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Death Spiral of European Offset?

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ABSTRACT

This paper is concerned with evaluating the impact of the Procurement Directive, 2009/81/EC, on defence offset in Europe. The aim of the Directive was to reduce the extent of Article 346 derogations based on offset. Indirect offset has disappeared, and while the evidence is patchy, direct offset appears to be declining. This gradual demise of offset is in line with the global trend, especially among advanced countries. Offset is increasingly becoming a developing country phenomenon.

The origins of defence offset are European, dating back to the 1870s when Japan procured warships from Great Britain and demanded offset concessions. After WWII, Europe again benefitted from offset via licensed production of US weaponry, but it was not until the 1970s that offset dramatically expanded. European states articulated offset via 'win-win' narratives. However, this failed to chime with reality, given that most offset regimes adopted prescriptive, penal and over-ambitious policies that failed to generate enduring high value investment and skilled employment. Moreover, the associated arms deals were burdened with offset cost premiums, reflecting inefficient resource allocation and anti-competitive market behaviours.

There has been a belated realisation that offset carries costs as well as benefits, engendering a discernible slackening of global institutional enthusiasm, evidenced by US 2017 export-related offset liabilities shrinking to the fifth lowest since records began in 1993. Moreover, the US has never conceded that 'Buy American' equates to offset. On the other side of the Pacific, Australia abandoned offsets in the 1990s, and in the Middle East, Kuwait suspended it offset programme in 2014. Accordingly, Europe's suppression of offset through the European Procurement Directive (2009/81/EC) was not an isolated event but part of an emerging global trend. The Directive's principal goal was to promote evolution towards a European Defence Technological Industrial Base (EDTIB), assisted by limiting near-automatic derogation of EU competitive tendering procedures through Article 346. Henceforth, derogation would only be possible if based on national security grounds. Thus, at a stroke, indirect offset was eradicated, and direct offset severely constrained, as the claimant was now required to justify national security exceptionality. This was risky, though, as Greece discovered in 2009 when the European Court rejected its bid to locally produce German supplied submarine battery kits. Supporting the Commission's efforts to evolve the elusive EDTIB were six Directive exclusions, including collaborative programmes, Government-to-Government sales and acquisitions through international treaty organisations, such as NATO and OCCAR, driven by interoperability reasons.

The Directive was not universally welcomed, and implementation proved tortuous. Rather than August 2011, full transposition was not achieved until May 2013. The EC soon toughened its stance

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on states routinely, without good cause, seeking to justify offset on national security grounds. In February 2016, it sent a 'Letter of Formal Notice' to 13 member states requesting clarification of recent procurements. This was followed in 2018 by infringement proceedings against Poland, Italy and Portugal for directly awarding contracts to national suppliers, and Denmark and the Netherlands for unjustified offset demands from non-national suppliers. Legal decisions remain pending on these cases.

Pre-Directive, more than half of EU procurement was effected through Article 296, with eighteen member states having formal offset frameworks, imposing offset quotas averaging 100 percent. Evidence is patchy, but there is a sense that post 2009/81/EC offset in Europe is reducing. Nearly all offset frameworks have been dismantled, and a 2016 Commission Report indicated that from transposition to the end of 2015 defence contractors receiving offset requests, 'very often', had fallen from 33 to 24 percent.

The proportion of equipment procured through the Directive between transposition and 2015 was low, as suggested by UK and French shares plateauing at 18 and 10 percent, respectively. The 'very significant' share of defence procurement conducted outside the Directive relates to increasingly joint-developed complex weapon systems such as fighter aircraft, combat helicopters, submarines, frigates and tanks. This extra-Directive acquisition is arguably strengthening the EDTIB through: firstly, multinational collaboration, including the 6th-Generation Future Air Combat System (Germany-France-Spain) and Tempest (UK-Italy-Sweden); secondly, OCCAR-managed programmes covering 14 major air, naval and land systems; and, thirdly, Government-to-Government programmes. However, the latter are primarily US offset-related FMS programmes, with Europe accounting for 30 percent of all US offset programmes in 2017. Thus, offset remains on the table, though with the possibility that for intra-European trade the Directive may have forced it 'under the table'.

Offset is increasingly a developing country phenomenon, with few advanced countries now 'formally' engaging in the practice. Europe's efforts to reduce offset, raises the tantalising question as to whether future evolution towards a single EDTIB will accelerate, especially given BREXIT and the huge financial pressures on defence budgets, post Covid-19.

Disclosure statement

No potential conflict of interest was reported by the author(s).

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