

Excerpt from: Sköns, E. and Weidacher, R., 'Arms Production', SIPRI Yearbook 2002, (Oxford University Press: Oxford, 2002), pp. 341-346.

Privatization

The national arms-producing facilities which were built up in the 1930s to provide states with effective control over military production have gradually been replaced by, or transformed into, private commercial companies that produce weapon systems for the state on contract. The privatization of arms production continued throughout the 1990s. By the early 2000s a large part of the arms industry was privately owned in most major arms-producing countries.

Three major drivers of privatization in the post-cold war period can be distinguished. Table 7.6, shows the major events of privatization since 1990: (a) the privatization of the major remaining state-owned arms-producing companies in Western Europe (France, Italy and Spain) and Australia in the first stage of their participation in measures of concentration, often also involving their internationalization; (b) the transition of the formerly centrally planned CEE economies to a capitalist system with private ownership, which also involved the arms industry; and (c) the privatization in other minor arms-producing countries as a result of industrial offsets in major arms import programmes. In France, where the state controlled most of the development and production of military equipment as late as 1998, the aim of European integration brought about a series of privatizations of its main military aerospace and electronics companies in 1998–99. However, significant assets remain under state management or ownership, including the shipbuilding company DCN, the aircraft maintenance company SMA, the military vehicle company GIAT Industries and the aeronautics engine company Snecma. There are plans to transform DCN from a state-managed into a state-owned company by 2003,¹ while the partial privatization of Snecma, planned for late 2001, was postponed when the aeronautics market declined after 11 September.² In Italy—where throughout the 1990s almost all arms-producing enterprises (except FIAT) belonged to large state holding companies—the major aerospace company (Finmeccanica) was privatized and privatization of the shipyard Fincantieri was initiated in 2000.

Spain, another country with state ownership as the dominant mode in the arms industry, has initiated a series of privatizations since 1999 in order to be able to join in the internationalization of the European arms industry. Thus, by the early 2000s large private companies were the dominant mode of ownership in the arms industry in all major arms-producing countries in the West, similar to the situation before World War II.

Outsourcing of military services and functions

In recent years not only military hardware but also the provision of services has become subject to contracting to private industry (outsourcing). Outsourcing includes a range of services (support services for military equipment, military facilities and military operations), which until recently were the prerogative of government organizations such as units of the armed forces or departments of ministries of defence. Private companies are thus assuming an important role also within the field of military support services.

¹ Mackenzie, C., 'France's DCN approaches privatization with task list', *Defense News*, 12–18 Nov. 2001, p. 32.

² Lewis, J. A., 'Snecma privatization plan is put on hold until markets recover', *Jane's Defence Weekly*, 26 Sep. 2001, p. 14.

Excerpt from: Sköns, E. and Weidacher, R., 'Arms Production', SIPRI Yearbook 2002, (Oxford University Press: Oxford, 2002), pp. 341-346.

This practice is the result of increasing budgetary constraints and the view that there is potential for greater efficiency with increased participation by private industry in the provision of government functions. The services supplied by private companies vary with regard to their proximity to war fighting capabilities and range from non-military specific services such as management of housing, to equipment support services and the provision of a variety of military support functions.

The key distinction between public and private, or outsourced, provision is whether the provider is acting as a private entity on contract, subject to profit-making discipline, or is operating within the public sector and subject to direct democratic and civil service accountability systems. A study of the implications of privatization and outsourcing in the USA found that 'the enormity of the difference in behavior and motivation of agents operating under these two very different systems is not well understood or acknowledged by most analysts.'³

The study concluded that there are no clear benefits from the privatization of military purchases but there are significant risks. While the main argument in favour of privatization is its positive impact on cost through increased competition, there is broad acknowledgement that it is not the private ownership per se, but competition that can induce better quality services at more reasonable cost. The study found that this is the case only under certain conditions: that there are more than three competitors; that competition persists over time; that the task and performance requirements are clear; and that there is active monitoring by the government customer and sustained capacity to do so. The risks associated with privatization included the potential for corruption and the capture of political decision making by politicians. In the USA privatization is associated with the potential for heightened influence over military policy by private contractors to the DOD—through lobbying and financial campaign support for presidential and congressional candidates, domination of DOD advisory committees and growing monopolization of the expertise needed to design, build and operate modern weapons.⁴

The outsourcing of support services and functions is considered most advanced in the UK.⁵ The process has been supported over the past decade by a number of government initiatives, such as the Competing for Quality (CFQ), Private Finance Initiative (PFI) and Public Private Partnership (PPP) programmes. In the USA outsourcing of military support activities was stalled during the first half of the 1990s as a result of strict competition requirements but gained increased importance during the Bill Clinton Administration.⁶ In Germany the Gesellschaft für Entwicklung Beschaffung und Betrieb, (GEBB) was established in late 2000 with the purpose of freeing the armed forces from service functions that were not part of core military capabilities by finding private

³ Markusen, A., 'The case against privatizing national security', *Governance*, vol. 16, no. 4 (forthcoming 2003), available at URL <<http://www.hhh.umn.edu/people/amarkusen/writings.htm>>.

⁴ Sapolsky, H., Gholz, E. and Kaufman, A., 'Security lessons from the cold war', *Foreign Affairs*, vol. 78, no. 4 (1999), pp. 77–89, cited in Markusen (note 57).

⁵ RAND, Public–Private Partnerships: Proceedings of the US–UK Conference on Military Installation Assets, Operations, and Services, 14–16 Apr. 2000, URL <<http://www.rand.org/publications/CF/CF164/>>.

⁶ A RAND publication that summarizes US and British efforts in the field found that the US Congress has placed a variety of restrictions on outsourcing and privatization, in particular through Circular A–76. RAND (note 59). See also Bailey Grasso, V., *Defense Outsourcing: The OBM Circular A–76 Policy*, Congressional Research Service (CRS) Report to Congress (Library of Congress: Washington, DC, 21 Feb. 2002).

Excerpt from: Sköns, E. and Weidacher, R., 'Arms Production', SIPRI Yearbook 2002, (Oxford University Press: Oxford, 2002), pp. 341-346.

industry solutions for them.⁷ Similar developments are under way in other countries. As a result, services account for an increasing share of private industry revenues from military customers. In the USA the share of the value of services in the total value of prime contract awards to US companies increased from 12 per cent in 1988 to 29 per cent in 1999.⁸ BAE Systems expected the market for outsourcing of defence services to grow by 5 per cent as compared to military procurement by 2.4 per cent.⁹ According to Serco, 'In the UK alone the market for defence services is expected to reach £15.1 billion by 2009'.¹⁰

Equipment support (i.e., life-cycle support of military equipment) is accounting for an increasing share of system costs. The system itself often accounts for less than half of total revenues, the rest being different kinds of services associated with the programme. According to Boeing:

the design, development and production of a military aircraft system make up only 30 per cent of a government's investment in total ownership cost. The overwhelming 70 per cent of that total cost is in sustainment and support—from program planning and management, through training, technical manuals and support equipment, to maintenance, modifications, upgrades and other ageing-aircraft sustainment activities.¹¹

Equipment support services are provided primarily by large prime contractors, which supply services that cover the entire life-cycle of the weapon they produce. Aircraft maintenance and repair services contribute significantly to the arms sales of a large number of major military aerospace companies such as BAE Systems, Boeing and Lockheed Martin (table 7.7). Roughly one-half of Bombardier's arms sales in 2000 were derived from support services to the military. Bombardier not only provides pilot training services but also maintains ownership over the training aircraft ('power by the hour') within the NATO Flying Training in Canada (NFTC) programme.¹²

Services related to command, control, communication and information systems (C³IS) equipment are assuming particular importance within the broader field of equipment support services. The rapid advance in information technologies is considered to have changed the conduct of warfare and lead to a shift in military requirements from single platforms to integrated networks, so-called Network Centric Warfare (NCW). This is an evolving concept based on the idea that linking various systems together will generate greater military benefits than could be derived from individual weapon platforms.¹³ A broad range of companies, from major traditional arms-producing companies to small and fast-growing military IT specialized companies, provide services related to the integration of individual surveillance, information management and combat platforms.

⁷ The GEBB Internet site can be accessed at Bundesministerium der Verteidigung, URL <http://wirtschaft.bundeswehr.de/index_.html>.

⁸ Department of Defence, Directorate for Information Operations and Reports (DIOR), *Prime Contract Awards*, annual.

⁹ BAE Systems, *Annual Report 2000*, p. 6.

¹⁰ Serco, *Annual Report 2000*, p. 9.

¹¹ Boeing, 'Military aerospace support', URL<<http://www.boeing.com/defense-space/military/as.htm>>.

¹² See NFTC Internet site, URL <<http://www.nftc.net/introduction/ExecutiveSummary.html>>.

¹³ Holzer, R., 'Center brings together pieces of Network Centric Warfare puzzle', *Defense News*, 27 Aug.–2 Sep. 2001, p. 26.

Excerpt from: Sköns, E. and Weidacher, R., 'Arms Production', SIPRI Yearbook 2002, (Oxford University Press: Oxford, 2002), pp. 341-346.

Large prime contractors for weapon platforms perceive diversification into federal IT products and services as a way to expand in a growth sector and apply technologies and knowledge they have accumulated through weapon systems integration.¹⁴ IT-specialized companies, such as the large US companies Computer Science Corporation and Science Applications International, play an equally strong role in this market. The largest contract in the field was awarded in 2000 to EDS—a contract worth \$6.9 billion over eight years to upgrade the US Navy–Marine Corps Intranet.¹⁵

Military support functions that have been privatized (sold and/or outsourced to private contractors) include: (a) management of base facilities and related services, (b) logistics (military supply chain), and (c) military advice (planning and intelligence) and training services. Examples of companies specializing in this field—often referred to as Private Military Companies—are Serco (UK), which provides facilities management and ground maintenance work for the British Ministry of Defence (MOD), and Dyncorp (USA), which provides a wide range of services to the US military—from policy support to operating and maintaining ships for the US Military Sealift Command (MSC) and providing support services to US forces deployed in peacekeeping operations.¹⁶ MPRI, a US company specializing in the provision of military training services and policy consulting to armed forces, was acquired in July 2001 by the US military electronics and IT company L-3 Communications.

Although small in terms of financial importance in comparison with equipment support services, the provision of military support functions by private companies has raised concerns as regards government control, in particular as a significant share of these support functions are exported from major Western countries to areas of conflict. In a recent initiative—the Green Paper on Private Military Companies—the British Government has started to discuss the necessity and possibilities for regulation of this relatively new sector.¹⁷

¹⁴ Ratnam, G., 'Information technology market draws US firms: flat DoD budgets force contractors to diversify into booming sector', *Defense News*, 26 Feb. 2001, p. 34.

¹⁵ Wakeman, N., 'Companies ride the e-gov tidal wave', *Washington Technology*, URL <<http://www.washingtontechnology.com/top-100-2000/top-100-20002.html>>.

¹⁶ See the Dyncorp Internet site, URL <<http://www.dyncorp.com/companies/index.htm>>. The company also maintains the US State Department's aerial fleet in the Andes. Vest, J., 'State outsources secret war', *The Nation*, 23 May 2001, URL <<http://www.thenation.com>>.

¹⁷ UK Foreign and Commonwealth Office, *Private Military Companies: Options for Regulation*, Feb. 2002, HC 577, Stationery Office, London, accessible at URL <<http://www.fco.gov.uk>>.

Excerpt from: Sköns, E. and Weidacher, R., 'Arms Production', SIPRI Yearbook 2002, (Oxford University Press: Oxford, 2002), pp. 341-346.

Table 7.6. Major cases of company privatization, 1990–2001

Year	Country	Company	Share privatized (%)	Form of privatization (sales of shares)	Buyer type	Nationality
1990	Norway	Raufoss	47	Public offering	IS	–
1993	Netherlands	Fokker	51	Private sales	C	F (FRG)
1993	Norway	NFT	49	Public offering	IS	–
1993	Sweden	Celsius	75	Public offering	IS	–
1994	Brazil	Embraer	55	Private sales	IS	D/F (USA)
1994	Germany	IABG	45	Private sales	C	F (USA)
1995	Germany	IABG	23	Employee buyout	–	D
1995	Argentina	AMC	–	Leasing	C	F (USA)
1995	Australia	ASTA	Majority	Private sales	C	D/F (USA)
1997	Greece	Elefsis Shipyards	..	Private sales	C	D
1998	Czech Rep.	Aero Vodochody	34	Private sales	C	F (USA)
1998	France	Thomson-CSF	33	Public offering	IS	–
1999	Australia	ADI	100	Private sales	C	D/F (FRA)
1999	Bulgaria	Arsenal	51	Employee buyout	–	D
1999	France	Aérospatiale	–	Merger	–	–
1999	Norway	Norsk Jetmotor	33	Private sales	C	F (SWE)
1999	Spain	Indra	66	Public offering	IS	–
1999	Sweden	Celsius	25	Private sales	C	D
2000	Bulgaria	Trema	50	Employee buyout	–	D
2000	Greece	Hellenic Vehicle Ind.	43	Private sales	C	D
2000	Italy	Finmeccanica	38	Public offering	IS	–
2000	Spain	CASA	–	Merger	–	–
2001	Czech Rep.	Tatra	91.6	Private sales	C	F (USA)
2001	Finland	Patria Industries	26.8	Private sales	C	F (EUR)
2001	Greece	Hellenic Shipyards	51	Private sales	C	D
2001	Italy	Fincantieri	17	Public offering	IS	–
2001	Poland	PZL Warszawa-Okecie	51	Private sales	C	F (EUR)
2001	Poland	WSK PZL Rzeszow	85	Private sales	C	F (USA)
2001	Spain	Santa Barbara	100	Private sales	C	F (USA)

IS = Individual share holders; C = Company; F = Foreign; FRG = Germany; D = Domestic; USA = United States; FRA = France; SWE = Sweden; EUR = Europe.

Sources: SIPRI arms industry files.

Excerpt from: Sköns, E. and Weidacher, R., 'Arms Production', SIPRI Yearbook 2002, (Oxford University Press: Oxford, 2002), pp. 341-346.

Table 7.7. Selected companies providing services to the military, 2000

Figures are in US \$m.

Company, unit, country	Main military services	Sales to MODs 2000
Anteon, USA	IT services for US Navy	410
BAE Systems, Customer Solutions & Support, UK	Aircraft training and maintenance	2 500
Boeing, Military Aircraft Support Unit, USA	Aircraft training and maintenance	
Bombardier, Defence Services, Canada	Fleet management, aircraft training	[160]
Computer Sciences Corp., USA	IT services	1 610
Dyncorp, USA	IT services; fleet management; policy support	800
EDS, USA	IT services	950
Lockheed Martin, Technology Services, USA	Space operations support, aircraft support, management of nuclear weapon programme	2 280
MPRI, USA	Policy support; armed forces training	
Science Applications Int., USA	IT services	1 950
Serco, UK	Management of facilities	[300]
Silicon Graphics, USA	IT services	370
Titan, USA	IT services	780
Veridian, USA	IT services; R&D, test and evaluation of aircraft and spacecraft	[590]
Vinnell, USA	Management of facilities, armed forces training	. .

Sources: SIPRI arms industry database and SIPRI arms industry files.