The EU and defence procurement

By Ian Bond

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Against a background of falling European defence budgets, the European Commission has sought to increase the efficiency of the European defence market by reducing barriers to intra-EU defence trade and by encouraging competition. In principle the UK supports open competition in the defence sphere, but it has been reluctant to accept that the Commission should have a greater role in policing a single market in defence and promoting co-operative procurement programmes.

The advantages and disadvantages of EU action in defence procurement?

The defence budgets of EU member-states have fallen since the start of the economic crisis in 2008 from around €200 million to around €170 million. At the same time, the cost of defence equipment has continued to rise. Defence spending in Europe, though still significant, delivers less than it should because of inefficiencies. Defence companies are often monopolies or oligopolies at the national level, but fragmented and unable to exploit economies of scale at the European level.

Member-states have resisted consolidation and the creation of an effective single market in defence for a variety of reasons. First, despite the fact that most EU member-states are also NATO allies, there is a lack of trust between them: nations continue to procure nationally because they are concerned about security of supply in a crisis. The UK is typical in this: the MOD stated in evidence to the House of Commons Select Committee on Defence in May 2012 that "We must be able to operate, maintain and refresh certain capabilities effectively, without being dependent on others". In some cases this may be necessary, but in most cases, as the government has recognised in its national security strategy of 2010, if Britain is involved in military operations it will be working with allies and partners and relying more on "sharing of military capabilities, technologies and partners". When resources are constrained, it would make sense for the UK to pay more attention to value for money when procuring defence items from allies and partners, and to worry less about theoretical risks to security of supply. In the late Cold War, Czechoslovakia supplied some NATO members with explosives for use in ammunition, despite the fact that they were notionally "the enemy"; so the UK should be able to rely on other EU member-states – some of which have been its allies since 1949.

Second, governments are often keen to protect jobs in their national defence industries, both to preserve skills and to avoid increasing unemployment in areas where other heavy industry, for example shipbuilding, may already have closed. As the European Commission has noted, defence-related industries largely operate outside the single market, and more than 80 per cent of investment in defence equipment is spent nationally.

On security of supply, EU action could help to reassure the UK and others that foreign suppliers will continue to deliver defence goods and services, even in a crisis. The European Commission has started a consultation process with a view to getting a political commitment from member-states to assure the supply of defence goods, materials or services within the EU.

On protectionism, national governments are very unlikely to change their policies unilaterally. The European Commission can therefore play a useful role in ensuring that in defence as in other areas of the Single Market there is a level playing field. The MOD stated in its response to the House of Commons Defence Committee's Seventh Report of 2012-2013 that it supported efforts to open up the defence market to more competition, including through proper implementation of the Defence and Security Procurement Directive (Directive 2009/81/EC), and expected that this would in time eliminate economically-motivated 'buy national' policies in the defence market.

The assessment of costs and benefits from EU rules in the defence industrial sector

National rules implementing the defence procurement directive and a companion directive, 2009/43/EC (which aims to simplify transfers of defence goods items between member states through a system of general licences), were due to be in force by August 2011, but most member-states missed this deadline. The Commission started legal proceedings against four governments that were more than a year late; its July 2013 communication indicates that all member-states have now transposed the two directives into national law. But it is still too early to say exactly how all member-states are carrying out their obligations.

It is also too early, therefore, to say what effect EU rules are having on British businesses. In principle, however, they should be helpful. The UK is one of the six EU member-states with a large-scale defence industry (the others are France, Germany, Italy, Spain and Sweden). The UK defence sector is largely in the private sector and is internationally competitive. As such, it should be well-placed to compete also in European markets, provided that everyone is playing by the same rules. It will be the responsibility of the Commission to police that.

The Commission's efforts to support small and medium enterprises in the defence sector should also help British businesses, by giving them better access to EU-wide markets.

At the same time, a more open and competitive European defence market will create losers as well as winners. British defence firms may also lose jobs as a result of foreign competition, even if the end result, ie better value for money in the defence budget, is positive for the UK as a whole. The Commission has indicated that the European Social Fund and European Structural and Investment Funds could be used to retrain workers and to support regions hit by the closure of defence manufacturers (though it has not suggested how much money should be available). Provided that such aid is fairly distributed, this would help governments, including the British government, to offset the short-term costs of rationalising defence production.

The obstacles to the creation of a single market in defence goods and services

The European Council in December welcomed the Commission's communication on the defence and security sector, and supported full implementation of the two 2009 directives. But the level of enthusiasm for greater EU engagement in defence market issues varies among member-states. The UK is at the most sceptical end of the spectrum, despite its interest both in increased European defence capabilities and increased value for money in its own procurement.

The key obstacles to the creation of a single market are likely to remain: lack of mutual trust among partners; and the tendency of governments to see defence industries in part as job-creation or retention schemes, not just instruments of national security policy.

Further complications may arise from the importance of the US in the European defence market. The scale and sophistication of the US defence sector creates challenges for Europe, and there are differing views on how best to respond. The UK's leading defence firm, BAE, reportedly sells more to the US than to the UK. It also makes use of many US components and technologies, and in most cases seems able to work within the constraints US legislation imposes on their re-export. Other European companies (and countries) would rather avoid using US items and create European alternatives; this could make it easier for them to export goods to destinations (for example in the Middle East) which the US might see as sensitive.

Future opportunities and challenges for the EU in the defence industrial sector

The biggest challenge is the continued reluctance of EU member-states to draw the right policy consequences from continued pressure on national defence budgets, and increase European defence industry integration.

If that can be overcome, there are a number of areas in which the EU (including the European Defence Agency) could make a useful contribution:

★ Harmonising the system for regulating domestic and foreign investments in defence companies, to make consolidation easier while still protecting security interests.

★ Funding research into military capabilities. This does not mean the EU owning its own fleet of drones; but it should mean that when it is difficult for a single nation to fund research, or when different member-states are researching the same area, the EU can put together integrated research projects.

★ Exploring the scope for a 'Defence TTIP'. Defence has not so far featured in the negotiations on the Transatlantic Trade and Investment Partnership. Negotiating an agreement would be formidably difficult: this is an area in which the US is both highly protective of its own market and highly prescriptive about re-exports of US systems or components to third countries. But a more open transatlantic defence market could be transformative for both sides, creating new economies of scale and new opportunities for European defence exports.

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Additional information

Further CER views on the European defence market can be found in:
'The trials and tribulations of European defence cooperation', a policy brief of July 2013 by Clara Marina O'Donnell
'CSDP between internal constraints and external challenges' (EUISS, October 2013), which contains a chapter by Clara Marina O'Donnell on the state of Europe's defence industry
'Not flashy but effective: closer EU cooperation in defence investments', an insight of December 2013 by Clara Marina O'Donnell
'Fail to plan, plan to fail: European security and defence', an insight of November 2013 by Ian Bond

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