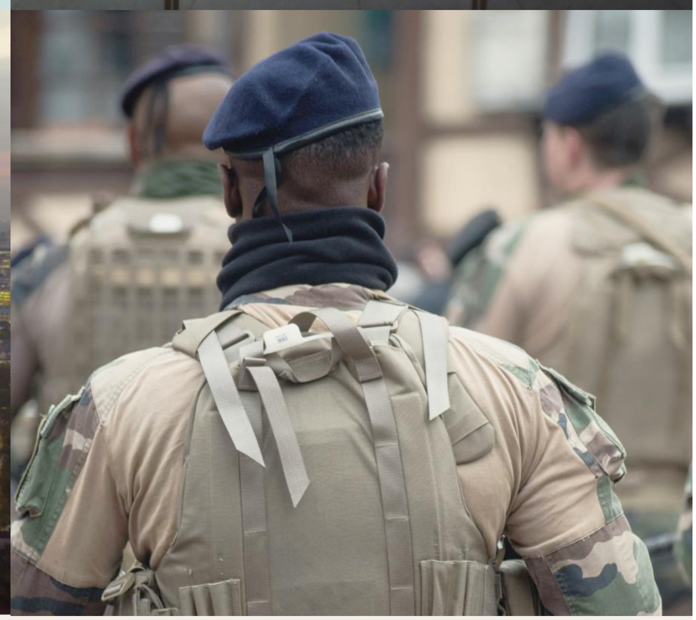
The cost of non-Europe in defence procurement



ASD Paper

The cost of non-Europe in defence procurement

The state of play: The predominance of non-European suppliers in European defence markets

Ever since the end of World War II, the biggest part of European defence acquisition budgets has been spent on non-European systems and equipment. After the end of the Cold War, this trend continued (albeit to varying degrees among European countries) on the basis of drastically reduced defence budgets.

In the two years following the full-scale Russian invasion of Ukraine the predominance of non-European suppliers in Europe reached a new peak. Between February 2022 and mid-2023, acquisitions from outside Europe accounted for 75% of new orders publicly announced in the EU.

The causes

Several long-term structural factors and short-term situational circumstances contribute to this imbalance in European defence procurement.

1. **Politics:** Most defence acquisition decisions have a political rationale. Armament procurement is often used to reinforce a strategic and/or security partnership. This has traditionally been a strong argument for many Europeans to buy US equipment.

2. **'FMS' effect:** Foreign Military Sales (FMS) is a security assistance programme of the US government to facilitate the purchase of US defence equipment to foreign governments. European customers often use the FMS, as it offers several benefits, including a 'package deal' that entails seemingly reduced overall costs; training, maintenance, and logistical support; a streamlined, one-stop-shop procurement process that reduces procurement timelines and administrative burdens; the ability to derogate from EU procurement rules; and the possibility of financing and related security assistance programmes. These benefits can often tip the scales in favour of US suppliers.
3. **Availability:** Following Russia's invasion of Ukraine, short-term availability of purchased equipment has become a key concern for European governments and militaries. As a result of larger domestic market size (US) and/or higher defence readiness levels (South Korea), some non-European companies have been able to maintain greater production capacity and thus to deliver (or promise) larger volumes of equipment and at greater speed than European companies could after decades of downsizing and underinvestment. Countries such as the US had also maintained significant stocks and reserves (mothballed) of equipment that could be made available to partners and/or Ukraine relatively quickly.
4. **Legacy effects:** Past acquisitions can also shape future procurement decisions. Militaries may want to replenish and/or increase their stocks of existing systems, equipment, and ammunition. They may also prefer new versions of equipment they are already familiar with, or equipment designed to work integrated with other materiel they already use. Given the long-standing widespread use of US equipment in Europe, this limits the market opportunities for European suppliers.
5. **Interoperability with (non-European) partners:** A military may favour a particular equipment because it seeks interoperability with other allies that already operate it. This can create a network effect: the more militaries procure a system, the greater the interoperability incentive for other militaries to follow them. While interoperability is highly desirable and a compelling

argument also for European collaboration, it is frequently and successfully used by the US to promote the acquisition of US-made systems, leveraging the fact that the US is the key security partner for most European countries. This is further exacerbated by US suppliers' and the US government's refusal to share IP to the extent required for integration of European systems with existing US ones.

6. **Absence of European solution:** In certain market segments (e.g. MALE UAV, tactical ballistic missiles, and long-range artillery rockets, etc.), there is currently no European solution available on the market, due to European governments' underinvestment, prioritisation, and industrial policy decisions over the previous decades.
7. **Performance/cost:** Non-European solutions which benefit from larger domestic markets and economies of scale may provide performance similar to European alternatives at a more competitive cost (at least if only the purchase cost is considered).
8. **Technical/regulatory constraints:** In certain cases, specific technical/regulatory requirements can dictate the choice of equipment to be procured, particularly when combined with tight time constraints.

The consequences for European industry

Preference for non-European products has a series of interrelated negative effects on Europe's defence industry.

1. **Diminished market position:** By procuring non-European products, European governments weaken the market position of European companies while bolstering the position of non-European counterparts in Europe. Given that defence products often have decades-long lifecycles, a procurement decision in favour of a non-European equipment provides the chosen non-European supplier with a steady and secure revenue stream and closes off the specific market segment to European products for a very long time.

2. **Loss of revenue and investment capacity:** Due to reduced domestic demand, European defence firms lose possible revenues. This, in turn, constrains their ability to invest in critical areas such as research and development (R&D) and production capacity enhancement.
3. **Missed economies of scale:** Where an alternative European product already exists, the decision to buy non-European reduces the potential production volumes. This hinders European producers from capitalising on economies of scale and inhibits cost efficiencies.
4. **Heightened export dependency:** The less European producers sell in Europe, the more they must rely on exports to generate revenues. This exposes them to the geopolitical uncertainties and market fluctuations. At the same time, failure in European markets can weaken the competitiveness of European producers vis-à-vis non-European rivals also in global markets.
5. **Knowledge and capacity loss:** Without a sufficient customer base in Europe, European companies may have to give up the production of certain equipment or not develop it at all. This is critical in particular for systems based on new and emergent technologies (e.g. hypersonic, directed energy weapons) that require massive investments This may lead to a permanent loss of know-how and production capacity in Europe.

The consequences for European countries

The predominance of non-European defence purchases has ramifications also for the security of European countries:

1. **Reduced security of supply:** Dependence on non-European suppliers exposes European countries to the evolving foreign policy agendas of third countries and the commercial priorities and production capacities of their industries. This can jeopardise the security of vital defence supplies in particular in times of crisis and high demand.
2. **Limitations in equipment customisation:** Buying abroad constraints European defence ministries in tailoring equipment to specific requirements. It also impedes system-level

understanding and hinders flexibility in modifications, upgrades, and integration with European-made equipment.

3. **Loss of operational freedom:** Foreign-made products may be subject to operational or export restrictions which curtail European armed forces' operational autonomy and European governments strategic/political autonomy.
4. **Renouncement of technological sovereignty:** By forgoing European development programmes and relying on off-the-shelf procurements, European countries relinquish technological sovereignty and diminish their strategic and political influence.
5. **Challenges for co-development efforts:** The lack of a critical mass of European systems limits the basis for any future co-development efforts in the framework of European collaboration.
6. **Economic impact:** Procurement of non-European equipment entails adverse economic consequences in Europe, including the loss of highly skilled jobs, supply chains fragility, and reduced innovation capacity.

Conclusion

Most defence procurement decisions have important ramifications: militarily, technologically, strategically, and politically. Consequently, the predominance of non-European suppliers on European defence markets bears far-reaching implications for Europe's security.

In its European Defence Industrial Strategy (EDIS) of March 2024, the EU therefore calls for reversing the current procurement trend. It even sets specific targets, whereby by 2030 at least 50% of defence procurement budgets should be spent within the EU, and 60% by 2035.

However, defence procurement decisions are an exclusive prerogative of national governments. The EU can provide incentives to cooperate and buy more European, but ultimately it is for Member States to decide what to buy and from whom. The key to reversing the persistent dominance of non-European suppliers in Europe lies in capitals.

To avoid critical dependencies and safeguard Europe's security, national policy- and decisionmakers should carefully evaluate the short- and long-term consequences of their procurement decisions and the total cost of buying non-European

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