

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

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Panel 18, 15 May 2008

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”)

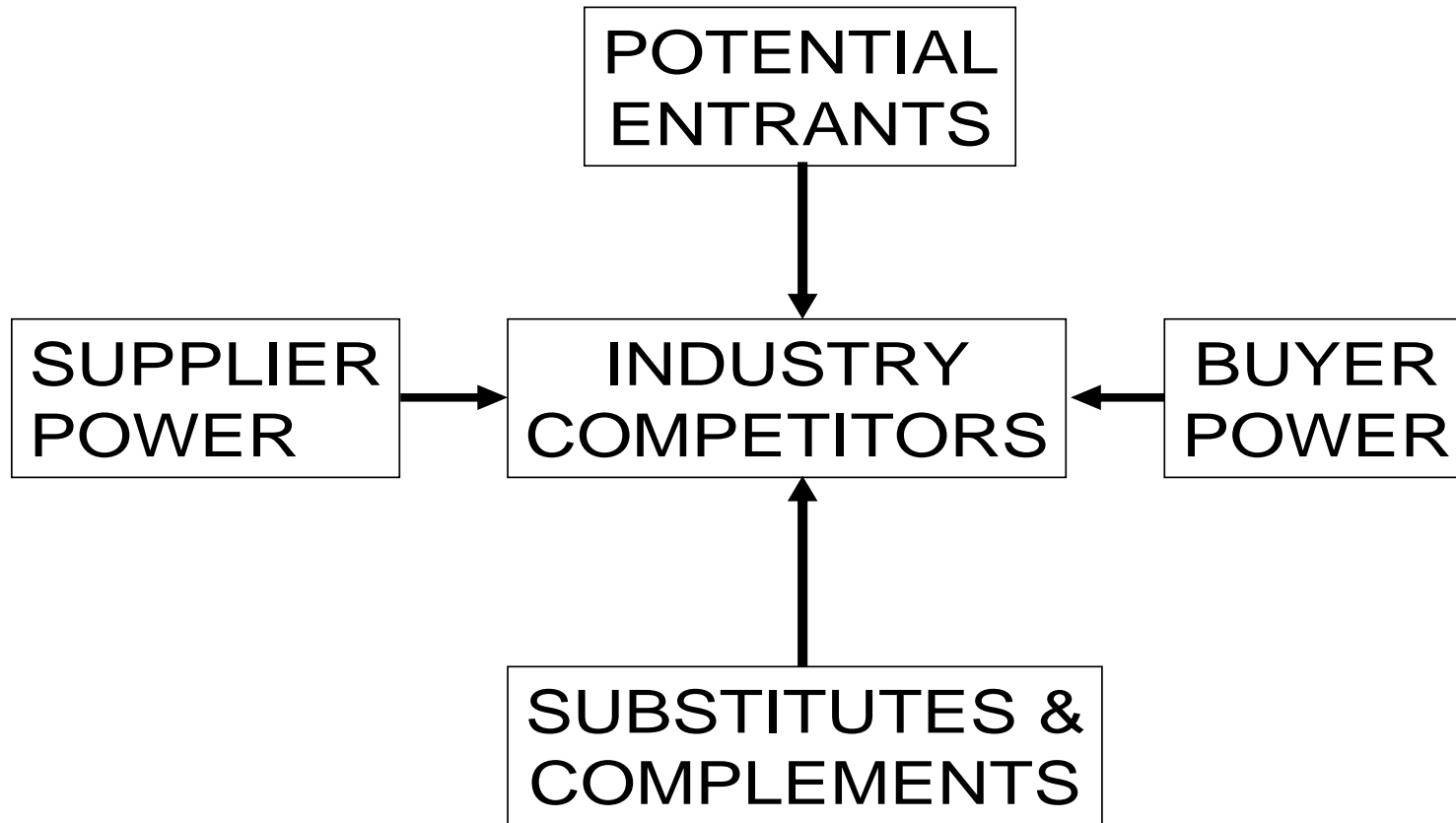
OFFSETS (Udis & Maskus)

- 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



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