

## Chapter 2

# Competition in Defence Practice: Theory and Reality

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### ABSTRACT

*This chapter compares theory about the consequences of competition with market structures and procurement experiences in the defence sector. The arguments are largely theoretical, reflecting commercial logic and propositions about behaviour in highly imperfect market structures. They are meant to illuminate what can happen, and sometimes does occur, rather than what must result. A crucial theoretical question is how competition is likely to work when there is only one immediate customer (and only a few possible customers in the longer run) and only a small number of potential suppliers (for each of whom an order may be of strategic significance). However, the US and the UK have published empirical data on the use of competition in defence, and appropriate reference is made to this.*

### INTRODUCTION

There is no shortage of writing in Economics to support the beneficial effects of competition. In essence it is seen as generating a crucial incentive on the producer to do better than his/her rivals, constantly to improve and thus to put the buyers in an ever better position. Without competition or with limited competition, the supplier can safely become complacent and also extract excessive rent from buyers. Monopoly and oligopoly are thus closely associated with poor performance, high prices and excessive profits.

And of course, any procurement professional knows that competition is likely to drive more dynamic markets, bringing more in the way of value for money, customer service and innovation (Smith, 2014).

Worthy of note is that companies, while recognising the logic behind competition, often seek to remove it from their environment because it makes their lives easier and profitability more problematic. They prefer de facto monopoly positions that can be created by the generation of ‘unique’ products, by mergers and takeovers, and by driving competitors out of a sector. In recognition of this, governments

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regulate to prevent the emergence of monopolies and on occasions insist on the break-up of firms that have become too powerful.

The view that competition should be a key element in government procurement is well established in many western countries. In the United States, both law and policy favour competitive tendering in defence as a procurement strategy, and the same is the case with European public procurement law and national policy stances. The US Undersecretary of Defense for Acquisition, Technology & Logistics, Frank Kendall observed simply that “competition works. It works better than anything to reduce and control costs” (Kendall, 2014). The DoD insists that:

*Competition is the single best way to motivate contractors to provide the best value (i.e., the best performance at the lowest price). (Department of Defense, 2014)*

Competition is also required by regulation when international bodies such as NATO need something from the private sector.

This piece, however, offers a different perspective. It makes a series of arguments indicating that competitive tendering in defence procurement can often be neither practical nor desirable. It also suggests that these arguments have empirical support from the incidence of governments’ rejection of competition as a procurement strategy.

It should be stressed that this emphasis on the limitations and indeed shortcomings of competition do not apply to all defence procurement tasks, certainly not the purchase of routine, commodity items or things that are bought also in a similar form by the civilian world. However, they are relevant to the purchase of major defence platforms and weapons systems where so much of the money goes and where problems are often prominent. They are especially pertinent when a government is contemplating a development and production effort rather than buying an existing product from a production line, normally in another state. It is these items which receive annual attention in the major defence reports of the Government Accountability Office in the US, the National Audit Office in the UK and the Australian National Audit Office.

The implications of this are substantial, for they imply that mean that governments should spend less time looking for ways to increase the incidence of competitive procurement, and put more effort into consideration of the efforts needed for cost-effective procurement on a sole-source basis. As the references in this chapter indicate, many of the messages here are by no means original, so the words here largely represent an effort to build more recognition for arguments that will not be welcome to enthusiasts for the operation of free markets.

## **THE APPROACH AND METHODS**

This chapter compares theory about the consequences of competition with market structures and procurement experiences in the defence sector. The arguments are largely theoretical, reflecting commercial logic and propositions about behaviour in highly imperfect market structures. They are meant to illuminate what can happen, and sometimes does occur, rather than what must result. A crucial theoretical question is how competition is likely to work when there is only one immediate customer (and only a few possible customers in the longer run) and only a small number of potential suppliers (for each of whom

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