“Error 404: the European defence project you were looking for does not exist”

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Abstract

This essay analyzes the challenges defence industries and governments are currently facing in the context of a constrained domestic demand and new competition arising from the BRICS and other emerging countries. It identifies major drivers and stages in the globalization process of arms industry and put them in perspective with the evolution of the global defence and security markets since the end of the cold war. It also isolates the underlying trends that are currently shaping the global process of arms production now and possibly in the next decade. This contextualization allows for the identification of threats but also opportunities for European defence groups. It also underscores the fact that corporate strategies pursued by firms that are growing less dependent on the domestic market will have various political and policy implications, notably on the European defence project. Measures implemented by the US and the emerging countries and the situation prevailing in Europe may significantly damage, any attempts to create a truly European military power relying on an industrial base resilient enough to ensure the old continent’s strategic autonomy.

Résumé « Erreur 404 : le projet de défense européenne que vous cherchez n’existe pas »

Ce texte analyse les défis auxquels sont actuellement confrontées les industries de défense et les gouvernements dans le contexte d’une demande interne sous contrainte et d’une nouvelle concurrence venue de BRICS et d’autres pays émergents. Il identifie les principaux moteurs et les grandes étapes dans le processus de mondialisation de l’industrie des armements et les met en perspective avec l’évolution des marchés de la défense et de la sécurité depuis la fin de la Guerre froide. Il isole également les principales tendances orientant le processus de production des armements au plan global, actuellement et possiblement pour la prochaine décennie. Cette mise en contexte permet de cerner des menaces, mais aussi des opportunités pour les groupes européens de défense et de souligner le fait que les stratégies mises en œuvre par des firmes étant de moins en moins dépendantes de leur marché domestique ont des conséquences politiques, notamment pour le projet européen de défense. Les mesures implantées par les États-Unis et par les pays émergents et la situation prévalant en Europe pourraient nuire de manière significative à toute tentative de créer une puissance militaire proprement européenne s’appuyant sur une base industrielle de défense suffisamment solide pour assurer l’autonomie stratégique du vieux continent.
Introduction

Financial crises, end of major wars in Afghanistan and Iraq, sequestration and political gridlock in the US, Western public debts, collapse of the domestic demand for defence in Europe, ambitions of emerging countries... After a decade of continuous growth, the defence industry is once again at the crossroads. Faced with another significant transformation of the market through reduced budget and orders, it would be tempting to draw a parallel with the post-cold war transition and think that the adjustment process will materialize along the same lines as it did in the 1990’s and leave it at that. But it would ignore twenty years of uninterrupted change in the industry, encompassing a phase of transatlantisation (land systems, mainly, but also naval construction and maintenance, etc.), restructuration, privatization and supply-side diversification, as well as mutations of the demand, with the generalization of a wide diversity offsets policies and technology transfers requirements in the international market.

The current profile of global military expenditures clearly highlights Europe as an exception in a world where most regions, including Africa, are modernizing their defence through vigorous acquisition programs backed by significant growth in national wealth. While the construction of a common European defence remains an elusive goal, military corporations from the old continent are looking abroad in a bid to ensure their continued growth or, for some, their survival, and are actively contributing to the process of change at the global level by creating new partnerships with actors from the client state.

The purpose of this paper is to analyze the challenges the European actors, defence groups and governments, are now facing in the context of a constrained domestic demand and new competition arising from the BRICS and other emerging countries. It will shed light on the major drivers and stages in the globalization process of arms industries, put in perspective with the evolution of the global defense and security market since the end of the cold war. This will lead to isolate the underlying trends that are currently shaping the global process of arms production now and possibly in the next decade. This contextualization will allow the identification of threats but also opportunities for European defence groups and will underscore the fact that corporate strategies pursued by firms that are growing less dependent on the domestic market will have various political and policy implications, notably on the European defence project.

Drivers of the globalization process of arms industries: offer and demand trajectories since 1991

It is possible to present the evolution of the globalization process of arms industries into five main stages. They cannot really be considered as successive phases since they were sometimes simultaneous and for some of them, are still ongoing.

The first stage concerns the industrial consolidations dynamic encouraged by the government on both side of the Atlantic Ocean, mainly at a national level but also at the European one. The years following the collapse of the Soviet Union saw difficult industrial adjustments processes in the US and in Europe. From 1991 to 1998 (year the US defence budget started to increase again) the military arsenals of NATO members were seen as far
too big to deal with the new international context (idea of *peace dividends*), the doctrines were considered ill-adapted to the new security challenges in Africa (Somalia, Rwanda) or in Europe (ex-Yugoslavia), and the political will to use NATO as a *global police force* was progressively abandoned if it was ever seriously considered. At this time, Western countries developed different agendas on defence and security issues and, for most of them, priorities moved away from defence to deal with the impacts of the recession of the early 1990s. Thus, the demand for armaments in Europe and in the US went quickly down. The 1980s having seen most countries in Asia and South America modernizing their arsenals, the industry could not compensate lost market shares with exports. To face the situation the governments encouraged their industries to merge on both side of the Atlantic Ocean. The idea was to limit the number of actors into the arms production sphere in order to favourably position themselves into the global defence market. Some national champions popped out from this period, those that were able to integrate smaller companies, but also multinational groups in Europe such as EADS or MBDA.

The second stage of the globalization of arms industry was its “transatlantisation” which refers to a process of acquisition of industrial military capabilities on one shore of the Atlantic Ocean by actors coming from its other shore. British groups such as BAE (land systems) and Cobham (electronic, air sub-systems) and Italian ones like Fincantieri (naval vessels) and Finmeccanica (electronic) were the main European actors engaged in this process. Their goal was to secure the access to the US defence market, by far the most attractive in the world, even in the current environment. General Dynamics (land systems) is the US company that deployed the most significant efforts to develop a presence in Europe through Foreign Direct Investments, with the acquisition of Santa Barbara Sistemas in Spain, Mowag in Switzerland, Steyr-Daimler-Puch in Austria and CDC Systems UK which became GD UK. General Dynamics’ ambition was to reduce its dependence to the Pentagon’s orders. It partially worked but the demand following major deployments in Asia and its consequences on US demand for land systems and ammunition marginalized the non US activity in GD’s revenue. These are the most evident manifestations of the transatlantisation process. However it is uncertain how smaller groups, mainly sub-systems providers, were or are affected by this logic.

GD’s trajectory actually leads to the third stage, one induced by the major deployments in Afghanistan and Iraq. While the two first stages were characterized by the need to reduce the dependency to a declining domestic market, this one is strongly influenced by a return to prosperity for several of the defence groups, mostly American. After a period of austerity, some western military powers rebooted their defence efforts and decided to proceed with a modernization process of parts of their military arsenal. On one hand, this

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1. The recession of the early 1990 it a general concept referring to a period of economic downturn having affected much of the world in the late 1980s and early 1990s.

2. The Iran-Iraq war lead most countries in the Middle East to arm in order to prevent any regionalization of the conflict. In South America, Argentina quickly rearmed after the Malvinas/Falklands War. All along the 1970’s and the 1980’s, Brazil also modernized its arsenal in developing a quite prosperous industrial defence base.

3. For instance, Lockheed Martin, Boeing, Raytheon, Northrop Grumman, General Dynamics in the US, Thales, DNCS in France, Rheinmetall in Germany, Finmeccanica in Italy, and BAE in the UK.
was driven by the global war on terror (GWOT) and, on another hand, by the doctrine of network centric warfare and by the revolution in the military affairs (RMA). NATO members finally took into account the end of the cold war and adjusted their weapons requirements to a counter-insurrectional and expeditionary context (the need to project their forces sometimes quite far from the North Atlantic). However, this mainly and almost exclusively concerns the major powers of NATO (France, UK, USA) or actors claiming some ambitions in regional or international security (like Poland). Most Western countries did not feel concern by the operations in Asia, or at least not enough to give significant resources to defence over a long period.

At the same time, and this leads to the fourth stage, (re)emerging countries such as the BRICS but also a second group of less influential States (Argentina, Colombia, Chile, Venezuela, Viet Nam Indonesia, South Korea...) began to increase their defence investments with the aim to modernize their arsenals in a way that would allow comparisons with smaller NATO members (except with the US). To achieve this goal, they implemented ambitious offsets policies to develop indigenous arms production capabilities. The emerging countries took advantage from the situation the European firms were facing in their home market to negotiate substantive transfers of capabilities and technologies. European groups may have accepted conditions they would probably have rejected in another context. Those unable to gain a strong foothold in the American market were still under pressure to export and had to look to Asia and to South America for profit. The deployments in Asia mixed with the new and strong demand for military equipments from the emerging countries almost put an end to the consolidation process in Europe. The global market was, for a moment, big enough to allow various groups to survive at the condition to be willing to let go part of its technological advantage and to engage in the development of their future competitors.

Finally, the fifth stage concerns the end of the major deployments in Asia and the financial crisis of 2008 and its aftermaths. Around the world, most governments had to re-evaluate their budget priorities in the face of growing public debts. Most of them used defence as an adjustment variable. The US is one of the most significant examples, having started to decrease its military expenditures in 2011, and doing it in a context of political gridlock.

In this environment, the European firms are competing with each other for major export contracts, and there will necessarily be losers. If the consolidation process of European defence industries was, for a time suspended, or at least slowed, it now appears as a necessity... once again. The last decade showed major trends that question the will and ability of European states to consolidate their defence industry.

**Major trends, threats and opportunities**

Regarding the actual structure of the defence economy, some concerns emerge about the main trends of the 2000’s and the way they will shape the arms production processes at the international level for the next decade. Measures implemented by the US and the emerging countries and the situation prevailing in Europe may significantly impact, and actually damage, any attempts to create a European military power relying on an industrial base resilient enough to ensure the old continent’s strategic autonomy.
Lessons learned from the major operations combined to domestic budgetary pressures and a reluctant public opinion have led the US to reassess its approach to its global war on terror and to change the way it tackles the problem. Relying strongly on ISR assets developed during the 2000s and intervention using remotely piloted tools (UAVs) it seeks to maintain capabilities to counter this threat while at the same time addressing “new” ones. In short, the US is reshaping their hegemony. It has made clear choices and they are now in the process of readjusting their massive military apparatus to gear it to new goals, making the Asia pacific region the focus point. With respect to the emerging countries, they seem intent on increasing their influence in their respective regional security systems and to secure domestic polities. What about Europe? Europe is simply not arming. It has other priorities, national priorities that could threaten the still evasive project of European defence.

**Reshaping the US hegemony**

For Washington it is quite clear that the future security challenges are not in Europe but in Asia and to some extent in Africa. The Obama administration accelerated a process started under Bush’s presidency: the so called Strategic transition. It is not something Washington expects to do alone. The Pentagon is actually reorganizing its various partnerships around the world to commit the country’s closest allies to a greater role in regional security management. Washington will do more than before in Asia and less in Europe. The fact the European States are not willing or able to devote more resources to their defence has no influence on this project. Europe is seen as a consumer of security, or even a free-rider, and Washington has made it clear since the turn of the decade that it has to do more for itself and the rest the world and cannot rely anymore on the massive US investments on the region. These discourses are not really new, the debates about burden sharing within NATO being a fixture of the transatlantic discussion. The problem for the Europeans States is that this time, Washington is following through with its stated line of conduct.

Despite the financial crisis and a difficult domestic political context characterized by an impasse on the deficit issue and the budget sequestration crisis, Washington made the clear choice to support its defence industry. Once more, the US DIB is placed at the core of the renewal of the US hegemony. Its mission is still to provide a decisive technological advantage to the US forces (i.e. China, the only potential challenger in the long term). US corporations are also seen as an extension of the US power and its capacity to attract and, to some extent, to commit the allies to a renewed collaboration in regional security. In this regards it is interesting to note that in spite of pervasive problems and huge costs overruns, the F-35 program is still attractive for the initial program partners (figure 1); it is even drawing potential new buyers (Japan, South Korea). Washington is also currently more interested in supporting its Crown jewels on the international markets than it was during the previous decade. It should be anticipated that US military products will seduce governments in Asia, South America and Africa. The US companies come with two significant assets: 1) buying American usually implies a wider security partnership with the hyperpower, 2) they are now technologically so advanced they can potentially agree to transfers of technologies without putting their competitive advantage into jeopardy although there are some worries on the US sides for certain segments.
Emerging countries’ external, domestic and industrial needs

Four main drivers are currently shaping the future military forces of the emerging countries: 1) the will to modernize an aging military arsenals, 2) the will to play a more important role in regional and sometimes international affairs, 3) the will to secure the domestic systems of governance and the actors benefiting from it and 4) the will to develop national industrial capabilities able to at least partially support the governmental ambitions in the future.

As previously mentioned, the last decade showed a strong commitment from several emerging countries to modernize their military arsenals. Since most new weapons were acquired in the 1980’s and sometimes in the late 1970’s, important parts of their inventories became obsolete in the turn of the millennium. Thus, the mid 2000’s saw countries in Asia and in South America showing important national growth and engage in substantial acquisition programs. But since the early 1980s, the international context has changed and the requirements are now quite different from those formulated during the cold war period. Regional rivalries are still part of the equation (in Asia, including Middle East) and they obviously influence government’s choices in the selection process of systems (fleets, anti-missiles systems, aircrafts…). However, growing concerns about social unrest leading sometimes to revolutions like those in the Arab States are making crowd control and population surveillance part of the equation. Some helicopters and light armored vehicles, for instance, are also acquired to face this challenge. Moreover,
because of the dissemination of new, widely available technologies in the population (Internet, smart phones social networks...) it implies massive investments into surveillance systems that are not exclusively dedicated to the protection of borders, strategic resources or critical infrastructures but also to the surveillance citizens who are paying for these systems.

Figure 2: Value of global offset obligations to be accrued from 2012 to 2022 (current million USD) ⁴

Source: IHS Jane’s, 2013

4. Data collected and presented here are a conservative assessment based on existing proprietary data-sets. The study is based on the procurement programmes of 23 defence markets: Argentina, Brazil, Brunei, Canada, Chile, Colombia, India, Indonesia, Israel, Jordan, Kazakhstan, Malaysia, Oman, Peru, Philippines, Saudi Arabia, Singapore, South Africa, South Korea, Switzerland, Taiwan, Turkey, and the UAE.
The industrial ambitions of the emerging countries are related to the previous objectives and can be linked to the idea of strategic autonomy or sovereignty. The central idea is to reduce the dependency on external suppliers and to position their local industry in a new international division of labor in terms of arms production. Offset policies implemented in most countries play a significant role in this logic. Demands for transfers of capabilities and technologies are now essential conditions to fulfil for most companies existing on the international markets (figure 2). Due to the number of actors (insufficient consolidations in Europe, new players coming from emerging countries) the clients are in good posture to negotiate and sometimes require technologies and/or skills transfers threatening the advantage of some of the most advanced groups. Because of the dimension of their home market, only US groups seems at the moment able to refuse to engage in this process with emerging countries.

**The European logic of the snooze button**

In this context the situation of European firms and of the States relying on them for their defence equipments and strategic autonomy are facing a difficult situation. Their successes during the 2000’s were based on 1) a lack of interest by Washington for foreign markets, the priority being to support the wars in Afghanistan and in Iraq, 2) the demand within the emerging countries and their inability to rely on domestic capabilities 3) their technological advance allowing them to satisfy the criteria of the offsets policies. Now, the US companies will certainly be more involved in the international markets, capabilities are arising within the emerging countries and are sometimes successfully challenging the European products (Turkey, South Korea, South Africa for land systems, for instance), the European demand is insufficient (figure 3) to allow most of the European defence groups to survive. The future does not look good for them, unless they decide to diversify significantly into commercial markets.

To some extent, the 2000’s seemed like a snooze button for the European states defense industrial bases. The consolidation process was, and still is, largely on hold. Entering now in a period of decline, we see that very little has been done regarding the industrial aspects of defence as a European project. Who is to blame? Both, the industry and the governments? They all agreed to go where the money was and to sacrifice part of the competitive advantage they had on their non-western competitors. At some point, even if some European States modernized some of their equipments, the old continent was less important in terms of orders for them than the US, the Brazilian or the Indian markets, for instance. The governments are also responsible, because several mergers proposal were denied the process was judge to threaten their national strategic autonomy or vital interests. The role Germany played in the failure of the merger project between BAE and EADS is enlightening in this regards. Let’s be clear, there is for the moment no European common interest regarding the defence industry.
Conclusion: is there still time for a European wake-up call?

Is the European defence project vanishing? Yes, at least the idea of the United States of Europe, since for the last decade European governments and industries largely acted like lone riders preferring to struggle with each other than to collaborate. Can this logic be reversed? Yes. Will it be or will the actual fear of being significantly marginalized within the moving global structure of arms production play the role of a wake-up call for the European defence project? It is doubtful at this stage. The European governments would probably also have to acknowledge the fact that they will be unable to buy the full scope of the future generation of armaments and to maintain their current influence on the global security affairs. Maybe security is not only about defence, but it is also about defence.

Time is a critical factor and it is running out. The actors of the European integration process have rarely shown their ability to react quickly. To some extent, it is easy to agree on threat and on the means to face it. Because of NATO or what can be called a Western military culture, it is to also quite simple somehow to collaborate from time to time in international operations led by the US or strongly supported by the superpower (like in

5. Several lessons can be learned from the evolution of the F-35 programme.
Libya). It is however deeply more challenging at the political level to engage into military industrial cooperation. States and industries must agree on requirements, and put together know-how, production capabilities, budgets on so on... many resources committing the partners sometimes for decades, if not forever due to the cost of an eventual the turning back.

The world is changing and European countries made singular choices. They will probably push some of the EU members closer to US. They will also let the others having to decide what to put in common and how to do it knowing that even if they do it well, they will still face major difficulties to finance the next generation of armaments due to the burden of the public debt and the increasing competition on the export markets. In the meantime, the European industry cannot simply wait. It has to secure its access to the US market when there is one or to strengthen the actual partnerships they developed in some of the emerging powers and face all the political and industrial challenges implied.

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