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## The Future of the European Defence Industry after the December Summit: Ten Polish Priorities

**Paulina Zamelek<sup>1</sup>**

*December's European Council Summit for heads of state or government has been tasked to deliberate European defence industry issues based on proposals provided by the European Commission. A divergence of interests expressed by interlocutors representing Member States, national defence industries and European institutions could result in heated political debate. The ability to accommodate the interests of Central Eastern Europe and Poland in particular in this process is not yet certain, especially as the EU's ambitious plans for strengthening the European Defence Technological and Industrial Base (EDTIB) are discordant with the current level playing field across Europe.*

There is still a lack of agreed vision and direction for Common Security and Defence Policy (CSDP). Of course, the EU has long been at a crossroads, unable to decide whether to become a global player or to remain a mainly economic union. But today, that dilemma has sharpened. Any ambitions to become a credible security actor, responsible for the EU's foreign interests and capable of meeting new challenges, clashes not just with the EU's current tasking but with the absence of an effective European Defence Technological and Industrial Base (EDTIB).

A succession of financial crises had already shrunk the European defence market, forcing European companies to look to the global defence market for the instruments necessary for their survival. Now economic austerity is eroding national defence budgets, too. This has dashed hopes for a revised trend, and intensified competition on export markets among all of the defence companies, pushing them to resort to the optimisation of their capabilities and exploration of new defence niches.

That may be beginning to change. After defence issues had lain dormant in the EU for half a decade, and any progress in the defence industry area had proved sluggish and ad hoc, new political momentum was given in the European Council conclusions of 13–14 December 2012. Out of the three priority areas foreseen for the European Council planned for 19–20 December 2013,<sup>2</sup> the European defence industry issue features

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<sup>1</sup> Paulina Zamelek is attached to the Armaments Policy Department, Polish Ministry of National Defence. The views presented in this paper, though, reflect the personal opinions of the author.

<sup>2</sup> The agenda foresees three axes of priority actions: one, increasing the operational effectiveness, visibility and impact of CSDP; two, enhancing the development of defence capabilities; and, three, strengthening Europe's defence industry.

most prominently, with high expectations that a breakthrough here will increase awareness of CSDP and political will.

The summit is focusing primarily on revitalising existing proposals and the likelihood of consensus lies in maximizing synergies between the European Commission's proposals and the interests of other players—especially the European Defence Agency (EDA), the private sector and, of course, national governments. In this regard, Poland's priorities are shaped by the development of its own defence market and concern about the effects of liberalisation. Although it is not yet a leading player in the field, the geostrategic costs of ignoring its concerns would be high. It is worth elaborating its priorities.

## **What Is on the Table: The Commission's "Carrots" and "Sticks"**

The bulk of the preparatory work for the summit has been undertaken by the European Commission, albeit with input from the High Representative, the EDA, European Parliament, and the Member States, and resulted in the Communication of 24 July 2013, "Towards a more competitive and efficient defence and security sector." Acknowledging that defence is ultimately the prerogative of the Member States, the Communication's focus is on existing policies in the areas of the internal defence market, industrial policy, research and innovation, space technologies, and energy, as these areas were found to warrant Commission funding and instruments to facilitate cooperation, generate skills and economic growth, support innovation and the competitiveness of European defence companies, and eliminate obstacles to EU defence trade.

Building on past Commission proposals,<sup>3</sup> the Communication provides a set of initial proposals in the form of "sticks" and "carrots" to find ways towards a more competitive and efficient defence and security sector. Strengthening the internal market for security and defence material is the key priority and is classified as a "carrot" equally for Member States and industries. It will be ensured by the full transposition of the Defence Procurement and the Transfers Directives of 2009, but facilitated by a proposed "stick" the Commission proposes to monitor the openness of national defence markets, based on an assessment of derogations made with regard to Art. 346 of the Lisbon Treaty and the phasing out of offsets (countertrade agreements, obliging the successful winner of a tender to invest in the defence industry of the customer country). From the Commission's point of view, and in times of "common defence policy" and "open defence market," governments really cannot justify recourse to such an anachronism as derogation of EU law in the defence sector.

At the same time, the Commission intends to explore the possibilities for improving security of armaments supply and lifting the control of strategic defence industrial and technological assets, as well as promoting a more competitive industry. To this end, the Commission proposes to explore the creation of "hybrid standards" for equipment with military and civilian applications (i.e., remotely piloted aircraft systems, or drones), common certification (i.e., military airworthiness), ways to guarantee the supply of raw materials, and initiatives to support small- and medium-sized enterprises (SMEs). Dual-use (military and civilian) synergies will be exploited with the objective to reinforce innovation and foster cooperation by co-funding research and development or generally setting incentives for industry to engage in emerging technologies (i.e., drones). The Commission also foresees a similarly ambitious approach in space issues and energy consumption.

An interesting option included in the Communication concerns an effort to strengthen the international dimension of EU companies by exploring their potential to break into third markets. But, tellingly, this is at present unrealistic: whenever any major contract for military equipment is on offer elsewhere in the world, Europeans tend to compete against one another, even when this comes at the expense of all the rules of reason and market success. It shows how domestic interests prevail regardless of the "carrots" on offer at the European level. Unsurprisingly, therefore, the Communication receives general support from Member

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<sup>3</sup> The 2007 Communication, "A strategy for a stronger and more competitive European defence industry," paved the way for the EC's defence package, i.e., Directives 2009/81 EC and the 2009/43/EC.

States when it comes to the identification of key industrial shortfalls and the inclination for defence-capability reinforcement, but the “sticks” and “carrots” are perceived differently by each country. Some, for instance, see in the proposals potential gains to be had from the increased transparency and reduced fragmentation (although the defence market is seen as atypical).

Nevertheless, the analysis will appeal to some countries more than others for a simple reason: the Commission looks at the European defence market from the perspective of the biggest defence manufacturing countries.

## **Mapping Member State Influence: The Downgrading of Central Eastern Europe Interests?**

European governments have had several occasions to express their opinion on the topics being prepared for the European Council, including within the framework of meetings with the EDA, with the European Commission, as well as bilaterally and multilaterally in various configurations, and finally at ministerial levels with the participation of ministers for the economy (COCOM), foreign ministers (FAC), or defence ministers meetings (Dublin in May and Vilnius in September). But it was only as December loomed that the positions of some countries crystallised, as shown at the November FAC, where the United Kingdom and Poland refused to back down on what they saw as unfavourable wordings in the conclusions, leading to delays in their adoption.

As the forerunners of the European defence-industrial sector, the so called Letter of Intent (LoI) countries—France, Spain, Germany, Sweden, Great Britain and Italy—unquestionably had the greatest impact on the Communication (although some of the proposals went beyond even their control). These countries possess a significant national defence-industrial base, generally represent 80% of the EU defence market, are competitive and innovative, and have the best chances of holding their own in the face of global competition. Unsurprisingly, they are supportive of actions aimed at strengthening SMEs and dual-use R&T that might in turn prove useful in helping their already competitive defence industries to go global.

And, for similar reasons, the LoI countries share three concerns: Art. 346, strategic-asset control (i.e., their autonomy to define government-to-government sales) and offsets on third markets as requested by third-country governments. In other words, they reject any new regulatory approach or interpretation of the defence package. They opt for national control of strategic assets to be made inherent in the national framework. And they consider the limitation of offsets on third markets as potentially damaging to the European Defence Technological and Industrial Base. The parts of the Communication that the LoI countries support or neglect thus reflect the interests of their national defence industries, and are carefully selected on the basis of projected benefits (i.e., SMEs, R&T) or losses (Art. 346) connected with the liberalisation and opening up of the market.

Besides this, individual LoI countries express stronger or weaker feelings depending on the issues at hand. For example, the United Kingdom puts great emphasis on improving the level of competition in the EU market, on supporting SME growth and expanding innovation, but only with market-driven tools. The UK also, predictably, presents a strong position on matters that would require the UK’s support for further action. For that reason it opposes any new regulations and disregards ideas that impinge upon national sovereignty or its competences or duplicates efforts, especially in the defence-export context. It is notable that the UK is against offsets within the EU; however, when it comes to supporting national exports and other external defence trade issues, such as third-country offsets, its position firmly disregards Commission efforts.

The trouble is that the needs of Central and Eastern European (CEE) countries have scarcely been taken into account by the Commission, and there are clashes of interest.

France in its positions jointly expressed with Germany underlines the role of free access to the European defence market, of the open competition principles, monitoring of the Defence Procurement Directive and adequate application of the Transfer Directive, as well as its support for the Commission’s intention to phase-out offsets within the EU. On these issues, the Polish national interest does not correspond with the French and German interests. What’s more, whereas France strongly supports improving the

competitiveness of the European defence industry and the significance of standardization and certification in the interoperability of armed forces, Poland shares the opinion that efforts in the latter fields should be based on existing national institutions dealing with those issues (i.e., in the EDA) without appointing additional institutions. Poland is in favour of ideas to support defence-related SMEs through clusters, structural funds and other means of financial support and dual-use technology development.

There is also a potential clash between the CEE countries and large national firms. In their position papers, industry generally supports the direction of the Commission's intervention in the defence sector. The obvious complaints concern the low levels of spending on defence, lack of significant new programmes and bureaucratic obstacles to cooperation. At the same time, they see other problems, such as technological dependencies, lack of synergies in European and national research programmes, the need for improvement of defence technology "branding" in European society, implementation of effective standardization, and ethical risks seen in defence investments by commercial financial institutions. Smaller firms, such as those in the CEE, underline the potential threats of emphasising competitiveness issues, which tends to be considered an artificial barrier to tighten market competition and limit the chances for partnerships.

## **The Polish "Decalogue"**

Due to the specificity of the domestic defence industry and national interests, Poland articulates a different approach towards the future of EDTIB to the one represented by the Lol countries. Poland claims that the European Union as a collection of 28 Member States should demonstrate in the defence-industrial sector greater understanding, and that which is appropriate for a truly Community approach. The EU should see this issue from more than the perspective of the major defence manufacturing countries and be able to predict the future consequences of its actions today.

Along those lines, Poland supports the viewpoint that only a coherent political vision of CSDP development can form a sound basis for the long-term implementation of its strategic goals, which underpin capability development and reinforce the notion of a regionally balanced European defence industry. The 10 main priorities of the Polish position on European defence market development, in brief, are:

- I. To have the EU recognise the concept of balanced development of EDTIB, which rests on the assumption that the EU proposals should take into account the condition and needs of Member States in different parts of Europe, including security of supply aspects and not only the prospects for Lol industries. According to Poland, the development of EDTIB needs to follow a balanced path that ensures the essential defence and security interests of all of the Member States and promotes sustainable growth in all countries and regions of the EU. The balanced development concept also views open competition as a threat when used as the sole method for building EDTIB without acknowledging national defence industries in all of the EU countries as the basis for EDTIB. The balanced development concept would lead to reducing the gaps between industries across the EU regions as a condition for its effective development. Therefore, when defining EDTIB, also the enterprises of the defence-related sectors should be taken into account.

Also important is the convergence of opinion on the optimal way of developing EDTIB provided by the European Economic and Social Committee to the Commission's communication on 17 October 2013 (CCMI/116). The committee's opinion stated that one of the main problems of building EDTIB is the profound difference in the potential of the main defence equipment-producing countries (Lol) and the other members. It follows that EDTIB should be built in a balanced way in all EU Member States because if the conditions for competition in the internal European market become too harsh, it may adversely affect the competitiveness of the European defence industry in the global market, and the only companies to benefit from competition of European companies will be the defence industries of third countries (non-European).

- II. To reject any new regulatory approach regarding directives 2009/81 and 2009/49 and the use of Art. 346 TFEU. Poland considers attempts to politically prohibit the use of Art. 346 TFEU as interference in the essential national security interests of the state. Therefore, the only acceptable way forward is to continue with the EC's assessment of defence-package implementation and its

impact on Member States in order to provide its report to the EP by June 2016. On this point, the Polish view is shared to some extent by the Lol countries.

- III. To keep offsets. Poland considers the intention to phase-out offsets incoherent with the Interpretative Communication provided by the European Commission in 2006. The concept of offsets in the defence sector is strictly linked to essential national security interests and therefore the idea of phasing-out offsets in the EU should depend solely on national policies and national authorities. Offsets should not be considered by the Commission as simply a market distortion. On the contrary, Poland argues that offsets are beneficial for the development of EDTIB as it gives opportunities for maintaining and modernizing Member States' defence and industrial capabilities and is vital for future growth in the European defence market. Moreover, offsets may also result in better and more efficient achievements and increase cooperation among defence industries in the field of R&T.
- IV. To respect national frameworks inherent in strategic asset control. Poland holds as an essential national security interest to keep control of strategic defence assets, as they contribute to long-term security of supply. Moreover, this view is generally shared by the Lol countries.
- V. To make it easier for SMEs to access the defence market. For Poland, it means not only creating fair and non-discriminatory reference terms for defence industrial capabilities development within SMEs but also reducing the regulatory burden for SMEs in the defence sector. The aim here should be to foster innovation in the dual-use market with a focus on creating better opportunities for SMEs. Although the majority of Polish defence companies do not fulfil the SME criteria, Poland supports the idea of plugging in a range of defence-related and dual-use enterprises to the national defence and technological bases in order to support the development of the core defence industries. To meet this aim, the reconstruction of the prime contractors' supply chains and contributions to a mechanism of a level the playing field are necessary to support other actions offered by the current directives.

Important elements in the formation of European industrial policy with regard to SMEs are based on proposed instruments for strengthening SME competences, such as the EU's "Horizon 2020" programme, which was accepted on 3 December 2013, and the COSME programme. To Polish SMEs, these seem to be proper starting points for mitigating differences and extending SME access to innovative dual-use technologies. Another positive aspect of SME policy that wins support from the Polish side is regional specialisation with regard to defence Centres of Excellence and other forms of networking and clustering that promote synergies in civil-military cooperation.

- VI. To consider using European structural funds more widely, especially to support public and private ventures in developing new technologies in dual-use fields. Poland strongly supports this instrument as a backbone of the EU economy and which could provide greater opportunities for the defence sector, as well as one that has proved its effectiveness in reskilling the defence sector in the last two decades.
- VII. To promote participation in R&T programmes. Poland considers bilateral and multinational R&T projects to be a key element in the maintenance and improvement of the competitiveness of the defence sector, both in Poland and the EU. So far, Poland has had little chance to benefit from joining trans-European supply chains and becoming involved in collaborative weapons investment programs. The adequate forum for specific R&T projects and dual-use capabilities was the EDA, and Poland would like to follow this model of cooperation in future projects.
- VIII. To join capability development projects with dual-use applications. Poland is deeply interested in taking part in EU flagship initiatives such as aerial surveillance and drone programmes (RPAS), air-to-air refuelling (AAR), cyber warfare programmes, or government satellite communications (GOVSATCOM). The Commission's intention is to provide financial support for cooperation on particular programmes coordinated between the EC and the EDA, and is particularly welcomed by Poland.

- IX. To prevent the standards and certification process from implementing additional, restrictive criteria that would limit the number of enterprises able to fulfil them. The standardization and certification process is fully supported by Poland, since it is in line with the need to achieve greater military interoperability within the EU, but no additional institutions should be created at the EU level for that reason, and the process should not enforce new certification models, generate extra service costs, or become a means for additional competition on the market.
- X. To develop an effective consultative mechanism. Poland considers it necessary to strengthen cooperation amongst European industries. The EDA platform is a positive example of this, but the thematic scope of consultations is limited only to the agency's projects. Hopefully, a similar form of a consultative mechanism for industrial partners would also limit the current common practice of European institutions talking mostly to defence industry leaders.

## Conclusions

Defence-industrial matters rank high on the December European Council agenda. But the ambitious proposals presented by the Commission on Europe's defence industry and market issues will only have an impact if they receive strong political backing from EU governments, and the extreme expectations of various interlocutors show how difficult and important are the issues put on the table for consideration. It is unlikely that Member States will accept all of the Commission's ideas at the Council in December, such as those with international aspects, but some proposals may receive the support of most governments and the industry, with the SME and R&T issues as examples. However, the fate of other significant issues related to the opening of the European defence market, such as the narrowing of the scope of Art. 346 TFEU, its interpretation, or the acceptance of offsets, is still to be decided. The chances to accommodate the interests of all of the players are hardly possible. For Poland, these matters have even greater validity as they tend to define the next milestone in the definition of the future prospects of its important defence industry. Any kind of compromise reached on the 19–20<sup>th</sup> December in practice should lead to "A [regionally balanced,] sound, innovative and competitive European Defence Technological and Industrial base (EDTIB) [,which] is a prerequisite for stimulating innovation, growth and jobs and securing up-to-date capabilities."<sup>4</sup>

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<sup>4</sup> The Council Conclusions on CSDP adopted on 26 November 2013.