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BUSINESS DAY

Federal Contracts Plunge, Squeezing Private Companies

By DANIELLE IVORY JAN. 15, 2014

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The big business of Washington — federal contract work — is losing some steam.

After spiraling higher for much of the last decade, the value of federal contracts awarded to companies is falling rapidly.

In the fiscal year that ended Sept. 30, the total fell by \$58 billion, or roughly 11 percent. It was the steepest decline — in percentage and nominal terms — in at least a decade, according to an analysis of federal contract data by The New York Times.

The federal government is still awarding hundreds of billions of dollars in contracts. For the 2013 fiscal year, the total was \$460 billion. On Wednesday, the House approved a \$1.1 trillion spending bill for the current fiscal year, which would include a sizable amount of contracts.

But for many businesses — particularly small ones used to lucrative contract work — the trend is worrying. Even for major corporations like Boeing, the cost of Washington's budget battles is coming into sharp focus. Few expect contract work to rise broadly in 2014 and many expect the decline to continue, given the politics of the budget.

Small-business owners like Lisa Harris, who runs an environmental consulting firm in Tucson, are feeling the reductions most acutely. As federal contracts have slowed, Ms. Harris said, she has let go half of her 35 workers. The rest have had to take brief furloughs. "I am down to the bare bones," she said.

The latest decline largely reflects cuts in military spending related to Iraq and Afghanistan, and efforts to squeeze the budget with voluntary cuts and the broad

reductions known as sequestration. Contract spending had been declining since President Obama took office, but not as sharply.

The decline during the Obama administration contrasts with the administration of President George W. Bush, when contracts more than doubled after the Sept. 11 terrorist attacks.

Contracts at the Defense Department fell most last year. The Pentagon awarded about \$308 billion in the fiscal year that ended Sept. 30, 2013. That was about \$54 billion less than in the 2012 fiscal year. Though contracting figures can fluctuate after the government makes awards, the Office of Federal Procurement Policy, which oversees contracting, confirmed that no significant changes were expected.

Joseph G. Jordan, who will resign as administrator of the office on Friday for a job in the private sector, attributed some of the decline to agencies employing “smarter, strategic buying techniques.” The procurement office is trying to ensure that cost-saving measures, such as bulk purchasing, become part of the normal contracting process, he said.

But Daniel I. Gordon, who led the office during Mr. Obama’s first term, said reduced government spending could hold back the nation’s fragile economy. He predicted that federal spending would continue to decline in coming years.

“This is the new reality,” said Mr. Gordon, who is associate dean for government procurement law studies at the George Washington University Law School. “In 2014, you could see another drop of 10 percent.”

Like Ms. Harris in Tucson, Heather Cotter said the decline has been trying for her Washington consulting firm, which focuses on public safety. She began working with federal agencies in 2009. Initially, the money was good.

“The first two years were pretty rock ‘n’ roll,” Ms. Cotter said. Roughly 90 percent of her small firm’s revenue came from federal contracts, she said.

Then the work dried up. Last year, she changed her business model and began focusing on web seminars, mostly for local law enforcement. Federal contracts now account for a fifth of her business.

Eric DeMarco, chief executive of Kratos Defense and Security Solutions, which produces electronics, and satellite and other security products, saw his company’s contracts fall last year. “Our commercial business went up, thank God,” Mr. DeMarco said.

He said the thinning of the budget will ultimately be good for Kratos, which is based in San Diego and derives more than half of its \$1 billion in revenue from the government. Agencies, he said, will favor firms that can deliver innovative products for reduced prices.

“It’s giving us a shot that we didn’t have before,” Mr. DeMarco said. “I’m going to figure out how to deliver that widget for \$20. There is some good here, as well as pain.”

Major corporations are feeling the pinch, too. Boeing and Raytheon, two of the largest recipients of federal contracts, had declining awards last year.

“I caution against drawing too broad of a conclusion from year-over-year data,” said Todd Blecher, of Boeing. “There’s a regular ebb and flow to government contracting that can cause what otherwise would be notable fluctuations in annual data.” A Raytheon spokesman declined to comment.

But Lockheed Martin, the top recipient of federal contracts, won about \$43 billion last year, an increase from \$35 billion the previous year.

While small businesses received about 18 percent of federal contracts in the last two years, total dollars awarded to the companies tumbled to \$83 billion from about \$90 billion.

The total impact on small businesses is difficult to determine because many rely on subcontracts from large companies, which are hard to track. As large companies feel squeezed, they may be less likely to dole out jobs to smaller suppliers, or the work may become too competitive for little companies to survive.

Kathryn Waldron, who owns KAU Inc., a general contracting company in Fredericksburg, Va., said dozens of contractors often vie for work that pays relatively little. And some are submitting bids that seem impossibly low.

“There is no point in doing a project if you are not going to make any money,” she said.

A version of this article appears in print on January 16, 2014, on page B1 of the New York edition with the headline: Federal Contracts Plunge, Squeezing Private Companies.