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February 2014

SECURITY POLICY BRIEF

An Industrious European Council on Defence?

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The December 2013 Council meeting set in motion a number of important "roadmaps" for defence-industrial policy in Europe. Now the member states, the European Defence Agency and European Commission need to be aware of the potential roadblocks ahead.

The December 2013 European Council meeting on defence has come and gone. As expected, there were no major revolutionary steps forward but more of a measured and systematic response to the future direction of European defence. The ability of the member states to agree to initiatives on air-to-air refueling, remotely piloted air systems (RPAS), satellite communications and cyber security is a step in the right direction. Some important steps were also taken in the sphere of defence-industrial policy including calls for greater certification and standardisation for defence equipment, to step-up defence-related research cooperation, to support small and medium-sized enterprises (SMEs) and to encourage security of supply.

THE ROADMAP

The European Council should be applauded for putting defence-industrial matters on the agenda at the highest level in the European Union (EU), even if the conclusions agreed upon in December reflect issues that have long afflicted European defence markets. The member states not only reiterated the importance of the European Defence Technological and Industrial Base (EDTIB), but they also stressed the absolute need for EU law and its ability to shape Europe's defence markets. The member states stressed 'the importance of ensuring the full and correct implementation and application' of the "defence package" – two EU Directives agreed upon in 2009 on intra-EU defence equipment transfers and defence procurement. In this regard, the European Council welcomed the European Commission's 2013 Communication on defence.

In response to the pressing needs of Europe's defence industry, the member states agreed to four specific work areas in the Conclusions (see pp. 8-10):

1) Research – Dual-Use: the Council recognised the critical importance of technological expertise to the defence industry. The Council called on Member States to increase cooperation on Research and Development (R&D) programmes and investments. The

Council also invited the Commission and European Defence Agency (EDA) to develop policies that would stimulate dual-use research, and it announced that a preparatory action on Common Security and Defence Policy (CSDP)-related research would be set up.

2) Certification and Standardisation: the Council acknowledged that the development of European standards and certifications for defence equipment could drive down costs, harmonise demand and enhance interoperability. On this basis, the Council is waiting for a joint EDA-Commission roadmap on defence standardisation, which should be ready by mid-2014.

3) SMEs: the Council recognised that SMEs can be a source of innovation and are vital to the EU's competitiveness. The Council welcomed the Commission's proposals on promoting greater defence- and security-market access for SMEs. It also strongly encouraged more involvement by SMEs in future EU funding programmes.

4) Security of Supply: the Council emphasised that without security of supply in defence markets there could be no development of long-term planning, cooperation or the proper functioning of the internal market. The Council called on the EDA, European Commission, Member States and the High Representative to design a roadmap for a "comprehensive EU-wide Security of Supply regime".

THE POINT OF DEPARTURE

The December Council could not have come at a more important time for the defence-industrial sector in Europe. Indeed, the EDA recently estimated that the total level of defence expenditure across the 26 participating member states of the Agency decreased by €1.1 billion in the space of a single year from 2011-2012. A total of €189.6 billion was spent on defence in 2012; the lowest amount since 2006. R&D and Research and Technology (R&T), critical components of Europe's defence-industrial evolution, also decreased sharply. From 2006 to 2012, R&D saw a 38% decrease in expenditure levels whereas R&T decreased by 27.4% (European Defence Agency, 2013). Most of the key factors that go into strengthening the EDTIB are on the wane. On top of these reductions are the extant problems of market fragmentation, capability duplication, procurement transparency, etc.

The problem is deeper, however, when one looks at the state of Europe's prized defence-industrial champion: the European Aeronautic Defence and Space Company (EADS). Following the failed 2012 merger between BAE Systems and EADS, and the subsequent moves by EADS to re-balance the state-to-private composition of their board, in May of this year the company will effectively off-load its defence-related business and take up a new name: Airbus Group. This is hardly the inspirational company name that was meant to symbolise private and state defence cooperation in Europe. Airbus Group will focus mainly on civilian aerospace now.

The recent of history of EADS is a good barometer of all that is wrong with the defence industry in Europe. With low demand for military equipment, the high costs of R&D and technology development and increasing international competition EADS has no choice but to make rational decisions based on the current state and future forecasts of the defence sector in Europe. EADS is consolidating its defence portfolio by bringing together Airbus Defence and Space, Astrium and Airbus Military in order to cut costs in the face of a lack of demand: as one might say, while the "strategic direction is away, the markets will play". Defence-industrial consolidation in Europe is currently rudderless and without political direction, so the markets are steadily ensuring that Europe's defence

firms turn away from military business in favour of civilian contracts.

Demand is the key to keeping companies such as EADS, with their wealth of virtual and human technological know-how and capital, in the defence sector. Yet quite how the EU member states foresee themselves giving direction to and consolidating their future military capability needs is still an unanswered question. True, the December Conclusions talk about the need for more coherent defence planning across the member states; both within the EU and NATO. However, the emphasis has been placed on the naming of collaborative armament projects such as RPAS. To be sure, such projects do much to boost trust between and political buy-in from the member states but they do not in themselves constitute the level and type of demand required by European primes, tiers and SMEs. A common European RPAS will not be enough to fill the order books.

THE POTENTIAL ROADBLOCKS

Even though the Council has made clear that there are to be no detours or pit stops, no journey would be complete without a few bumps in the road or even perhaps a roadblock or two. The four initiatives selected by the Council are open – and indeed prone – to political problems. Firstly, the research and dual-use track will see the EU structural funds – worth €325 billion over 2014-2020 – and COSME (the Commission's Competitiveness of Enterprises and SMEs initiative), Horizon 2020 and Framework Programme 7 (particularly the Security Research Programme, which places great emphasis on dual-use technologies) mechanisms come into play. Such an initiative makes clear sense; if member states will not invest in defence R&D, then the EU will support SMEs to do so.

The idea here is to integrate disparate industrial bases: the military and the commercial. Yet there is a danger in promoting dual-use research. In a world where military-specific R&D is healthily maintained, it makes sense to promote civil-military cooperation. Europe, however, is not home to healthy levels of R&D outlays. The danger is that the *commercial world* – where the rationale for product design and production is profit – and the *military world* – where the rationale for product design and production is security, strategy and warfare – may engage in an unhappy marriage with companies rather than the military defining technological needs and possibilities. Civilian products may sometimes be too costly to adapt for, and technologically ill-suited to, military purposes; that is unless militaries are willing to accept more of a commercial paradigm for their politico-military strategy making.

The issue of SMEs will more than likely see the Commission explore how Horizon 2020 and the structural funds could be used for defence-relevant companies. The Commission will most likely be successful in leveraging its financial and policy tools for the benefit of SMEs, but this is bound to cause a degree of friction between the different types of defence firms. Primes might be disgruntled as to why SMEs are getting special attention when it is them and top tier firms that are responsible for most of the R&T and R&D behind the production of defence capabilities for which most SMEs are incapable. Primes and top tiers have long held that EU funds channeled through them would be a good way of trickling down the benefits to SMEs, as orders come in and supply chains for finished products become engaged. However, the Commission is essentially hamstrung when it comes to primes and top tiers because of the restriction on EU funds being utilised for strictly military purposes.

One solution could be to look for alternative sources of funding in the constellation of EU financing mechanisms. Any such alternative would have to be made available to primes, tiers and SMEs if it is to truly integrate the

defence industry. One such suggestion forwarded by this author (Fiott, 2013) is to make better use of the € 242 billion of available capital at the European Investment Bank's (EIB) disposal. In line with Article 309 of the Lisbon Treaty, the EIB is free to fund military and civilian projects so long as they yield a return. EIB loans usually fund up 50% of a particular project by raising capital on international markets at reasonable rates, with projects focused on innovation and regional development – two areas that relate well to the defence sector – being favoured. Loans are approved by the Board of Directors – a body made up of member state representatives, a Commission representative and others – on the basis of a majority vote consisting of at least one third of the members able to vote and representing 50% of the subscribed capital invested by the EU member states (European Investment Bank, 2014). Using the EIB may not overcome institutional and political friction but its 'loans could be a lifeline to the EDA […] which has seen its operational budget cut over successive years' (Fiott, 2013b: p. 74).

There are two reasons for the Commission's emphasis on support for SMEs. Firstly, by stressing SMEs – which tend to produce dual-use goods and services – the Commission can draw on the EU budget and other community tools, giving it an important buy-in to European defence-industrial policy making – the Commission is marginalised when it comes to supporting firms that produce purely military products (Fiott, 2013a). Secondly, as many primes are heavily interdependent with and sometimes owned by national governments – in the EU and elsewhere – this allows the Commission to avoid any uncomfortable political entanglements. The Council's endorsement of the importance of SMEs has derived from two sets of interests: i) from those member states with primes and top tier firms that do not want the Commission to become involved with national dynamics; and ii) from those member states which have no primes or top tiers and that want support from the Commission for their national industries.

SMEs are also linked to the issue of security of supply. While it might be true that to increase the supplier base available to member states may ease security concerns, it is also important to ask whether this supplier base is reliable and able to deliver quality defence equipment and componentry on time – relying solely on markets does not always ensure supply security (Fiott, 2013b: p. 76). An open market, transparent procurement framework and an increased supplier base through support to SMEs will no doubt form the backbone of the Commission's future Green Paper on security of supply.

Putting in place an EU-wide security of supply regime will therefore be challenging. The first hurdle will be to define "security of supply" as it relates to the defence sector. No state has ever really managed to obtain complete autarky in defence supplies, and the member states will certainly not attempt to rely on Europe's own stocks of raw materials and productive factors to supply the defence sector: they realistically cannot given Europe's resource constraints. The question will be whether the EU can put in place a security of supply regime that does not discriminate on market grounds.

Certification and standardisation may also be a cause of friction. On the table in this regard are Chemical Biological Radiological and Nuclear (CBRN), RPAS and military airworthiness. Given the emphasis on dual-use items, surely the idea of standardisation would somehow have to be extended to the civilian sector. Given the importance of innovation in non-defence markets –think about how the operational distinctiveness of an Apple iphone and a Blackberry are their respective selling points –, is the EU sure that civilian operators will be comfortable with defence standardisation requirements? Some defence firms may also object. Further still, given the

emphasis on dual-use items and the greater participation of the civil sector, how will commercial operators be fed into equipment programmes that are marked as "top secret". Again, the issue of security of supply – of information in this case – rears its head.

FINAL DESTINATION?

The fact that the European Council has called for a number of defence-industrial roadmaps may imply that the EU is still at the beginning of its journey towards a strengthened EDTIB. This may console some, but it may worry others. How can the EU only be at the beginning of its journey if its defence-industry is in such disarray? This is a justified question but one that is only partially reflective of reality. True, there is still a long way to go before the Europeans have anything like a sustainable and strong defence industry. Consolidation is still high on the agenda, as is putting in place a legal framework under EU law that works effectively. Yet the Europeans have been on the journey towards a strengthened defence-industry for decades: indeed, the European Defence Community and the Western European Union deliberated defence-industrial matters.

The enduring problem has always been the tendency for member states to fall back on their own national positions. Just when one thinks a merger between Europe's industrial powerhouses is on the cards for example, governments intervene to protect their interests and scupper the deal. The careful reader of the December conclusions will note that no remedy for such national positions is given, yet at least two of the four specific future work areas selected by the member states – standardisation and security of supply – strike at the very nerve centre of national sovereignty. The European Commission should be able to make important progress on SMEs and research over the next few years, but it remains to be seen whether or not the tension between national interests and European cooperation in areas of sensitive defence-industrial policy will lead to a *cul-de-sac*.

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