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# Defence Concentration in Sovereign Industries Post-Covid-19

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The Covid-19 health crisis has highlighted the need for strong sovereign industries to reduce dependence on third parties. On the high-tech health markets it is now necessary to reach a critical mass in order to have the resources to stay in the race, as has been demonstrated by the acquisitive efforts of companies like Sanofi or Bayer. The alternative is to position one's self in a niche, in the role of critical subcontractor or as leader in a very defined industry domain: hyper-specialised CureVac or BioNTech are examples of this latter option. These strategies also depend on the culture of the country in question: in Scandinavia or France the preference is towards building champions, whereas in Germany it is towards specialisation to position oneself at a critical level of the value chain. In order to compete with American or Chinese companies, European companies must seek to eliminate redundancies and fratricidal competition to guarantee sovereign access to certain technologies.

The European Union's Gaia-X, the cloud data infrastructure project, is a good opportunity for Europe to troubleshoot on this point, making market and company structuring decisions from the outset to ensure greater sovereignty and competitiveness on the world stage. That is, so long as German habits do not torpedo the spirit of the programme. The German Minister of the Economy, Peter Altmaier, recently stated rather troublingly that "[n]umerous European companies but also extra-European companies like for example, Google, Microsoft, or IBM, are allowed to participate [in the project]."

The arms industry is the quintessential sovereign industry of excellence, but, since the end of the Cold War, NATO budgets at half-mast have naturally created a context favourable to the emergence of giants. Europe is the most obvious theatre of this phenomenon. Companies like BAE or MBDA represent the first wave of consolidation. The second wave is presently underway, a coping mechanism for the technological challenges coming from the dawn of a major innovation cycle. The Franco-German company KNDS is a proven example for land armament, while the naval sector is trending in this direction, with discussions between Fincantieri and Thyssen-Krupp or Naval Group. Along with wrestling with the complexities of artificial intelligence, robotics, and digitisation, a second force exerting pressure is the toughening of international competition.

Industrial strategies are not always in line with the ultimate purpose of armaments, which is to serve the defence policies of European countries, individually and as a whole — and therefore staying in line with a logic of secure sovereignty. Often consolidations are made for capital-intensive purposes or without real synergies between the constituent companies. GDELS is a good example of this. Over the years it has bought out Santa-Barbara Systems, Mowag and Steyr-Puch, to create a siloed but homogeneous group of companies without any overall industrial rationale.

There is equally a lack of coherence within certain national policies. Policies which remain in place purely out of principle and whose concrete achievements are a testament to their contradictions. The case of Germany is, from this point of view, particularly striking: a contradiction between the will not to export and the will not to consolidate.

The atomisation of certain markets today forces industrialists to export in order to survive. Given the restrictive defence budgets of European states, military industrial production necessitates overseas sales to subsidise state

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spending. It also sets the stage for consolidation so that companies can access sufficient areas of the market to be successful. These are realities that seem to elude some German politicians. MEP Katja Keul, for instance, believes that the European defence market is “economically not so uninteresting” making the search for export success superfluous. This is just one more indication of the depth of understanding German politicians have in respect to innovative technologies and their true costs. It is perhaps not surprising that German defence projects tend towards such colossal cost creep.

The German government, however, is generally rather reluctant to authorise exports of military equipment, not least because of its longstanding pacifist stance. This is detrimental to the logic of economies of scale that make it possible to equip European national armies at bearable unit costs. Similarly, Germany, which officially promotes the strengthening of the European defence industrial and technological base (DITB), does nothing concrete to encourage consolidation. As in the case of the Main Ground Combat System (MGCS), where it is pushing a third player in the project, RheinMetall: instead of strengthening the integration and synergies of the two KNDS entities, it fuels German-German debates and weakens the position of a Franco-German champion. Or again, there is the case of the MKS-180 frigate whose contract was awarded to Damen, a manufacturer from the Netherlands. Instead of pushing a clear consolidation strategy, the government awarded a strategic contract to a foreign industrialist, once more demonstrating a complete lack of coherent industrial planning.

All these developments, if they do not fit into a clear political vision, present risks. A major one is the potential for interference from non-European players in the capital of champions, companies with a European appearance. This poses a risk to the future of these industries and to the autonomy of decision-making, in R&D, employment, and export considerations. It is admittedly sometimes difficult to determine the “Europeanness” of the DITB. However, certain priority criteria can be retained, such as the head office, R&D and production sites, and above all, the nationality of shareholders and the distribution of voting rights. One of the challenges for land armaments in Europe is not to let GDELS dominate the European defence industry, because even if GDELS (GD European Land Systems) is a European company, it is American-owned and controlled by the United States.

Some European countries seem not to have taken this dimension into account in wanting to open up the PESCO to non-European countries. While transatlantic tensions have been ruffling feathers in Europe, there is a message to be found: the US wants less reliance on it defensively from Europe, and yet it wants to enjoy orders from the European market. This position is not likely to change all that much under President Joe Biden. This only makes sense: it is win-win for the US — but surely, that makes it lose-lose for European defence strategy and industrial development. The most looming question, of course, is why is Germany seeking at all costs to open PESCO to third parties?

A certain awareness should have reached Germany after the award of the G-36 rifle replacement contract, in which a chosen foreign-owned European supplier became embroiled in patent infringement against Heckler and Koch: ill-considered cost saving makes for poor strategy. When asked about the breakdown of the tender process, Defence State Secretary Benedikt Zimmer was not even able to comment on the company’s ties to the United Arab Emirates. It seems unclear whether or not Germany has chosen its path in this matter, lost between an Atlantic tropism inherited from the post-World War II era, and a still diffuse perception of contemporary geo-economic realities. With the announcement of US troop withdrawal from Germany, Marie-Agnes Strack-Zimmermann, the defense policy spokeswoman for the FDP party asserted that “NATO is a precious commodity that is being destroyed by the current US President.” Tellingly, across the aisle, and more crucially, in the ruling party, Germany’s current defence minister, *Annegret Kramp-Karrenbauer*, stated that “Illusions of European strategic autonomy must come to an end.”

The second major risk is the emergence of a disconnect between the industry and the defence sector. If concentration emerges through a financial and commercial — or even industrial — logic, but not through a logic of responding to needs, there is a risk of an DITB that imposes designs that are out of step with military requirements. An ensuing fallout risk is a lack of competition, meaning that the composite industrialist imposes its solutions and prices regardless of alignment.

There is also the risk of fiasco through technological aggregation, due to a lack of relevant integration. To stay with the German case, an example of extraordinary technological difficulty, the Gorch Fock restoration project, was

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originally priced at €10 million, but ballooned to €135 million as a result of inadequate examination, ignorance of vital information, and insufficient communication. This kind of acute inefficiency for large complex builds is one that has marred German defence projects. The most recent example is the late delivery of Puma; such issues require careful, considered attention to rectify.

That competition remains in place is not simply desirable, it is necessary. Without it the industry is able to impose its prices, and this creates problems of budgetary drift for armament programmes and ultimately wastes taxpayers' money. It is necessary to find a balance in the mergers to create players of critical size without stifling competition. One can look to the wave of mega-mergers in the aeronautics industry in the United States after the so-called "Last Supper." It subsequently became clear that the United States needed to put an end to the rampant consolidation created through its own rather pointed budgetary reductions. Secretary Perry explained a decade later on that, despite good intentions in 1993, the resulting "trend toward fewer and larger prime contractors has the potential to affect innovation, limit the supply base, pose entry barriers to small, medium and large businesses, and ultimately reduce competition." Most of all, it resulted in a waste of taxpayers' money.

It is necessary to give priority to responding to national military needs within a European framework, within a logic of sovereignty and integration of multiple capabilities, striking the right balance between concentration and maintaining a competitive ecosystem: one that does not impose its prices and is creative in terms of responding to needs. European countries need truly European champions, capable of innovating, designing and/or integrating weapon systems into combat systems, while continuing to develop key know-how at the heart of these systems. Bringing systems integrators closer together will ultimately make it possible to manage export competition and develop high-performance systems. These are the ambitions pursued by programmes such as MGCS and FCAS, which bring together French and German champions in their respective logic of greater added value.