Internationalization of the Aerospace Industry

By

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[The following is a reprint of a statement by General Fish presented in Congressional testimony before the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance, and Urban Affairs in Washington D.C., on May 10, 1989.]

I appreciate the opportunity to appear before the House Banking, Finance and Urban Affair's Subcommittee on Economic Stabilization this morning to discuss the international competitiveness of the U.S. defense industry. I am testifying on behalf of the American League for Exports and Security Assistance, ALESA, a trade association of 25 companies and 2 unions which promotes government policies that facilitate American exports of defense products, so long as such exports are consistent with U.S. foreign policy and security interests.

I will cover three areas: the position of the U.S. defense industry in the international market, the trend toward "internationalization" in the defense industry, and the potential impact HR 486, *Defense Production Act Amendments of 1989*, could have on the international competitiveness of the defense industry.

Today there are many suppliers of most defense products, including our close allies, the Soviet Union and her satellites, and a growing number of developing countries. In the past few years the U.S. has dropped from supplying about one-third of the world's exports of defense products to less than one-quarter. Refusing to allow the export of a U.S. defense product to a given country now means simply that the country turns to another supplier, not that the country is denied the product or defense capability.

The chart below shows the trend in defense exports since 1980.

U.S. Arms Transfers FY 80-88
($ in millions)

Year	FMS Agreements	Commercial Deliveries
80	14,241	1,968
81	7,486	2,198
82	17,755	1,801
83	15,745	3,973
84	14,053	3,755
85	12,105	6,646
86	7,099	3,714
87	7,077	2,186
88	12,476	5,031
89	(est.) 9,000	-------
90	(est.) 8,000	-------

As can be seen from the chart, the international market for defense equipment, with the exception of 1988, has been and will continue to be relatively flat. There are a variety of reasons for this trend. The number of suppliers has grown dramatically, and the market is undergoing a structural shift, with more customers interested in manufacturing know-how and technology transfer than in end-item purchases. It should also be noted that many countries made major aircraft purchases in the late 1970s and early 1980s, which were in part responsible for the high level of sales during that period. Increased Congressional involvement in the arms transfer process also has led to decline in sales to moderate Arab states, notably Saudi Arabia.

One of the important difficulties faced by the defense industry in competing in the international market is the lack of adequate export financing. The U.S. government has no export promotion program for defense equipment. The Foreign Military Sales Program (FMS), administered by the Defense Security Assistance Agency (DSAA), is used as an instrument of foreign policy. Most of the available finance[ing] in that program is earmarked by Congress for a handful of countries.

By contrast, European governments generally regard defense exports as but one component of their entire international trade picture, drawing little distinction between civil and military exports. Consequently, European defense contractors receive active political and economic support from their governments in marketing their defense products. The U.S. Export-Import Bank is prohibited by statute from supplying credits to developing countries for defense products, and by policy does not offer export credits for such products to any country.

Despite these problems, one of the few bright spots in our overall trade picture is defense sales. Our annual defense exports (actual deliveries) total $11-14 billion, nearly 5 percent of our total exports, and about 20 times the value of our defense related imports. We believe those exports could be $3-4 billion higher a year, were it not for actions by the Executive Branch and the Congress that inhibit such sales. Such export losses in defense sales undercut the U.S. defense industrial base. They also adversely affect the civil sector. When a customer country has a close military supply relationship with another country, civilian trade follows. For example, when Saudi Arabia bought Tornado aircraft, they also decided to give the United Kingdom a sole source contract for two air bases valued at $4 billion—a sale involving engineering and construction services, and hundreds of millions of dollars in civilian products—from air conditioning units to road sweepers.

There are other, more serious, economic side effects of the Saudi Tornado purchase. Riyadh has now agreed to the purchase of $20-30 billion in aircraft and support equipment from our toughest European competitors. Profits from these sales will be a major resource for the research and development of the next generation of European aerospace products—both military and civilian, with which we will be competing in international markets over the next two decades.

The intense pressure to reduce the defense budget, and the increasing expense to design and produce new weapons systems, makes exports and cooperative undertakings with our allies increasingly important. As U.S. military procurement budgets are reduced, maintaining and increasing exports will become even more significant if we are to sustain our defense industrial base and avoid reduced production levels of defense equipment which result in increased unit costs.

THE TREND TOWARD INTERNATIONALIZATION

Internationalization is nothing new to the defense industry. U.S. defense companies have been involved in a wide variety of coproduction and coassembly programs with allies for more than 35 years. These programs have been, and will continue to be, an important element in America's foreign policy of helping our friends and allies defend themselves.

These programs make sense on military grounds, where common weapon systems prove to have great advantage in coalition warfare as well as logistics supportability and sustainability. They also make good sense on economic grounds because of the high content of American-made components.

In the early days of coproduction most of the equipment, including T-33s, F-5s, F-86s, F-104s, F-4s, AIM-7 Sparrows, AIM-9 Sidewinders, M-113 Armored Personnel Carriers, M-60 Tanks, and MD-500 helicopters to name a few, were direct copies of American equipment. However, the technology flow for coproduction has not been all one-way. The U.S. has adopted and has coproduced a number of systems or subsystems developed by our friends and allies. Recent examples are the AV-8 Harrier, the 120mm tank gun, Mobile Subscriber Equipment, the MAG-56 Machine gun, the Beretta pistol, the improved 81mm mortar, the Light Armored Vehicle, Air Defense Anti-Tank System, and the Bridge Erection Boat.

More recently, the defense industry has been encouraged by Congress and the Executive Branch to move forward with defense-industrial codevelopment programs with our NATO allies. The short term goals of this cooperation are obvious: reducing duplicative research and development efforts for each participant and obtaining greater return on R&D investment for NATO as a whole. Over the long term, defense cooperation holds the promise of lower unit production costs for specific weapons systems, greater commonality in allied weapon systems, and technology transfer between allies that will lead to stronger defense industrial bases in all the countries. The potential for these benefits will be heightened by the conversion in 1992 of the European Common Market into one integrated economy second in size only to the U.S.

The Nunn-Quayle-Warner amendments contained in the FY 1986 defense authorization legislation allowed for codevelopment projects with our NATO allies in which each side shared equitably in financing the development work. This legislation was later extended to other close allies, including Israel, Egypt, Japan, Korea, and Australia. A number of such projects have been launched. One of these projects involves airframe design—the X-31 program—in which the U.S. and Germany are producing two prototype aircraft to test ways to enhance maneuverability in future aircraft. The Germans are providing much of the original technology.

There are those who argue that such arms cooperation between the United States and its allies reduces the U.S. industrial base and makes it less capable to respond to national requirements in event of an international crisis.

There are several reasons why I believe the converse to be true—that is, arms cooperation will actually strengthen our defense industrial base and make it more capable of responding to defense needs in event of a possible national mobilization.

Before I go into those reasons, I want to point out that the portion of our industrial base dedicated to defense production at any one time is relatively very small. I understand that is sometimes very hard to accept here in Washington where we spend so much time debating the issues pertaining to the defense sector. But the facts are that the preponderance of the U.S. industrial base is not normally directed toward the needs of the defense community and can be brought to bear on our nations security requirements if the need arises. Some would argue that our industrial base is even stronger than it was fifty years ago given the increasing importance of electronics and high technology in our armaments.

For some time now—and for a variety of reasons—technology in the civilian or commercial marketplace has advanced more rapidly than military technology and, thus, except in certain specialized areas like stealth technology, civilian technology is leading military technology in many disciplines.

Given these circumstances, arms cooperation will further enhance the defense sector by increasing the size of the potential market, and by ensuring that our industries have access to technical innovations from abroad, as well as access to the lowest cost sourcing for components that go into the products they make.

POTENTIAL AFFECTS OF H.R. 486 ON THE DEFENSE INDUSTRY'S INTERNATIONAL COMPETITIVENESS

As currently drafted, Section 107(b)(1) of H.R. 486, *Defense Production Act Amendments of 1989*, would require the U.S. to limit " . . .to the maximum extent practicable, the national defense production of existing and new weapons and their systems, including all parts and components, to domestic manufacturing and assembly sources within 5 years following the date of enactment of this section." In our view this provision is unworkable for political, economic, and military reasons, and would have a deleterious impact in the international competitiveness of U.S. defense contractors.

In general, we think it is a mistake to single out defense-specific sectors of the economy for restrictive legislation while ignoring the wider economic picture. One cannot isolate civilian and military components of an economy, since both operate in an environment of international competition and are affected by many of the same forces that shape the marketplace.

Moreover, threatened sectors of our economy already have means available under Section 232 of the Trade Act to seek relief from overseas competitions. The domestic ball bearing industry recently successfully invoked that section. If a particular industry is having difficulty competing, then it should file for relief under Section 232, and the U.S. government should address the situation in an appropriate international forum.

On the political level, the U.S. Congress and the Executive Branch have for the last five years encouraged U.S. companies to enter into joint industrial teaming arrangements with our NATO partners as part of the Nunn-Quayle NATO cooperation programs. Industry is consequently pursing a wide variety of cooperative programs, which, when they come to fruition, will assure even greater integration of U.S. and allied weapon systems. The political commitment toward greater armaments commonality is one of the most important elements in NATO's effort to promote alliance security in an era of austere defense budgets. To abrogate this commitment could be done only at great political and economic cost.

In addition to the obvious military benefits of such cooperation, the two-way street provides economic benefits to U.S. companies by giving them increased access to the European markets and access to advance technologies possessed by European companies.

The trend toward more integration of U.S. and foreign weapon systems also has been encouraged by the Defense Department's emphasis on competition. This emphasis on cost has forced the defense industry to look for the most efficient suppliers and to search out the best technology available wherever located. The result has been U.S. weapon systems integrating components from a wide variety of suppliers, both domestic and foreign.

The net effect of Section 107 would be to increase the cost of U.S.-produced defense equipment and could well mean that our forces would be fielding equipment that is lower in quality than that of our allies and even our enemies because purchasing from less efficient producers shifts funds away from research and technological innovation.

The increased cost that would result from Section 107 would have a disastrous affect on the international competitiveness of the defense industry. Our market share would undoubtedly

shrink, and we would lose the political and economic benefits now gained from defense exports. Reduced exports also would further drive up the costs of equipment for our own armed forces.

In summary, our position is that it would be unrealistic and inadvisable economically, politically, and militarily for the U.S. to attempt be become fully self-sufficient in defense production, particularly after the implementation in 1992 of the European Common Market.

U.S. Exports: Foreign Policy Controls

[The following is a reprint of an April, 1989 edition of GIST, a quick reference aid on U.S. foreign relations published by the Bureau of Public Affairs, U.S. Department of State.]

Background: The Bush Administration is committed to promoting U.S. exports. Exports provide jobs and profits, and enable us to import vital goods to meet growing domestic demand. The U.S. imposes certain controls, however, to ensure that exports are consistent with our foreign policy. Most controls apply to equipment and technology of importance to the economy of the importing country. They affect less than 5 percent, by value, of current U.S. exports.

These foreign policy controls are applied on a worldwide and/or country-specific basis to 10 target areas under the authority of the Export Administration Act of 1979 (EAA)

Terrorism equipment controls: Using the authority of Section 6(j) of the EEA, the Secretary of State had designated Cuba, Iran, Libya, North Korea, Syria, and the People's Democratic Republic of Yemen as countries that repeatedly have provided support for international terrorism. On items for them, broad, country-specific export controls are in place.

Crime equipment controls: These regulate the export of crime control and detection instruments and equipment, and related technology worldwide, except to NATO member countries and Japan, Australia, and New Zealand. Generally, licenses are issued unless we have human rights concerns about the government of the importing country (for example, South Africa and Chile).

Regional stability controls: Exports of equipment used to manufacture military arms and equipment are reviewed to ensure that such exports would not contribute to the destabilization of the region or country of destination.

Anti-apartheid controls: The U.S. prohibits the export to South Africa and Namibia of all military and police equipment; computers to the apartheid enforcing government agencies; facilities for nuclear production and utilization; and all items covered by the United Nations mandatory arms embargo. (The Department of the Treasury prohibits U.S. importation of 13 product categories from South Africa, including all agricultural produce and products, iron, steel, uranium, and gold in all forms.)

Missile technology controls: The U.S. assists other countries in the peaceful uses and exploration of space but seeks to halt the development of weapons delivery systems. On a worldwide basis, the U.S. controls the export of dual-use equipment and materials that are commercial in nature but also useful in the development of missile systems.

Chemical/biological weapons precursors controls: In cooperation with our allies, the U.S. controls the worldwide export of nine chemicals useful in the production of chemical weapons. Exports of an additional 31 chemicals are controlled to specific destinations. Currently all 40 are prohibited to Iran, Iraq, Libya, and Syria. Similar controls are in place on a wide range of bacteria, fungi, protozoa, toxins, viruses, and viroids.

Nuclear controls: The U.S. actively assists other countries to use atomic energy for peaceful purposes but also seeks to halt the spread of nuclear weapons. Thus, the U.S. controls exports of goods or technology that, if misused by the recipient country, could contribute to the production of nuclear explosive devices. The Atomic Energy Act, as amended by the Nuclear Non-Proliferation Act, establishes the controls. Before permitting an export, the U.S. reviews the item's proposed use, whether the government of the purchasing country has signed the Nuclear Non-Proliferation

Treaty, and whether there are acceptable assurances that the item, or nuclear material produced from it, will not be diverted to develop nuclear weapons.

Short supply controls: Controls occasionally are necessary to protect the domestic economy from an excessive drain on scarce material. Congress has legislated restrictions on the export of crude oil and natural gas, refined petroleum and gas products, helium, ammonia, unprocessed Western red cedar logs, and horses for export by sea (to prevent unauthorized slaughter abroad).

Supercomputer controls: For foreign policy reasons, the U.S. requires the individual licensing of supercomputer exports worldwide.

Treasury Department controls: The Treasury Department embargoes most trade and financial transactions with Cambodia, Cuba, Libya, North Korea, and Vietnam. It controls direct trade between the U.S. and Nicaragua and some financial transactions with Panama and South Africa. It also regulates certain imports from Iran and South Africa.

Guidance for exporters: Exporters should consult the *U.S. Export Administration Regulations*, 1988-89 edition (copies are available from the U.S. Government Printing Office, (202) 783-3238--stock number 903-013-00000-1) and the Commerce Department's Office of Export Licensing, Exporter Assistance Staff, (202) 377-4811. For information on the Treasury Department's trade and financial control on Cambodia, Cuba, Iran, Libya, Nicaragua, North Korea, Panama, and Vietnam, exporters should contact the Treasury Department's Office of Foreign Assets Control, (202) 376-0392.

For further information: See Department of State *GISTs* on "U.S. Exports: Strategic Technology Controls" (replaces "Controlling Transfer of Strategic Technology") and "U.S. Export Controls and China."