

Defense report targets Wall Street for sabotage of technology policy

by Leo F. Scanlon

During October, a leaked copy of a Defense Science Board study of the defense industrial base made its way to the news media, and provoked howls of protest from Pentagon critics, austerity gurus, and economic ideologues. The release of the report in mid-November revealed the cause of the protest—for the first time in recent memory, an official military document dares to take aim at the Wall Street speculators, raiders, and their accomplices in the Congress and the IRS who have demolished the credit flow into advanced research-and-development in the U.S. economy.

Ironically, what the critics have focused the media attention on, the report's modest proposal that the Secretary of Defense take an active role in national economic policy, is a bureaucratic remedy of little consequence in itself. What the board actually proposes is that the Secretary of Defense be directly involved in "tax and trade policy" matters—issues which are at the center of the bitter fight which has blown apart the "bipartisan" National Economic Commission recently. The DSB proposal to make industrial and technological revival a national security priority, strongly emphasized in public remarks by Secretary Frank Carlucci in the same time period, will be a major roadblock to forging an austerity consensus in the new administration.

Furthermore, the proposal that tax and trade matters be evaluated from the standpoint of a national security requirement for a healthy industrial base, harkens to the Kennedy era tax incentive policies which created the wealth to finance the space program, and the military technologies spun off that effort. Many had hoped that those issues were buried with Kennedy.

Wall Street, the fifth column?

The DSB does not propose specific policies in this direction, but limits itself to attacking the "free trade" shibboleths which have blinded the Reagan administration, and then rips into the institutional destruction of the economic system. On the first point, the report points out, "The defense industry does *not* conduct business in a free enterprise system. . . . Exercising its monopsony power, the government has created

a regulated industry, similar to a public utility. . . . The government wants the defense industry to act like commercial businesses but promulgates uncoordinated regulations and policies to such a degree that any observer schooled in basic business theory must be surprised the system works at all." The dramatic effects of this on subcontractors has been described in earlier reports in *EIR*, the DSB points out that "restricting defense-related business is widespread enough that it denies needed technology to the DoD."

This "denial of technology" to the defense sector occurs not only on the level of subcontractors driven out of business by government regulations. The far more pernicious phenomenon is the abandonment by major contracting firms of the defense business altogether, behavior which is rewarded by the capital markets! The DSB begins its analysis of this part of the problem with a quote. "The decline of the position of manufacturing is a major industrial development for this country. . . . There are so few exceptions to the decline of the international positions of U.S. manufacturing industries that one must seek . . . general causes that act on the entire economy."

The report continues, "In recent years, the power and influence of large institutional investors (pension funds, mutual funds, brokerage firms, and others) has increased markedly. . . . Pension funds own 50% of the shares traded on the New York Stock Exchange and 65% of the largest defense contractors found in the Standard & Poor's 500. The motivation of these owners largely determines companies' ability to obtain capital for investment."

It is then explained that such institutional funds are obligated to seek the highest returns on their investments, which may or may not allow the funds to stay invested in a long-term venture based on capital formation and industrial development such as a defense R&D project. This hostility to long-term investment in the capital markets is the dirty little secret behind the speculation-driven "recovery" of the Reagan years. The DSB points out, "Should a corporate raider propose a take-over, or a proxy fight commence, large institutions are almost certain to support whomever promises them the higher

short-term returns.”

In fact, as the report points out, the combination of congressional reforms of the acquisition process, and tax code revisions enacted in recent years, has “increased corporate risk and at the same time vastly increased the need for external financing,” thus putting national defense at the mercy of the sharks and raiders on Wall Street.

The response of defense contractors to these pressures is predictable. They take the “practical” route and dump their defense business: “Allied Signal, IBM, and Motorola have all publicly stated that they would not expand their defense businesses. The Wall Street response to the Allied Signal announcement in November 1987 was a 5% increase in the value of the stock.”

Not surprisingly, when these companies eventually go on the auction block, they are bought by foreign interests, often unknown. The DSB report considers this process regrettable, but part of an “irreversible globalization of the economy.”

This all serves to highlight the criminal insanity of the Reagan Justice Department’s “waste, fraud, and abuse” vendetta against the defense industry—the legal assault is tailored to mesh with the regulatory and financial reforms which are destroying the industrial capability of the nation. It is no accident that the lawyers who have written the congressional acquisition reforms, the tax code revisions, and scripted the DoJ attack on the Pentagon, like William Weld, are also the representatives of Wall Street investment houses.

That these circles are very conscious of this power is indicated by what a top congressional staffer told this publication. “We are counting on the international financial markets to force the budget deficit reduction through. . . . The National Economic Commission won’t be able to do much. The financial markets are key here.”

The alternative: the American System

After providing an insightful and almost unprecedented analysis of the financial mess the country is in, one would hope to find a series of hard-hitting reform proposals following in the report. Unfortunately, this is a document produced for the government, and intelligent and simple solutions are much too controversial. So, we are served the standard fare of bureaucratic measures to create committees, task forces, and the like to deal with a national security emergency! Fortunately, there is evidence that the DSB has a pretty good idea of what should be done, even if they don’t want to say so openly.

Last year, Norman Augustine presented the DSB report on the collapse of the U.S. computer chip industry. He showed conclusively that the nature of the U.S. capital markets militated against successful R&D, as does this DSB report. He went on to show that the Japanese producers who dominate the market are benefitting from the tax and savings policies of the Japanese government, not from unfair trade practices—a matter, he was careful to point out, that was beyond

the mandate of his report.

He was asked by this author how he would therefore propose to remedy the broad categories of problems he had identified, without a change in U.S. tax and financial structures. “I’m afraid I’m not supposed to discuss those matters,” was the gist of his reply. Now, this latest DSB report still “won’t discuss those matters” in detail, but does point out what “those matters” are. You might say that if you can’t talk about the American System for America, you just point to Japan and hope people get the message.

The profile of Japanese investment policy is summarized thus: “Japan conducts little direct defense R&D. However, Japan ranks third, behind the U.S. and U.S.S.R., in total investments in science and technology. The overwhelming emphasis of Japanese research is on applied R&D or production technology, much of which is applicable to defense products. . . . Another factor enabling companies to engage in defense production is that defense-related business accounts for a relatively small percentage of a company’s business.”

In short, the Japanese “civilian” economy produces more than enough wealth to finance their defense production needs. It should be noted that while pundits point to the fact that Japan spends less than 2% of GNP on defense, the reality is that 2% of a real economy is a lot more than 6% of hot air in a speculative stock market. In fact, there has never been a defense buildup that was not riding the coat-tails of an expansion of the entire economy. This was the secret of the World War II mobilization of the U.S. economy, and as the DSB complains, “The establishment of a national policy for the protection and development of those portions of our industrial and technological base that support national security has been an elusive goal since the demobilization that occurred after World War II.”

The failure to maintain that type of economic mobilization was not a necessary consequence of the end of the war. We now are facing the consequences of that failure, and as the Soviets steadily approach technological parity with Western weapons systems, and threaten to soon surpass us in most areas, defense planners find themselves in a dilemma.

The deterrent which has prevented the Soviets from even more aggressive expansionist moves in the postwar era has been the fear that such moves would provoke the United States to mobilize itself as it did in World War II. The Soviets watched that mobilization with awe, but were even more impressed with the inexplicable, to them, near complete demobilization of the West after the war. The margin of difference in “mobilization” capabilities between the two economies is watched by the Soviets as a top strategic priority, and they have devoted unlimited propaganda resources to campaigns against the development of basic infrastructure and investment in the West. The time bomb which is now being detonated by the Defense Science Board will hit the most sensitive concerns of Soviet planners.