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Echoes Across the Pond:
Understanding EU-US Defense Industrial Relationships

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ECHOES ACROSS THE POND: Understanding EU-US Defense Industrial Relationships

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OUTLINE

• SELECTED MAJOR DEVELOPMENTS IN THE INTERNATIONAL MARKETPLACE

• ANALYTICAL PARADIGMS: Offsets, Transaction Cost Economics, Corporate Strategy

• SELECTED CASES: JSF, UK Defence Industrial Strategy, KC-30 PROPOSAL
  – NARRATIVE
  – INTERPRETATIONS
ONGOING DEVELOPMENTS

• MILITARY AFFAIRS
  – TWO RMAs: OURS AND THEIRS
  – EFFECTS OF THOSE RMAs
    • CURRENT COMBAT OPERATIONS
    • DEFENSE ACQUISITION AND INDUSTRIES
    • ERA OF RECAPITALIZATION?

• OBSERVATIONS
  – ARE PLATFORMS BECOMING DECADENT TECHNOLOGIES?
  – TENSION BETWEEN HYPERADAPTIVE WARFARE AND ACQUISITION PROCESSES THAT ARE HYPERBUREAUCRATIZED, HYPERLEGALIZED AND HYPERPOLITICIZED.
DEVELOPMENTS (Cont)

• INTERNATIONAL DEFENSE MARKETPLACE: Reform, Globalization
  – TENSION BETWEEN NATIONAL SOVEREIGNTY AND GLOBALIZATION
• US-EU DEFENSE INDUSTRIES
  – MAJOR ROLES IN WORLD MARKET
  – DEFENSE BUDGET TRENDS
  – PATTERNS OF REORGANIZATION
EXPLANATORY PARADIGMS

• **ESSENCE OF DECISION** (Allison)
  – MULTIPLE MODELS IMPROVE UNDERSTANDING OF COMPLEX EVENTS.
  – MODEL I – UNITARY RATIONAL ACTOR
  – MODEL II – ORGANIZATIONAL BEHAVIOR
  – MODEL III – GOVERNMENTAL POLITICS

• **OUR MODELS**
  – OFFSETS (Udis & Maskus, 1991)
  – TRANSACTION COST ECONOMICS (Williamson, …)
  – CORPORATE STRATEGY (5 Forces, “Co-opetition”)
OFFSETS (Udis & Maskus)

• A MEANS OF REACHING POLITICAL CONSENSUS FOR PURCHASING IMPORTED MILITARY EQUIPMENT.

• A PARTIAL REDRESS FOR THE IMPERFECTIONS FROM OLIGOPOLIES AND PROTECTIONIST POLICIES OF ARMS EXPORTERS (e.g., Buy American legislation, French industrial policy).
TRANSACTION COST ECONOMICS

• BEGAN AS A SYSTEMATIC STUDY OF THE “VERTICAL” BOUNDARIES OF THE FIRM … ESPECIALLY THE “MAKE OR BUY” DECISION

• SPECIAL ATTENTION TO THE COSTS AND RISKS OF OUTSOURCING RELATIONSHIPS
  – COORDINATION
  – MOTIVATION (OPPORTUNISTIC BEHAVIOR AND “HOLDUPS”)

• NATION-STATE AS DEFENSE ENTERPRISE
CORPORATE STRATEGY: Five Forces Model

SUPPLIER POWER

POTENTIAL ENTRANTS

INDUSTRY COMPETITORS

BUYER POWER

SUBSTITUTES & COMPLEMENTS
First “Case:” Joint Strike Fighter

• POST-OFFSET TRADE? JSF consortium concept intent is changing customers into collaborators – in search of first-best efficiency in the program.
  – Answer: Probably not.

• TCE: Preserving competition in the supply chain. Avoiding the “fundamental” transformation to bilateral offset negotiations.

• STRATEGY: JSF model is a way of addressing buyer power held by sovereign entities, by creating stakeholders within those countries.
UK Defence Industrial Strategy

POST-OFFSET WORLD?

• seems structured for a trading regime without offsets.

• … but with an offsets (as industrial participation) negotiation template built in …
  – Core Industries
  – Appropriate Sovereignty

• Answer: probably not
UK Defence Industrial Strategy

• TRANSACTION COST ECONOMICS:
  Protection from costs and risks associated with outsourcing (importing) defense equipment.
  – Risks of military dependence vs. imperatives of technology and globalization
  – Hedges against opportunistic behavior from suppliers with forms of tapered integration …
    • …with core sectors in certain defense industries.
    • … and significant capabilities for life-cycle management
UK Defence Industrial Strategy

• CORPORATE STRATEGY: The DIS addresses threat to profits for domestic firms that globalization presents through a more competitive defense marketplace.
  – Reservation for domestic producers (Core Industries) a (partial) barrier to entry to the UK defense market.
  – “Appropriate Sovereignty” provisions are a way for the MOD to deal with supplier power.
KC-30 PROPOSAL

• STEALTHY OFFSETS? The public details of the NG-EADS proposal included substantial industrial participation … consistent with tacit bargaining over offsets.
  – “Northrop Grumman's KC-45 Tanker program will support 48,000 direct and indirect jobs at 230 supplier companies in 49 states.”
http://www.northropgrumman.com/kc45/benefits/commitment.html
KC-30 PROPOSAL

• TRANSACTION COST ECONOMICS: REASSURANCE ABOUT THE RISKS OF A “HOLDUP” THROUGH US CONTENT.

• CORPORATE STRATEGY:
  – REDEFINING CORPORATE ENVIRONMENT: entering the US defense market
  – SUPPLIER POWER: US insistence on KC-X competition
  – OVERCOMING BARRIERS TO ENTRY: Partnership with Northrop Grumman
CONCLUSION: Some Support for Our Multiple-Models Hypothesis

• ALL THREE FRAMEWORKS HAVE SOME EXPLANATORY POWER IN ALL THREE CASES.

• BEST MODELS (OUR ASSESSMENTS)
  – JOINT STRIKE FIGHTER: OFFSETS
  – UK Defence Industrial Strategy: TRANSACTION COST ECONOMICS
  – KC-30 PROPOSAL: CORPORATE STRATEGY