



New Investments, Possible Consolidation: France's Support of Its Defence Industry

Łukasz Maślanka

Despite a huge increase in France's budget deficit related to the coronavirus pandemic, the government does not intend to abandon its plan of boosting military spending in 2021. It justifies it by the deterioration of the security situation in the wider EU neighbourhood and the importance of the defence sector to the French economy. The increased spending may be followed by consolidation of this sector on both the national and European levels.

The high mobility and battle-readiness of the French armed forces is crucial not only for the country's defence but also for its foreign policy. Defence spending has been increasing since the beginning of Emmanuel Macron's presidency. The purpose is to build up France's credibility among its allies, as well as the country's position in the EU. The French military force is also an added-value in selling France's concept of European strategic autonomy. About 200,000 people are employed in the French defence sector, which is a €30 billion business. All these factors pushed the Defence Commission of the National Assembly to prepare a report proposing a dedicated help package for the defence sector. Armed Forces Minister Florence Parly announced simultaneously that the increased defence spending plan will be maintained in the years to come.

Defence Sector amid the Pandemic. The French defence industry has suffered a lot during the lockdown. Some big export contracts have been suspended and the completion of ones already in progress is uncertain. Arms producers worry that the defence spending of many countries is about to fall in the coming years, which can significantly limit the demand. France's arms exports amount to €9 billion (third highest in the world). Maintaining production rentability of some kinds of weapons vital to the military (especially helicopters, planes, and ships) strongly depends on foreign orders. Exports thus are not only economically important but also strategically significant. The competitiveness of French arms production is also at stake, given the recovery plans

already announced by some states (U.S., Germany) for their defence industries.

The French crisis also concerns supply: in the peak period of the lockdown (March-May), only 75% of French arms industry staff were working (30% at the workplace and 45% in home-office, with the cuts in the former resulting in lower production capacities). New sanitary protocols have increased the costs of production by about 10-20%. [Thanks to public assistance](#), no bankruptcies have taken place. The most difficult situation for the industry is expected in the autumn, when the state help will slow or cease, and loans taken in spring come due.

Public Assistance. Even if the French government hasn't prepared a special plan of aid for the defence industry, the Minister Parly announced that the defence budget will not be reduced next year. The legal basis for the development of the French armed forces from 2019 to 2025 is the Law for Military Programming (LPM). It imposes annual increases in military spending, aiming to achieve 2% of GDP before the law expires in 2025 (for now, the spending level is about 1.84%). The military budget is set to receive an additional €1.7 billion in 2021, or €39.21 in total.

The Defence Commission of the National Assembly has simultaneously issued a report presenting the needs of the arms industry during the crisis. The report claims that just maintaining French military orders is not enough to keep the sector in business. The Commission urged the government to change the orders schedule to ensure the solvency of producers who are suffering losses of exports. The most

important task is to preserve French technological advantages. A good example is nuclear propulsion for carrier ships. The MPs also expressed the need to accelerate Air Force acquisitions. The LPM sets the quantity of Dassault Rafale multirole fighters the Air Force should have 225 units by 2035. The Defence Commission proposes to order 20 additional planes in the fourth (and penultimate) tranche, allowing the Air Force to have all 225 units at its disposal as soon as in 2030. Until now, this had been opposed by the General Direction for Armaments (DGA), which, in representing the interests of the state treasury, had been trying to limit Dassault's expectations of public assistance and encourage the company to find market outlets abroad. Industry representatives quoted by the authors of the report argue that public investments in defence are beneficial to the French economy because of a high rate of return (2:1). Conflicts exist also within the industry. Small and medium-sized enterprises (SMEs) are more exposed to bankruptcy and at the same time dependent on payout schedules established unilaterally by the big companies. SMEs also have fewer technological assets to obtain public grants. The Commission's proposal is to set up a special mediator to settle conflicts of interest between enterprises, as well as between the state and industry.

Research funding and protection for startups from foreign takeovers is another important issue. The decrease of defence funding after 2008 led to a loss of technological advantage for the French arms industry in some key sectors (e.g., drones). Special public funds have been created to solve this problem: besides the Definvest (€100 million) fund, another one, Definnov, was started this year to promote innovation amongst SMEs. The aeronautical industry has its own fund (Aerofund IV) based on cooperation between the sector's giants and SMEs. The MPs would like to see another big fund created, with this one authorised to issue public bonds and its solvency ensured by the state. The Commission argues the time is right for such a fund because of the large amount of liquid capital on the market, extraordinarily low interest rates and the high level of private savings among the French. The MPs also want the state to help pull back from abroad some production important for the defence sector (e.g., steel, engines, batteries).

Engaging the EU. Actions on the national level are not enough: the Defence Commission claims the consolidation of the European defence industry to be a condition for an effective competition with champions from Asia and North America. For Europe, it would be essential to create a large naval industry actor comparable to Airbus. The turnover of the French Naval Group amounts to €3.7 billion annually, compared to the Chinese navy holdings of €15 billion. The MPs argue that the pandemic should convince the European

Commission to "think strategically, instead of limiting itself to the market criteria". The Defence Commission also hopes for the creation of the European Defence Fund (EDF). If its estimates are correct, France should receive from 20% to 30% of this €7 billion fund. The industry should focus on the most promising—from the French point of view—of the PESCO projects: European Missile Defence (Twister), a possibly competitor to the US Patriot system, and the European Patrol Corvette. The MPs also propose a new project: a medium-range transport plane, a possible successor to the A400M.

The consolidation of the European defence sector will reduce the cooperation of the French industry with extra-European partners. Cooperating with the U.S. makes the French arms sector dependent on the International Traffic in Arms Regulation (ITAR) legislation, allowing the U.S. authorities to impose unilaterally heavy financial penalties on partner countries in case they decide to export products with American components to countries not maintaining friendly relations with the U.S. A special status with the UK should be maintained despite Brexit. It is strategically important in the opinion of the Commission to support cooperation within the Franco-British holding MBDA.

Conclusions and Prospects. The effectiveness of public aid plan for the defence industry will depend on settling conflicts between the big players and subcontractors from the SME sector (concerning the payout schedule and public grant apportionment), as well as between the producers and the DGA (scale of the aid). The report by the Defence Commission tries to reconcile the needs of the industry with the budget constraints. The high rate of return for defence investments may be an important argument in favour of this, but to grant all the wishes of the producers would violate the rulebook of healthy competition and could make the state dependent on this cartel-like market. It could also decrease the quality of production. The Defence Commission's proposals to speed up orders and create a new investment fund is a compromise solution.

The consolidation of the EU defence industry is a precondition for the further development of the French arms enterprises in the long term. The actions of the French government to reach this goal will be consistent with the Franco-German proposals, supported also by Poland and Italy, to water-down EU antitrust regulations. Consolidation on the European level would force the Polish arms industry to research new market niches for their products and to enter into cooperation with EU partners (also with the French) at the expense of non-EU companies. However, cooperation with French industry is still burdened by a lack of trust, a result of Poland terminating in 2016 a contract to buy Caracal helicopters, which led to the withdrawal of plans to build an Airbus factory in Poland.