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THE EUROPEAN ARMAMENTS SECTOR: THE NEED FOR THE STATE TO ADAPT

The parameters of the European armaments sector have undergone significant change in recent years. The states' armaments policies have only partially taken this transformation into account so far. Multilateral arms cooperation has been slow to develop. The necessary structural improvements in the defense industry are sometimes obstructed by protectionist measures. Unless coordination within the European armaments sector is improved, the freedom of action of European states in security and defense matters will be degraded in the medium and long term.

German-French press conference at the seat of Airbus in Toulouse, 16 July 2007

The core function of the armaments sector is to equip and supply the armed forces with effective products. By developing and maintaining military capabilities, it contributes to the state's overall capacity to act. The sector is shaped by the state's armaments policy on the one hand, and by market and production structures on the other.

Since the end of the Cold War, the parameters of the sector have changed significantly, but also asymmetrically. As a result, the rationales of the market and those of armaments policies are occasionally at odds with one another. While economic considerations militate in favor of an internationalization of supply and demand, defense and procurement planning generally remains limited to the national level. This is due to the dilemma of a common armaments policy, which makes sense economically, but also threatens to undermine the autarky of the individual state defence matters. However, it is becoming more and more obvious that national armaments policies in Europe are coming under increasing pressure to adapt.

Challenges in armaments policy

In terms of armaments policy, the European states are today faced with a multifold challenge: They have to maintain the operative and strategic effectiveness of their armed forces against the contradictory relationship between decreasing resources and increasing numbers of ongoing operations. Despite the military engagements in the Balkans as well as in Afghanistan and in Iraq, defense budgets have not recovered from their massive cutbacks after the end of Cold War. In those states where defense expenditures have been slightly increasing again in the past few years, the added funding has rarely been used for investments in military capabilities or equipment. Frequently, these sums only cover the increased attrition of material due to the many military operations.

The problem is aggravated by the necessary, but cost-intensive transformation of capabilities. Against the background of changed threats, appropriate military equipment not only needs to be adapted to a new mission spectrum via cost-intensive technological innovations. An additional requirement is that of interoperability. Since military missions today are mainly undertaken in multilateral frameworks, the use of compatible or jointly developed arms products and maintenance concepts as well as standards and procedures is a key to higher effectiveness and lower costs.

Limited Europeanization

In view of these developments, coordination between the various national armaments policies seems advisable. However, no such systematic approach can be discerned so far. Instead, several loose forms of intergovernmental armaments cooperation have emerged since the 1990s. A process of Europeanization of armaments policies is still far off.

Within the framework of the Western European Union (WEU), the Western European Armaments Group (WEAG) and the Western European Armaments Organisation (WEAO) were created in order to coordinate research and arms procurement. In the "Letter of Intent" (LoI), the six major EU arms-producing countries (France, Germany, Britain, Italy, Spain, and Sweden) agreed to coordinate the restructuring of their defense industries and to make it easier to engage in cooperative arms projects. Another body based on a limited membership is the *Organisation conjointe de coopération en matière d'armement* (OCCAR). It serves as a management organization for multilateral arms procurement projects. Additionally, several NATO bodies deal with the coordination of procurement, standardization, interoperability, and research and development.

The European Defence Agency

The outcome of these efforts so far has not been a more efficient European armaments policy, but an increase in institutional diversity in Europe, with overlapping memberships and potential responsibilities. The remarkable progress of European Security and Defence Policy (ESDP) in recent years has given rise to new hope that systematic European armaments cooperation can be built up within the framework of the EU.

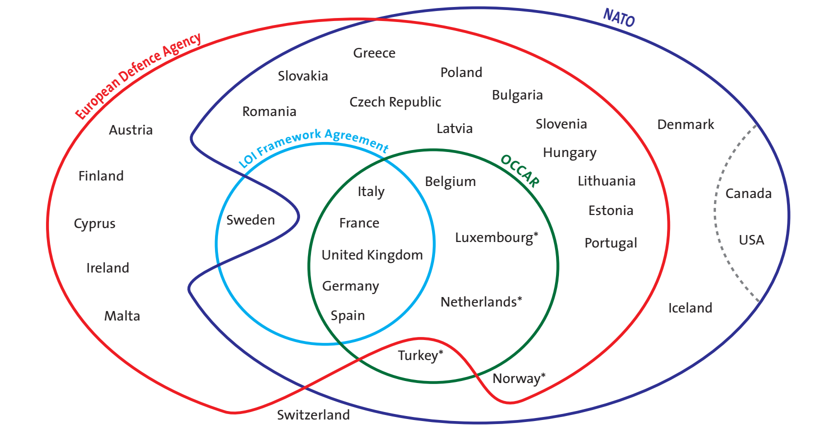
The European Defence Agency (EDA) has the task of supporting the EU states in the development of military capabilities for crisis management operations. In this context, its agenda reflects all aspects of the armaments sector in Europe. Its purpose is to coordinate, optimize, and harmonize cooperation between the member states. The EDA has already taken some initial steps towards a more Europeanized armaments policy. For example, the inefficient WEAG and WEAO were dissolved and their projects transferred to the EDA. Also, a systematic integration with OCCAR is currently underway. Furthermore, initial successes are being registered in the regime created in 2006 to promote international tendering of procurement projects and in the joint investment program in the area of research and technology.

It is worth noting, however, that the EDA's room for maneuver is limited. As an intergovernmental institution, its task is to support the EU member states. Besides, Article 296 of the EC Treaty de facto exempts the armaments sector from any Community initiative. Accordingly, the success of the EDA as well as any initiative of the EU Commission depends on the political will of the national governments.

Obstacles to cooperation

This political will has often been lacking. Overall, armaments cooperation in Europe is largely determined by ad-hoc programs and has hardly had any restructuring

Multilateral armaments cooperation in Europe



* Participating at program level

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effect yet. There are four main reasons for this. First of all, many arms-producing states continue to perceive their national independence and the security of supply to their armed forces as being linked to the maintenance of their own armaments industry. Secondly, the divergent national security concepts result in different demands for capabilities and correspondingly different role conceptions for the national defense industries. Thirdly, there are varying views as to the role that the state should adopt towards its own defense industry – as a regulator, as a shareholder, and as a customer. Fourth, only very few European countries have a comprehensive production infrastructure of their own, leading to heterogeneous procurement and market policies. Arms-producing countries often prefer the products of their own industry. Moreover, among the bigger producing countries, there is a continuing tendency to maintain as broad a range of national production capacities as possible. Non-producing countries, on the other hand, do not even necessarily purchase their defense products on the European market, but from the US, for example.

The state and the armaments industry

While the European states are very hesitant in overcoming the fragmentation of their armaments policies, many of the structures and processes related to the defense market and armaments production have become strongly internationalized. Defense companies are competing in an increasingly globalised environment for profits and market shares. These changes came about due to the sharp reductions in defense budgets in the 1990s. Like the US, Europe experienced a consolidation of production capacities through acquisitions and mergers and rationalization efforts. The result was a concentration of production capacities in the shape of large, occasionally multinational defense corporations such as BAE Systems or EADS. At the same time, the network of subcontractors, i.e., suppliers of components and parts, has become more transnational. Due to the decline of domestic demand, there is an increasing need to boost exports in order to ensure that production lines operate at full capacity and that unit prices remain competitive via economies of scale. Thus, the shrinking of markets has led to their globalization. This tendency is likely to continue as long as investments in the domestic markets do not increase significantly.

However, in Europe these developments have not extended equally to the whole defense industrial sector. The consolidation of production capacities and the creation of multinati-onal corporations have primarily affected the aerospace and electronics sectors. The market segments for land-based and maritime systems remain fragmented. This fragmentation is due to the structure of regulatory policies towards the European armaments sector. Due to heterogeneous national rules and procedures for procurement, competition, etc., it consists of several small national markets instead of a single, but bigger European one.

The consequences are severe for both suppliers and customers. The fragmentation of demand has lowered the influence of the individual customer vis-à-vis the producer and the product specifications. Moreover, the downsizing of armed forces has been accompanied by shrinking procurement budgets. Lesser demand, however, has led to higher costs per unit as investments had to be allocated to smaller production lots. Thus, in a sense, the state today pays more because it buys less.

On the producer side, to compensate to some extent for these price increases, participation in the international markets and production chains has become indispensable. Here, especially small and medium-sized companies – which do not have national branches in every important state – depend on simplified access to these markets. However, not only these companies, but all non-domestic suppliers find themselves in conflict with the prevailing practice of governments, which protect their national markets and suppliers, e.g. through individual procurement policies and regulations for tenders. These tend to prefer domestic contractors and hinder international competition and participation in domestic tenders. The only actors that are exempt from this practice are major companies that act as prime contractors in intergovernmental multinational procurement projects. However, such projects are typical examples of protectionism or state subsidies through the "juste retour" practice, which guarantees the distribution of the budget to the participating suppliers along a politically negotiated distribution key.

The resulting deficient competition among producers as well as different forms of state aid gave rise to duplication of production capacities as well as of research and development activities. At the same time, many producers are losing their potential international competitiveness and market shares due to the national protectionist measures, while other uncompetitive domestic suppliers are kept alive without being forced to adapt to the current state of market affairs or cutting-edge products. Consequentially, the products of these domestic suppliers are becoming less attractive or affordable for European customers, as the latter have to insist on best value for money due to the known budget restrictions.

Ironically, a vicious circle results if the domestic producers fail to achieve the necessary revenues even despite these state measures. They are then forced to compete on the international markets, where they in turn experience discrimination against non-domestic suppliers. Additionally, as they adapt their product range towards the export markets, they find that equipment requirements are rather heterogeneous due to incompatible national armament policies. Accordingly, they may be less able and willing to deliver the products demanded domestically. In turn, some states that have a long tradition of state subsidies to their defense industry find themselves left alone once "their" companies adapt to the market structure.

The prevailing pursuit of national armaments policies no longer reflects the market realities of the armaments sector. While the current practices aim to ensure the survival of individual companies in the short term, in the longer term, they prevent the necessary consolidation of the defense industry in Europe. Economic pressure towards structural changes that can enhance efficiency and reduce costs is alleviated. With a view to the defense industrial and technological base, the question is no longer which capabilities should be preserved by the nation-state, but which ones Europe requires. Today, no single European state retains the ability to produce and develop the entire range of capabilities on its own. The vision of national security of supply and independence becomes unaffordable. Instead, international dependencies in production, supplies, and services will become the norm.

The future of the armaments sector

If European states are unable to acquire effective military capabilities from economically competitive producers, they reduce their security policy options as well as the operative safety of their armed forces. The national regulatory approaches to the armaments sector have reached their limits. As the industrial dependency of states on non-national supplier will inevitably increase, the only remaining question is whether the European states will actively shape the necessary restructuring. This will decide whether their political interests can be brought to bear on the process, or whether the outcome will be left to market forces. At this point, the Europeans at least can still decide on whom they wish to be dependent and to what extent the relationship should be an interdependent one.

Systematic cooperation in armaments policy will be the key to achieving such necessary influence. The litmus test will be whether the states are prepared to give up national jurisdictions, revise relations between the state and the private sector, and discard their established points of view. If they are not prepared to do so, the current suboptimal structures in the armaments sector will essentially remain in place. Cooperation would have to remain intergovernmental, which in return sets small margins for long-term accountable commitments. Cost savings can be realized through pooling of existing national capabilities. Further potential would be limited to ad-hoc arrangements in crisis situations and during individual operations.

This characterizes the current practice in the EU and NATO. One example is the Movement Coordination Centre Europe created by 15 states in order to coordinate their national sea, land, and air transportation assets. Furthermore, pooling through acquisition of capabilities is also a conceivable option. A much-discussed alternative is that of specialized roles, where the individual states would limit themselves to a few military capabilities while coordinating with neighboring countries in order to ensure that all relevant capabilities would be available through a composite structure.

All of these options can be also conceived as intermediate confidence-building steps within a systematic approach towards the whole armaments sector. Such an approach would result in a more integrated, but not necessarily fully-fledged European armaments market. Such an approach would cover all elements and segments of the armaments sector as well as their interplay.

A logical beginning would be a stronger harmonization of capability requirements and of the resulting needs for equipment. This would amount to a harmonization of the demand side. Furthermore, other market instruments might be considered, for which the countries could create an overarching framework in the shape of binding rules and procedures. This might extend to competition law (regulation of state subsidies, control of mergers and acquisitions), industrial cooperation (simplifying transnational cooperation between private actors in the armaments industry), procurement (transparency and harmonization of rules and procedures), and simplified transfer of components in the context of production processes.

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