

## THE POLITICAL ECONOMY OF DEFENSE

Today's focus is on the structure, conduct and performance of the defense industries (aerospace, shipbuilding, combat vehicles, defense electronics and ordnance). Next two sessions related –Weapons Acquisition and the Management of Defense ----topics too ignored in security studies.

Key points:

1. New business-----prior to WWII relied more on arsenals, government facilities
2. Cycles -----10-15 year cycles of Boom and Bust, shapes behavior
3. Regulated business----thousands of pages. ASPR
4. Monopsony ----very rich but very, very strange customer

### I. NEW BUSINESS

Pre WWII. Wars infrequent, very small standing force, not enough to sustain contractors who brought in for short spike in business. Most of needs met by arsenals that kept the technology of war alive between wars and had the weapon designs for contractors. Lots of profiteering (or belief that there was profiteering during wars) so most wars followed by investigations into scandals.

Post WWII. Contractors stay on due to continuous mobilization. Of course in newest technologies no arsenals---aircraft and missile (Navy aircraft exception; Army missile exception). Creation of **Private Arsenals**.

Closed down arsenals/shipyard to feed contractors. Big waves in 1960s and 1970s. Five BRACS after Cold War. Depot flap. Portsmouth Naval Shipyard. A-21 procedures cut into civil service. Domestic Brown & Root.

- I shop in the Watertown Arsenal
- Some of Boston's best condos are in the old Boston Naval Shipyard
- I stay at the goat island hotel in Newport –the site of the Navy's Torpedo Factory

Why Favored?

- more responsive?
- more attractive to talent, better pay?
- more flexible?
- more politically supportive?

Created what Don K. Price called the Contract State---a **blending of the Public and the Private**.

- Government absorbs the risks of technological development
- Contractors manage government programs
- Mutual dependencies---good or bad?

What is Lockheed Martin---private or public? How about Boeing?  
We have a set of Private Arsenals instead of Public Arsenals to design and build our weapons.

## II. CYCLES

The Cold War draw down gentlest of them all

WWII-----four years at 8.9% of GDP per year (40% to 3.7%)

Korea-----three years at 1.4% of GDP per ( 14.5 –10.2%)

Vietnam—ten years at .48% per year

Cold War---eleven years at .26% per year (6.4 to 3.5%)

With cycles pressure to buy-in/ services collude CONCURRENTY!!!

Production and spares is where money is made. Government underfunds R&D

Defense spending in band between \$275-450 Billion. Now moving to new highs.

### **III. REGULATED BUSINESS**

#### POST COLD WAR MERGER WAVE

Clinton Administration believed in Industrial Policy but not in the only industry that needed it! Last Supper. Just had Last Plus One.

#### **Encouraged great merger wave**

- Most Fortune 500 firms exited---IBM, GM, (Hughes), FORD, TI, Westinghouse
- Some bought one of everything---Lockheed
- Some moved back in ---Boeing (to balance)
- Some tried to Diversify---Raytheon
- Some gave up----McDonnell Douglas, Grumman
- Some did nothing ---United Technologies
- Some did everything---General Dynamics

Not a single assembly line closed!!! We still have 6 big private shipyards, 13 aircraft plants, a dozen armor vehicle lines. Only missiles and engine lines consolidate after Cold War.

Not like commercial mergers---why?

More contractor employees working now than at low point of Cold War.

We bought out military (2.1 million to 1.4 million) and civil servants (from 1.1 million now to 600K)

Cold war different -----now jobs program just like Europe during and after Cold War.

#### IV. MONOPSONY

The buyer from **HELL**:

Fickle, political, fearful of scandal----regulation and more regulation, exotic tastes. What is real expertise of companies? Why is it hard for them to *convert*?

hiring ex-military---good or bad?

Jointness cuts buyer competition ----seller innovation; buying by committee.

Buyer Characteristics:

- performance, program not cost oriented
- procurement officers 2<sup>nd</sup> class-----\*\*\* v \*\*; Sears and Allstate
- Sellers recognize service key or pay price during Cold War: (Curtiss Wright) now can win (Newport News). Security Panics v. Pork (kosher in US)

**Business---allocated, more teaming, no losers (any winners?)**

Better cut excess capacity---buy out companies, workers and communities; not Payoffs for Layoffs.

Keep some design or potential design competition (Soviet style but also nuclear weapons production system----two design labs, one production line.

International collaboration-----not likely, Europe will subsidize own; but Joint Strike Fighter may become alternative model.

#### V. THE NEW MARKET

- Logcap, health care
- Britainand the JCGSC