

**Summary:** This paper argues that the prospect of transatlantic defense industry cooperation is fading away. Analyzing the implication of the economic crisis on the European and U.S. defense industry, it presents a realistic view of the difficult interaction between political and industrial perspectives in the decision-making process. It outlines different scenarios of the future of transatlantic security cooperation, and highlights the key questions each partner needs to ask itself to promote its strategic interests.

## Europe, the Transatlantic Defense Industry, and How to Make the Right Choice?

by Christian Mölling

### A Little Bit of Context

Building a strong European defense industry will necessitate making hard and strategic choices on two levels. The first will concern hashing out what kind of defense technological and industrial base (DTIB) current political realities call for, and its answer will be found in the definition of the long-term military level of ambition of member states, since there is a strong interconnectedness between the DTIB and the existence of military means. The second set of choices concerns the implementation of the DTIB, and “how” it should be organized to ensure military force responds to future policy options.

In practice, policymakers make their decisions on both levels based on military and other objectives they think can be achieved through defense industry: these include industrial, technological, and social policies as well as political symbols, prestige, etc. Big ticket projects like the Joint Strike Force and the U.K. aircraft carrier are social programs as well as defense programs. However, this inevitably leads to compromises being made on the defense programs, as they get more

expensive and deliver less capability than initially required.

Moreover, it appears that structural characteristics are often ignored in the decision-making process, which represents the extent to which the defense industrial field is uniquely politicized. While many people speak of competition, efficiency, and other targets, this area remains severely characterized by state intervention, as governments play the central role of both customers and regulators. Further to this point, defense makes up one of the largest portions of public procurement in many countries, a process conducted by the state — and one single agency: the ministries of defense.

Governments remain especially interested in a DTIB that offers security of supply, i.e. ensuring a constant flow of defense material and services to armed forces, and assurance against political risks (in case another state blocks the delivery of means of warfare) or industrial risks (whereby companies would no longer be able to insure supply).

The defining issue in security of supply is the tension between

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national desires and the global reality of DTIB. Many states continue to aim for a strong national DTIB, which they consider key to their independence and sovereignty, and remain reluctant to rely on others for the supply of defense material. However, today's DTIBs are essentially international endeavors. States, even the biggest, cannot escape this global dimension.

## European Defense Autonomy: A Dream Almost Over

An assessment of the transatlantic defense industrial structure and issues has to start with the EU — there is no European defense industry. EU member states have constantly argued that a European Defense Technological and Industrial Base (EDTIB) is needed to ensure security of supply for EU member states in order to create the conditions for reasonable prices. However, some European capitals constantly contradict themselves because of their individual political choices. This continued defense industrial nationalism allows the EU to enjoy the diversity of 28 defense markets with 28 different regulations and 28 state customers, who all perceive their needs as unique. Policies therefore continue to be driven by national industrial and technological policies rather than security policy. Old habits also prevail in armaments cooperation: it is the last resort, and if it takes place, governments ensure not product quality but the return of investment into their countries (*juste retour*). Although institutions and rules have proliferated at the EU-level (European Defense Agency, European Commission, Lisbon Treaty articles), they do not have a significant impact. While there is room for industrial consolidation, the possibility of mergers has been hit hard by diverging national industrial interests, as recently highlighted by the failed EADS-BAE Systems merger.

This in turn allows for increased industrial globalization, which creates new and more diversified dependencies.

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While Europe is less dependent on non-EU-system integrators, it has developed multifaceted (inter-) dependencies. Globalized supply chains have made industries — and thus states — increasingly dependent on imported technologies, components, and material. These import dependencies increasingly reach beyond Europe and thus challenge the concept of the EDTIB as the future basis for security of supply. In addition to that, European industries are heavily dependent on exports: the EU's key defense industrial countries export between one-half and three-quarters of their goods, but 60 to 90 percent of these go to non-EU destinations.

A specific issue is the growing realm of defense companies and technologies. Pure defense companies increasingly struggle to survive in a field where civilian technologies are often cheaper or allow for better performance. More and more, military products result from civilian technological developments, with the effect that defense establishments become increasingly dependent on civilian supply chains. Moreover, as the civilian part of the business generates the majority of the turnover and income, it will get ever more difficult and costly for the military to establish highly reliable supply lines.

While certain national austerity measures have already affected the defense industry, the more serious impact is still to come: European countries will have significantly fewer programs and less equipment — hence less to earn through production and service, and more overcapacities. Europe's DTIB may further shrink, since the domestic consolidation into national champions prevents a further Europeanization, and the acquisition of niche companies by U.S. buyers limits a true European strength.

## Transatlantic Defense Industrial Relations: Less Cooperation, More Competition

While the United States is facing the same problems as Europe — namely, a need for exports and imports of cheap components and raw materials — the degree of pressure is by far lower. Moreover, the United States (fortunately) lacks the political nightmare of 28 states and one Commission fighting over their roles in defense industrial decisions.

Even if the orders from the United States are expected to shrink to some extent — due to the end of wars and ongoing fiscal constraints — the United States will still provide the biggest market in the world, to which local

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companies have exclusive access, since the United States, just as Europe, has regulations in place favoring national companies for supply. However, the main business for most of the top U.S. companies remains domestic, since export rates make up for only about 30 percent of average production. Besides the size of the market, the other advantage of U.S. companies is to be found in having just one prime contractor to deal with (the U.S. government) — instead of several small markets as in Europe. From a customer's perspective, the situation may ensure security of supply for almost all critical elements, but also creates the biggest problem of the U.S. government: since there is no longer any serious competition among U.S. companies, this tends to decrease quality and increase prices.

The transatlantic dimension of the defense industry is fading away. Multinational programs are running out, and U.S. sales via the government-supported "Foreign Military Sales" program are either continuing or even better, increasing. Europe is now becoming a true market (and less so a defense partner) as the sale of few F-16s to Romania does not seem to make any sense in military terms. The extent to which EU partners will participate in the F-35 program is also a function of budget. EU sales to the United States are also an exemption: Eurocopter managed to sell new helicopters, and BAE Systems' role in the United States is likely to shrink with the planned drawdown from Afghanistan. Besides this, the role of EU companies in the United States is now limited to second- and third-tier suppliers.

Outside the transatlantic dimension, competition in markets is rising: the United States is the biggest defense exporter, with 40 percent of the world share. Given European companies' increased push for exports, EU and U.S. companies often meet as rivals over tenders for jets and tanks in Asia, Middle East, or even in Europe.

A glimpse of hope for transatlantic cooperation may arise from the needs created by modern security challenges. Electronics and other products that are used by both civilian and military organizations are anecdotally reported to experience fewer problems in terms of transatlantic

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cooperation. The classical defense industry is a business with a foreseeable end of life since the means of security are shifting from the defense into non-defense realms. In the end, this may change the conditions for competition.

Changes in transatlantic regulations will come gradually and easier from the civilian domain, where imported civilian standards will become more important as the percentage of turnover is likely to increase.

## Putting the Political Question Upfront

Serious thought should be given to the idea of joint transatlantic strategic choices related to the defense industry. This applies to the "why" as well as to the "how." Defense-related decisions on both sides of the Atlantic will inevitably affect the other side. However, transatlantic similarities and differences on the political and industrial levels do not play in favor of a future transatlantic defense industrial framework: we currently face decreasing cooperation on defense matters due to different risk perceptions and increasing competition on defense industrial issues due to similar export markets. The key question is whether the future transatlantic defense relations will be driven by politics or by industry. Do we see each other as political partners and why? Or do we see the other side of the Atlantic as just another (protected) market?

The defense industry choices on "how to do DTIB" differ seriously for the United States and European states. The challenge for Europe is to manage its growing dependencies instead of letting them happen, keeping in mind the need to identify the key elements and redundancies of its national DTIBs. For the United States, affordability seems to be the key issue. Hence, while the choice for the EU is on whom it wants to be dependent, the U.S. choice is: how much the country is willing to pay for its continued supremacy. There are thus three choices and related consequences for the future evolution of defense industry:

- **Keep the defense industry national:** security of supply would become more critical, and would need to be organized globally and individually. The EU cannot maintain national industries and will get sucked into the United States and global production and supply chain. This will lead to faster and deeper globalization of EU security of supply. The United States will have to struggle with other rising defense industry blocks, possibly in Asia, and rising costs at home.

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- **Two blocks:** The EU integrates into one EDTIB with the United States remaining as it is: the EU can then reduce costs by activating economies of scale and reinvesting into research and technology for the next generation of defense technologies and products. The U.S. industries would possibly feel the heat of such developments on export markets and, later, at home since the U.S. government could re-energize competition through European companies. At the same time, the EDTIB would generate more efficiencies from spending and growing interoperability of EU-forces.
- **Transatlantic asymmetry e.g. through TTIP:**<sup>1</sup> The EU is integrated in the U.S. market. Europe would widely achieve security of supply but lose most of its autonomy. The new transatlantic block will cherry pick the best EU capacities that will survive, and represent the basis of a strong transatlantic DTIB.

What is missing for the right choice is the rationale, and hence the political question should be asked first. Do we want to remain security/military partners, and why?

The political context in security and defense policy is changing. With the end of the International Security Assistance Force in Afghanistan mission, the direct need to cooperate on a major operation that almost all NATO members are committed to is fading away. The United States may opt to cooperate in smaller-scale operations with only a few Europeans, those who are naturally more expeditionary in mind. At the same time new dividing lines are appearing, such as the question of how to protect liberal rights, or the legality of how to use intelligence and on whom.

If the United States wants to have EU states as military partners, it should encourage the integration of the defense sector on Europe, participate in standards definition and ensure interoperability, by all means a big step forward. The United States would further have to consider that their military and defense industrial interests in Europe may not always match.

If the United States primarily sees the EU as yet another market and technology resource, then it would simply have to wait until more and more companies become short on

<sup>1</sup> TTIP may foster a new dynamic in transatlantic relations — except for the defense industry. Due to the fragmented nature, a common market would seriously change the balance in favour of the U.S. industry and does not take into account the customers of the defense industry. Transatlantic programs that the potential TTIP rules could be applied to in order to shape markets and industries are missing.

cash and EU industries can no longer match the demand of its armed forces. This would come at the expense of a certain degree of partnership and ability to deploy jointly with the United States — at least for a certain time.

Europe will also have to decide on its future commitment to the United States. How would a world order shape up without the United States? Are we still a “community of risks”? And what is the role of military force in this assessment?

## About the Author

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