

## **Conference proposal for the Fifteenth Annual Conference on Economics and Security**

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### **Title: US defence industry's current changes - A new strategy?**

There seems to be a growing sentiment that in the context of 1) protracted effects of the economic and financial crisis on US national finances, 2) emergence of new players and possible future competitors in the world's defence market and 3) perception, in the US and elsewhere, of an erosion of its influence due to the somewhat mixed results shown by the operations in Afghanistan and Iraq, the current US Defence industry's leadership could be challenged. This idea needs to be carefully evaluated in light of its possible consequences on defence market dynamics.

The communication aims to address this important issue in three ways. First, by reviewing the past two decades to identify the key drivers that led and/or enabled the US defence industrial base (DIB) to occupy its current position. In the post-cold war "era" (1990's), some well known and documented choices were made by both the Clinton administration and by industry leaders that initiated a process of deep change. What is interesting in this is that most of the country's military leaders, considered by many to be highly wasteful and unresponsive to market mechanisms, emerged from a business environment characterized by a 42% drop in procurement spending between FY 1992 and 1998<sup>1</sup> with strengthened industrial profiles and upgraded technological capabilities. They were therefore well prepared for the upturn announced in the second half of the decade along with the launching of new modernization phase and therefore, planned - but measured - increases in procurement.

In 2001, defence expenditures were boosted in the wake of WTC/Pentagon attacks and the subsequent Global War on Terror. Amounts allocated to acquisition (both procurement and R&D) were also significantly increased (50% both between 2001 and 2008) in order to push the development and deployment of new strategically ambitious and technically bold systems such as ABM and the Future Combat Systems. Issues of costs control were somewhat sidelined, encouraging a highly concentrated US DIB to focus on the domestic market, inducing a partial loss of interest on its part, in export markets. US defence companies turnovers literally exploded from 2001 to 2009, and all showed an increase in reliance on domestic orders for business from the previous decade. However, the American defence market's attractiveness combined with the highly oligopolistic profile of the domestic industry saw an increase in participation from European players such as BAe and

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<sup>1</sup> Based on FY 2012 Greenbook data (outlays), US constant 2011 dollars.

Finmeccanica, which were allowed - with some conditions - to participate by buying second tiers enterprises.

The second part of my presentation seeks to draw a picture of the current situation in the US with regards to budget and acquisition and the way industry is coping with present and anticipated changes to its market's conditions. Although current budgetary trends are unclear and will likely remain so until a definitive exit from Afghan/ISAF operations is well underway, major actors in the US DIB have already enacted strategies to consolidate their position in what are globally considered growing markets in defence and security such as cyber, maintenance, C5ISR, autonomous vehicles, green energy, etc. At the same time, a renewed interest in export opportunities is clear but international competition is as fierce as ever and what is new is that emerging markets are in a position to dictate terms of access to their projects. Some of these conditions, which are mostly conveyed through offsets policies, are sometimes difficult to commit to for American firms subjected to ITAR controls.

To some extent, it clearly seems like the US industry is preparing for an alteration of its domestic business environment. What is striking is that at this time, changes in the US defense procurement budget are not evident and spending continues to grow. True, major programs were cancelled, but for most, funding was redirected to new projects seeking to acquire the same capability. Cost control is once more on top of priorities, and efficiencies policy has been imposed on both the industry and DoD, but the money saved is channeled in the procurement budget. Moreover, Obama's administration is making decisions that sheds some light on a possible rudimentary framework of the government approach to the current process of industry change. For instance, once more faced with a possible Lockheed-Martin/Northrop Grumman merger, DoD announced it was open to industry consolidation, as long as it did not involve its top 5-6 suppliers; another example is embodied by the ITAR reform that aims to simplify and speed-up process of international arms sales and transfers.

In this context, the third part of my presentation explores the idea that the current "adjustment" phase might not be exclusively intended to adapt to the changing US market conditions, but may also be directed in support of an increase in international activities of US firms in a changing global defence market. If that is the case, several issues will need to be closely tracked: a possible increase in more sophisticated conventional weapons systems proliferation, new alliances between North and South military firms; the increasingly significant roles played by Russia and China in export markets, just to mention these

I conclude by saying that if the current approach is to stabilize and strengthen US industry in order for it to be better positioned on the international level, it is premature to consider an erosion of its position or leadership. We are more likely faced with a redefinition of the way it materializes.