

What Does It Mean to Be a European Defense Company Today?

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In many ways, defense firms in Europe should be pleased with the recent uptick in defense spending. Russia's actions in the east of Europe and question marks about the transatlantic relationship have forced European governments to reverse the damaging decline in budgets witnessed in Europe. The European Defense Agency calculates that from 2005 to 2007 there was a EUR 11 billion increase in defense spending in the EU, but after the financial crisis spending fell by EUR 14 billion from 2007 to 2013. It is only since this time, with growing geopolitical turmoil, that Europe has witnessed growth worth some EUR 15 billion from 2013 to 2017.¹ Defense spending in Europe continues to rise. In theory, this extra money should make its way into new defense technology projects and capability programmes but we know that most European governments are still too coy about investing more in defense research and development. Industry has made it clear that it needs programmes in Europe otherwise skills and investment will dry out, meaning that firms will not be able to meet any future sudden demand for armaments production nor have a sustained reason to design or develop cutting-edge defense technologies.

The issue of skills in the defense sector is crucial. The defense industry is involved in producing and offering high value components, systems and services but it relies on an army of technical experts, engineers and scientists in order to stay at the forefront of military technology development. One recent survey by the European Defense Skills Partnership shows that a number of European defense industries are lacking in skills ranging from software engineering, systems testing, electronic warfare, thermal engineering and cybersecurity.² The reality is that under-investment in the defense sector has put off new young graduates, who would prefer to work for 'Silicon Valley' type firms in sectors other than defense.

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The meaning of the new push

Many European defense firms also look with interest at new European Union-level initiatives, in particular the European Defense Fund. Rather positively, the Union now intends to spend up to EUR 13 billion on defense over the next seven years from 2021 to 2027. This may seem like a pittance compared to some European national defense budgets, and it certainly pales in comparison to what the US government spends on defense. Nevertheless, industry is pleased that the EU has finally broken an important taboo on using the EU budget on defense. Firms are also intrigued by the leveraging potential of the Fund because it could unlock further billions of euros for collaborative projects between European governments.

Notwithstanding the fact that numerous defense companies and governments still maintain a privileged relationship with Washington, Europe's defense giants are pleased that the EU and various leaders are talking about strategic autonomy for the Union.³ These are bold calls but industry sees them as a way to ensure the health and competitiveness of European defense technological and industrial base, as well as ensuring that Europe's armed forces have access to effective and reliable technologies, equipment and systems. Although armed forces in Europe are reliant on a range of American-only strategic enablers, industry believes that this is an important political moment to ensure that Europe delivers on defense.

Of course, we have been here before. Back in the heady days of the European Convention in 2003, and disagreement over America's invasion of Iraq, Europe was pushing ahead with defense integration and industry put great stock in the potential of the Common Security and Defense Policy and the formation of new bodies such as the European Defense Agency. Industry may have been excited back then, but today similar questions about the level of ambition governments actually have for EU defense remain.⁴ Not only is the American government working hard to warn EU member states of the possible consequences of investing in the European Defense Fund and initiatives like Permanent Structured Cooperation,⁵ but the truth of the matter is that many member states simply cannot rely on fellow European governments for their security in the way they do Washington, especially through the Atlantic Alliance.

Industry also looked with interest at EU initiatives such as the 'defense package' in 2009, which saw the European Commission open up defense markets and procurement in the single market through legislative tools. Such tools will always take time to have an effect on the European defense market. Despite the evidence of more cross-border transfers of equipment and non-discriminatory procurement tenders since the package, there is still a long way to go before national supply chains are opened up to SMEs from across the Union. The hope for many industry actors is that initiatives like the European Defense Fund will break down barriers further by stressing the need for collaborative defense R&D and capability development.

Nevertheless, industry looks at the recent European level of ambition as positive and there are certainly a lot of positive signals around future new capability programmes such as the Future Combat Aircraft System (FCAS) and the Main Ground Combat System (MGCS) – projects that should come online from 2035-2040 onwards. Although these programmes have largely been initiated by France and Germany, other governments such as Spain are involved in FCAS and Poland and other countries would like to join the MGCS. Of course, Europe has proven its ability to launch major weapons systems programmes and the Eurofighter and A400M are stand-out examples. Yet, keen observers of the development of such past programmes will be all too aware of the fact that beyond initial R&D partner governments still need to harmonize military requirements, set a fair *juste retour* structure and iron out differences on export policies.⁶ It is, therefore, positive that following the January 2019 Aachen Treaty and the October 2019 Franco-German Security and Defense Council meeting, that France and Germany have already signed an industrial Letter of Intent on the MGCS, launched a joint concept study on the FCAS and have concluded negotiations on a legally binding agreement on arms exports.

Industry's contributions to the European defense endeavor

Industry is doing its part for European defense. In 2015, French-owned Nexter Systems joined forces with the German firm Krauss-Maffei Wegmann to create KNDS, a European leader in land defense systems. French and Italian shipbuilding companies are also looking to advance a joint venture to develop and produce warships.

Germany's Rheinmetall and the UK's BAE Systems have also launched a joint venture on military vehicles. Many of Europe's leading transnational defense firms have also fared well in international export markets with Airbus Defense and Space⁷ and MBDA⁸ both registering strong growth in 2018. Despite the potential turbulence caused by Brexit, European firms see international demand picking up on the back of China's rise, among other factors.

Despite these steps towards consolidation, however, defense companies view the European market – and attempts to regulate and invest in this market – differently. The larger trans-European defense players are fully invested in EU steps to support the defense market. However, a number of national defense giants are either fully dependent on national government demand, which means that they are loath to open up supply chains, or they went global decades ago and are able to operate in a competitive environment and in non-European markets. Defense-related Mid-caps and SMEs are also in two minds: some favor the chance to compete for Europe-wide contracts because national demand is not high enough, while others are afraid that integration into larger European supply chains will crush their ability to protect intellectual property rights. Again, the use of financial incentives under the European Defense Fund may help with this divergence of interests.

This sort of fragmentation also points to the shifting nature of defense technologies. The truth for the defense industry is that cutting-edge innovation is increasingly emerging out of the commercial sector, but the paradox is that only defense firms and governments can align civil technologies to defense end-user needs. Today, we hear a lot about the potential of artificial intelligence, quantum computing, hypersonic propulsion, nano and biotechnologies and robotics. Yet Europe is woefully underinvesting in these technology areas, especially in terms of how they could be applied to armaments development. While defense firms with the required capital and culture of innovation can integrate commercial technologies into defense systems, the industry as a whole has still not unlocked the full potential of emerging technologies for defense.

Structural challenges ahead

Industry also recognizes that while European governments are increasing the amount they spend on defense, there loom budgetary challenges on the horizon because of a range of structural factors. The systems that defense firms are producing today are increasingly sophisticated in technological and service terms. As 'Augustine's Law' dictates, governments will continue to want to field high-tech military capabilities but it will simply become more and more expensive for them to do so. They will probably buy less armament and rely on sophisticated systems to serve as a sort of Swiss Army Knife. Furthermore, governments will have to weigh up how much they invest in new acquisitions compared to the money they need to service legacy capabilities. This 'bow wave' of budgetary restrictions may lower the appetite for new high-tech solutions, which would not be good for Europe's strategic autonomy or its defense industry.

What is more, international competition in defense markets is only set to rise. At present, America has secured the lion's share of foreign contracts but we wait for China to seriously enter the market beyond the small arms and drones it currently exports. Europe will continue to rely on exports for any new armaments programme it launches, but there will be fierce competition from the US and new market players. For Europe, this poses a particular dilemma because the European market is home to intra-EU competition and competition from American firms too – the US market is still overwhelmingly closed to European or other global firms. Of course, Europe can still maintain its military edge in this climate by simply buying off the shelf American solutions, but at what cost to its defense technological and industrial base?

If European governments are serious about ensuring an adequate level of strategic autonomy in defense, then investment is key: reliance on the European Defense Fund while governments slash defense budgets will not do. Yet, there is a bigger challenge on the horizon. We may fool ourselves that the problems facing the European defense market are economic in nature (e.g. consolidation, fragmentation, duplication, etc.). The reality is that the problem is political. European governments have not yet collectively decided on what type of defense actor the Union should become, and they may be incapable of doing so. This is a core problem in European defense.

Industry needs governments to lead with major defense capability programmes and a clear sense of the likely future demand is required. What is more, European governments need to be more open about the types of defense technologies they want to be able to autonomously develop, purchase and use together. Without an answer to this question, European defense is likely to disappoint – again.

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