
10. The Nordic attitude to and role in EU-linked defence industrial collaboration

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I. Introduction

In chapter 9, Björn Hagelin describes and analyses a number of important elements of defence industrial cooperation in the Nordic region—covering Denmark, Finland, Norway and Sweden. He points to institutional arrangements as well as the patterns and processes of a market that is increasingly driven by commercial concerns but remains political at its core. It reveals a multifaceted reality in which ambitions and capacities, intentions and outcomes, statements and actions often conflict.

This chapter explores some of the options open to the Nordic countries, elaborating on the contradictions between and common characteristics of ‘Nordic’ and ‘European’ orientations. It considers whether the muddling through strategy described by Hagelin—with the Nordic dimension one of several factors influencing decisions by governments, defence ministries, armed forces, procurement authorities and defence companies—is avoidable, and whether there are realistic alternatives with clearer priorities, such as a dominant role for Nordic defence industrial collaboration or a full integration of the Nordic dimension into a European Union defence market.

The chapter focuses on the following three questions: can there, should there and will there be a Nordic dimension in defence industrial collaboration in Europe? The approach taken here is more conceptual than empirical, in order to provide an additional perspective to Hagelin’s factually oriented contribution.

II. Can there be a Nordic dimension?

Defence production is becoming increasingly commercialized. Private ownership of defence companies has become the rule and state ownership the exception.¹ Similarly, procurement authorities are under strong pressure to economize and buy arms on a competitive basis. Consequently, defence production has become more international, particularly in Europe.² However, in

¹ See, e.g., Serfati, C. (ed.), *Changing Government–Industry Relations in the Defence Industry* (Office for Official Publications of the European Communities: Luxembourg, 1999).

² See, e.g., Serfati, C. et al. (eds), *The Restructuring of the European Defence Industry: Dynamics of Change*, COST Action A10 (Office for Official Publications of the European Communities: Luxembourg, 2001); and Schmitt, B., ‘The European Union and armaments: getting a bigger bang for the euro’, Chaillot Paper no. 63, EU Institute for Security Studies, Paris, 2003, URL <<http://www.iss-eu.org/>>.

spite of this trend towards a ‘normalization’ of the arms industry, it remains an industry shaped by political decisions. The industry is not independent of strategic political interference, and it is unlikely to avoid interference in the future. Today, the main publicly stated reason for the special government–defence industry relationship is economic: the defence industry is one of the few industrial sectors where many governments continue to take explicit responsibility for the level of employment. The economic rationale for keeping the defence industry outside the realm of anti-protection regulations purely in order to preserve employment may be questioned. However, the potential for shielding the defence industry from a more commercial approach is enhanced because the economic argument is linked to a more powerful one, related to the types of goods produced. Weapon systems remain an exceptional product both in relations with other countries and internally. Arms production continues to carry symbolic connotations of independence, alliance and power.

The special nature of government–defence industry relations carries over also to transnational and international collaboration. Defence production in Europe, particularly production by the EU member states, is becoming increasingly integrated, but this integration has been based largely on decisions made nationally. Defence producers without a ‘home base’ in one of the countries continue to find it difficult to compete for contracts. This is true even for a seemingly ‘European’ company such as EADS, as illustrated by the heated discussion in the autumn of 2004 about the continuation of a two-man French–German team at the top of the organization.³ One of the effects of the continuing control of national governments over defence production is that each country can, at least in theory, pursue alternative strategies. There remains much room for specific action to shape the future of the defence industry, but it almost always carries a heavy price tag, an issue that is taken up again below.

The continuing special nature of the relationship between governments and arms producers has several elements, including the following.

1. *Procurement.* Arms procurement will remain a national prerogative for the foreseeable future. A possible exception could be procurement for troops for joint operations, such as multinational brigades or battle groups. Even for this exception, however, it looks as if interoperability, rather than joint procurement, of major equipment will be the best that can be achieved.

2. *The defence industrial base.* While there is an industrial logic to creating large multinational units, there is also room for smaller entities. Governments, even those of small countries, can use such niche operations to promote national capacities.

3. *Defence industrial policy.* Major steps have been made in the past few years—both through national action, particularly in France, and through joint EU action, such as the establishment of the European Defence Agency (EDA)—to provide a common, level playing field for defence industries in

³ See, e.g., Hagmann, G. and Clark, T., ‘EADS bekommt neue Führung’ [New leadership for EADS], *Financial Times Deutschland*, 6 Dec. 2004, p. 1.

Europe. The EDA will be a useful platform for the exchange of information, the harmonization of regulations in EU member states and the further integration of defence procurement. However, with the possible exception of procurement for multilateral units within the European Rapid Reaction Force, the EDA will not be a procurement authority. National governments will remain in the driving seat, a fact that was not lost on the major European defence producers when they criticized EU member states as being too timid in the creation of the EDA.⁴ Even with the EDA, the defence markets will continue to be dominated by decisions made nationally. Larger producer countries will continue to protect their markets and all, including the smaller ones, will keep open their options to procure outside the realm of the EDA, particularly of course in the USA. The Joint Strike Fighter project, described by Hagelin, is only one—albeit a major—example of cooperation by European countries with the dominant power in the global arms market, the USA.

The defence industrial environment allows much national room for manoeuvre, *inter alia* by the Nordic countries. Iceland, a country without a defence industry, and Denmark, Finland and Norway, with small and selective defence industries, cannot go it alone in defence production. They can, however, at least in theory, choose between alternatives such as going with the USA, going with Europe and, in combination with the Swedish industry, going Nordic. Hagelin, however, questions the viability of this last option on the basis of the empirical evidence of the past. The next section of this chapter picks up some of the points he makes and expands the argument in the direction of asking how useful a Nordic dimension would be in a more European defence market.

III. Should there be a Nordic dimension?

In the above discussion of the possibility of a Nordic orientation of defence production in the four countries considered, a distinction was made between the theoretical possibility and the realism of such an option. While it would be possible to pursue this option, it might well be economically costly and politically harmful to the interests of Nordic states. For instance, the EU member states might see the pursuit of this option as running counter to the European Security and Defence Policy, of which Finland and Sweden are proactive members. A Nordic orientation of defence production would have several other consequences, some of which are mentioned by Hagelin, such as implications for access to technology. One particular aspect is highlighted here—the balance between cost and competition.

⁴ On 15 June 2004, an open letter written jointly by the chief executive officers of Thales, EADS and BAE Systems calling for more resources and powers of the EDA was published in several European newspapers. For the text see, e.g., Ranque, D. et al., 'The new European Defence Agency: getting above the clouds', Press release, Thales, 24 June 2004, URL <http://www.thalesgroup.com/home/home_dyna/1-7723_357_10704.html>.

The lack of integration in European defence markets continues to carry high costs, as demonstrated by well-known examples such as the variety of fighter aircraft produced and procured in Europe. The research and development costs of many weapon systems are high. The higher the number of units of a weapon system over which these and other fixed costs can be distributed, the lower the unit cost of the weapon. Longer production runs also bring savings because of the exploitation of learning costs. Weapons produced in small numbers are therefore more expensive than weapons produced in larger numbers. Procurement authorities that choose weapon systems because they are produced domestically generally pay a premium, which may be substantial if the weapon system is produced in only small numbers. If there was only one type of fighter aircraft, and all the European air forces bought it, taxpayers would be better off.

European countries have responded to this problem of small production runs by promoting the concentration of production and procurement. This two-track approach has dominated defence industrial policy in Europe for at least 30 years—since the days of the Independent European Programme Group within NATO.⁵ Much has been achieved in terms of greater concentration of production in several sectors of the defence industry over the years, but coordination of procurement has remained a difficult endeavour. The EDA will continue to push for this agenda.

However, as inherently logical and potentially cost-saving as further concentration of both production and procurement may be, there are limits to it. Along with the logic of falling unit prices with longer production runs goes the logic of large companies reaching dominant, or even monopoly, positions in markets and charging excessive prices. Sub-markets for defence products are particularly vulnerable to monopoly positions because of the specificity of many defence products. The recent experience in the USA is quite sobering in this respect. The consolidation wave of the 1990s has not resulted in substantially lower prices. Consolidated companies had great difficulties in reducing costs. In fact, because of the lower level of competition, they were able to develop various strategies to avoid cost cutting, such as keeping several production lines open.⁶ Europe continues to have a fairly diversified defence industry, with scope for further concentration in several sub-markets such as those for armoured vehicles and corvettes. However, competition for some types of military technology, including large conventionally fuelled submarines, for example, is already down to two or three producers. The jury is out on whether further integration of defence production in Europe will lead to lower or higher prices for defence equipment.

⁵ Brzoska, M. and Lock, P. (eds), *Restructuring of Arms Production in Western Europe* (Oxford University Press: Oxford, 1992).

⁶ Sapolsky, H. and Gholz, E., 'Restructuring the US defense industry', *International Security*, vol. 24, no. 3 (winter 1999/2000), pp. 5–51; and Sköns, E. and Baumann, H., 'Arms production', *SIPRI Yearbook 2003: Armaments, Disarmament and International Security* (Oxford University Press: Oxford, 2003), pp. 388–402.

Competition is a good check against the overly high prices that can result from a near or full monopoly position. In the current situation in Europe, such competition can come both from the inside, from within the EU, and from the outside, in particular from the USA. However, perpetuating a situation in which US companies are relied on to balance the market strength of a few European companies would run counter to the idea of a competitive European defence equipment market as part of the ESDP. A viable European defence market needs to have a sufficient level of internal competition if is not to become a burden rather than a boon for the ESDP.

The nature of the defence market—with its generally short production runs, specificity of products and, above all, close relations with governments—means that it takes policy intervention to ensure a sufficient level of competition. The arms market is so different from most civilian markets that the economic textbook prescription for open competition—government non-intervention—is not an option. Governments that do not intervene could well find themselves faced with an unsatisfactory situation of near or full monopoly. One of the main driving factors behind many European governments' efforts to seek more intensive international cooperation in arms production—to widen national markets beyond one or, at best, a few producers—would come full circle if Europe ended up with only one or very few producers.

There is still much scope in Europe for making savings in arms procurement costs through further concentration of production and procurement, but there is also the danger of this same process leading to monopoly or near-monopoly situations. In the absence of open competition, as is the case in much of the defence sector, it is difficult to assess whether a market is still too diversified or already in danger of becoming monopolized. While there remains much scope in Europe for further concentration in most sub-markets for certain types of weapon systems, it makes sense to protect some production capabilities in order to counter monopolization tendencies. It is much more costly to rebuild a competitive market that has been captured by a monopoly than to manage competition while it still exists. One of the objectives of the EDA should be to keep a watchful eye on the various sub-markets while it promotes further integration of the defence industry in Europe. As it is not clear what the power and potential of the EDA will be, this task also needs to be performed by national governments.

Is there a Nordic dimension to the balance between cost and competition? Hagelin is sceptical, arguing on the basis of both trade data and experiences with collaboration on individual projects, and the present author largely concurs. However, there are alternatives to the current level of Nordic cooperation and what Hagelin sees as the most probable future trend. Hagelin mentions the institutional frameworks among Nordic countries that could be used for enhanced cooperation on defence industrial matters. A considerable challenge lies, of course, in the fact that this cooperation includes both EU and non-EU and both NATO and non-NATO members. In addition, industrial capabil-

Table 10.1. Shares of exports of defence equipment of select EU countries that went to Nordic countries, 2002

Figures are percentages.

Exporter	Share of exports that went to Denmark, Finland, Norway and Sweden	Share of exports that went to non-Nordic EU members
France	2.1	14.3
Germany	8.5	33.4
UK	3.3	20.0
Denmark	15.9	14.2
Finland	67.8	10.2
Sweden	42.2	17.4
All EU	4.6	21.6

Source: 'Fifth Annual Report According to Operative Provision 8 of the European Code of Conduct on Arms Exports', *Official Journal of the European Union*, C320 (31 Dec. 2003), URL <<http://europa.eu.int/eur-lex/lex/JOIndex.do>>, pp. 1–42. Data are according to the EU's Common Military List of equipment covered by its Code of Conduct on Arms Exports. No data are available for exports from Norway.

ities overlap in only some areas of technology, and the interests of the major countries differ substantially. Nonetheless, within the dynamics of the developing European arms market, a strong Nordic dimension in defence production could well help balance the centralizing and monopolizing tendencies in the EU.

IV. Will there be a Nordic dimension?

While a Nordic dimension in defence industrial collaboration would be possible politically, and even the economics of a strong Nordic dimension make sense, at least under some circumstances, Hagelin is correct in saying that it is unlikely that a greater Nordic dimension will develop in the foreseeable future. The primary reasons are the differences between defence industries in the Nordic countries and their individual links to defence industries in other European countries.

Hagelin provides both SIPRI and national data on the defence trade which attest to the central position of Sweden. This may be complemented with data for the European Union more generally.

Table 10.1 shows, in the first column, how important Denmark, Finland, Norway and Sweden are as customers for the defence industries of select EU countries. The Nordic countries are important markets for the Finnish (68 per cent in 2002) and Swedish (42 per cent) defence industries. They are much less important for the Danish defence industry (16 per cent), but its share is still well above the average for defence industries in the EU (5 per cent). Among the major EU producers, Germany is clearly the strongest partner for the Nordic

Table 10.2. Imports by Nordic countries from Denmark, Finland and Sweden as a share of imports of defence equipment from the EU, 2002

Figures are percentages.

Importer	Imports from Denmark, Finland and Sweden as a share of imports from the European Union
Denmark	3.8
Finland	75.7
Sweden	14.8
Norway	11.2
All EU	3.8

Source: 'Fifth Annual Report According to Operative Provision 8 of the European Code of Conduct on Arms Exports', *Official Journal of the European Union*, C320 (31 Dec. 2003), URL <<http://europa.eu.int/eur-lex/lex/JOIndex.do>>, pp. 1–42. Data are according to the EU's Common Military List of equipment covered by its Code of Conduct on Arms Exports. No data are available for exports from Norway.

countries: almost 9 per cent of German defence exports went to these four countries in 2002.

In table 10.2, a different question is asked of the data: what proportion of the Nordic countries' imports of defence equipment from the EU come from Nordic countries (for which data are available)? A similar picture emerges: imports from other Nordic countries are very important for Finland (76 per cent) but much less so for Sweden (15 per cent) and Norway (11 per cent), although these two countries import much more from the Nordic countries than the EU member states do on average (4 per cent). For Denmark (4 per cent), the other three Nordic suppliers are no more or less important than they are for the rest of the EU.

These data thus support the data presented by Hagelin in showing that the Nordic dimension is of particular importance for Finland and of no importance for Denmark. Norway and Sweden are somewhere in the middle.

A picture of Swedish dominance emerges with respect to equity capital links between major companies in the Nordic countries, as shown by Hagelin. The Swedish defence industry has particularly strong links with the United Kingdom (aircraft and armoured vehicles), Germany (shipbuilding) and the USA (artillery and ammunition). While there are also equity links between Nordic defence companies, the foreign ownership of major Swedish companies is more important for the questions discussed here because of the central position of the Swedish defence industry in the Nordic area. The international orientation adopted by Sweden, as the most important defence producer among the Nordic countries, has also found expression in Sweden's leading role in European

defence industrial institutions, such as the 2000 Framework Agreement on the restructuring of the European defence industry.⁷

In the end it is hard to avoid Hagelin's conclusion that most of Sweden's defence industry is likely to become even more interested in the wider European defence industrial playing field in the future. The Nordic dimension will remain of interest for Sweden, particularly with respect to some niche production where producers in the other Nordic countries can offer interesting technology. Finland and, to a lesser degree, Norway are also important customers for Swedish industry because they strengthen the Swedish position within their industrial partnerships. As the Swedish defence industry is an important partner for defence industries in Finland and, to an extent, Norway, the relationship is of mutual benefit.

The logic behind the existing Nordic links is not, then, primarily one of creating a common Nordic platform to further Nordic interests within the emerging European defence market. It is primarily a defence industrial logic or, to be more precise, two defence industrial logics. The first is the Swedish ambition to maintain a strong defence industry, to be among the six or so largest players in Europe. The second is the rationale of the smaller defence producers, Finland and Norway, which seek cooperation with Sweden as a medium-sized partner in order to protect themselves against overly strong competition. This does not preclude them, however, from buying elsewhere, including from the USA.

The defence market is a political one, albeit one based on economic realities that are costly to defy or to manipulate. Defence industrial structures are complex mixes of both industrial and political interests and agendas. The Nordic dimension, while potentially a strong factor in determining the course of defence production and defence industrial cooperation, is obviously not sufficiently attractive for these governments to counter the commercial logic driving the defence industries in the Nordic countries, particular in Sweden. Instead, the Nordic dimension is currently shaped by the industrial and institutional dynamics at the European level. It would nevertheless make sense for the Nordic governments to nurture this dimension in order to keep their options open, at least in those areas of defence production where this approach is not overly costly, and particularly in those areas where further European integration of defence production might lead to unwarranted monopoly situations.

⁷ The Framework Agreement between the French Republic, the Federal Republic of Germany, the Italian Republic, the Kingdom of Spain, the Kingdom of Sweden and the United Kingdom of Great Britain and Northern Ireland Concerning Measures to Facilitate the Restructuring and Operation of the European Defence Industry was signed on 27 July 2000. See URL <<http://projects.sipri.se/expcon/loi/indrest02.htm>>. On the agreement see Davis, I., SIPRI, *The Regulation of Arms and Dual-Use Exports by EU Member States: A Comparative Analysis of Germany, Sweden and the UK* (Oxford University Press: Oxford, 2002), pp. 105–109.