

Beyond the 'guns or butter' dilemma The December European Council and the future of the European defence industry

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An overdue appointment with the European defence industry

On 19 and 20 December 2013, the European Council will discuss the state of Europe's defence industry as part of its wider agenda on the Common Security and Defence Policy (CSDP). Following an earlier mandate of the Heads of state or government in December 2012, the European Commission, European Defence Agency (EDA) and European External Action Service (EEAS) have presented a number of policy proposals to strengthen the European defence technological and industrial base (EDTIB) through the Commission's Communication, 'A New Deal for European Defence' and the High Representative/Vice President's 'Final Report on CSDP'. Such a high-level 'appointment' with the sector was long overdue.

By providing European armed forces with cutting-edge military capabilities, in 2012 the European defence industry generated around 1,360,000 direct and indirect skilled jobs, a turnover of €96 billion and €3 billion worth of R&D with spill-over effects in electronics, space and civil aviation. Despite its significant contribution to Europe's growth, including via *niche* productions by around 1,300 small and medium-sized enterprises (SMEs), the EDTIB has been severely affected by uncoordinated austerity-driven cuts in European defence spending (around -20% between 2005 and 2013 in real terms), including in R&D and procurement, with a likely exhaustion of major programmes in the next few years. These trends are in deep contrast with rising spending by BRICS countries.

Moreover, the European defence market remains fragmented due to nationally-defined demand, supply and regulations, and is affected by inefficient equipment duplications. Also, Member States' use of Article 346 TFEU, exempting application of EU rules on procurement for national security reasons, can easily result in disguised protectionism. This has prevented European companies from reaching those economies of scale and financial critical masses often experienced by their US competitors, while further industrial consolidation remains heavily influenced by national political and socio-economic imperatives.

Due to stagnating domestic demand and market opportunities, many European companies have increasingly diversified globally, building on the dual-use features of their technologies and/or massively turning to emerging export destinations in Asia, South America and the Middle East. Yet, there they have become exposed to local requirements of technology and know-how transfers or production reallocation, with detrimental effects on their long-term competitiveness.

Given the far-reaching technological, economic and security implications of a potentially abrupt 'defence de-industrialisation' in Europe, the EU has been increasingly involved in framing an embryonic 'governance system' for the sector, whose foundations were laid by the establishment of EDA in 2004, its EDTIB Strategy in 2007 and the Commission's market-focused work-strand, culminated in the adoption of the Directives on defence and security procurement, and on intra-EU transfers of defence-related products in 2009. In parallel, a specific Commission-funded civilian security research programme has been running since the 2007 Seventh Framework Programme.

Despite the encouraging progress in the last decade, EU policies are affected by severe limits, including reluctant involvement by bigger Member States in – and inadequate budgetary resources for – EDA, non-application of the new EU rules in government-to-government sales and international agreements, political and legal 'red lines' to the Commission's deeper involvement in defence, as well as a slow and potentially unbalanced implementation of the 2009 Directives across Europe.

A politically-driven roadmap for EDTIB: challenges and priorities

Admittedly, the sector's inherent sensitiveness is likely to lead to the European Council's conclusions being far too vague to be translated into concrete action. Indeed, it is difficult to achieve consensus among Member States with dissimilar security perceptions, capability goals, productive capacities and 'industrial philosophies'.

Divergences particularly affect those seven countries (France, Germany, UK, Italy, Spain, Sweden and Poland) concentrating more than 90% of European production, with clear-cut rifts between 'pro-competitiveness' (e.g. Sweden) and 'pro-sovereignty' (e.g. Poland) players, private (e.g. Germany) and state-centred (e.g. Italy and Spain) models, Transatlantic (e.g. UK) and 'Euro-global' (e.g. France) approaches, with a unique policy mix for each country. All this gives rise to recurrent policy cacophony on key issues such as industrial consolidation, 'regional' vs. 'market' specialisation, 'buy European' practice and EU-wide collaboration. This was epitomised by the recent 'EU Council Conclusions on CSDP', where defence ministers hardly agreed on a rather 'cold welcome' of the Commission's Communication and tasked it to make further proposals on SMEs, standards and certifications, and CSDP-related research topics, in cooperation with EDA and national capitals.

The apparent lack of a shared vision is highly risky, since dispersed national or sub-regional initiatives are simply insufficient to guarantee the sector's long-term sustainability, autonomy and competitiveness, thus undermining fulfilment of the targets set by the Commission's 2012 Industrial Policy Communication. This demands a genuinely political and policy cross-cutting reflection based on the overarching logic of European interdependence.

European leaders should therefore use the Summit to inaugurate an incrementally ambitious and periodically reviewed 'roadmap for EDTIB'. This primarily requires addressing the underlying question of European defence integration by framing a more capable CSDP, designing a fully-fledged Common Armament Policy, 'disambiguating' the definition of EDTIB and 'operationalising' its Strategy based on clearer identification of Europe's capacities and dependencies.

Building on that, Member States should agree on systematically pooling R&T/R&D via common budgetary benchmarks and maximised synergies with the Commission and EDA's respective security and defence research agendas, but also carefully examine the 'game-changing' potentials of Commission-financed, purely military R&T. In parallel, they need to launch new collaborative procurement programmes to fill priority European capability gaps through harmonised requirements, while considering complementary options like EU-owned dual-use assets.

Fuelled by these 'upstream' measures, further unlocking of Europe's domestic markets must be pursued, including through equal implementation of the 2009 Directives and fuller access by SMEs to non-domestic procurement, enhanced intra-European security of supply and regular consultation *vis-à-vis* non-EU foreign direct investment inflows.

The long-term implications of more EU defence market integration inevitably entail a continuing, mature debate on industrial re-structuring, based on demand consolidation and EU-supported adaptation and mitigation strategies, but also on appropriate national measures. In order to do so, EU governments should raise more public awareness of the benefits of an efficient EDTIB through constructive engagement with 'non-converted' sectors of European societies and politics. Clearly, building wider internal consensus also requires more transparent practices by industry and public buyers alike, both at home and abroad.

Such comprehensive and multi-level response should be supported by a robust and impartial EU institutional framework, including via stronger resource endowment for – and clearer division of labour between – the Commission, EDA and EEAS. While the EU's involvement clearly needs to prioritise internal issues, the external dimension could be investigated further, notably by exploring the potential of possible EU support to European consortia in export markets and promoting meaningful intra-European debate on Transatlantic defence industrial relations, given the ongoing Transatlantic Trade and Investment Partnership negotiations.

Macroeconomic theory has sometimes depicted choice between military and civilian production as a 'guns-or-butter' dilemma. Yet, the proven economic benefits of 'defence-born' technologies demand a truly cultural shift in European public policies. Current and future EU leaders must start conceiving their defence industry as a truly strategic investment in security, jobs and innovation, to the benefit of all European citizens. Failing to do so, or acting too late, might just leave the continent at the mercy of others.

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These issues are also being discussed within the context of the EPC's Industrial Policy Task Force.

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