

Gunnar Eliasson

# Advanced Public Procurement as Industrial Policy

The Aircraft Industry as a Technical  
University



Springer

# Contents

|          |  |           |
|----------|--|-----------|
| <b>1</b> | <b>On the Cloud of Technology that Surrounds<br/>Advanced Production: A Summary of Results.....</b>                      | <b>1</b>  |
| 1.1      | The Spillover Multiplier.....  | 1         |
| 1.2      | Twelve Conclusions on How to Overcome<br>the Underinvestment in Private R&D Among<br>Advanced Industrial Economies ..... | 2         |
| 1.3      | Joint Production and Joint Customership .....  | 5         |
| 1.4      | The Questions Raised .....   | 6         |
| 1.5      | The Nature of Spillovers .....   | 8         |
| 1.6      | Social Value Creation: The Magnitudes Involved.....  | 9         |
| 1.7      | Competition Between Alternatives .....   | 12        |
| 1.8      | Competitive Bidding and Competition Policy .....   | 14        |
| 1.9      | The Contents of the Spillover Cloud.....   | 16        |
| 1.10     | The Advanced Industrial Environment .....  | 17        |
| 1.11     | Policy Implications .....  | 18        |
| 1.12     | Complete Competence Blocs are Spillover Generators<br>and Advanced Learning Environments.....                            | 20        |
| 1.13     | Macroeconomic Growth .....   | 21        |
| 1.14     | Notes .....  | 22        |
| <b>2</b> | <b>The Art of Defining, Pricing, and Marketing Advanced<br/>Multidimensional Products that Spill Technology.....</b>     | <b>25</b> |
| 2.1      | The Pricing of Complex and Multidimensional<br>Systems Products .....  | 28        |
| 2.2      | The Joint Manufacturing of Products and Intangible<br>Spillovers .....   | 32        |
| 2.3      | The Economic Nature of Intangible Spillovers.....  | 34        |
| 2.3.1    | The Existence, Magnitude, and Economic<br>Value of Spillovers.....   | 35        |
| 2.3.2    | Receiver Competence .....  | 37        |
| 2.3.3    | Diffusion Channels .....   | 39        |
| 2.3.4    | Accessing the Global Pool of Technology.....   | 41        |

|          |  |           |
|----------|--|-----------|
| 2.4      | Competence Bloc Theory and the Critical Role<br>of the Advanced Customer.....  | 42        |
| 2.4.1    | Customer Competence Contributions .....  | 43        |
| 2.4.2    | Technology Supply .....  | 44        |
| 2.4.3    | Commercialization .....  | 44        |
| 2.4.4    | The Allocation of Tacit Knowledge and the Limits<br>of a Firm.....   | 46        |
| 2.4.5    | Critical Mass .....  | 48        |
| 2.4.6    | Going from Micro to Macro (Aggregation).....   | 49        |
| 2.5      | Aircraft Industry as a Spillover Source: A Preview<br>of the Industry Case .....   | 50        |
| 2.6      | Boosting Receiver Competence Through Policy .....  | 53        |
| 2.6.1    | Capturing the Rents from Spillovers: Joint Customership<br>and Industrial Participation Programs as a Joint Policy<br>and Business Opportunity ..... | 54        |
| 2.6.2    | Summarizing on Joint Production and Joint<br>Customership as a Policy Opportunity.....   | 55        |
| 2.7      | Notes .....  | 56        |
| <b>3</b> | <b>Spillovers and Innovative Technology Supply:</b>  |           |
|          | <b>A Literature Survey .....</b>   | <b>61</b> |
| 3.1      | The Existence and Magnitudes of Spillovers:<br>A Brief Background on Economic Theory .....   | 62        |
| 3.1.1    | Austrian/Schumpeterian Micro- to Macrodynamics<br>and the Long-Term Sustainability of Spillovers<br>and Growth.....                                  | 62        |
| 3.1.2    | Long-Term Sustainable Productivity Growth<br>is a Matter of Resource Reallocation,<br>Not of Raising Employment .....                                | 64        |
| 3.2      | Intangible Spillovers and Economic Growth .....  | 65        |
| 3.2.1    | Technology Creation and Productivity Growth .....  | 66        |
| 3.2.2    | The Mysterious Technology Residual.....  | 66        |
| 3.3      | The Macroeconomic Effects of Spillovers.....   | 68        |
| 3.3.1    | Salter Curve Analysis.....   | 69        |
| 3.3.2    | Dynamic Simulation .....   | 72        |
| 3.3.3    | Commercialization .....  | 75        |
| 3.4      | Notes .....  | 77        |
| <b>4</b> | <b>Capturing the Direct and the Serendipitous Spillovers:</b>  |           |
|          | <b>The Case of Sweden's Military Aircraft Industry .....</b>   | <b>79</b> |
| 4.1      | A Brief History of Saab .....  | 79        |
| 4.2      | The Saab Group Strategically Reorganizing,<br>for a Different Future .....   | 83        |
| 4.2.1    | A Business Organization in Constant Transition .....   | 84        |

|          |   |            |
|----------|---|------------|
| 4.2.2    | Military Aircraft Technology is the Platform<br>for Future Industrial Development of Saab.....  | 85         |
| 4.3      | The Cloud of Spillovers .....   | 86         |
| 4.3.1    | Core Technologies (Aircraft and Engines).....   | 86         |
| 4.3.2    | Related Technologies (Case 3).....  | 92         |
| 4.3.3    | Engineering General (Cases 5 and 6).....  | 95         |
| 4.3.4    | Industry General and Serendipitous Discovery .....  | 97         |
| 4.3.5    | Creating a Critical Mass Aircraft Industry<br>Competence Bloc Rich in Spillovers (Case 7).....  | 98         |
| 4.4      | Digital Mobile Telephony: A Swedish World Success<br>with a Military Origin <sup>18</sup> (Case 8) .....  | 99         |
| 4.4.1    | The Origin of Nordic Mobile Telephony:<br>How the Advanced Public Customer Initiates<br>a New Swedish Industry .....  | 101        |
| 4.4.2    | The Emergence of Digital Mobile Telephony<br>as a Swedish World Success .....   | 102        |
| 4.4.3    | The Critical Technology Elements of the Early<br>Digital Mobile Telephone System.....   | 104        |
| 4.4.4    | Advanced Consumer Electronics .....   | 107        |
| 4.4.5    | One Technology Wave After Another: Nobody Is Safe.....  | 108        |
| 4.4.6    | A Number of Civilian Opportunities and Challenges.....  | 112        |
| 4.4.7    | Summing Up .....  | 112        |
| 4.5      | Secondary Spillovers: Ericsson HP Telecom and Telecom<br>Monitoring and Control Systems (Industry General, Case 9).....   | 114        |
| 4.6      | The Emergence and Disappearance of a Swedish<br>Computer Industry <sup>33</sup> (Industry General, Case 10) .....   | 116        |
| 4.7      | The Business Information Systems Venture<br>of Ericsson (EIS, Case 11).....   | 117        |
| 4.8      | Medical Technology Spillovers (Sectra):<br>A Creative Entrepreneurial Environment (Case 12) .....   | 120        |
| 4.9      | Notes .....   | 121        |
| <b>5</b> | <b>Looking into the Future on JAS Gripen Spillovers .....</b>   | <b>125</b> |
| 5.1      | Spillover Areas: A Brief Survey .....   | 127        |
| 5.2      | The Erieye Surveillance System, Electrically<br>Directed Antennae and the Minilink: The Development<br>of an Early Networked Defense System Moving<br>Ericsson Mobile Telephony On (Case 13)..... | 131        |
| 5.2.1    | Erieye Surveillance Technology .....  | 132        |
| 5.2.2    | Antennae .....  | 133        |
| 5.2.3    | The MiniLink .....  | 133        |
| 5.2.4    | A Networked Defense Enhances Spillover Intensity .....  | 135        |
| 5.3      | Distributed and Integrated Production as a Generic<br>Engineering Organizational Technology:<br>The Art of Systems Integration (Case 14) .....  | 135        |

|        |  |     |
|--------|--|-----|
| 5.3.1  | The Nature of Complex Products .....   | 136 |
| 5.3.2  | Integrated Production.....   | 138 |
| 5.3.3  | Systems Effects in Integrated Production .....   | 139 |
| 5.3.4  | Systems Integration: An Illustration .....   | 140 |
| 5.4    | Safety-Critical Software Engineering (Case 15).....  | 141 |
| 5.5    | Manufacturing Lightweight Technology (Case 16).....  | 143 |
| 5.5.1  | Lightweight Aircraft Structures: Saab and Gripen .....   | 143 |
| 5.5.2  | Lightweight Engine Designs:<br>Volvo Aero Corporation.....   | 146 |
| 5.5.3  | Welding Simulation.....  | 148 |
| 5.6    | Automobile Safety Systems as a Swedish Export Product.....   | 150 |
| 5.6.1  | Case 17: The Swedish Automotive Safety<br>Industry and Autoliv .....   | 151 |
| 5.7    | Maximizing Functional Flexibility and Minimum<br>Life Cycle Maintenance and Service Costs (Case 18).....             | 153 |
| 5.7.1  | Product Design and Functional Flexibility .....  | 154 |
| 5.7.2  | Maintenance-Free Products .....  | 154 |
| 5.7.3  | Real Options Pricing of Flexibility .....  | 156 |
| 5.7.4  | Lifetime Product Support.....  | 156 |
| 5.7.5  | Product Life Management.....   | 157 |
| 5.8    | Additional Product and Technology Areas the Origin<br>of Which Can Be Traced to JAS 39 Gripen .....                  | 157 |
| 5.8.1  | Space Research and Exploration (Case 19) .....   | 158 |
| 5.8.2  | Virtual and Secure Online Design:<br>Encryption/Security (Case 20).....  | 158 |
| 5.8.3  | Civil Security (Case 21).....  | 159 |
| 5.8.4  | Unmanned Aircraft and Future<br>Air Transport (Case 22) .....  | 160 |
| 5.9    | The Development of a Specialist Consulting<br>and Subcontracting Industry: Competence Bloc Formation.....            | 161 |
| 5.9.1  | Advanced Subcontractors as a National<br>Competitive Advantage.....  | 161 |
| 5.9.2  | Engineering Consulting Bridges the Gap<br>Between Technology Creation<br>and Technology Adoption (Case 23) .....     | 163 |
| 5.9.3  | Industrial Competence Bloc Formation<br>in Linköping(Case 24) .....  | 164 |
| 5.9.4  | The Subcontracting Contract .....  | 166 |
| 5.9.5  | Risk Sharing Among Contractors .....   | 167 |
| 5.10   | What Did Not Happen .....  | 168 |
| 5.10.1 | Spillover Opportunities Missed (Case 25).....  | 168 |
| 5.10.2 | The Large Part of Gripen Spillovers<br>Has Been Captured by the Large Partners<br>in the IG JAS Industry Group ..... | 171 |
| 5.11   | Notes .....  | 172 |

|  |     |
|--|-----|
| <b>6 Saab in South Africa: Technology Transfer to an Industrializing Economy</b> .....   | 175 |
| 6.1 The South African Opportunity .....  | 177 |
| 6.2 The Downsizing of the South African Arms Industry .....  | 180 |
| 6.2.1 Armscor .....  | 180 |
| 6.2.2 Denel .....  | 181 |
| 6.2.3 Saab Denel Aerostructures .....  | 181 |
| 6.3 The Nature of the Product and of Spillovers .....  | 182 |
| 6.4 Gripen in South Africa: Facts .....  | 184 |
| 6.4.1 The Gripen Purchase: Technical Background .....  | 185 |
| 6.4.2 Volvo Aero Corporation in South Africa .....   | 186 |
| 6.4.3 The Organization of Technology Transfers .....   | 187 |
| 6.4.4 Subcontracting in South Africa .....   | 189 |
| 6.5 South African Receiver Industry .....  | 190 |
| 6.5.1 A Dual Economy Isolated from Industrial Neighbors .....  | 191 |
| 6.5.2 Participating in Global Production<br>and Marketing Networks .....   | 192 |
| 6.5.3 Management Competence .....  | 193 |
| 6.5.4 Attractive Technologies .....  | 195 |
| 6.6 New Firm Formation .....   | 196 |
| 6.7 Competence Blocs, Lack of Commercial Attitudes,<br>and Venture Capital Insufficiency .....                                       | 197 |
| 6.7.1 Case 26: TMI Dynamics .....  | 198 |
| 6.8 Labor Quality Supply .....   | 199 |
| 6.8.1 Case 27: The Saab Industrial School project<br>in South Africa .....   | 201 |
| 6.9 Political Uncertainty High .....   | 202 |
| 6.10 Conclusions .....   | 203 |
| 6.11 Notes .....   | 204 |
| <b>7 The European Policy Perspective</b> .....   | 207 |
| 7.1 The Future Dependence of Western Industrial<br>Economies on their Engineering Industries .....                                   | 208 |
| 7.2 The European Concerns .....  | 210 |
| 7.3 Facilitation Rather Than Directed Procurement<br>Becomes Important .....   | 211 |
| 7.4 Dassault Aviation, France (Case 28) .....  | 212 |
| 7.5 What Should Europe Do? .....   | 212 |
| 7.6 Notes .....  | 214 |
| <b>8 Private and Social Spillover Benefits from Advanced Procurement:<br/>Defining and Estimating the Spillover Multiplier</b> ..... | 215 |
| 8.1 How to Capture Spillover Rents Privately and for Society .....   | 215 |
| 8.1.1 Innovative Pricing .....   | 215 |

|          |  |            |
|----------|--|------------|
| 8.1.2    | On the Principles and Practices of Offset<br>Trade Requirements .....                                    | 217        |
| 8.2      | Estimating the Spillover Multiplier.....   | 218        |
| 8.2.1    | Beware of Calculation Biases Based<br>on Oversimplification .....  | 218        |
| 8.2.2    | Defining the Spillover Multiplier of the JAS 39<br>Gripen Development Investment.....                    | 220        |
| 8.2.3    | Estimating (Approximating) the Spillover<br>Multiplier from the Microlevel and Up.....                   | 221        |
| 8.3      | How to Turn Potential Rates of Return into Actual<br>Rates of Return .....                               | 226        |
| 8.3.1    | The Policy Issue .....   | 226        |
| 8.3.2    | The Art of Rent Seeking .....  | 226        |
| 8.3.3    | The Art of Innovation Policy .....   | 227        |
| 8.4      | Incentive Contracts .....  | 228        |
| 8.5      | Notes .....  | 230        |
| <b>9</b> | <b>Advanced Purchasing as Industrial Policy:<br/>On the Advanced Firm as a Technical University.....</b> | <b>233</b> |
| 9.1      | Public Goods as Infrastructure.....  | 233        |
| 9.1.1    | Market or Public Failure to Satisfy<br>a Private Demand? .....   | 234        |
| 9.1.2    | R&D Investment as Infrastructure:<br>The Underinvestment Proposition.....                                | 235        |
| 9.1.3    | Technology Policy.....   | 235        |
| 9.1.4    | Public Procurement as Industrial Policy:<br>The Role of the Competent Customer .....                     | 236        |
| 9.1.5    | Are There Any Other Advanced Public<br>Procurement Objects? .....  | 238        |
| 9.2      | The Public Purchasing Contract: A New Demand Policy .....  | 239        |
| 9.3      | Aircraft Industry Already Today Uses<br>the Technologies of Future Engineering Industry .....            | 240        |
| 9.3.1    | The Large Firms Dominate as Spillover Receivers .....  | 240        |
| 9.3.2    | The Opportunity Cost May Be Negative .....   | 242        |
| 9.3.3    | Marketing the Cloud: Saab as an Agent of Democracy.....  | 243        |
| 9.4      | The Advanced Firm as a Technical University .....  | 244        |
| 9.5      | Notes .....  | 245        |
|          | <b>Technical Supplements .....</b>   | <b>247</b> |
| S1       | The IG JAS Investment .....  | 247        |
| S1.1     | The Procurement of the JAS 39 Gripen<br>Aircraft with Swing-Role Capabilities.....                       | 247        |
| S1.2     | Swedish Military Aircraft Procurement History .....  | 249        |
| S1.3     | The JAS 39 Gripen Concept .....  | 250        |

|                     |  |     |
|---------------------|--|-----|
| S1.4                | The Industry Group JAS .....   | 251 |
| S1.5                | Weapons and Communications System .....  | 251 |
| S1.6                | The New IG JAS Procurement Method .....  | 252 |
| S1.7                | Subsystems Categories Outsourced to Non-Saab<br>Subcontractors.....                                | 254 |
| S1.8                | The JAS 39 Gripen Procurement Sequence .....   | 255 |
| S1.9                | The JAS 39 Gripen Investment Budget.....   | 256 |
| S2                  | Estimating the JAS 39 Gripen Macroeconomic<br>Spillover Multiplier: Going from Micro to Macro..... | 257 |
| S2.1                | The Different Estimation Methods .....   | 257 |
| S2.2                | Method 1: Identifying and Aggregating<br>Over the 45 Spillover-Receiving Firms .....               | 262 |
| S2.3                | Method 2 (Indirect): Econometrically<br>Determined Social and Private Rates of Return.....         | 269 |
| S2.4                | Method 3: Micro-to-Macro Simulation .....  | 271 |
| S2.5                | The Value of JAS 39 Gripen Spillovers:<br>Analysis, Evaluation, and Discussion .....               | 272 |
| S2.6                | Summing Up .....   | 278 |
| S3                  | A Future Research Agenda: The Advanced<br>Firm as a Technical University .....                     | 279 |
| S3.1                | The Double Customer Role of Government .....   | 280 |
| S3.2                | The European Dimension .....   | 281 |
| S3.3                | Suggested Continuation of the Project.....   | 282 |
| S3.4                | The Spillover Multiplier.....  | 282 |
| S3.5                | The Future Role of the Old Engineering<br>Industry in the New Economy .....                        | 283 |
| S3.6                | Overcoming the Underinvestment .....   | 284 |
| S3.7                | Advanced Firms and Technical Universities<br>Competing for Public Resources .....                  | 284 |
| S3.8                | The Optimal Public Procurement Area.....   | 285 |
| Notes               | .....  | 286 |
| <b>Glossary</b>     | .....  | 289 |
| <b>Bibliography</b> | .....  | 295 |
| <b>Index</b>        | .....  | 307 |