SPECIAL REPORT

New scenarios for Industry and Defense policies beyond the financial crisis

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1.BOTH SECURITY AND DEFENSE, SHOULD BE ASSOCIATED TO AN INDUSTRIAL AND TECHNOLOGICAL BASE

Over the past decades, Spain has made great efforts to develop security and defense policies in accordance with the country's priorities, its partnerships and consistent with the role Spain is willing to play in the international scenario. As a result, Spain has achieved, although somehow belatedly, to join the allies transformation process started at the end of the Cold War. The process in Spain **is based on three main pillars: the professionalization of the Army, adaptation to new missions and the modernization of the capabilities.**

On balance, we can state that the Spanish military capability matches its commitments and objectives even if they need to be adapted to new scenarios. Therefore, the challenge is not to reach an excellent level of capabilities but to maintain them. However, the financial crisis affects the necessary adaptation to the deep global changes, which needs to be constant and efficient. The new risks' and threatens' scenario needs some answers we cannot provide and requires some capabilities the Army does not have yet.

There is no doubt the effort made to modernize the Army has also lead to **the development of a technological and industrial base, modern and competitive**. It has also consolidated a sector with a strategic dimension for the country's security and which boosts innovation and the society's development in general. We must bear in mind that the military industry of a country is necessary not only to provide the Army with the necessary tools, but also to transfer and develop technology and knowledge.

There are not many researches regarding the size and characteristics of Defense in Spain. We know around 850 companies of all kinds form it. **At least 50 of these companies are relevant in the areas of system integration, design and production of components, technical support and maintenance as well as in simulating and testing** (competence areas in which Spain participates). However, when it comes to the 100 ranking of the biggest Defense companies in the world, the first Spanish company only appears in the 60th position.

The Spanish companies in this sector are usually small: **only 10 % of them have a turnover above €100 million**. This group is responsible for 85 % of the sector's total turnover; 60 % belongs to the internal market and 40 % to exportation. The exportation percentage includes

"The defense sector is made by about 850 businesses of all kinds, of which about 50 are especially relevant. Of the 100 largest defense companies, the first Spanish one ranks No. 60"

the turnover of the multilateral programs of the Defense Ministry.

The information above shows the sector's high dependence on the programs of the Defense Ministry. This fact has been common worldwide although the current tendency is to diverse it and orientate it to dual programs.

2.THE IMPACT OF THE FINANCIAL CRISIS

The financial crisis endangers the continuity of the efforts to modernize the Army. Cuts are affecting all public policies, including Defense policies. In the short and medium-term, the forecasted scenario presents deep fiscal adjustments and, according to experts, such adjustments may last at least one decade until the public spending returns to the levels of five years ago.

Nevertheless, the decrease on the Defense budget has come along with new missions for the Army on both, national and international scenarios. We should not forget that there are critical thresholds and if the cuts mainly affect the development of defense technologies, it can become a factor to weaken and undermine our safety. It is clearly not an exclusive problem of Spain, but it presents special characteristics in our case.

As well as Spain, different governments all over Europe face the revision on the defense budget from the scope of efficiency. However, efficiency plans have already been implemented and now we can only expect a higher reduction on spending coming from substantive changes that could eventually affect capabilities, the organization and objectives. A further problem in Spain is that there already were some harsh economic obligations to be accomplished before the current crisis. The pillar of the modernization of the Army has been **the special armament programs. These programs represent the main financial problem for the sector and, in case we do not take any measures, they could affect, for decades, the sector's spending**, Defense policies and could eventually be a problem to launch new programs to obtain necessary capabilities.

In order to introduce new rules and management models that will enable the opening of a new cycle of procurements and will avoid the risk of a financial collapse, the problem needs to be solved. Some of the main causes of this problem are: the imbalance between the expenditure committed and the available financial resources (regarding the Spanish low expenditure effort on Defense); the fake financial illusion caused by the adopted German system based on a deferred payment until the system's delivery; the confusion between a obtainment model and an acquisition model; the bad planning of the modernization cycle of the capabilities (no priorities were planned among the systems); and also a failure to forecast other expenses such as the

"The special weapons programs have been and remain being the keystone of our financial difficulties and can compromise for decades the stage of spending"

recurrent expenditure and the life-cycle of the systems (which can sometimes double the initial price of the programs).

We are not facing a temporary problem caused by the adjustment and austerity policies to fight the crisis. We are talking about a structural problem whose final cause is the insufficient economic effort the society assigns to Defense policies. However, the direct cause for the crisis is the poor planning of the rhythm and intensity of the spending coming from the abovementioned programs. This is because the Spanish percentage of the GDP assigned to military expenses is far from the investment of our partners and allies.

3. CONCLUSIONS AND PERSPECTIVES

At the end of 2008, the Ministry of Defense assigned to a group of experts a research on the situation of the sector in Spain. The research approached the situation from the economic and financial perspective with special emphasis on the budget assigned to Defense policies and on the Ministry's management of the budget. An extra objective of the research was to analyze the situation regarding the imminent situation of economic restrictions.

The research concluded that the current economic situation **does not make a big difference since in the recent history of Spain the budget for Defense policies has never met the expectations.** What is interesting about this situation is the contrast between the high perception in the society regarding Defense policies and the high military ambition with the lack of required resources and an adequate economic effort.

This lack of resources for Defense is not a singularity of Spain. Since the end of the Cold War, most industrialized countries (with some exceptions) have tended to reduce their military spending. For this reason, even those countries with a higher strategic projection know that having the required resources for Defense is as important as using them in the most efficient way.

The whole situation should have led European countries to join their efforts regarding Defense policies, but so far, there have not been important changes in this aspect. All in all, there is no doubt the scenario has not changed so all the agents, including industry, working in the sector are forced to redirect their strategies.

4. STRATEGIES TO FACE THE CRISIS IN EUROPE

All European countries are reorganizing their military agenda to face the new scenario of economic restrictions and austerity. The crisis has not affected all countries in the same way, but we could take the example of some of our partners to extrapolate them to the Spanish case. According to a recent research on the different strategies adopted **by European countries, restrictions haven been applied first in the number of troops and its maintenance**

and operations' cost. However, big differences can be observed regarding the big investment programs for capabilities and systems and their maintenance.

For example, Germany has decided to maintain the full spectrum of their capabilities but to reduce the number of systems or renegotiating their contracts. France, however, has adopted an anti-cyclical policy, which extends its modernization plan and its policy to stimulate the industry. However, a severe readjustment is expected regarding the implementation of the new strategy. Italy has decided to maintain all its capabilities and reduce its operability to the minimum due to the harsh economic context.

"Of particular interest is the policy established by Great Britain, whose funding deficit in major programs amounted in 2010 up to 38,000 million pounds for the next 10 years"

The case of Great Britain

The case of Great Britain has special interest for Spain. This country has a funding gap regarding its spending commitment for big programs, which reached, in 2010, 38,000 million pounds for the following 10 years. Therefore, their answer for the current situation has some singularities and great coherence. The first step was to carry out a public review of the National Defense and Security Strategy; then, the Government passed a Spending Review Strategy based on a reduction of capabilities (especially those concerning high-intensity conflicts of possible threats to the country and sovereignty and to the capacity of projection on conflict scenarios). At the same time, the country defined and articulated the required capabilities to face the new non-conventional risks and threats.

The following step was the implementation of a reduction and hibernation program for the capabilities (aircraft carriers, marine patrols and heavy weapons). The program also postponed the initiation of some systems, cancelled new committed programs and included the reduction and withdrawal of troops.

Together with this reduction plan, GB has shown its intention to share capabilities and systems with a bilateral ally interested on a pooling and sharing cooperation as well as a joint technological and industrial development focused on creating new capabilities and systems related to the new non-conventional risks and with special interest on natural disasters. There is no doubt France was the target of this offer.

In short, apart from all the conventional readjustments and the drastic reduction on the conventional systems, **GB is promoting a strategy based on technological innovation, which aims to create a new generation of capabilities regarding cyber-defense** and cyber-intelligence to face new risks. The strategy would also help to preserve its industrial and technological bases by looking for a greater critical mass through alliances with third parties.

5. DEEP CONTEXTUAL CHANGES

It is clear that our partners' reorientations on Defense policies have been forced by the impact of the crisis and its consequent budgetary restrictions. However, the truth is that these reorientations are happening in the middle of deep changes on the contexts. The world is now more complex and uncertain and that requires a constant adaptation to changeable realities. Modern societies have a growing awareness of risk since they can notice that the number of decisions that need to be taken in an uncertain context is growing every day.

The security demand of modern societies goes beyond the traditional defense of sovereignty and the protection of national interests. The security demand is now based on the virtual scenario of new vulnerabilities which is part of the complex society we live in. **This is the paradox of our society: citizens ask states for higher security but the financial resources available are gradually decreasing.**

Everything is happening in a new global context of social and political perception of the international scenario. **The USA has a new positioning regarding the Asian-Pacific area; emergent countries are joining the international scenario; Europe has lost importance as a global actor due** to its inability to set common policies for foreign affairs and defense; the persistence of regional conflicts; uncontrolled migratory flows; a growing awareness regarding the impact of natural disasters and the climate change; new threats due to power vacuum and failed States; terrorism and organized crime; cyberterrorism; our life systems' vulnerability and our assets protection from cyberattacks.

It is not surprising that the former concept of Defense, understood as a State's attribution, linked to sovereignty and historically orientated to protect the integrity of the national borders, has now changed and simplified as the wide concept of Security. Thus, it is not possible to just offer a military response since now the conflict does not exclusively use weapons. Designing a new security and defense policy and defining the required military organization needs to take into account the new risks and threats that appear in all short of forms usually diffuse and asymmetric. It is neither surprising the growing demand of new technologies and systems to face the new threats and the general conviction regarding the lack and obsolescence of the current systems to face these threats and risks.

To sum up, we need to do more and get new means for the current context lacking on resources. From a military point of view, new armies need to give a rapid and efficient answer which should be independent and multinational able to face a crisis anywhere

and including all types of operations beyond the traditional war. We are talking about missions of interposition, peace, stabilization, reconstruction and counterinsurgency. Few countries can offer an autonomous and adequate answer for a situation like the ones described.

In this sense, Europe has its own weaknesses. Experts point out that none of the European countries can face on its own the conventional and non-conventional threats. Partly because there is a financial effort to be made and partly because it is not possible to have all the capabilities required anymore. We are living a transition period affected by the financial crisis and the consequent restrictions on the Defense budget in Europe. It is a changing period which intends to replace the heavy and conventional weapons for light weapons which are easily deployed and which looks for new capabilities to face non-conventional threats. If this transition takes too long, we will be running behind the risks.

6. SOME REMARKS ON THE NEW ORIENTAIONS

There are several common points concerning new risks and threats on our allies National Security Strategies. Another common point is the problem to maintain the current spending. Several countries are pointing out their inability to preserve on their own all the capabilities of their troops and to achieve by themselves autonomy concerning the security and defense areas. This opens a debate on the possible models to share capabilities without losing autonomy and sovereignty.

They all agree there are some critical capabilities that are not negotiable and that they should leave behind the static and conventional defense based on heavy weapons. The new model should be a security projection model based on light weapons and new technologies as well as more appropriate to face new risks. In other aspects, there is no general agreement. Anyway, **the lack of a common strategy and cooperation agreement among the European partners implies a common risk: making unilateral decisions that could imply the impossibility of an ally to use certain capabilities** since there was not a previous coordination of the reductions and some countries could not provide the required capabilities when needed.

It is clear the new scenario requires higher cooperation in order to profit all the benefits concerning the spending cuts. There are other advantages such as a better alignment of policies, a greater interoperability and a better specialization of industries. All these facts clearly show the need of a European Common Defense Policy. Although we are aware of the disadvantages and distortions this cooperation could imply regarding the status quo, we believe there is not a better path to follow. Some of

the decisions that have already been adopted are pursuing this objective as for example, the hibernation of capabilities or bilateral alliances. However, the process needs to be shared in order to avoid unwanted effects.

The problem is that in general, the adjustments' dynamic is following a national strategy instead of a common strategy. This creates deep dysfunctions. We need an intelligent guidance of the process to adjust capabilities framed by the definition of an European strategy that coordinates the reorganization of efforts to preserve those critical capabilities according to the new model, boost the specialization level of the national industrial sectors, promote the combination of capabilities in accordance with the new scenario, reach an agreement for key factors (specially regarding ISTAR technologies, Drones and projection and transport) and set operation plans based on the combined capacity to deploy troops.

To achieve our objective, the debate should not be focused on how to preserve capabilities (since it is impossible from the financial and operational points of view) but on how to share all the capabilities while each country specializes in one of them to offer it to other partners and allies. Trying to preserve the autonomy in all capabilities would lead into inefficiency and irrelevance. We need to follow the path of joint work and cooperation and the objective should be to analyze the real risks as well as the capabilities we need to develop and obtain to face those risks. We need new capabilities coming from flexibility and projection that are appropriate for the new risks and threats.

"The obsession with maintaining all the capabilities, particularly the conventional ones, can produce financial suffocation and hinder the creation of a new cycle of non-conventional capabilities"

7. ORIENTATIONS FOR SPAIN

One of the main problems of Spain is its inability to develop a proper industrial and technological policy to meet our general interests regarding Defense. Although the current context does not make it easy, Spain cannot give up on its objective. Insisting on maintaining all the capabilities can imply financial trouble and make it difficult for the new generation of non-conventional capabilities which will enable the country to face new threats and meet the society's expectations regarding the risks that need to be defeated.

Spain has not finished the required analysis of all the risks and threats that need to be taken into account and the required means to face them. As far as the risks are not well identified establishing what are the required capabilities and give them priority is impossible. At the same time, Spain is not setting a shared strategy of cooperation and sustainment with any other European partner to align capabilities. Moreover, there is not a clear budget to forecast what is the level of effort required for the next years.

However, the demand is asking for more functional and new systems, with lower costs and design cycles

"The European dimension of our country can be combined with the special relationship we have with Latin America in order to achieve a significant projection of our industry also in the defense field"

and with a shorter development and production. All these requests are framed in a less industrial context which is more linked to the information and knowledge society which needs to offer the military capabilities (including the new cyber capabilities) in a network scenario. We are talking about low cost technology, fast production and high performance. Technological superiority. The best, most efficient and most innovative answer. Therefore, the industrial base needs to reduce its working area to some capabilities which are difficult to obtain but essential for Defense. As for the other capabilities, they will belong to a wider area which includes other technological sectors and which pursues conventional security and cyber security.

The first step for the Spanish **Defense Policy is to generate savings through the reorganization of the current programs and reducing its effort on conventional systems.** At the same time, it needs to set the basis for a reorganization of the committed financial obligations taking into account the priorities of our strategy. The last step is to streamline the acquisitions forecast and its link to the industrial basis in order to project it in the new needs. We need an approach that guarantees the implementation of the joint actions measures, the reduction of costs and generation of economies of scale. This new approach should enable the development of an Industrial Strategy that promotes the creation of a community of interests with an industrial and technological base to enhance synergies and alliances.

It is clear that taking all the measures at the same time is impossible. However, the current scenario needs the combination of financial management measures with measures to support the industry. As a broad idea, the main measures that should be adopted in the short-term are: rescheduling obligations, compensation of the debtors' and creditors' flows between the Administrations and the industries; reorganization of capabilities; reviewing the sustainment and life cycle strategies; and cuts on the spending concerning the maintenance of the prime capabilities. Of course, all the implications of the possible decisions need to be taken into account. These implications are not only from the operational, financial, judicial, industrial and technological perspective but also regarding the international commitments that could be affected.

As for the midterm, it is necessary that we create a new structure for the programs management; that we facilitate the integration processes specially focusing on those integration strategies in clusters; promote the internationalization of the industry and orientate it to exportation by supporting government-to-government agreements; support R&D programs by identifying the industrial and technological excellence areas; boost the European dimension of our sector and guaranteeing an efficient and competitive environment.

Regarding the long term, the objectives are: recover a budget for Defense Policies which will enable to intensify the effort

to obtain new capabilities; implement a prioritization plan for those capabilities and achieve greater integration between the Defense systems and the Security systems regarding the so-called "securitization".

The industry needs to be responsible for its own maturation and restructuration processes of the business. We need to be more critic in order to succeed, which implies concentration processes and agreements and alliances with countries and companies. This will enable the industry to be competent in our internal market as well as have the best conditions to cooperate, export and open to new markets.

In order to obtain a relevant projection of the industry in the area of Defense, we should combine the European dimension of Spain with the good relationships with Latin-American. None, the size of our country or the dimension of our internal market guarantees the survival of our industrial base (especially in the current scenario of financial restrictions). However, the sector could and has to highlight its value and capacity not only to meet the current demands but also to generate scientific and technological progress. The current scenario of risks demands capabilities that we do not have now and the industrial and technological bases need to fill that gap.

AUTHORS

Joan Navarro. Partner and Vice-president of Public Affairs of LLORENTE & CUENCA. Joan is a specialist in political communication and has been Director of the Cabinet of the Public Affairs Minister (2004-2006), Director of Communication and Institutional Relations of the State Society ACUAMED (2006-2008) and Director and Spokesman of the Creators Coalition (2008-2009). He works as a professor in centres such as the INAP, the Instituto Ortega y Gasset or the Universidad Camilo José Cela. In 2009 he was considered one of the 100 most influential personalities by the magazine El País Semanal. Joan is a Graduate in Sociology by the Universidad Nacional de Educación a Distancia (UNED) and in Senior Management Program (PADE) by the IESE.

jnavarro@llorenteycuenca.com

Constantino Méndez, is a lawyer. He was State Secretary of Defence from 2008 until 2011, period of time in which he was responsible for the politics related to the biggest armament programmes of the Ministry and of military equipment of the Armed Forces, as well as the negotiations with the parliamentary groups on new legislation. Before that, he worked as delegate of the Government in Madrid (2004-2006) and as Secretary of State for Public Administrations (1994-1996).

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Organisation

CORPORATE MANAGEMENT

José Antonio Llorente
Founding partner and Chairman
jallorente@llorenteycuenca.com

Enrique González
Partner and CFO
egonzalez@llorenteycuenca.com

Jorge Cachinero
Corporate Director for Innovation
jcachinero@llorenteycuenca.com

SPAIN AND PORTUGAL

Arturo Pinedo
Partner and Managing Director
apinedo@llorenteycuenca.com

Adolfo Corujo
Partner and Managing Director
acorujo@llorenteycuenca.com

Madrid

Joan Navarro
Partner and Vice-President of Public Affairs
jnavarro@llorenteycuenca.com

Amalio Moratalla
Partner and Senior Director
amoratalla@llorenteycuenca.com

Juan Castillero
Financial Director
jcastillero@llorenteycuenca.com

Lagasca, 88 — planta 3
28001 Madrid (Spain)
Tel. +34 91 563 77 22

Barcelona

María Cura
Partner and Managing Director
mcura@llorenteycuenca.com

Muntaner, 240-242, 1º-1ª
08021 Barcelona (Spain)
Tel. +34 93 217 22 17

Lisbon

Madalena Martins
Founding Partner
mmartins@llorenteycuenca.com

Carlos Matos
Founding Partner
cmatos@llorenteycuenca.com

Rua do Fetal, 18
2714-504 S. Pedro de Sintra (Portugal)
Tel. + 351 21 923 97 00

LATIN AMERICA

Alejandro Romero
Partner and Latin American CEO
aromero@llorenteycuenca.com

José Luis Di Girolamo
Partner and Latin American CFO
jldgirolamo@llorenteycuenca.com

Antonio Lois
Regional Director of Human Resources
alois@llorenteycuenca.com

Bogota

María Esteve
Managing Director
mesteve@llorenteycuenca.com

Germán Jaramillo
Chief Executive
gjaramillo@llorenteycuenca.com

Carrera 14, # 94-44. Torre B — of. 501
Bogota (Colombia)
Tel. +57 1 7438000

Buenos Aires

Pablo Abiad
Partner and Managing Director
pabiad@llorenteycuenca.com

Enrique Morad
Chief Executive for the Southern Cone
emorad@llorenteycuenca.com

Av. Corrientes 222, piso 8. C1043AAP
Ciudad de Buenos Aires (Argentina)
Tel. +54 11 5556 0700

Lima

Luisa García
Partner and CEO of the Andean Region
lgarcia@llorenteycuenca.com

Cayetana Aljovín
General Manager
caljovin@llorenteycuenca.com

Av. Andrés Reyes 420, piso 7
San Isidro. Lima (Peru)
Tel. +51 1 2229491

Mexico

Juan Rivera
Partner and Managing Director
jrivera@llorenteycuenca.com

Bosque de Radiatas # 22 — PH7
05120 Bosques las Lomas (México D.F.)
Tel. +52 55 52571084

Panama

Javier Rosado
Partner and Managing Director
jrosado@llorenteycuenca.com

Avda. Samuel Lewis. Edificio Omega, piso 6
Panama City (Panama)
Tel. +507 206 5200

Quito

Catherine Buelvas
Managing Director
cbuelvas@llorenteycuenca.com

Av. 12 de Octubre 1830 y Cordero.
Edificio World Trade Center, Torre B, piso 11
Distrito Metropolitano de Quito (Ecuador)
Tel. +593 2 2565820

Rio de Janeiro

Yeray Carretero
Director
ycarretero@llorenteycuenca.com

Rua da Assembleia, 10 — sala 1801
Rio de Janeiro — RJ (Brazil)
Tel. +55 21 3797 6400

São Paulo

Juan Carlos Gozzer
Managing Director
jcgozzer@llorenteycuenca.com

Rua Oscar Freire, 379, CJ 111, Cerqueira César
CEP 01426-001 São Paulo SP (Brazil)
Tel. +55 11 3082 3390

Santiago de Chile

Claudio Ramírez
Partner and General Manager
cramirez@llorenteycuenca.com

Avenida Vitacura 2939 Piso 10. Las Condes
Santiago de Chile (Chile)
Tel. +56 2 24315441

Santo Domingo

Alejandra Pellerano
Managing Director
apellerano@llorenteycuenca.com

Avda. Abraham Lincoln
Torre Ejecutiva Sonora, planta 7
Santo Domingo (Dominican Republic)
Tel. +1 8096161975

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