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Defence Industry in Europe in a Changing Policy Context

Brussels, July 2022

Inhalt

1. Russia’s war in the Ukraine: the big game changer

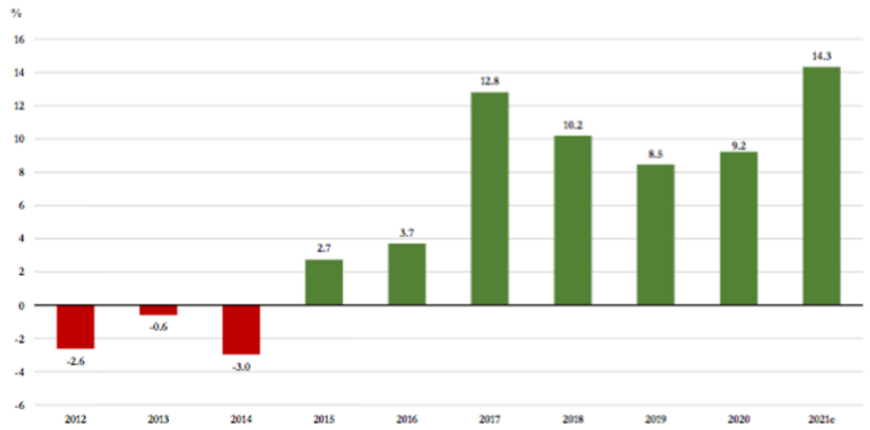
Higher priority for defence and security

- At the beginning of the IndustriAll project, three years ago, the European defence industry were at a crossroads:
  - overcapacities,
  - restrictive national export regulations,
  - unclear perspectives for new procurement programs
  - tense military budgets.
- Developments of global dimensions require a response beyond national decision-making
- Russia’s war in Ukraine: a turning point in the security situation of Europe.
- Russia’s war revitalized both NATO and the EU and underlined the importance of US presence for Europe’s security.
- EU Strategic Compass promises “a stronger and more capable EU in security and defence”
- Consequence: intensified role of defence industry. It will operate in an entirely new security landscape.

Spending more money on defence equipment

- Additional finances for for defence.
- Increases already in the past
- Beyond NATO’s aim of spending two percent of their Gross Domestic Product on defence.
- NATO states aim at spending at least 20 percent of the defence budget on equipment. This budget category is particularly relevant for the defence industry as it represents a proxy for procurement.

NATO Europe and Canada – Major Equipment Expenditure (annual real change)



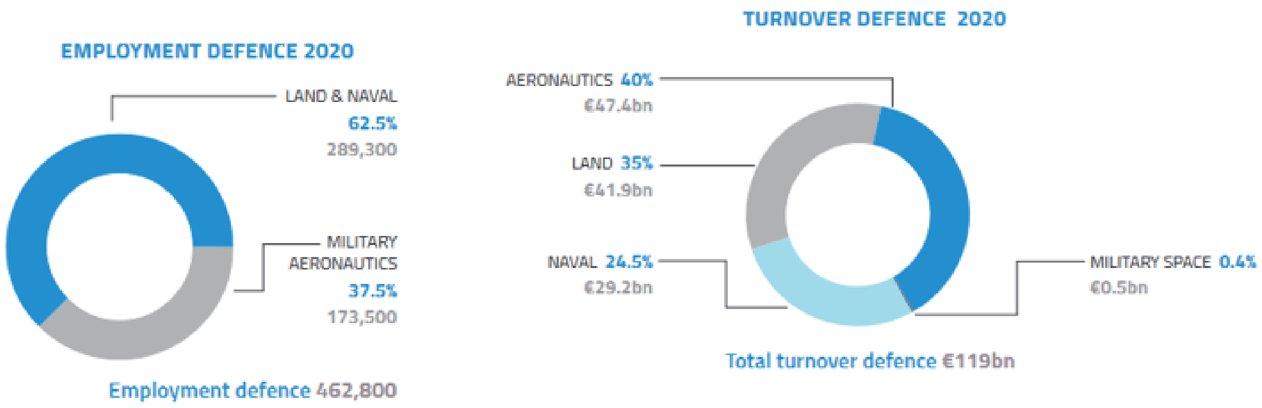
Source: NATO https://www.nato.int/nato_static_fl2014/assets/pdf/2022/3/pdf/220331-def-exp-2021-en.pdf
Note: based on 2015 prices and exchange rates; figures for 2021 are estimates.

2. Overview European Defence Industry

Structure of the European Defence Industry

- The AeroSpace and Defence Industries Association of Europe: 2020 European defence industry turnover = €119bn.
- €95.6bn from companies located in in six countries (France, Germany, Italy, Spain, Sweden and the United Kingdom).
- ASD: number of jobs in European defence industry increased by 22,000 from to 2019 to more than 462,000.

Distribution of size and turnover in the defence industry



[ASD_Facts&Figures_2021]

- The top EU-based defence companies, like BAE Systems, Airbus, Leonardo and Thales, are global rather than national or European players. But comparing turnover in global arms sales, US companies clearly dominate.
- The American company Lockheed Martin Corp., the largest defence producer in the world, reported an arms turnover in 2020 (58 bn. US $) 2½ times larger than BAE-Systems.

Four key branches (1)

Naval industries

- For many shipyards military ship building is key activity. Today 11 European companies are the most important players: Babcock, BAS Systems, Chantiers de l Atlantic, Damen, Naval Group, Fincantieri, Navantia, Naviris, Saab Kockums, TKMS and Prinvest (Naval Shipyards).
- The pressure to consolidate military shipbuilding capacities on a European level shaped the discussions for the last decade. Implementation repeatedly failed due to national interests mainly in France and Germany.
- EU member states supported their naval industries to remain independent. *All options for a more consolidated sector in Europe will depend on political decisions.*

Four key branches (2)

The Aerospace Sector

- Strong and competitive civil and military aeronautics industry with more than 462.000 employees, 146,7 billion Euros revenues in total.
- Defence markets share = 40% of turnover with 173.500 jobs depending on military spending.
- Strong network of European aircraft industry cooperation and joint ventures in defence programs, supported by the states.
- Prospects strongly depend on new joint procurement programmes and successful corporation consolidation.
- Larger units beyond national capacities are required to maintain existing research and production capacities.

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Four key branches (3)

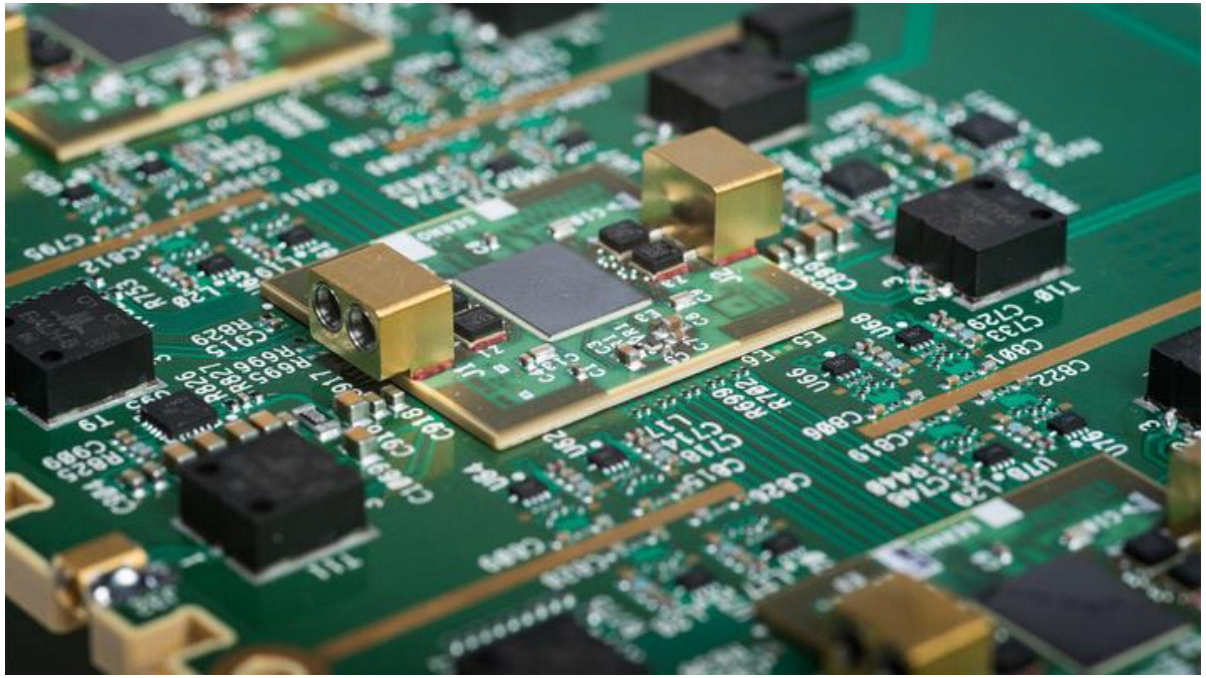
Land Systems

- 10 important larger companies dominate land armament sector, located in the UK, Germany, France, Italy and Finland.
- Important producers: BAE Systems, Rheinmetall, KNDS (KMW and Nexter) and Leonardo.
- The Russian war in the Ukraine has changed the perspective of land systems producers decisively in two respects:
  - importance of land defence systems as a result of the type of war being fought in the Ukraine.
  - pressure on military budgets (procurement budgets) is replaced by the availability of additional funding.

Four key branches (4)

Defence Electronics

- Growing importance of electronics in defence systems. Electronic components are part of almost all weapons systems and pieces of equipment.
- Ongoing innovation in weapon technologies = growing impact of IT, computer and electronics.
- Major suppliers: BAE, Thales, Leonardo, Safran, Rheinmetall, Saab, Indra and Hensoldt. The companies' strategies: recognizing the growing importance of electronics.
- In addition to "classic" players, many civilian companies are active in the military electronics: from the US and especially the so-called GAFAM (Alphabet [Google], Amazon, Meta [Facebook], Apple and Microsoft).



3. Ten observations on future trends in the European defence industry

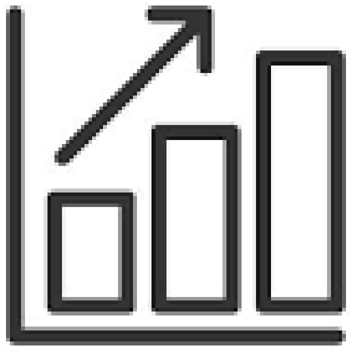
Ten Take-Aways (1)

A Boost and a Boom

The war in Ukraine has fundamentally changed the security landscape in Europe with important decisions to invest more in the armed forces of EU and NATO countries.

Military expenditures will grow in the short- and medium-term and it can be expected that the NATO aim of spending at least 2% of the Gross Domestic Product will be surpassed in many cases.

We expect a strong boost in military expenditures and a boom for the defence industry.



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Ten Take-Aways (2)

Parallel Trends: A Revival of "Classical" Armaments and Automatization of the Battlefield

The Russian war has changed perspectives of land systems producers:

The importance of land defence systems has grown as a result of the type of war.

EU countries will upgrade their tank and armoured vehicles' capacity.

New technologies are integrated into weapon systems, particularly electronics and information technologies. Autonomous and robotic warfare and collection of real-time data are play an increased role.

Revival of "classical" armaments

Automatization of the battlefield

Ten Take-Aways (3)

Blurring Boundaries: Commercial and Military Technologies

The enormous growth in commercial electronics and information technology has led increasingly to blurring boundaries between the defence and the commercial sector.

Commercial developments are relevant for weapon systems and are increasingly applied in defence development.

We can observe increased use of commercial technologies in military environment.

Ten Take-Aways (4)

Pulling in Two Directions: Growing Europeanization and Continuation of National Interests

Procurement policies in Europe have traditionally been and are still driven by a priority for national champions.

The armed forces of EU countries operate a large variety of competing types of weapon systems.

The EU Strategic Compass aims at overcoming national approaches.

National oriented security and defence policy in Europe is no longer a realistic option, but EU co-operation remains a slow and laborious process.

The war in Europe intensified discussions on a more independent EU security and defence policy.

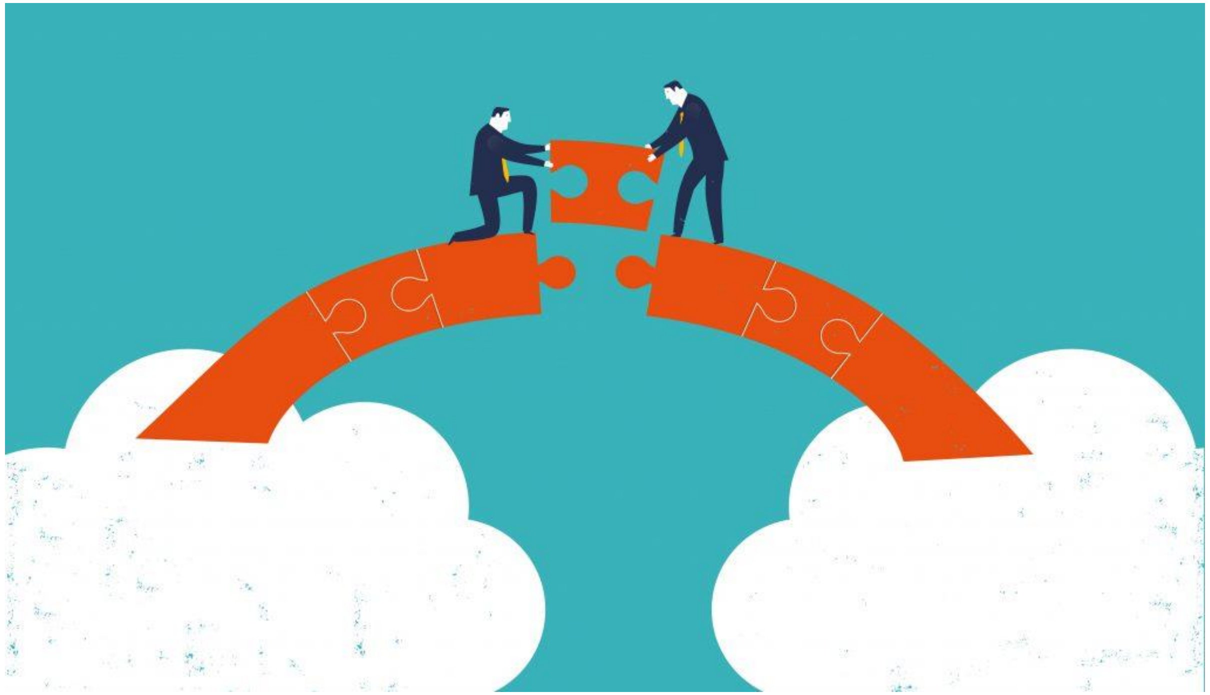
Ten Take-Aways (5)

Technological Competencies: At the Forefront and Comparative Gaps

European companies have been very successful in arms export.

This is a sign of their technological competitiveness on the world market particularly the case for ships (submarines, frigates, fast patrol boats) and certain land systems.

In other areas (fighter aircraft, helicopters, certain sectors of military electronics) European companies lag behind US companies that dominate global defence production.



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Ten Take-Aways (6)

Defence Industrial Base: In many European countries small and overall too fragmented

Out of a total of the global top 100 defence companies 25 are located in Europe, compared to 41 in the US. The European companies are considerably smaller.

Systematic implementation towards common defence industrial base in Europe repeatedly failed due to national interest.

The structural problems of the European arms industry are not solved. The current boost in demand is just moving the structural deficits into the future.

Ten Take-Aways (7)

Uneven Distribution: Location of Companies

The regional European map of arms producing companies shows a clear imbalance between East and West.

The larger companies are all located in Western Europe (France, Germany, Italy and Spain (and the UK, no longer in the EU).

Thus, the second and third tier supplier industry is mainly distributed in these Western European states as well.

Unless national interests are overcome, this imbalance is likely to reproduce itself, which poses a hindrance for systematic EU procurement cooperation.

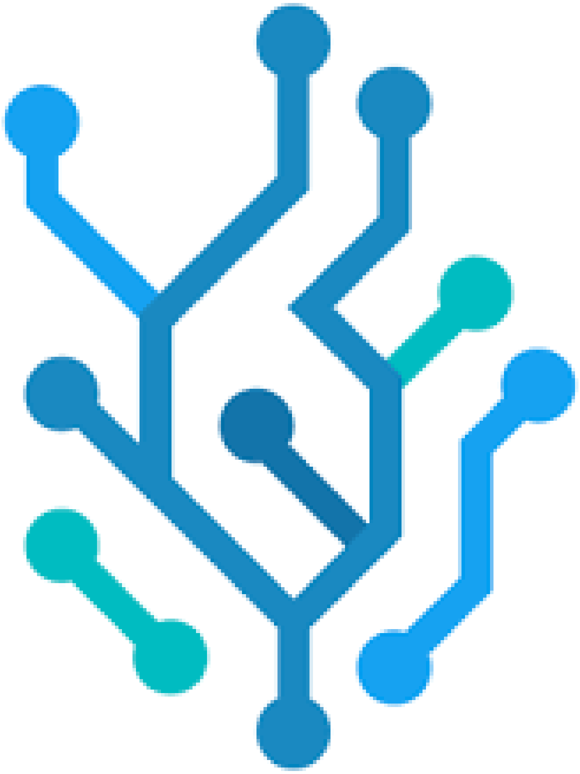
Ten Take-Aways (8)

Uncoordinated Export Policies: Increased Globalization and Export Dependency

EU defence producers depend on arms exports in the global market. Exports have become a must for all larger defence companies to keep existing capacities occupied.

Globalization has increased since companies manufacture increasingly less in-house and rely on supply from subcontractors. This leads to a complex landscape of supply chains and a diversified network of sub-contractors and suppliers, often in several countries.

National laws regulate such exports. Increasing cooperation in Europe will require common EU laws or guidelines to regulate exports.



Ten Take-Aways (9)

Lack of Qualified Personnel and Need for Union Representation

Most defence companies must employ more, and especially, highly qualified personnel. Such qualifications are not easily available.

Trade unions are challenged by the consequences of consolidation and European solutions because they will have consequences for regional distribution and also jobs in parts of the industry.

Networking workers' interests between military and commercial sectors and across national borders seems to become one of the main tasks for trade union work in the coming years.

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Ten Take-Aways (10)

Financial Squeeze: Can all the promises be met?

Decisions about increase in defence budgets suggest growth for the defence industry.

However, a growing challenge to finance European policy in the defence sector is due to the high deficit spending in the corona crisis and fears for an economic recession.

Since weapons are becoming increasingly complex their unit cost keep increasing. Not everything discussed today will be possible under future economic restrictions.

Many thanks for your attention!

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