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**CENTER FOR THE STUDY
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THE WEAK CASE FOR CONVERSION LEGISLATION

by Murray Weidenbaum

The likelihood of substantial cutbacks in the military budget has focused attention on the hitherto arcane subject of "defense conversion" and on a perennial proposal which until recently has been ignored. Since 1977, Representative Ted Weiss (D-NY) has been introducing legislation on defense conversion, but no bill has passed, or even come up for a vote. However, congressional interest in the subject is growing, as demonstrated by recent hearings on the Weiss bill.

The congressional hearings to date have been dominated by uncritical supporters of Congressman Weiss' bill. They have presented a minimum of analysis of how the ambitious program of "economic conversion" would work. Under the circumstances, it would seem useful to examine the specific provisions of Weiss' proposed legislation and of his supporting statements.¹

Key Features of the Weiss Conversion Report

The essence of Weiss' approach is to require each defense plant to set up joint business-labor "alternative use committees" to develop plans for shifting production to peacetime use when defense contracts get canceled. The bill also would establish a public-private Defense Economic Adjustment Council to oversee the entire process and to provide support and guidance. The latter would be an official part of the federal government.

Alternative Use Committees

Each military facility of 100 or more employees would be required to set up an alternative use committee.² The notion of a military facility is defined very broadly. It

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covers any plant or establishment used under a defense contract, no matter how small and including subcontractors and suppliers. In its present form, the proposal would cover every business, no matter how small a share of activity is devoted to defense work, so long as 100 or more people are on the payroll.

There is no indication as to how many of the tens of thousands of defense contractors, subcontractors, and suppliers would be covered. Nor is any justification provided for the use of 100 employees as the cut-off point, although Congressman Weiss indicates that the specific number is negotiable.

Each committee would have at least eight members and be made up of equal numbers of management and labor representatives. The labor representatives are to include members of union bargaining units and democratically elected representatives of unorganized workers. In addition, every locality within which the facility is located may appoint nonvoting representatives to the committee, who would participate in an advisory capacity.

Each committee is directed to prepare, in advance, plans for converting the facility and its resources to the manufacture of civilian products. These plans would be developed and implemented if there was a "substantial" cutback, reduction or elimination of the facility's defense contracts.

Each alternative use committee is given a broad mandate. First of all, it is to evaluate the assets of the defense facility and the resources and requirements of the local community in terms of physical property, manpower skills and expertise, accessibility, environment, and economic needs.

No guidance is provided as to what are the "requirements" of a locality or its "economic needs." These are vague, undefined notions which cannot be quantified in any objective sense. We can presume, given the thrust of Congressman Weiss' testimony, that this provision refers to maintaining the status quo in each locality covered by the bill. As he stated in the *Congressional Record* when introducing the 1989 version of the bill, "The

Defense Economic Adjustment Act provides a detailed plan for preserving the jobs of those affected by decisions to eliminate unnecessary military spending."

The second function of the alternative use committee is to develop detailed plans for converting the facility to "efficient, non-defense-related productive activity." The plans are intended to provide the local community and the employees of the defense facility with "a viable and workable blueprint for the conversion of the facility."

One must wonder whether Congressman Weiss knows the high attrition rate of new products and new businesses in the civilian economy. The expectations that would be engendered by the bill are, to put it kindly, inconsistent with the experiences of mortal men and women. The circumstances triggering such plans are unusually vague:

... in the event the facility is affected by a government decision to reduce, modify, or close the facility, terminate any defense contracts, or disapprove a license to sell or export defense materials to nongovernmental parties

It is doubtful whether the author of this provision appreciates its vast sweep. In the case of each of the larger (and many medium-size contractors) there is a constant ebb and flow of contracts, old ones being terminated and new ones being signed. Conceivably, the cancellation of the smallest contract would trigger the conversion activity even if the same firm simultaneously received a massive multi-billion dollar new defense order to be produced at the same facility. Conversely, a "defense facility" would have to actuate its "conversion plan" even if defense business represented an infinitesimal portion of its total activity -- and even if that nondefense portion were rising rapidly. Also, it is not apparent why disapproving a single export license should be sufficient grounds to convert the entire facility.

At this point, let us examine the stipulated content of the required conversion plan. Each plan shall "maximize" the extent to which the personnel required for the "efficient" operation of the converted facility can be drawn from people with the types and levels of skills possessed by the employees of the facility prior to its conversion. Then the plan must

specify the numbers of personnel, by type and level of skill, employed at the facility prior to conversion, whose continued employment is not consistent with the efficient operation of the facility after conversion.

How anyone could be precise in making such estimates defies the imagination. What company knows in advance the exact number and type of products that it will produce in markets new to it, much less the precise number and type of people required under those circumstances? Such rigidity exceeds the normal defense production process; it certainly is foreign to the dynamic civilian economy.

The next part of the plan is to specify the number of new positions, by level and type of skill, that would be required. Again, how could anyone make more than the roughest guess? But the planners would also have to specify "in detail" the new plant and equipment, and modification to existing plant and equipment, required for the converted facility. The capstone would be a financial plan, including an estimate of financing requirements.

Nowhere is there any acknowledgement of the many unsuccessful diversification efforts on the part of defense contractors nor of the findings of the various postmortems that have been performed. Inevitably, however, a few special interests are served. Each plan must provide for extending the labor contract to workers until conversion to non-defense-related operations is completed -- which, it is specified, cannot last more than two years.

For employees displaced by the closing of a defense plant, each committee shall provide occupational retraining and reemployment counseling services -- or ensure that such retraining and services are provided by other federal, state, or local agencies.

The degree of compulsion in the planning and implementation activity is awesome. Any contractor which fails to submit an alternative use plan or refuses or fails to carry it out shall be barred from future defense contracts for three years, forfeit termination

payments due it on existing or recently cancelled contracts, and lose eligibility for tax credits.

The Defense Economic Adjustment Council

The Weiss proposal also would establish a 22 member Defense Economic Adjustment Council to oversee the entire conversion effort. The Council would consist of 10 cabinet officers and other senior federal officials, six representatives of the "business-management community" to represent nondefense business, and six from labor unions. The idea that a committee with a majority of private citizens would exercise the powers of the federal government is certainly an innovation in political science. In the past, such joint committees have been limited to advisory roles.

A new Office of Economic Adjustment would be established to provide staff support for the Council. Given the responsibility placed on the Council, a substantial staff would be necessary.

The Defense Economic Adjustment Council would be more than a coordinating and advising body. It would establish the criteria for assistance, determine which communities are eligible, and rule on appeals. It also would rule on disputes on the sale or lease of surplus property to localities. Moreover, it is expected to quickly solve the key problems that perennially face decisionmakers entering new lines of business. It would have to do so by responding to the provision ordering it to prepare and distribute a Conversion Guidelines Handbook which shall contain the following:

- the basic requirements of programs for professional retraining of managerial personnel to reorient them to the management of civilian enterprise (failure to take the program would bar the people from the financial benefits described in the section "Assistance to Workers," which follows),
- the basic requirements for the length and nature of occupational retraining for production workers and junior level administrative employees,

- a checklist of critical points requiring attention at each stage of the conversion process.

The Council also would solicit, direct and coordinate "concrete plans" for civilian public projects, addressing "vital areas of national concern." The proposed legislation refers to alternative use plans "approved" by the Council, but makes no provision for any process of submitting, reviewing or approving such plans.

One year of advance notification would be required of plans to cut back or terminate a defense contract or a military base. The Defense Economic Adjustment Council would be responsible for informing local officials and alternative use committees of pending cutbacks. Because the federal budget is sent up to the Congress about 7 months before the start of a fiscal year, the notification requirement would mean, in practice, notice of 1-1/2 years before the actual cutback. The scope of the notifications would be very broad, covering "reduction, technical changes, or elimination of a program. . . ." Given the hundreds of technical changes that are normally made in the course of producing a single weapon system, the paperwork flow would be substantial.

Assistance to Workers

All employees who lose their jobs ("in whole or in part") by a cutback in the volume of defense work at the facility are eligible for two years to benefits equal to 90 percent of the first \$20,000 of annual earnings and 50 percent of the next \$5,000. (The benefits would be reduced by government unemployment compensation and actual earnings). Those who lose their jobs within six months prior to the "reduction of the volume of defense work" also receive the benefits. No explanation is given for that windfall, or more generally, why unemployed defense workers should be treated so much more generously than other unemployed people.

Unemployed defense workers would be eligible for job search allowances similar to those provided under the Trade Act of 1974. They also would be reimbursed for "reasonable" relocation expenses incurred in moving to another location in order to take

advantage of a civilian employment opportunity to which the worker is referred or which is determined to be suitable by the Secretary of Labor.

All managerial and technical employees who have spent more than half of the preceding decade working in defense-related jobs must participate in or have completed a program of "professional retraining" to be eligible for the financial assistance. The program must meet the requirements specified in the Conversion Guidelines Handbook.

In addition, the employer would have to continue paying into the employees' pension fund in behalf of each of those laid off workers for a period of two years. Also, the employer would be required to maintain for two years any medical and life insurance coverage which was in force when the employee was working. There is no provision for recovering these large costs under defense contracts. It would not be surprising, if such benefits were required, that many companies -- especially the smaller ones -- would declare bankruptcy as soon as their defense contracts were cancelled when faced with these expensive burdens.

Benefits to Communities

Federal adjustment assistance of undesignated amounts would be provided for communities and workers while a defense facility was being "converted." Communities "seriously" affected by defense cutbacks also would be eligible for federal planning assistance. It is not clear whether the communities would request the financial support after the defense cutback was announced or after it actually occurred. But it is interesting to note that the defense companies are expected to put their plans into practice as soon as the cutback is announced, while the localities would only begin planning at that point.

Congressman Weiss views the role of the Defense Economic Adjustment Council as providing pertinent planning information to localities. The Council would also encourage regional and national discussion and planning to provide information "indicating where local people should be looking to see what they should be doing." That supposedly would serve as a guide for "what the economy really needs."³

There seems to be no understanding, in this section of the proposal or elsewhere, that not every cutback announced by the Pentagon takes place. Congress is not exactly a rubber stamp. Proposed cut-backs by the Department of Defense would trigger all sorts of "conversion" activity by the communities and companies affected, even if Congress decides not to go along with the proposed action. The needless uncertainty and wheelspinning engendered by the Weiss proposal could be awesome.

Cost and Financing

No estimate of cost is contained in any of the materials accompanying Representative Weiss' proposals. When asked about the cost he replied, "I think it is really almost impossible to project."

He has suggested several methods of financing in his congressional testimony. One is to allocate 1-2 percent of the defense procurement budget for "economic conversion purposes." H.R. 101 requires that 1-1/4 percent of each defense contractor's sales to the Department of Defense be used for economic conversion purposes. Either approach would represent a major new federal spending program, in excess of \$1 billion a year.

Analysis of the Conversion Legislation

Proponents' Objectives

During every period of substantial reduction in defense spending a popular response emerges: the high-powered resources previously devoted to defense are too valuable to lie fallow; they should be utilized to deal with the various shortcomings in our society, generally through the public sector. It is not surprising that unemployed defense workers -- and those who fear that they soon will be laid off -- urge the government to spend money to keep them busy. Nor is it unusual for other citizens to think of periods of defense cutbacks as a good opportunity to use science and engineering in civilian pursuits.

However, much of the support for the current legislative proposals to "convert" defense industries to civilian tasks arises from a different -- and essentially noneconomic -- set of concerns. Many people and organizations who favor lower levels of military outlays

fear that citizens will resist large defense cutbacks because they may result in many people losing their jobs. Hence, in order to defuse the opposition to lower military spending, leaders in the peace movement seek to convince the public that attractive civilian alternatives exist for defense contractors. Congressman Weiss is very clear on that point:

By creating viable alternatives to military spending, economic conversion would assure the millions of workers in military dependent industries that their jobs will not be sacrificed in the effort to achieve meaningful arms control. . . . This would significantly enhance the prospects for ending the nuclear arms race.⁴

Professor J. Davidson Alexander is even more specific: "Fear of economic losses entailed by cutbacks, without comprehensive advanced planning to protect particular people in particular workplaces, marshalls substantial opposition to military cutbacks."⁵

Alternative Views on Defense Spending

At first blush, it is hard to take Representative Weiss' conversion proposal seriously. It is composed of equal parts of naivete and wishful thinking. One clear fallacy of this line of thinking is the simple-minded assumption that people who object to large defense cutbacks do so solely out of economic self-interest. That may be the case for quite a few who are directly involved in defense work, but it ignores several more basic factors.

First of all, many people whose incomes and jobs are not at all affected support high levels of defense because they view the world differently than the advocates of conversion. That is, they believe that the United States exists in a dangerous international environment, with potential threats coming from such varied sources as terrorist gangs, tribal warfare, and small nations with atomic capability, as well as conventional "super power" rivalry. Thus, they sincerely believe, a high level of defense (although not necessarily the current amount) is needed for the nation's welfare.

Lessons from Experience

The second shortcoming of the "conversion" position is the adverse experience of the past. Previous efforts -- public and private -- to force-feed the transition from military to civilian pursuits have generated a disproportionately large number of failures. The most

comprehensive studies of past attempts by large defense contractors to use their capabilities beyond the aerospace market have been unable to find any important examples of successes.⁶ The failed diversification efforts cover the entire period since the end of World War II. The unsuccessful efforts include product lines ranging from canoes to computers to coffins.

The most enthusiastic supporters of conversion planning acknowledge the sad history of previous defense industry diversification efforts. Professor Seymour Melman, whom Congressman Weiss acknowledges as the intellectual guru of the conversion movement, has written that "close scrutiny suggests that managements of the . . . military-industrial firm are infused with a strained incapacity for operating civilian enterprises functioning in the civilian marketplace."⁷

Representative Weiss uses even stronger language:

Thus, unlike most firms in a free enterprise system, their [defense firms'] focus is not on making cheaper or better products Often, these firms manufacture products which are essentially useless to the civilian population and uncompetitive in international markets.⁸

Although Melman and Weiss are entirely too negative in assessing the overall capabilities of defense contractors, they do focus on the difficulty these companies encounter when they try to use their defense capabilities in the civilian economy.

There are numerous reasons for that shortcoming. Given the nature of the military's needs, defense companies are geared to low volume production of expensive, specialized equipment, which rarely incorporate the tradeoffs between quality and price so common in commercial markets. These firms produce under detailed government supervision which generates large overhead costs. Moreover, the major defense contractors lack the marketing and distribution systems required in the consumer-oriented economy.

There is a third point that is ignored by the conversion advocates: the need to maintain an adequate research, development and production base for defense should the

current optimistic view of the international climate undergo another shift. Sadly, history provides numerous examples of the cyclical nature of superpower relations and of the abrupt shift from belligerency to "glasnost" -- or "detente" -- and back again. Surely, China, the Middle East, and Central America provide examples of unstable situations that could generate future threats to our national security.

The fourth shortcoming of a "conversion" strategy is that it focuses on keeping existing jobs in place. If that approach were followed, it would be a recipe for stagnation. The adjustments required by defense cutbacks are not basically different from the responses that regularly occur from shifts in consumer demand or in the pattern of foreign trade or from the introduction of new products that render existing products obsolete.

The fifth shortcoming of the conversion approach may be the most compelling. Peace is not about to break out and the reductions in the military budget are not likely to be overwhelming. Compared to the 2 percent annual reductions in real military spending previously planned, we might experience perhaps a 4 percent annual cut. The resultant "savings" would not be enough to bring the budget deficit below \$100 billion a year.

Conclusion

It seems clear that the limited ability to transfer defense technology to civilian uses has not been due to lack of trying. If the companies on their own want to continue such high risk attempts, we should wish them well. But "conversion" does not seem to be an attractive use of taxpayer money and, directly or indirectly, the money for "conversion" would be taken from the funds voted by the Congress for national defense purposes.

Despite protestations to the contrary, the "conversion" process would be a major step toward increased governmental control of private business. In view of the vagueness with which its provisions are drawn, enactment of bills like the proposed Defense Economic Adjustment Act would provide a field day for disputatious lawyers, bureaucrats anxious to expand their turf, and consultants who want to develop plans to increase the power of government.

Even more scary is the statement by the editors of a recent book on economic conversion that, "It is a model that can be enormously effective when applied to any production facility whose product is no longer in demand, or competitive on national or international markets."⁹ We are also told that conversion advocates are as concerned with what is produced and how goods are produced as they are in job creation and maintenance.

Finally, we come to the hidden agenda of the conversion advocates -- to move away from the market-oriented private enterprise system. There is no need to guess. We can refer to their own words:

Conversion advocates therefore recognize that the conversion process must help working people and their communities frame a new series of choices and that these must be centered around the concept of socially useful production, rather than production that merely serves the profit requirements of corporate managers.¹⁰

The conversion debate thus is really a dispute about the role and power of government in our society. The answer seems clear: In a period of budget stringency, there is no compelling case for devoting public resources to force feeding such "conversion" efforts. Nor is it obvious why public policy should interfere with the voluntary shift of resources to other sectors of the economy. Indeed, a large reduction in defense spending -- and a concomitant reduction in federal deficit financing -- would be a welcome opportunity for increasing the extent to which consumers, producers, and investors make their own decisions on the use of their income and wealth.

NOTES

1. U.S. House of Representatives, Committee on Banking, Finance, and Urban Affairs, *Economic Conversion* (Washington, D.C.: U.S. Government Printing Office, 1988), pp. 39-46, 349-378; U.S. House of Representatives, Committee on Banking, Finance, and Urban Affairs (Washington, D.C.: U.S. Government Printing Office, 1989), pp. 94-105.
2. The analysis of specific provisions is based on the proposed Defense Economic Adjustment Act (H.R. 101), introduced in the 101st Congress on January 3, 1989.
3. Honorable Ted Weiss, "The Defense Economic Adjustment Act," *Congressional Record*, January 3, 1989, p. E24.
4. *Ibid.*
5. J. Davidson Alexander, *Conversion Planning: 1945 and 1990*, a paper prepared for the Allied Social Science Association meetings, Atlanta, Georgia, December 29, 1989, p. 30.
6. See Denver Research Institute, *Defense Industry Diversification*, U.S. Arms Control and Disarmament Publication 30 (Washington, D.C.: U.S. Government Printing Office, 1966), p. vii; John E. Lynch, ed., *Economic Adjustment and Conversion of Defense Industries* (Boulder, Colo.: Westview Press, 1987); Suzanne Gordon and Dave McFadden, eds., *Economic Conversion* (Cambridge, Mass.: Ballinger Publisher, 1984).
7. Seymour Melman, *Pentagon Capitalism* (New York: McGraw-Hill, 1970), p. 173.
8. Weiss, "Defense Economic Adjustment Act," p. E24.
9. "Introduction," in Gordon and McFadden, *Economic Conversion*, p. xvi.
10. *Ibid.*, p. xviii.