

# The European Investment Bank could help meet some of the challenges facing Europe's struggling defence industry

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*European countries face significant challenges in funding defence research and development programmes. Among the most important are declining defence budgets, fierce international competition, and the increasingly expensive nature of high-end technologies. Daniel Fiott argues that the European Investment Bank could play a much greater role in Europe's defence sector and serve as a life-line to defence research and development, dual-use projects and small and medium sized enterprises.*



However highly one might rank the importance of security and defence, the reality is that governments have to make difficult decisions as to how national budgets should be spent. Nevertheless, at the December 2013 European Council meeting on defence, heads of government agreed that "defence matters". In [mid-2013](#) I suggested that the European Investment Bank (EIB) could potentially finance certain defence-industrial initiatives at the EU-level. The suggestion has since been echoed by a number of [groups](#) and [individuals](#). Furthermore, the December 2013 [draft conclusions](#) specifically invited the European Commission and the European Defence Agency to draw 'on the financial expertise of the European Investment Bank', even though this line did not appear in the final conclusions.

## The European Investment Bank

The EIB is owned by, and works in the interests of, the EU member states. With over €242 billion of available capital, the bank made project loans totaling €71.7 billion in 2013 – this amount is more than the combined total of French and German defence expenditures in 2012. The Bank principally finances up to 50 per cent of total costs for public and private projects that exceed €25 million in value: all projects must be economically, financially and technically feasible and environmentally sound. The Bank, along with the European Commission and participating public/private banks and institutions, is also a shareholder in the European Investment Fund – the Fund has a range of financial products to offer small and medium sized enterprises (SMEs).

The Bank can directly issue loans to SMEs or it can make loans through public bodies (called 'intermediated loans'). The Bank also offers guarantees and securitisation to businesses so that projects can be made more attractive to other investors. Alternatively, the 'Risk Sharing Finance Facility', which is jointly run by the EIB and the Commission, provides a maximum of €10 billion in loans, guarantees and investment for complex, long-term and public/private research, development and innovation projects such as applied or industrial research, feasibility studies, experimental development and pilot projects.

Furthermore, the European Investment Fund (EIF) specialises in venture capital investment for SMEs and the Bank holds a 62.1 per cent stake in the Fund, along with the Commission (which represents the EU with a 30 per cent stake) and a number of private banks (a total stake of 7.9 per cent). The European Investment Fund comprises two financing vehicles. Firstly, the Joint European Resources for Micro to Medium Enterprises (JEREMIE) allows national and regional authorities to redeploy part of their structural funds into market-driven financial instruments. Secondly, the fund provides risk capital to fund managers for SMEs developing projects that use advanced technologies.

## How the European Investment Bank could help support the defence industry

Many of the aforementioned products and facilities potentially offer financing options for the European defence industry, albeit in very specific ways. For example, while the EU's structural funds and budget comprise an important element in the development of dual-use projects and support to SMEs, these instruments cannot be used for 'purely'

military projects. However, under Article 309 of the consolidated version of the treaties, EIB and EIF instruments can theoretically be used *in all sectors of the economy* to modernise, convert or develop fresh activities that benefit the internal market.

This certainly applies to those elements of Europe's defence sector that are increasingly seen as falling under the internal market. The Bank could sure up the attractiveness of defence-relevant SMEs to other investors; lend credibility and resources to SMEs seeking investment to develop innovative dual-use projects; and encourage civilian SMEs to engage in defence-relevant research and development (R&D) and demonstrator projects. Such an initiative could tick the boxes of promoting economic knowledge, skills and innovation and it could eventually also enhance the international competitiveness of those SMEs involved in such R&D programmes. The spin-off technologies that derive from such initiatives may eventually benefit the commercial sector and lead to the type of profits that can be used to repay loans.



European Investment Bank, Credit: Forgemind ArchiMedia (CC-BY-SA-3.0)

Additionally, regional clusters specialising in industrial niches (also known as “clusters of excellence”) could benefit from EIB/EIF involvement. Such clusters are premised on the idea that large firms, SMEs and research centres are combined in close geographic proximity in order to increase R&D collaboration and specialise in a specific technology area (e.g. aircraft engines). Financial and political investment in these clusters – specifically for pilot projects – is critical if defence firms are to commercialise their technologies, internationalise their business and benefit from the structural funds; smart specialisation is a pre-condition for access to structural funds. Such investment could have positive knock-on effects for regional skills development, the high-tech knowledge base and scientific/industrial interdisciplinarity.

However, while the Bank potentially offers a range of useful instruments, it would not be a panacea for Europe's defence industry. Bank finances cannot fill the gaping holes in the defence budgets of member states, nor could they be used to maintain and acquire new military equipment and capabilities. The intrinsic nature of loans and investments is that they need repaying (with interest); defence, as a public good, does not always result in the kind of returns necessary to service loans.

There are some further, more specific, restrictions involving the EIB. Firstly, should member states want to draw on Bank loans they would still have to put up the other 50 per cent of the funds needed for EIB participation in projects over €25 million. These loans would also come with interest payments and expenses (legal costs, project-appraisal, etc.) which may drive up the costs of a loan. Secondly, the Bank takes seriously the EU's principles on public procurement: equal treatment, non-discrimination and transparency. Despite the provisions of the EU Directive on defence procurement (2009/81/EC), this could be a big hurdle in the EU defence-sector where open procurement is not the norm. From August 2011 to March 2013, for example, the [European Commission](#) estimates that only 3 per cent of total contracts awarded under the procurement Directive were cross-border in nature.

Finally, loans made under the EIB are not free from political considerations. While the EIB is an independent institution, its shareholders are the member states. France, Germany, Italy, Spain, Sweden and the United Kingdom (Europe's major defence-industrial players) contribute approximately 76 per cent towards the EIB's [capital base](#) of €242 billion. These states are likely to be reticent about what EIB support will entail. Therefore, it is little wonder that heads of government dropped any reference to the Bank in the final conclusions of the December 2013 European

Council on defence.

Nevertheless, despite the sensitivities and obstacles involved in drawing on the EIB for defence-industrial initiatives, there is still scope for the Bank to play a positive role. It is principally the European Commission, given its connections to the EIB and its 30 per cent stake in the EIF, that can make the case for greater involvement of the Bank in European defence. Building on its policies aimed at SMEs and regional smart specialisation, the Commission could investigate the ways in which the Bank might play a role in promoting economic knowledge, skills and innovation in the European defence sector.

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*Note: This article gives the views of the author, and not the position of EUROPP – European Politics and Policy, nor of the London School of Economics.*

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