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## Autarky or Interdependence: U.S. vs. European Security and Defense Industries in a Globalized Market

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# **Autarky or Interdependence: U.S. vs. European Security and Defense Industries in a Globalized Market**

## **Abstract**

Globalization theorists show how downward pressure to compete and/or save costs in global markets will lead producers and consumers to source goods and services in the cheapest and most efficient manner. However, in certain sectors, such as the defense industry, security concerns and politics can overshadow economic logic when it comes to making procurement decisions. These political and security concerns keep the U.S. defense industry from using the most cost-effective supply chains and manufacturing centers, whereas in Europe, post-Cold War socioeconomic and political realities allowed for more transnational cooperation on defense procurement. Three cases serve to illustrate the spectrum between autarky and interdependence in defense procurement and how fundamental political, legal, and structural constraints prevent the U.S. defense market from becoming fully efficient.

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## Introduction

Globalization describes the world's economic and social interconnectedness. It also describes a world where the boundaries of the state and jurisdictional barriers are becoming less significant towards impeding modernity, technological innovation, and progressive social change. Globalization theorists suggest downward pressure to compete or save costs in global markets leads producers and consumers to source goods and services in the cheapest and most efficient ways.<sup>1</sup> In capitalist market systems, the supply chains tend to be buyer-driven; hence, it is in a producer's best interest to establish decentralized production networks and interconnected modes of procurement.<sup>2</sup> In contrast, the American defense establishment leans distinctly towards autarky when it comes to defense spending, leaning on the principles of self-sufficiency and independence from the global market.<sup>3</sup>

Some governments tend to choose autarkic methods when procuring weapons because it "ensures security of supply sustains a strong defense industrial base and maintains national technological capabilities."<sup>4</sup> In his 1961 farewell address, President Dwight D. Eisenhower famously warned against America's growing military-industrial complex, and the rise of "misplaced power" or undue influence by the military establishment.<sup>5</sup> Yet, a nation's weapons procurement process is much more a result of its structural conditions versus a choice of agency. For instance, legal, military, and economic constraints inhibit the U.S. defense market from becoming completely globalized, interconnected, and efficient. Legal constraints, such as U.S. export regulations inhibit the U.S. defense industry and puts pressure on foreign companies to comply with U.S. security regulations. From a military standpoint, while the United States "is the champion of globalization, yet its role as military enforcer is territorially based."<sup>6</sup> Economically, there is little

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<sup>1</sup> Paul Hirst and Grahame Thompson, *Globalization in Question* (New York: Polity Press, 1999), 243.

<sup>2</sup> Peter Dicken, "A New Geo-economy," in *The Global Transformations Reader*, eds. David Held and Anthony McGrew (Cambridge, UK: Polity Press, 1998), 305.

<sup>3</sup> Richard Bitzinger, "Globalization in the Post-Cold War Defense Industry: Challenges and Opportunities," in *Arming the Future: A Defense Industry for the 21<sup>st</sup> Century*, eds. Ann Markusen and Sean Costigan (Washington, D.C.: Council on Foreign Relations Press, 1999), 305 – 333.

<sup>4</sup> Seth G. Jones, "The Rise of a European Defense," *Political Science Quarterly* 121:2 (2006): 241 – 260. doi:10.1002/j.1538-165X.2006.tb00571.x.

<sup>5</sup> Dwight D. Eisenhower, "Farewell Address," January 17, 1961, available at: [http://avalon.law.yale.edu/20th\\_century/eisenhower001.asp](http://avalon.law.yale.edu/20th_century/eisenhower001.asp).

<sup>6</sup> Robert Cox, *Approaches to World Order* (Cambridge: Cambridge University Press, 1996), 292.

reason for U.S. defense companies to cooperate with foreign companies; U.S. companies are self-sufficient and remained profitable without merging or creating economies of scale.

In contrast to the Americans, the Europeans have been trading sovereignty for interdependence, on military, socio-economic, and political levels since World War II. In 1951, France, West Germany, Spain, Belgium, the Netherlands, and Luxembourg created the European Coal and Steel Community (ECSC), a precursor to the European Union. The ECSC was a supranational organization, designed to create a common market for coal and steel. Since its creation, several institutions and intergovernmental organizations have come to govern Europe's political and economic landscape. Europe's integration reflects its liberal-leaning view of international relations. Equally, under the conditions of the liberal theories of complex-interdependence, "the meaning of sovereignty changes."<sup>7</sup> In the same respect, sovereignty "no longer enables states to exert effective supremacy over what occurs within their territories."<sup>8</sup>

## Historical Context

Throughout modern history, the nation-state has been responsible for its arms production. Even many capitalist economies control or completely own their defense companies.<sup>9</sup> The arms industry has a unique place in the global marketplace because industry professionals often see profitability and efficiency as less important than the ability to mobilize and secure national defense.<sup>10</sup> American and European defense industries are no exception to this trend. Although their share of the defense market is much larger than other nations, they are not immune from the pressures associated with remaining profitable yet technologically superior. What is unique about the current world military order is that "few states now consider unilateralism or neutrality as a credible defense strategy."<sup>11</sup> After World War II, nearly every Western nation became a member of a multilateral defense alliance or treaty organization; hence, they acquired overlapping security interests. Over the past century, these treaty organizations have grown in both size and scope, giving way to multilateral decision-making on national security issues.

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<sup>7</sup> Robert Keohane, "Sovereignty in International Society," in *The Global Transformations Reader*, eds. David Held and Anthony McGrew (Cambridge, UK: Polity Press, 1995), 155.

<sup>8</sup> *Ibid.*

<sup>9</sup> Bitzinger, "Globalization," 306.

<sup>10</sup> *Ibid.*

<sup>11</sup> David Held and Anthony McGrew, eds., *The Global Transformations Reader* (Cambridge, UK: Polity Press, 1995).

After World War II, U.S. forces remained in bases and posts throughout Europe as part of a security arrangement to deter Soviet aggression, maintain peace, and to aid with post-war reconstruction efforts. Policymakers established the North Atlantic Treaty Organization (NATO) in 1949 as a method of collective defense between the United States, Canada, and several Western European countries. Historically, the United States provided the bulk of the defense spending for NATO. In the United States, the Defense Production Act of 1950 defined the domestic defense industrial base as those “domestic sources which are providing, or which would be reasonably expected to provide, materials or services to meet national defense requirements during peacetime, graduated mobilization, national emergency, or war.”<sup>12</sup> Throughout the 1940s, 50s and 60s, the U.S.’s domestic defense industrial base provided all of the U.S.’s national defense requirements, as well as much of Europe’s defense requirements.

United States defense manufacturing peaked in the late 1960s and early 1970s, along with U.S. manufacturing in general.<sup>13</sup> During the 1970s an increasing number of manufacturing jobs across the entire U.S. industrial base were outsourced to foreign countries. The U.S. defense industry remained intact, however, mainly due to Cold War-era armament buildups, protectionist policies designed to keep defense jobs from going overseas, and a political culture that championed autarky in defense matters.

In 1972, Jonathan Galloway addressed the global implications of defense corporations by explaining their driving mechanisms. He demonstrated companies would act in their best interests regardless of national pursuits. Galloway’s work showed that despite their unique attributes as national assets, the driving mechanism behind defense corporations was capitalist in nature: they sought financial growth.<sup>14</sup>

The 1970s also saw the rise of multinational corporations. Joseph Nye addressed the difficulty multinational corporations faced given the basic political realities that underlaid the relationship between corporations and

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<sup>12</sup> *War and National Defense, U.S. Code Title 50* (2011), available at: <https://www.gpo.gov/fdsys/pkg/USCODE-2011-title50/html/USCODE-2011-title50.htm>.

<sup>13</sup> Joel Yudken, “Manufacturing Insecurity: America’s Manufacturing Crisis and the Erosion of the U.S. Defense Industrial Base,” *Cornell University ILR* (9/2010), available at: <http://digitalcommons.ilr.cornell.edu/laborunions/40/>.

<sup>14</sup> Jonathan F. Galloway, “The Military-Industrial Linkages of US-Based Multinational Corporations” *International Studies Quarterly* 16:4 (1972): 34–45. doi:10.2307/3013611

states. He showed poor states were hesitant to adopt institutional norms and practices that had benefited larger, wealthier states and concluded that state sovereignty was not threatened by the rise of multinational corporations.<sup>15</sup> Nearly thirty years later, Robert Gilpin explored the tension between national sovereignty and the forces of globalization.<sup>16</sup> He showed there are limits to globalization, and defended the sovereignty of the nation-state. He also showed that macroeconomic policies, both fiscal and monetary, kept the nation-state a viable entity and in control of economic policy. Likewise, Gilpin demonstrated the inherent tension between fixed exchange rates, national autonomy, and international capital mobility. The tension between multinational defense corporations and nation-states, especially regarding the issue of sovereignty, proves to be a key variable when comparing the European and the U.S. defense market.

By the late 1970s there was a remarkable rise in overseas trade around the globe. Helen Milner proposed that industry's political demands depend on the level of exportation and multinational operations within that industry.<sup>17</sup> She showed that firms that do not rely on the export of goods or multinational operations lean towards protectionist policies. Industries that are more internationalized, export more goods, and operate in a multinational environment, prefer free-trade policies. Milner concluded that as the world becomes interdependent, industry's political demands would divide along import, versus export, concerns.

In the late 1970s and into the Reagan-era defense buildup of the 1980s, there was a marked rise in the number of defense companies in the United States, as well as foreign companies with U.S. subsidiaries. As the number of foreign subsidiaries grew, so did the need for changes in how the U.S. government regulated the industry. In 1977, Congress voted the Foreign Corrupt Practices Act into law to address the bribery of foreign officials. In 1993, in a response to several national security incidents, Congress established the National Industrial Security Program to regulate the U.S. defense industry's access to classified information. Between 1975 and 1991, the United States entered 21 reciprocal defense memorandums of understanding (MOUs) with NATO countries. The MOUs promoted "standardization and interoperability of military equipment" as well as cooperation on the reduction of buy-national

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<sup>15</sup> Joseph Nye, "Multinational Corporations in World Politics" *Foreign Affairs* 53:1 (1974): 153–174. doi:10.2307/20039497.

<sup>16</sup> Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (Princeton: Princeton University Press, 2001).

<sup>17</sup> Helen Milner, *Resisting Protectionism: Global Industries and the Politics of International Trade* (Princeton: Princeton University Press, 1989).

laws and tariffs on imports.<sup>18</sup>

By the end of the Cold War, the defense market was again in a downturn. Pentagon policies of the 1990s forced the U.S. defense industry to consolidate into four major defense firms.<sup>19</sup> Europe's defense market also consolidated. The 'new world order' decreased the demand for military hardware and resulted in rising costs of both production and development. The Pentagon's new policies encouraged dual-use development, civil/military integration, defense conversion, and arms exports. Globalization offered many benefits to the ailing industry, including collaboration on research and development, offshore production, access to foreign innovation, and penetration into new markets.<sup>20</sup> Moreover, the long-term impact of globalization and the changing parameters by which nation-states produced and procured weapons made it increasingly difficult to "remain on the cutting edge in military technology" without internationalization in the production of weaponry.<sup>21</sup> While the U.S. continued to rely on its own resources for defense, in Europe, an era of nationalized defense was "superseded by a sharp increase in licensing, co-production agreements, joint ventures, corporate alliances and subcontracting."<sup>22</sup> Yet the change in Europe's defense industry was "far from being a simple pro rata adjustment of supply to changes in demands arising from objective changes in the security environment."<sup>23</sup> The restructuring was bound to the "development of institutions, policy paradigms (in both the military and the industrial domains) and business networks," as well the complex and interconnected relationships between European companies and European governments.<sup>24</sup>

The post-Cold War downturn in defense spending ebbed again after the terrorist attacks of 9/11. The U.S. military's intervention in Afghanistan and Iraq during the "Global War on Terror" revived defense industries around the globe. By 2010 the annual defense budget of the United States approached

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<sup>18</sup> "Report to Congressional Committees: International Procurement, NATO Allies' Implementation of Reciprocal Defense Agreements," *United States General Accounting Office*, 1992, available at: <http://www.gao.gov/products/NSIAD-92-126>.

<sup>19</sup> Ann Markusen and Sean Costigan eds., *Arming the Future: A Defense Industry for the 21st Century* (Washington, D.C.: Council on Foreign Relations Press, 1999).

<sup>20</sup> Bitzinger, "Globalization," 306.

<sup>21</sup> Stephen G. Brooks, *Producing Security: Multinational Corporations, Globalization, and the Changing Calculus of Conflict* (Princeton: Princeton University Press, 2007), 6.

<sup>22</sup> Held and McGrew, *Global Transformations*, 12.

<sup>23</sup> Markusen and Costigan, *Arming the Future*, 342.

<sup>24</sup> *Ibid.*

\$700 billion and annual defense industry profits nearly quadrupled.<sup>25</sup> Yet, after a decade of fighting in Afghanistan and the withdrawal of forces from Iraq, by 2011 the defense industry once again faced a downturn.

Three cases demonstrate the spectrum between interdependence and autarky in the defense industry and the fundamental barriers to creating economies of scale in the U.S. defense market. The first case shows how political, economic and security concerns drive sales (export) regulations in a globalized defense market through transnational mergers and acquisitions. The second case looks at how those same concerns sway procurement outcomes through co-development, lobbying efforts, and acquisition regulations. The final case looks at how U.S. economic policy and decision-making affects the profitability of European defense companies and the security of NATO countries.

### Case 1: Transnational Mergers and Acquisitions

After the Cold War, Europe took the first steps in creating fully integrated, transnational defense companies. This internationalization of the defense industry is significant; it is also representative of the growing integration of Europe's security and work towards military compatibility across members of the NATO and the Mediterranean Dialogue participants. Europe's defense market also reflects the European Union's drive towards cooperation at the supra-state level, especially after the end of the Cold War and fall of the Soviet Union. Their rationale was not only strategic; there was an economic motivation towards having a more integrated defense market. Although Europe had been cooperating on defense through NATO since the end of World War II, it is worth noting that it was not until Europe began integrating on a politico-economic level that transnational defense companies began to emerge. It is logical to conclude that cooperation on defense in the military sector is not a necessarily a precedent for transnational defense cooperation in the private sector, however increased economic integration within Europe and external competition with the United States did facilitate its growth.

In 2000, European governments merged several defense contractors into a single corporate entity. The first phase merged Germany's Daimler Chrysler Aerospace with a Spanish aircraft company, *Construcciones Aeronauticas SA* and later the French company, *Aerospatiale-Matra*. The merger created the

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<sup>25</sup> "A New Era of Responsibility: Renewing America's Promise," *Office of Management and Budget* (Washington, D.C.: Government Printing Office, 2009), available at: <https://www.gpo.gov/fdsys/pkg/BUDGET-2010-BUD/pdf/BUDGET-2010-BUD.pdf>



European Aeronautic Defense and Space Company (EADS), later named Airbus, the third largest aircraft company in the world. During the same period, British, French, Italian, and Spanish missile manufacturers consolidated to form the defense company *Matra BAe Dynamics Aerospatiale* (MBDA). The success of EADS and MBDA cannot be understated. The defense conglomerations reduced waste from duplicate projects and helped set a common framework for technological advances and innovation across Europe. Since the end of the Cold War, Europe reduced its employment and turnover in the defense sector by almost 50 percent.<sup>26</sup>

Transnational defense mergers between European and U.S. defense companies have not demonstrated the same kind of success as the purely European defense mergers. To be more competitive in the U.S. marketplace, most European defense companies chose to either acquire small to medium sized U.S. defense companies, start joint ventures with U.S. companies, or simply open an office in United States. Mergers with large U.S. defense firms, on the level that created EADS and MBDA, have proven to be painful and costly.

One impediment is that penalties for violating U.S. security rules and regulations are severe. Every year dozens defense contractors are caught in similar situations; foreign sections of their company violate U.S. security rules and regulations and are fined millions of dollars. For instance, the Department of Justice caught Pratt & Whitney, the Canadian subsidiary of United Technologies, selling sensitive information about attack helicopters to China, violating the U.S. Arms Export Control Act.<sup>27</sup> Likewise, in 2009, the United States suspected the Kuwaiti defense company Agility of contract fraud in Iraq, fined, and placed the group on an “Excluded Party List System,” a blacklist of firms excluded from doing business with the U.S. government.<sup>28</sup> This forced the United States portion of the Kuwaiti company to close and cost the company billions of dollars in lost revenue and fines.

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<sup>26</sup> PriceWaterhouseCoopers, *Gaining Technological Advantages: Aerospace and Defense Insights* (New York: PWC, 2011), available at: <https://www.pwc.com/im/en/publications/assets/shipping-aircraft-space/aerospace-defence-insights.pdf>.

<sup>27</sup> Department of Justice, “United Technologies Subsidiary Pleads Guilty to Criminal Charges for Helping China Develop New Attack Helicopter,” press release, June 28, 2012, available at: <https://www.justice.gov/opa/pr/united-technologies-subsidiary-pleads-guilty-criminal-charges-helping-china-develop-new>.

<sup>28</sup> Matthew Bigg, “U.S. Slaps new Fraud Indictment on Kuwait’s Agility,” *Reuters*, April 12, 2010, available at: <http://www.reuters.com/article/us-usa-agility-charge-idUSTRE63B5GS20100412>.

Another example of this phenomenon is the merger between the Italian defense conglomerate, Finmeccanica and the U.S. defense electronics and firm DRS Technologies. After 9/11, the Italian defense company recognized the need to enter the U.S. defense market to stay competitive within the industry.<sup>29</sup> In 2007, the two companies began acquisition negotiations. In 2008, Finmeccanica completed the purchase of the U.S. defense firm under the approval of the U.S. Congress. The U.S. Congress approved the purchase under the provision that company officials place DRS's top-secret defense contracts under a Special Security Agreement, which split the company into two independent entities. Furthermore, executives placed the most sensitive sections of the company under a *proxy*, which added a duplicate board of directors and prevented Finmeccanica from seeing DRS's classified information.

The U.S. Government and Finmeccanica had an unwieldy relationship from the beginnings of the merger. Finmeccanica had a supply chain that used Chinese manufacturing centers, as well as a robust presence in many places the United States found hostile. The Pentagon placed Finmeccanica under intense scrutiny for selling arms to the Assad regime in Syria in the years prior to their civil war. Furthermore, not long after the merger, a series of scandals plagued Finmeccanica, which led to the resignation of its Chief Executive Officer and the president of one of their subsidiary companies.<sup>30</sup>

Finmeccanica acquired DRS Technologies to leverage the American company's access to U.S. defense contracts and its share of the market, but instead the Italian company suffered. The first major setback for the company was in 2009, when the U.S. government terminated the helicopter procurement designed to replace Marine One from the 2010 U.S. defense budget.<sup>31</sup> A Finmeccanica subsidiary, AgustaWestland, was working on a joint team with Lockheed Martin and Bell Helicopters to produce a variant of

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<sup>29</sup> Finmeccanica SpA became Leonardo SpA in 2017.

<sup>30</sup> James Mackenzie, "Finmeccanica Sold Radio Equipment to Syria," *Reuters*, July 5, 2012, available at: <http://www.reuters.com/article/us-finmeccanica-syria-idUSBRE86415K20120705>; Paulo Biondi and Robin Pomeroy, "Finmeccanica to buy DRS Technologies for \$5.2 billion," *Reuters*, May 12, 2008, available at: <http://www.reuters.com/article/us-drs-finmeccanica-bid-idUSL1226765820080513>; Marco Bertacche and Sabine Pirone, "Finmeccanica Chairman Resigns Amid Probe as Orsi Takes Job," *Bloomberg Business News*, December 1, 2011, available at: <http://www.bloomberg.com/news/articles/2011-12-01/finmeccanica-s-guarguaglini-faces-showdown-with-board-amid-probe>.

<sup>31</sup> Stephen Trimble, "U.S. Navy Terminates VH-71 Presidential Helicopter Contract," *Flightglobal*, June 2, 2009, available at: <https://www.flightglobal.com/news/articles/us-navy-terminates-vh-71-presidential-helicopter-contract-327241/>.

AgustaWestland's 101 helicopter. After U.S. President Barack Obama cited cost overruns and procurement process "gone amok," in April 2009, U.S. Navy officials formally cancelled the contract.<sup>32</sup>

The second major setback for the company came in 2012, when the U.S. Air Force grounded its fleet of C-27J "Spartan" aircraft, a modified version of Finmeccanica's Aeritalia G222. In February 2012, after the release of the 2011 Budget Control Act and the effects of sequestration began to take place, the Pentagon divested from the C-27J program, citing the need to reduce excess capability and protect aircraft with multi-role capabilities.<sup>33</sup> Later that year, the U.S. Air Force cited mechanical issues in the C-27J's operating in Afghanistan, and grounded the entire fleet.<sup>34</sup> In late 2012, citing mechanical and maintenance issues, the U.S. Air Force cancelled a separate contract that provided modified G222 aircraft for the Afghan Air Force.<sup>35</sup> Because of the losses and allegations of mismanagement and negligence, the C-27J's manufacturer downsized its presence in North America.<sup>36</sup>

To complicate matters further, DRS Technologies operated under a completely different board of directors which isolated the company from Finmeccanica's decision-making apparatus. The company faced intense scrutiny on the initial acquisition, and due to the rigor of the contracting process, subsequent U.S. contracts proved extremely difficult for the company to win. Finmeccanica purchased DRS Technologies in 2008 for \$5.2 billion, but after being hit by a sharp decline defense spending several contract losses, it lost 40 percent of its value in just seven years.<sup>37</sup>

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<sup>32</sup> Ross Colvin, "Obama says U.S. Helicopter Project Costs 'Gone Amok,'" *Reuters*, February 23, 2009, available at: <http://www.reuters.com/article/us-obama-weapons-idUSTRE51M6UM20090224>.

<sup>33</sup> U.S. Department of Defense, *Defense Budget, Priorities and Choices* (Washington, D.C.: January 2012), available at: [http://archive.defense.gov/news/Defense\\_Budget\\_Priorities.pdf](http://archive.defense.gov/news/Defense_Budget_Priorities.pdf).

<sup>34</sup> Richard Dudley, "U.S. Air Force Grounds C-27J Fleet Due to Flight Control Failure," *Defense Update*, July 15, 2012, available at: [http://defense-update.com/20120715\\_us-air-force-grounds-c-27j-fleet-due-to-flight-control-failure.html](http://defense-update.com/20120715_us-air-force-grounds-c-27j-fleet-due-to-flight-control-failure.html)

<sup>35</sup> Tony Osborne and Amy Butler, "USAF Halts Troubled Afghan Transport Support Deal," *Aviation Week Network*, January 4, 2013, available at: <http://aviationweek.com/awin/usaf-halts-troubled-afghan-transport-deal>.

<sup>36</sup> Marcus Weisgerber, "Alenia Gutting North American Business Unit, Fires CEO," *DefenseNews*, February 12, 2013, available at: <http://www.defense-aerospace.com/articles-view/release/3/142645/alenia-guts-us-unit%2C-fires-ceo-after-losing-contracts.html>.

<sup>37</sup> Pamela Barbaglia and Mike Stone, "Finmeccanica Invites Bids for DRS Assets as Prelude to Possible Sale—Sources," *Reuters*, March 3, 2015, available at: <http://www.reuters.com/article/finmeccanica-equity-drs-technologies-idUSL5NoW44E120150303>.

## Case 2: Defense Procurement in a Globalized Market

After the Cold War, European Member States agreed on the need to foster, develop, and sustain a European Defense, Technological, and Industrial Base (EDTIB) that is capability driven, competent, and competitive. To achieve this objective, Member States elected to use different tools, in conformity with European Community law, aiming at a truly European defense equipment market and a level playing field at both European and global levels. To achieve that objective, the European Parliament established a legislative framework, which set the procedures for awarding defense contracts and the coordination of procurement timelines.<sup>38</sup> The combination of a common industrial base, regulatory framework, and a decline in absolute defense spending created opportunities to “reallocate defense resources.”<sup>39</sup>

Unlike the Europeans, whose procurement regulations are standardized across the European defense market, foreign defense companies operating in the United States are subject to a host of changing rules and regulations as well as protectionist procurement practices. Aside from political concerns about domestic jobs, interoperability and foreign supply-chains are also key issues. Europe has standardized many of its equipment regulations, whereas U.S. defense manufacturing only reflects interoperability with American-made equipment.

Ideally, procurement officials make contract awards through a competitive process that rewards the lowest priced, technically acceptable bids. Yet, political challenges and litigation prolong the procurement process, which hurts the U.S. government’s readiness and efficacy. The politicization of the U.S. defense industry can also inhibit competition from foreign firms. In 1990, Department of Defense officials estimated that only 44 percent of defense procurement in the United States was open to foreign competition.<sup>40</sup> Despite two decades of integration in Europe, market access in the United States is still a contentious issue. In 2011, The Department of Defense had a

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<sup>38</sup> “EU Directive 2009/81/EC,” *Official Journal of the European Union*, 2009, available at: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:216:0076:0136:en:PDF>

<sup>39</sup> Joachim Hofbauer, Roy Levy, and Gregory Sanders, “European Defense Trends: Budgets, Regulatory Frameworks, and the Industrial Base,” (Washington, D.C.: *Center for Strategic and International Studies*, 2010), available at: [http://www.csis.org/files/publication/101025\\_EuroDefenseTrends\\_web.pdf](http://www.csis.org/files/publication/101025_EuroDefenseTrends_web.pdf).

<sup>40</sup> U.S. Government Accountability Office, “International Procurement: NATO Allies’ Implementation of Reciprocal Defense Agreements,” March 18, 1992, available at: <http://gao.gov/products/NSIAD-92-126>.

\$137.5 billion budget for procurement.<sup>41</sup> Of the fifteen largest programs, each over \$1.5 billion, only one had a foreign defense contractor on the payroll.<sup>42</sup> The Buy-American Act and legislation such as the Berry Amendment, which mandates the DOD must procure certain defense articles and goods from American sources, makes it extremely difficult for European companies to compete for U.S. Government contracts.<sup>43</sup>

A prime example of the litigations challenges facing U.S. defense procurement agencies, as well as European defense companies, was the U.S. Air Force's competition for its Stratotanker replacement. In 2006, the U.S. Air Force released request for proposal (RFP) to replace aging fleet of KC-135 Stratotankers. Initially, competitors included the Seattle-based Boeing aerospace company and a Northrop Grumman/EADS (U.S./pan-European) team.

After the companies submitted their proposals, the U.S. Air Force procurement division announced the Northrop Grumman/EADS team as the winner. Boeing protested the bid to the U.S. Government Accountability Office (GAO), which put the bid into a litigation phase. It is common for defense companies to protest bid decisions, but the GAO rarely upholds protests.<sup>44</sup> Due to the size and scope of the contract, the media gave quite a bit of attention to Boeing's protest. The GAO upheld Boeing's protest and demanded a second competition.

During the initial phase of the second competition, the U.S. Air Force modified the 373 requirements for the Stratotanker. Boeing, the Northrop Grumman/EADS team, and a surprise bidder, U.S. Aerospace/Antonov (U.S.-

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<sup>41</sup> Office of the Under Secretary of Defense (Comptroller), "FY 2011 DoD Agency Financial Report (AFR)/DoD Performance and Accountability Report (PAR)," (Washington, D.C.: Government Printing Office, 2012), available at: [http://comptroller.defense.gov/Portals/45/Documents/afr/fy2011/DoD\\_FY11\\_Agency\\_Financial\\_Report.pdf](http://comptroller.defense.gov/Portals/45/Documents/afr/fy2011/DoD_FY11_Agency_Financial_Report.pdf).

<sup>42</sup> See: "Fiscal year 2011 Budget Request: Procurement Programs," *FY2011 President's Budget* (Washington, D.C.: Government Printing Office, 2010), available at <http://archive.defense.gov/news/d2010rolloutbrief1.pdf>; United States Department of Defense FY 2012 Budget Request (Washington, D.C.: Government Printing Office, 2011), available at: <https://fas.org/sgp/crs/natsec/R41861.pdf>; Rolls Royce is a prime contractor on the F-35 Lightning II program.

<sup>43</sup> See: Buy American Act of 1933 41 U.S.C. §§ 8301–8303; The Berry Amendment of 1941 10 U.S.C. § 2533a.

<sup>44</sup> Moshe Schwartz and Kate Manuel, "GAO Bid Protests: Trends and Analysis," *Congressional Research Service*, July 21, 2015, available at: <https://www.fas.org/sgp/crs/misc/R40227.pdf>; per the CRS report, from FY2001-2008 the GAO sustained protests in 22 percent of their opinions and from FY2009-2014 it dropped to 17 percent.

Ukrainian) each submitted bids. In one of the most intense battles for a U.S. Government contract in the history of defense contracting, Boeing launched an unprecedented effort to oust the Northrop Grumman/ EADS team. This effort included a lobbying campaign with Congressmen whose congressional districts were to be affected by the outcome of the contract decision as well as an aggressive marketing campaign in Washington D.C.-metropolitan area. In response, Northrop Grumman and EADS launched their own counter-campaign. Both EADS and Boeing faced off on the issue of how many jobs were to be sent overseas. Boeing contended that hundreds of U.S. manufacturing jobs could be lost if a foreign company were to win the contract. The claims were not completely true: although a pan-European company, EADS had a U.S. subsidiary owned and operated by Americans citizens. The EADS plan included using that company for the bulk of the labor on the Stratotanker contract.

From a security standpoint, it was difficult for the Pentagon to accept the U.S. Aerospace/Antonov team as a serious competitor because Antonov was also a major supplier to the Russian military. The U.S. Air Force eliminated the Aerospace/Antonov team from competition for submitting their bid after the due date. The U.S. Aerospace/Antonov team protested that decision, but the GAO dismissed protest. In the year before announcing the Stratotanker winner, Boeing spent nearly \$18 million in lobbying Congress on the procurement, over five times what EADS spent during the same period.<sup>45</sup> Five years after the U.S. Air Force released the original RFP, they selected Boeing as the winner. Defense analysts suggested Boeing won by bidding the contract at a loss.<sup>46</sup> The Stratotanker case not only demonstrates the power of protectionist policies, but also the barriers to entry in this competitive market.

### Case 3: Global Repercussions

Over the last thirty years, the International Monetary Fund, the World Bank, and the World Trade Organization have “governed” the process of globalization. Neoliberal economic reforms gained momentum as an orientation towards free market policies during the late 1980s through 2000 under the patronage of the Washington Consensus, which produced a set of

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<sup>45</sup> Donna Casata, “Boeing, EADS Spend Millions on Tanker Dogfight,” *Seattle Times*, February 21, 2011, available at: <http://www.seattletimes.com/business/boeing-eads-spend-millions-on-tanker-dogfight/>; per Congressional sources, Boeing spent \$17.9M in lobbying in FY2010, where EADS spent \$3M; Public Relations specialists show Boeing spent \$5M in print advertising compared to EADS’ \$1.7M.

<sup>46</sup> Loren Thompson, “How Boeing Won the Tanker War,” *Forbes*, February 28, 2011, available at: <http://www.forbes.com/sites/beltway/2011/02/28/how-boeing-won-the-tanker-war/>.

policy and economic actions, largely based on Keynesian economic principles. If taken at an early stage of democratic transition, in theory the principles enable a graceful progression into the world economy. The principles contain elements of macroeconomic reform (liberalization, stabilization, and fiscal austerity) and stress the importance of bringing down inflation and establishing economic growth. In addition, they incorporate elements of microeconomic reform such as privatization, and Foreign Direct Investment, as well as structural reforms.<sup>47</sup> The reforms provide fiscal austerity, rapid privatization, and market liberalization, but complexities in the international system can also cause hyperinflation, loose monetary policy, high interest rates, and unemployment.<sup>48</sup> In actuality, many of the reforms pushed “premature capital market liberalization” and failed to guide several countries in their transition to a market economy.<sup>49</sup>

Many European defense companies directly benefit from U.S. defense policy. British Aerospace and Electronics, Rolls Royce, Saab Defense, the French company Thales, EADS, and the Italian conglomerate Leonardo each directly profit from the U.S. defense market, and saw their bottom lines increase during the mid-2000s due to large contracts in Iraq, Afghanistan, other Overseas Contingency Operations, as well as modernization efforts by the U.S. military.<sup>50</sup> The consequences of complex interdependence have had far-reaching, global implications. For instance, the consequences of failed U.S. economic policy do not only hurt developing countries, they also affect Europe.

As an example, from 2010 to 2016, the United States saw a sharp decrease in its share of global defense spending. In 2010, the United States comprised 46 percent of total global defense spending (1.71 trillion), whereas in 2015 the United States only comprised 36 percent of the total global defense spending (1.65 trillion).<sup>51</sup> U.S. Congress’s struggle to balance the budget in 2012 provides one example of the unintended consequences stemming from U.S. economic policy. The Budget Control Act of 2011 outlined the sequestration as an austerity measure designed to cut an additional \$500 billion from the defense budget over a 10-year period. The measure implemented deep cuts

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<sup>47</sup> Robert Looney, “Banking on Baghdad: Financial Change in Postwar Iraq,” *Strategic Insights* 3:5 (2004): 12-19, available at: <http://calhoun.nps.edu/bitstream/handle/10945/11285/looneyMay04.pdf?sequence=1>.

<sup>48</sup> Joseph Stiglitz, *Globalization and its Discontents* (New York: W.W. Norton, 2002), 54.

<sup>49</sup> *Ibid.*

<sup>50</sup> Formerly known as Finmeccanica SpA.

<sup>51</sup> IHS Aerospace, Defence and Security, *Jane’s Defence Budgets, Annual Report 2015*, December 17, 2015, 7.

into all major defense programs. Sequestration combined with the post-2009 European debt crisis had a major impact on NATO's readiness, forcing the alliance to restructure its military priorities to accommodate new fiscal realities. The move meant security and more vulnerability of European nations, which account for less than 25 percent of NATO's overall budget and manpower.<sup>52</sup> NATO's overall growth decreased for five years: From 2011 through 2015, and only increased in 2016 because of challenges "posed by [the Islamic State] and Russia."<sup>53</sup>

## Conclusion

Over time, Nye's liberal vision for international world order became the reality in Europe, whereas in the United States it became a reflection of Gilpin's realist worldview. While Europe turned out to be more reliant on its multinational environment, the U.S. defense industry leaned towards protectionism. Europe's military and defense integration began after World War II, but became much more apparent after the collapse of the Soviet Union. During the Cold War, Europe benefited from the NATO alliance structure and took advantage of the security offered by the U.S. military to work on a common framework for defense. To compete with the United States, the Europeans had to consolidate its defense market. While the Americans and the Europeans have cooperated on defense efforts, the common framework of the European Community enabled Europe's defense companies the legal means to pursue common objectives. Europe's defense industry reflects a liberal world view- one governed through cooperation, interdependence, international laws, institutions, as well as globalization within the European defense market. To the contrary, the U.S. defense industry has remained autarkical, resistant to the forces of globalization, and as a result, distinctly realist.

Given the volume of the United States' share of the global defense budget, it is likely that U.S. defense spending will contribute to Europe's ebbs and flows in the market. For instance, 2014 was the "first year since 2010 that global [defense] expenditure rose, largely due to a slowdown of the rate of decrease in [U.S. defense] spending."<sup>54</sup> In real terms, analysts project growth among

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<sup>52</sup> Clara O'Donnell, ed. *The Impact of Military Spending Cuts for NATO's Largest Members* (Washington, D.C.: Brookings Institution, 2012) available at: <https://www.brookings.edu/wp-content/uploads/2016/06/military-spending-nato-odonnell-pdf.pdf>.

<sup>53</sup> IHS Aerospace, Defence and Security, *Jane's Defence Budgets, Annual Report 2015* (December 17, 2015), 62.

<sup>54</sup> *Ibid.*, 61.



NATO's European members will remain steady for the remainder of the decade, with "the U.S. acting as a drag on budgetary trends for the alliance."<sup>55</sup> When U.S. defense sequestration ends, it is likely NATO's (and Europe's) defense growth outlook will improve.

During the early 1990s, the United States' entry into the North American Free Trade Agreement signaled the United States was moving towards more integration and economic cooperation. If Europe becomes the model for economic and defense integration in the private sector; it is possible that parallel trends could be seen in North America at some point, despite decades of American hegemony in the defense market. The problem is American structural constraints, as well as a political culture that demands autarky, makes it difficult for true integration to develop. Security concerns from rogue states and arms proliferation also prevent U.S. companies from accepting the full benefits of a globalized market. Furthermore, from an economic standpoint, a significant threat to United States supremacy in the international arms market does not exist. If a transnational defense conglomeration were to emerge between the United States and Europe, it would most likely be in response to a threat from outside NATO, not from the fiscal benefit derived from economies of scale. Therefore, over time, U.S. defense manufacturers (and therefore U.S. government procurement agencies) are likely face increasing costs as the forces of globalization drive manufacturing and production to developing countries. Yet, the U.S. defense industry will only outsource manufacturing and production if companies globalized defense market can compete with a much more cost-effective and efficient product.

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<sup>55</sup> Ibid.