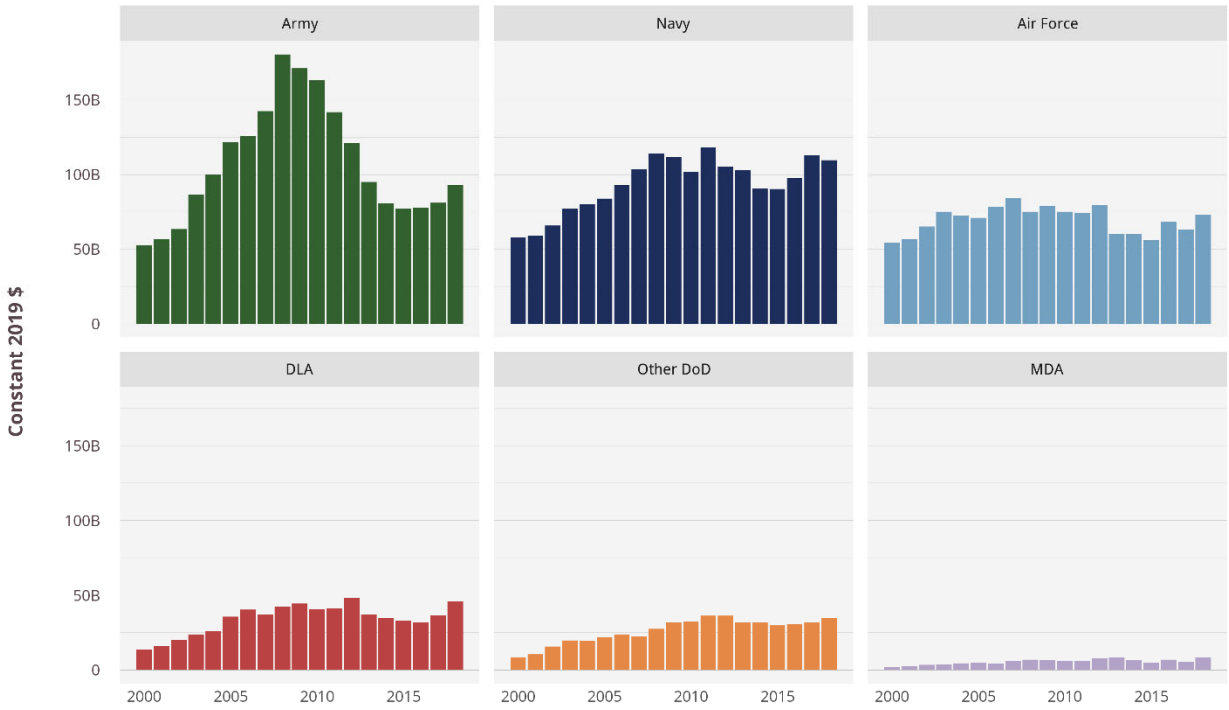

Figure 9. Defense Contract Obligations by Component, 2000–2018
(Source: FPDS; CSIS analysis)

Conclusion

No significant shift in the DoD's investment between products and R&D to reflect modernization priorities emphasized in 2018 National Defense Strategy

There was not a significant shift in the DoD's FY 2018 investment between products, services, and R&D despite the 2018 National Defense Strategy emphasizing modernization and the importance of great power competition. Although DoD spending on defense services caught up to spending on products in FY 2018, R&D contract obligations continue to trail far behind the other two areas of the DoD's investment portfolio. At the same time that the DoD is emphasizing the importance of modernization to meet the 2018 National Defense Strategies' priorities, in FY 2018, R&D fell to the lowest it has ever been this century as a share of total defense contract obligations.

Aircraft down; Land Vehicles and Facilities and Construction bounce back; Air & Missile Defense, and Ordnance & Missiles up

While there have not been significant shifts in the DoD's investment between products, services, and R&D, there were more significant changes at the sector level in FY 2018.

Land Vehicles and Facilities and Construction, two of the sectors hardest hit by sequestration and the defense drawdown, rebounded rather significantly in FY 2018. Land Vehicles contract obligations increased 51% in FY 2018, rising from $8.5 billion in FY 2017 to $12.9 billion in FY 2018, the highest level of Land Vehicles spending in the last six years. Facilities and Construction defense contract obligations increased 20% in FY 2018, twice the overall rate of growth.

Aircraft contract obligations, which had been the biggest beneficiaries of the first two years of the defense contracting rebound, declined 5% in FY 2018. This decline isn't too surprising as the Aircraft sector has been previously shown to be vulnerable to whipsawing back and forth between growth and declines.

Other notable trends include the year-to-year whipsaw in the Air & Missile Defense sector and steady growth in Ordnance & Missiles spending. While Air & Missile Defense contract obligations increased 37% from FY 2015 to FY 2018, a rate well above the 25% growth in total defense contract obligations, there has been a significant whipsaw year-to-year. After Air & Missile Defense contract obligations declined 15% in FY 2017, contract obligations subsequently increased 53% in FY 2018. Comparatively, Ordnance & Missiles contract spending increased 56% from FY 2015 to FY 2018, but with consistent growth year-to-year. In FY 2018, Ordnance & Missiles obligations increased 51%, and spending last year totaled levels not seen since FY 2007 to FY 2009.

Uneven recovery from the trough in the development pipeline for major weapon systems

The data show that the DoD has made some recovery in its development pipeline for major weapon systems, but recovery has been uneven across the different R&D activities. Despite System Development & Demonstration contract obligations increasing in FY 2017 for the first time since FY 2005, they subsequently declined 6% in FY 2018. In FY 2018, System Development & Demonstration contract obligations accounted for just 15% of total defense R&D contract obligations, whereas they have historically accounted for approximately 27% of annual defense contract obligations.

The largest recovery came in the mid-stage of the weapon systems pipeline where Advanced Technology Development (6.3) and Advanced Component Development & Prototypes (6.4) grew at rates well above the overall growth in defense R&D contracts in FY 2018. Of note, as the DoD has been emphasizing increasing experimentation and prototyping in the acquisition process, Advanced Component Development & Prototypes accounted for 23% of total defense R&D contract obligations in FY 2018, well above the historical average of 14% (McCormick et al., 2019).

OTA usage continues increasing across DoD

OTAs continue to gain popularity across the DoD following the recent legislative changes aimed at incentivizing their usage. Total OTA obligations across the DoD increased 81% in FY 2018 from FY 2017. Over the last three years, total DoD OTA obligations have increased 352% from FY 2015.

The data also show that total potential value of OTA agreements signed in recent years is growing at over twice the rate of OTA obligations. Between FY 2015 and FY 2018,

the total potential value of OTA agreements, were they to exercise all of their options, increased 352%.

The Army remains the predominant user of OTAs across the DoD, in large part due to its OTA Center of Excellence located at Picatinny Arsenal, but the other components have substantially increased their usage of OTAs in the last year. Army OTA obligations increased 86% last year and are up 348% from FY 2015. The Air Force made some limited use of OTAs prior to the recent legislative changes but has seen a 9982% increase in Air Force OTA obligations since FY 2015. Finally, the Navy has historically made little use of OTAs, accounting for less than 1% of all defense OTA obligations prior to FY 2018. While the Navy did make significantly greater usage of OTAs in FY 2018 than it had previously, it still only accounted for 1% of FY 2018 defense OTA obligations.

Big Five decline in FY 2018; Growth relatively evenly between Small, Medium, and Large

The Big Five benefited the most from the first two years of the defense contracting rebound but declined 1% in FY 2018. Instead, the 10% increase in total defense contract obligations in FY 2018 was relatively evenly distributed between Large, Medium, and Small vendors. Of note, Small vendors accounted for 20% of total defense contract obligations in FY 2018, their highest share of total defense contract obligations this century.

Number of prime vendors and new entrants doing business with DoD continues to decline

The data show that the number of prime vendors and new entrants doing business with the DoD continued declining in FY 2018. In FY 2018, the number of prime vendors doing business with the DoD declined 9%, while the number of new prime entrants declined 7%. Although defense contract obligations have increased 25% since FY 2015, the number of prime vendors doing business with the DoD has fallen 15%, while the number of new prime entrants has fallen 16%. Given the importance the DoD has placed on attracting new entrants, particularly non-traditional defense companies, these trends are worrisome.

Air Force bounces back; Navy starts decline; Army sees large upswing; MDA and DLA hit near-historic levels

There were notable differences in the contracting trends between the military components during the first two years of the defense contracting rebound and the FY 2018 trends.

Air Force contract obligations bounced back in FY 2018, increasing 15% from FY 2017. This continued the Air Force's year-to-year whipsaw between total contract obligations growing one year and declining the next, a trend that has been ongoing since FY 2015.

The Navy benefited the most during the first two years of the defense contracting rebound, hitting historic levels this century as a share of total defense contract obligations, but returned to more historic levels in FY 2018, experiencing a 3% decline in contract spending from FY 2017.

Army contract obligations, which had been growing at a slow but steady rate over the last two years after being the heaviest hit during sequestration and the defense drawdown, increased 15% in FY 2018.

Finally, DLA and MDA contract obligations increased 26% and 51%, respectively, in FY 2018 as these components' contract spending totaled near historic levels for this century.

Final Thoughts

The FY 2018 defense contracting data provides critical insights into the defense acquisition system's response to the 2018 National Defense Strategy and new administration's priorities. While the new administration had the opportunity to influence some of the trends seen in the FY 2017 defense contracting data, FY 2018 represents the first fiscal year fully executed by this administration.

Overall, the defense acquisition system has had a mixed response to the 2018 National Defense Strategy and the new administration's priorities. While you can look at most of the contract characteristics analyzed in this paper and see reflections of the National Defense Strategy and administration priorities, the interconnective thread that sews together the disparate data points is seemingly missing. For example, you look at the platform portfolio contracting trends and see increased investment in Air & Missile Defense in FY 2018, but this is not reinforced by any significant shifts in the composition of the DoD's investment portfolio between products and R&D. You look at the weapon systems pipeline trends and see Advanced Component Development & Prototypes (6.4) contract obligations at historic levels in FY 2018, as a share of total defense R&D contract obligations, but also a return to declining System Development & Demonstration (6.5) contract obligations.

If the DoD is to succeed at refocusing itself on peer and near-peer competition and forging a new relationship between the DoD and the National Security Innovation Base, and better recognize that interconnective threads are missing from the emerging from the FY 2018 defense contracting trends and explore why that is. How does the DoD balance its investment portfolio while also maintaining readiness through procuring and maintain existing platforms and fielding new modernization programs in the near-term despite continued cuts to System Development & Demonstration (6.5) while also leaving room for longer-term modernization funding? Why has the DoD continued to struggle to attract new entrants in recent years despite defense contract spending increasing 25% the last three years and several policies aimed at attracting new vendors, to include non-traditional defense companies? Understanding and addressing these missing interconnective threads are an evergreen issue for every administration but are of critical importance given that decisions today could transform the defense acquisition system and supporting industrial base for the next 10 to 20 years.

This paper presents only the initial findings of CSIS's analysis of the FY 2018 defense contracting trends in the FPDS. CSIS will continue to refine and expand its analysis on the trends presented in this paper and more in future reports.

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