



Paris, November 5, 2016

Eurodefense WG18 working group report

European Tools for Defence Materiel Autonomy

It is only since 2014 that European autonomy in the field of defense has become an acceptable notion, and even an explicit goal, in European defence discussions between European institutions and the member states.

Therefore, existing European regulations have been written with a view to extend public procurement competition rules to the defence sector, and national expenditure in military R&D has been implicitly considered as a state aid to industry, to be discouraged as much as possible. Exceptions being made, fortunately, for cooperative programs and for R&T.

Eurodefense has set up a multinational working group to examine if these existing European public procurement regulations were compatible with the business models of all parts of the defence industry, and found that they were not durably compatible with the funding of prime contractorship for major systems, which results necessarily in a partnership between a government or a group of cooperating governments, and a monopolistic prime contractor, be it national or European.

Most of the rest of the defence industry, and almost all of the non-defence industry, was found compatible with existing European free-trade rules, as R&D financing by industry is possible, albeit sometimes very risky. Competition being then stable, as losers can be replaced by new entrants, and no monopolies are created.

The working group also found that government(s)-contractor partnerships for the development of major systems specifically designed for military use could only be based on R&D funding by government(s), this funding being decided only if there was a desire to obtain a measure of national or shared autonomy.

The rationale for these findings is based on the investment decision process in all industries, which takes into account the predictability of the chosen market, and the cost and risk of investment,

measured by the intensity of R&D in the predicted turnover. In most cases, military products require a very risky and lengthy development, and suffer, in addition, from a quasi-unpredictable market.

Therefore, in those cases, no industry financing of R&D is possible and client funding is the rule, losers leave the market, no new entrants spontaneously appear, and monopolies are the stable form of the industry.

The attached Powerpoint document is a graphic presentation of this decision process and its far-reaching consequences.

Client funding means government funding, which could only be decided when national or shared autonomy is a goal.

For years, no desire for autonomy having appeared at the European level, the idea of creating the tools for such an autonomy, namely an European funding for R&D (cooperative) projects, was theoretically appropriate, but not implementable.

However, European civilian satellite and launcher programs had already shown that when there was a desire for autonomy shared by the Commission and a number of member states, European R&D and production funding could be appropriated, and appropriate management tools and Agencies could bring programs to success.

Eurodefense therefore proposes, now that autonomy in parts of the defence sector has become a goal of the European Union, that, following the lead of the civilian space sector, tools for autonomy be discussed between the Member States, the Commission, and Parliament:

- an R&D budget line, within an European defence budget that could also fund other defence endeavours, including operations covered by the Athena mechanism,

- a mechanism to select existing governmental cooperative projects where a share of the R&D funding could be European (for example today, a Male drone system), implemented by the EDA,

- a mechanism to select new capabilities and approve new R&D European programs, also within EDA

- implementation of all approved programs to be entrusted to OCCAr.

This proposal is not at all contradictory with the ongoing preparatory action, and the following European Defense Research Program (EDRP) for long-term R&T program being defined within the Horizon 2021-2027 Program, as it has quite a different ambition, which is to create products now.

There is absolutely no reason to wait for the potential new technologies resulting, in or around 2025, from this R&T program, as the existing capability gaps must be filled as soon as possible, which means filled by R&D programs using the existing technologies.

R&T is an enabler, but only R&D programs create products and capabilities, and we have capability needs now, not in a faraway future.

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The Eurodefense proposal above deals with the main issue of a defence industrial policy, which is the funding of R&D in prime contractors to obtain autonomy.

But the defence industry, now called European Defence Industrial and Technology Base, is also an important part of the whole industry, 5% of it in France for example, and its most technologically advanced part. Together with the aerospace industry, which shares many of its characteristics and technologies, it might represent 10% of the industry.

Therefore, the defence industry should be included in the scope of whatever general industrial policy is decided by the European authorities. Its present exclusion, for old ideological reasons, is not compatible with the current European defence and security situation.

Restrictions of access of the defence industry to EU or EIB loans, to the Juncker Investment Fund and to R&T programs must be therefore immediately abolished.

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Other issues must be dealt with. They concern mostly defence SMEs.

-when autonomy is funded at the prime contractor level, cascading R&D money to the various levels of subcontractors is an absolute necessity. SMEs, in particular, are unable to fund in advance whatever R&D funding is necessary in their field. This is done by the prime contractor under supervision of the contracting agency, or by the contracting agency itself. In major systems such as aircraft and ships, 70% of the system is subcontracted. Funding autonomy at the prime contractor level while leaving it free to subcontract anywhere in the world makes no sense and is a waste of money. This issue has been dealt with up to now on a national or bi-national basis by local procurement agencies. It is clear that it would be more efficient to organize sub-contracting on an European basis; it would also help potential defence subcontractors from countries where no major prime contractor is present.

-encouraging cross-border subcontracting in Europe being of interest, it must be done in a way that does not make the supposedly autonomous system finally dependent on third countries' laws and policies through ill-chosen subcontractors. The A400M programme, for example, has been conducted with this in mind, the prime contractor being tasked to choose European subcontractors under its responsibility, and report to the participating nations.

This requires a constant vigilance, and necessitates in particular an agreement on what is, in that respect, an European eligible subcontractor.

-another necessary condition for autonomy of systems is the absence of political conditions to the use of parts or subsystems procured across borders inside Europe. Military use of systems containing such parts, including outside Europe, must be unhindered. The continued existence of national export control rules for intra-European trade is, in that respect, a potential obstacle.

-the issue of export of systems outside Europe is a totally different one, in that it is not an autonomy issue per se, even if exports are a major contributor to the continuity of the EDTIB and therefore an indirect contributor to autonomy. Re-export of parts procured from an European country inside a major weapons systems exported by another European country is certainly a legitimate ethics in foreign policy issue for the supplier's government.

But it is clear that the multiplicity and variability in time of such national re-export concerns makes it very unlikely that a consensus to export outside Europe a major system with multiple European subcontractors could be obtained, and this is certainly a deterrence to subcontracting across borders.

Although agreement could not even be reached among the six nations of the so-called Letter of Intent (L.O.I.) group to let the exporting nation take alone the political responsibility of a re-export outside the group, it is clearly the way to go, and reaching such an agreement must be an important, defence policy goal of the European Union.

The existing Intra EU-Community Transfers Directive is a step in the right direction but does not completely address these issues.

- European rules to ban European governments' offset demands on armament purchases inside Europe are, in their present form, not extended to armament purchases outside Europe. Such rules will result in a major increase in imports from non-European countries, which all accept offsets in a visible or invisible way.

More sensible, pragmatic and effective rules should now be discussed.

Philippe ROGER, chairman, for Eurodefense WG18.

Attachments:

Powerpoint presentation

List of participants to the Eurodefense WG18 working group