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Arms Away

How Washington Squandered Its Monopoly on Weapons Sales

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[1]*Outgunned: assembling Rafale fighter jets near Bordeaux, France.* ***Click here to view a slideshow of the fading U.S. weapons industry.*** *[1] (Reuters / Regis Duvignan)*

Over the last two decades, the United States has enjoyed an unrivaled competitive advantage in the production and export of advanced conventional weaponry. The collapse of the Soviet Union and the breakup of the Warsaw Pact led to sharp reductions in Russian defense spending and a drop in Moscow's arms transfers to regional allies. Simultaneously, globalization rewarded firms with economies of scale, allowing U.S. defense contractors to capitalize on their size and on large orders from armed forces around the globe. The formula for success was simple: by producing a range of affordable yet sophisticated weapons, the Pentagon and its contractors would crush any rivals. Domination of the global arms trade, and the economic and geopolitical benefits that came with it, was the United States' to lose.

But that advantage is fading. In the 1990s, the United States controlled 60 percent of the global weapons market. Today, it is responsible for only about 30 percent. By focusing on cutting-edge technology and developing excessively expensive defense systems, Washington has left the door open for foreign competitors to market practical weapons at an affordable cost. Consequently, Russia has resurged as an arms merchant, and a host of other countries, such as China, Israel, and South Korea, are becoming important suppliers.

No program embodies the missteps threatening the U.S. defense industry better than the F-35 Joint Strike Fighter, which even its most optimistic proponents now admit is a procurement disaster. At the end of the Cold War, defense planners conceived of the F-35 as a jet that would reshape the marketplace. Designed to take the place of three different U.S. military aircraft, the F-35 would be produced for many years at home. That, in turn, would enable the plane to be sold at a relatively low cost abroad, since the up-front development expenses would be amortized over its long production life. The best that foreign manufacturers could do, so the argument went, was scrap their indigenous weapons development plans, retool their operations, and become part of the F-35's global supply chain.

But after 9/11, constraints on U.S. defense budgets loosened, and the price of the F-35 skyrocketed as it became one of the United States' infamous "gold-plated" weapons systems. Various U.S. military branches piled on additional technical specifications, making the F-35 a financial sinkhole. The defense procurement process is so complicated that cost estimates are extremely difficult to nail down, but the best calculations suggest that the price of the F-35 program has grown by 75 percent above the estimates made in 2001. The program is now expected to account for 38 percent of the Pentagon's procurement budget for all its current weapons programs. The ensuing sticker shock of the F-35 has led many buyers -- including key allies, such as Australia, Italy, and the United Kingdom -- to delay or reduce their orders.

The F-35 is hardly a unique case. According to the U.S. Government Accountability Office, half of all Pentagon procurement programs are operating beyond their budgets. But the United States' fading position in the weapons trade is more than just another blow to an already weak domestic economy (the U.S. aerospace industry employs more than 600,000 workers). In the past, the ability to arm its allies allowed the U.S. government to strengthen its friends while cashing in. By squandering its position in the international weapons market, Washington has undercut a critical tool of U.S. foreign policy.

THE MONOPOLIST'S CURSE

After the Gulf War, it was clear to customers around the world that U.S. weapons were the best on the market. And with the United States spending more on defense research and development than the rest of the world combined, it was not surprising that U.S. firms boasted capabilities, such as stealth technology, that no one else could deliver.

But as the United States' military budgets ballooned after 2001 as Washington geared up to fight the "war on terror," defense firms and the Pentagon began to disregard weapons costs. Congress opened up its wallet, domestic demand for high-tech armaments boomed, and the financial constraints on new acquisitions eased. Flush with cash, the industry envisioned a golden era of sales to the Pentagon. Investors bought in, too. In the post-9/11 era, share prices of the major defense contractors soared.

Today's conventional arms, such as aircraft and missiles, involve highly complex feats of engineering. Because the up-front expenses are astronomical, the price can be lowered on a per-unit basis only by producing many copies.

That makes exports all the more vital, since each additional sale reduces the individual price tag. Given the size of orders from the Pentagon compared with those coming from the Russian or European defense ministries, U.S. weapons programs have enjoyed relatively long life spans even when the U.S. military has been the sole customer. That fact alone should make U.S. weapons relatively less expensive on a per-unit basis.

Over the last decade, however, the United States has suffered the monopolist's curse, believing that buyers had no other alternatives. While Washington was giving carte blanche to the Pentagon as it fought wars in Afghanistan and Iraq, defense officials failed to realize that most countries could do without advanced stealth fighters or the latest combat ships. More often than not, lesser technologies are perfectly adequate. So as the prices for U.S. products rose, foreign customers began shopping elsewhere. In January 2011, for example, India decided to turn away from the U.S. firms Lockheed Martin and Boeing and instead spend $11 billion for an order of Rafale fighter jets from Dassault Aviation, a French company. This marked the first overseas sale of the Rafale, and the purchase suddenly made the plane globally competitive.

Granted, a handful of buyers can still pay for top-shelf U.S. weapons. The Persian Gulf states have kept up their orders, thanks to high oil prices and the unstable neighborhood in which they live. In 2010, for example, the U.S. Congress approved a $60 billion, ten-year arms deal with Saudi Arabia, much of which will involve the purchase of some of the most sophisticated fighter jets in the world. But even the Saudis have sought to diversify their supplier base, acquiring Eurofighter jets through the United Kingdom and threatening to purchase helicopters from Russia. More important, buyers such as the Persian Gulf states are few and far between and are growing less relevant as the United States shifts its strategic focus to Asia.

THE NEXT ARMS RACE

If the United States' sliding market share were just an economic matter, one might simply dismiss the issue by arguing that the country's defense industry, which must report to its shareholders, will soon be forced to face the consequences of its business strategy and retrench. But unlike other sectors, arms dealing has a geopolitical dimension, especially in Asia's booming export market, as well as an economic one.

When Washington inks a weapons deal, the partner country is unlikely to deploy those arms in a manner at odds with the United States' interests, which would threaten its access to those very weapons. So the more weapons Washington sells, the more control it has over security decisions made abroad. More specifically, Washington can exploit its market power to advance important foreign policy objectives. In 2005, for example, Washington suspended Israel's access to the F-35 program to force Jerusalem to stop selling unmanned aerial vehicle parts to China. The United States has used similar tactics to prevent Brazil and Spain from selling aircraft to Venezuela.

With Washington's interests turning toward Asia, arms sales make it possible for the United States to arm its Pacific allies and, at the same time, keep China isolated. This can be done in a direct manner, such as when the United States uses access to its domestic arms market to encourage European Union states to maintain the weapons embargo on China that dates back to the 1989 Tiananmen Square killings. But there is an indirect route, as well. By using its competitive advantage to shrink Russia's export market, the United States could make China's principal arms supplier less appealing.

In recent years, Russia has done a particularly good job servicing weapons needs across Asia. A firm such as Sukhoi, a major Russian aircraft manufacturer, knows it cannot rely on domestic orders alone for its survival. Over the last decade, it has succeeded in selling fairly inexpensive fighter jets to countries such as Indonesia and Malaysia. European producers, too, have ramped up production. Since 1990, firms across the continent have developed at least two new fighter jets in addition to France's Rafale. Sweden has sold its Gripen single-engine fighter to countries such as Hungary and Thailand; the Eurofighter, despite being inefficiently built on four separate assembly lines across the continent, has been sold to Austria and Saudi Arabia.

Meanwhile, signs of U.S. decline in the arms sphere in Asia abound. Pakistan's largest arms supplier is now China, Singapore is acquiring French naval vessels, and for the first time in its history, the Philippines is looking to non-American aircraft sources. These countries are less interested in the newest high-tech weaponry and more interested in medium-sized arms they can afford. Washington does not sell weapons to China or Russia, of course, and India purchases only a limited quantity. South Korea, a long-standing U.S. ally, has developed a growing domestic arms industry, producing, for example, diesel submarines that it exports to such countries as Indonesia. If Washington wants its "pivot" to Asia to stick, it needs to regain the ground in the arms market that it has lost.

All these shifts could prove destabilizing. As the United States risks losing its position as a principal arms supplier in the region, producers will proliferate, because small states entering the arms business have no choice but to be export-oriented to survive and grow. In essence, they need to produce as much as possible. U.S. firms, in contrast, can be more selective in their approach to exports, thanks to the large size of the United States' domestic market. Washington can withhold supplies, reducing the amount of advanced weaponry in the world. From a security and stability perspective, that is an advantage.

SIMPLER BUT BETTER

Yet there is good news as well: many of the U.S. defense industry's competitive advantages -- massive economies of scale, a research budget that still dwarfs the rest of the world's, and the proven quality of its products -- will remain robust for the foreseeable future. Washington can and should leverage these advantages to dominate a global network of military products that keeps European and other mid-tier states in, Russian exports out, and Chinese defense capabilities down.

Every administration calls for reform of the Pentagon's procurement process, but the results are invariably disappointing. Instead of fighting for a total transformation, policymakers should target a few high-payoff changes. The White House (with congressional support) must force the Pentagon and its suppliers to do something they have rarely been willing to do in the past: rather than design and produce unnecessarily sophisticated weapons for domestic use, they should develop simpler and more cost-effective ones for a global market, under rigorous civilian oversight.

Increasing defense spending will not help. U.S. production runs are already far longer than those of the competition, and the experience of the past decade suggests that any efficiency gains produced by larger weapons purchases turn into little more than higher profits for defense firms and fancier weapons for the Pentagon. The secret is not to spend more money but to spend money in a better way.

Paradoxically, to increase its foreign market share, Washington also has to be willing to shop for some weapons abroad. If the Pentagon threatened to import competing products from overseas, it could force domestic manufacturers to control costs and become more globally competitive. It is important to keep in mind that once the United States decides to buy a weapon from abroad, even when much of it will be produced in a foreign country, the order's size guarantees that the United States immediately becomes the most important customer. Weapons do not have to be American made to provide American influence. Additionally, other countries will be more willing to buy from Washington if they believe that their own products will have a fair shot at the enormous U.S. market.

Consider the contract competition the Pentagon recently held to buy a relatively low-tech propeller-driven plane for the Afghan air force's counterinsurgency efforts. The U.S. Air Force reversed its decision to buy the Brazilian company Embraer's A-29 Super Tucano -- a combat-proven plane used by six other air forces, which was to be built almost entirely in the United States -- in response to protests from Arkansas-based Hawker Beechcraft, whose competitor plane remains in development. The likely result will be increased costs, longer delays, a product inappropriately gold-plated for its mission, an increased chance of a Taliban victory, and the alienation of Brazil, one of the world's rising powers and fastest-growing importers of conventional weapons.

As the U.S. defense industry shifts away from expensive weapons systems, it must remember that simple does not imply primitive. The weapons just have to be affordable, effective, and appealing to the global market. In addition to producing more exports, simpler products would have another advantage: they are easier to make. They are less likely to be delayed due to immature technology or revisions of their requirements by the services. Perhaps most important, however, these simpler programs would reduce the industry's and the Pentagon's informational advantages and make civilian oversight more feasible.

Ultimately, it must be civilian leaders, rather than the armed forces and the defense industry, who take responsibility for deciding which weapons the United States develops, since those choices have grand strategic consequences. The current approach of building a small number of unrivaled superweapons that few states want and that wreck the nation's defense budget is not grand strategy; it is a policy devoid of strategy altogether. The United States now develops arms so sophisticated that they will supposedly deter opponents from launching their own weapons in anger. Instead, it should focus on preventing most foreign weapons from being built at all.

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