

The Economic Case for Investing in Europe's Defence Industry



© Lars Koch - photopress.com

Defence plays a pivotal role in promoting internal and external security, maintaining peace, stability and prosperity, and protecting personal freedom and our way of life. However, defence spending also has substantial macroeconomic benefits. A recent study commissioned by the European Defence Agency (EDA) outlines the advantages of investing in the European defence industry in terms of economic benefits, employment and sustainment of research and development capabilities.

Investment in Europe's Defence Industry brings economic benefits, jobs and stimulates research

In these times of austerity, with defence budgets under sustained pressure, a better understanding of the economic value of investing in Europe's defence industries was seen as supporting more informed investment decisions.

For this reason the European Defence Agency commissioned a study with an aim to provide a robust quantitative analysis on the European defence industry's impact on Europe's economy. This is the first such study which looked at the EU as a whole while the previous studies focused on the national level.

Study contractor, London based consultancy Europe Economics Ltd., examined the major areas of government spending (Transport, Education, Health and Defence) and compared the short- to medium macroeconomic impacts of a hypothetical investment of €100m in those areas.

Results

- At the EU level, the impacts on GDP, tax and employment of investing €100m in the health, education, transport and defence sectors are extremely similar.
- Each €100m cut from EU defence expenditure implies:
 - » €150m fall in EU GDP;
 - » €40m fall in EU tax revenues;
 - » 2 870 jobs lost; and
 - » 760 skilled jobs lost.

In some key dimensions, the overall macroeconomic benefit of investing in the defence sector may exceed that of investing in other domains. For instance, the study confirmed that defence investments have a far greater impact on highly-skilled employment and research and development, hence potentially leading to a long-term GDP growth rate. The results of the study estimated that the impact is 12 to 20 times greater than that generated by other forms of public spending.

Of equal importance is the fact that defence R&D creates a "spillover" of technologies to the civil sector. This often significant "spillover", means that investing in defence R&D is essential to the emergence of breakthrough technologies which has a knock on benefit in other areas eg civil aircraft market.

More generally, the study demonstrated that the macroeconomic impact of investment in the defence sector is greater at EU level than at the national level, because of the transnational effect of the investment, compared to other sectors.

Case studies of specific defence projects

In order to provide a more accurate picture of how defence expenditure translates into broader impacts on GDP, employment, tax revenue, exports and technology transfers to civilian sectors, the study looked at specific defence projects in the land, sea, air, and research & technology domains.

- Air:
 - JAS Gripen;
 - Dassault Rafale ;
 - Eurofighter Typhoon
- Land: Leopard 2 Main Battle Tank
- Maritime: Compact naval guns
- R&T Case Study: Intelligence, Surveillance and Reconnaissance Unmanned Air System
- Defence aerospace technology transfer and spin-offs

This approach allowed the study to focus both on the macroeconomic impacts of defence spending while also taking into account the more nuanced micro-economic benefits that investment can bring. Various key lessons were identified from these case studies.

Defence Investments can produce spectacular economic benefits

Investment in defence capabilities can sometime produce spectacular economic as well as defence benefits. Oto Melara's 76mm naval guns proved the capability that the Italian navy needed and also achieved export sales three times larger than domestic ones.

Investments in the EU defence sector can also lead to a significant cost savings relative to the next best alternative

The study concluded that investments in the defence sector could lead to considerable cost savings compared to the next best alternative. This was the case for Germany's investment in developing the its Main Battle Tank, Leopard 2, which enabled it to equip its cavalry regiments with a highly capable system for a cost that was 45 per cent lower than the next best alternative.

Labour productivity in the defence sector exceeds that in civil sectors

The study also found that labour productivity in the defence sector could be far higher than that in the civil sectors. This was the case for Oto Melara, which in 2010 and 2011, achieved a turnover per employee that was over one-third higher than the average for Italian manufacturing.

Advantages of developing new systems

Purchasing defence systems "off-the-shelf" is often advocated as a way of avoiding the enormous development costs and risks of new systems. The study made clear that there is usually a good case for examining this option as a default position. However it also highlighted potential adverse consequences from relying too heavily on non-EU off-the-shelf solutions. For example the Eurofighter Typhoon created 100,000 high skilled jobs, and exports of €13.4bn - €17.8bn, while maintaining European independence and security of supply. These benefits would be lost if non-EU off-the-shelf solutions were purchased, and the loss of skills and capacities would have made it more difficult and costly to develop new projects in the future, decreasing European countries' ability to act autonomously.

Last update: 20 January 2015