Scientific Bulletin
Vol. XXIX, No. 2(58), 2024

FOREIGN DIRECT INVESTMENTS IN THE ARMS INDUSTRY

Mihai Alexandru BALU
balu_mihai@yahoo.com

Mihai Marcel NEAG
mmneag@yahoo.com
"NICOLAE BĂLCESCU" LAND FORCES ACADEMY, SIBIU, ROMANIA

ABSTRACT

The arms industry plays a massive role in the global industry and business, producing and selling weapons, technology and military equipment. The conflict in Ukraine and the one in the Middle East have marked a major change in the dynamics of global security, forcing states and companies in the defense industry to adopt their strategies and invest massively in the development of new technologies and military capabilities. The geo-political situation at global level and the constant threats of a possible extension of the existing wars are leading to an increase in investments in the armaments sector. At an international level, start-ups and investment funds are focusing on the arms business, which is now, one of the most profitable sectors, indicating that a phenomenon similar to that of the pandemic is taking shape.

KEYWORDS:
Arms, industry, funds, investments

1. Introduction

The European Union was built as a peace project based on the principles of free economic and commercial exchange; the complementarity of other principles (single currency, common security and foreign policy principles, etc.) has created interdependencies between member states and consolidated peace on the European continent for seven decades under the security umbrella of NATO. The EU is making progress in developing the military union. The Council's decision on 23-24 March 2023 to jointly purchase weapons for a country at war is historic and has immediate implications.

So far, a general consensus has been reached at the level of the Union on the first three strategic objectives that define the future of the military union: (i) the establishment of a new fund to finance joint purchases (orders) of military goods in Europe, (ii) the abolition of the national right of veto on security and foreign policy decisions (the case of Hungary) but also on economic policy (fiscal policy could be another target area); and (iii) a new strategic approach to the future of the Union, when and under what conditions it will be possible to open accession negotiations for the new candidate states.

Currently, most of the urgent demand for military equipment is covered by the supply coming from countries outside the EU, which means a redirection of funding flows to third countries. However, the EU's production and competitiveness gap can be reversed if, in the medium and long term, the armaments sector is modernized quickly and flexibly enough. Solving the long-term competitiveness problem in the EU will it depends on striking a balance between short-term challenges and implementing policies that prove effective in the long term.

DOI: 10.2478/bsaft-2024-0021

2. Literature review

Global leaders often use the notion of a war economy, and in the context of the Russian-Ukrainian war, various specialists in international relations believe that European states should be encouraged to adopt this economic model. Although the term can refer to a country's economy during military conflicts, there are states that adopt this model in peacetime as well. The concept of war economy is related to the allocation of primary sources and funds of a country towards the growth of military industry. A war economy involves the procurement of weapons, military equipment and logistics, changes in production and employment patterns, and government control of the country's resources through regulations and price controls. Even though taxes are raised more than usual, there are specialists who believe that in a war economy there can be more industrial, technological and medical advances than normal. States in conflict are in direct competition and therefore under pressure to create better defense products at a lower cost (Borrell, 2023).

Economy of war refers to the reorganization of production and distribution capacities in a country during a conflagration. The reorganization of activity, in a war economy, involves the reorientation of resources in two major directions:

- support production of frontline units;
- subsistence production for the remaining population in the country.

The transition of the economy from a state of peace to a state of war is a complex process, designed to ensure both the needs of the forces in the defense system, as well as the functioning of state institutions and economic operators, as well as the supply of the population with what is necessary for consumption, even if the latter can and subject to a rationalized system. A real transition to the war economy would indisputably mean constraints and even deprivations and rationalizations for the great mass of society, because it would be imposed by the existence of the danger of war or even war itself.

In a war economy, most resources are allocated to the support economy. The other industries are forced to innovate to survive. They are forced to find alternative resources or develop entirely new products.

The strategic initiative to boost European industry is very welcome. At this critical moment for the European security order, defense production must be increased, it must be standardized, made compatible. The steps of this interoperability must be followed. Unfortunately, in the European Union it seems that each country had particularities in the production of armaments and especially ammunition. By pooling resources, better prices can be obtained, money is used better, more efficiently (EFAMA, 2022).

Trying to base our economic integration and economic stimulus on defense creates a precedent. If we build a defense industry, we will need conflict to feed that industry, to amortize the investment and make a profit. Supporting the defense industry will generate economic growth and jobs across the EU. But who are the major arms-producing countries? Are they Romania, Bulgaria, Slovakia, Portugal, Greece, the Baltic States, Ireland, i.e. the countries that would need an economic boost to reduce the discrepancies in the EU? No, it is Germany, France, Italy, and Sweden – where the "European industrial champions" will be revived, where investments will be made and profits will be obtained. Other states will simply have to buy these weapons – twice as many by 2030. And they will also have to help finance this production, through European defense bonds.

The EU defense industry is characterized by economic and technological components that are significant factors for Europe's industrial competitiveness. The European Defense Agency supports Member States in improving their defense capabilities and contributes to the development of their defense industry. The sector recently decided to tackle some of its main problems, including market fragmentation and low spending levels, by strengthening joint public procurement and increasing defense spending (Walter, 2022).

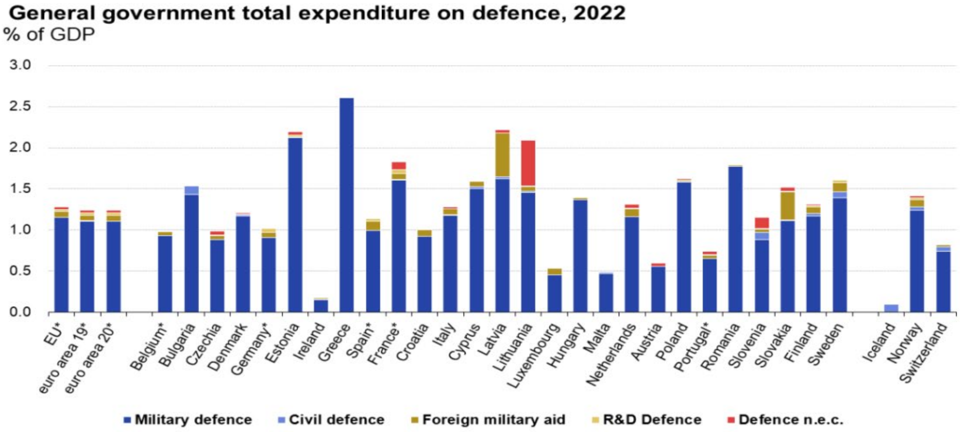

Figure no. 1: *General government expenditure in the EU on defence*
(Source: Eurostat, 2022)

The European Defense Fund will be implemented by the Commission through direct management. The general objective of the program is the modernization and interoperability of existing defense products and technologies, supporting investments in joint research and development activities of defense equipment and technologies, thus stimulating cost effectiveness, promoting purchases and joint maintenance by the member states of equipment of defense. Without replacing the efforts of Member States, it promotes cooperation between businesses of all sizes and research actors from across the EU and Norway (as an associated country). FEA supports competitive and collaborative defense projects throughout the research and development cycle, focusing on projects that lead to next-generation interoperable defense technologies and equipment. These measures, complemented by the Commission’s recently announced proposal for a European Defense Industry Program (EDIP), provide a longer-term, structural approach to achieving defense industrial readiness.

The war highlighted that European industry was not adequately prepared for some major challenges, such as the sudden increase in demand for large quantities of artillery ammunition. The arms industry in Eastern Europe is producing at a pace so alert that it has not been seen since the Cold War (Borin, 2022).

3. Foreign direct investments

In a recent report by Emerging Europe, Romania stands out as the second top destination for foreign direct investment (FDI) in the period 2018-2023. This result places Romania in a prominent place in the region, surpassed only by Poland. In this ranking, the Czech Republic completes the podium. The report highlights the strategic importance of emerging Europe, which plays a key role as a bridge between Western Europe and Asia. The region is crucial for trade and energy transit routes, having a significant impact on the global economy. Countries like Poland and Romania are not only central to the policies of the European Union, but also have an essential role within NATO, contributing to regional security and stability.

The national strategy for the defense industry redirects companies in the field to the production of munitions of war and possibly maintenance and repair for imported armaments. The weaknesses highlighted in the document developed by the Ministry of

Economy, with a predilection for specialized workforce and a lack of investment in modernization and retechnology, drastically reduce the directions of the Strategy. Of the 11 objectives of the National Strategy for the defense industry, a project developed by the Ministry of Economy, 7 concern ammunition production and 2 maintenance, a sign that these will be the priority directions for this sector. The weak points of the industry are the lack of investments in the state economic operators for a long time, the disappearance of some internal suppliers and the damage to the supply chains of economic operators with serious consequences in ensuring the security of supply, the physical and moral wear of manufacturing technologies, machinery and infrastructure elements and the accumulation of significant arrears/debts at the level of some state economic operators, the inability to finance their production from their own or borrowed funds (Giegold, 2023).

According to the Strategy, the threats to the defense industry are the accentuation of the economic crisis and its effects in terms of the re-engineering and development of production capacities, the increase in competition on the international market, the effects of changes in the economic, political and global security environment and the dependence on imports due to the disappearance of some horizontal collaborators from the national defense industry. Moreover, the Ministry of Economy also signals the possible insolvency of some companies due to accumulated historical debts, ecological and environmental constraints, the marked deprofessionalization and shortage of labor as a result of the lack of an adequate training framework for the defense industry, as well as the application of an EU embargo policy on certain sectors and countries, in the field of military equipment, which may temporarily block sales and the execution of contracts and orders.

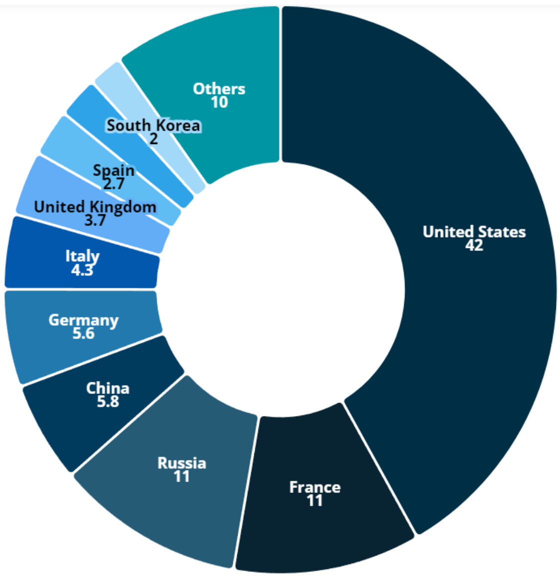

Figure no. 2: *Global shares of exports of major arms by the 10 largest exporters*
(Source: Euronews, 2024; SIPRI, n.d.)

Between 2019 and 2023, the US alone accounted for 42% of all arms shipments worldwide, sending weapons to 107 states – more than any other major exporter. On the other hand, combat aircraft supplied to Egypt, Qatar, and India accounted for the majority of the increase in French arms exports.

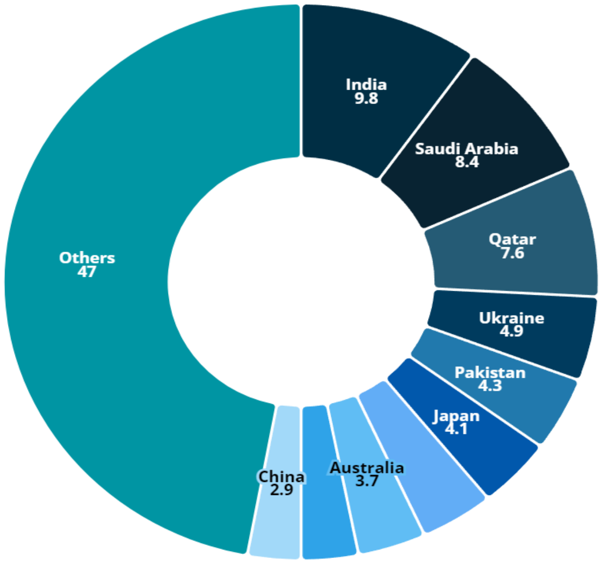

Figure no. 3: *Global shares of imports of major arms by the 10 largest exporters*
(Source: Euronews, 2024; SIPRI, n.d.)

The largest importers between 2019 and 2023 were Saudi Arabia, India, and Qatar. In second place is Ukraine, having received significant arms transfers from more than 30 nations between 2022 and 2023.

The problems of the production of armaments in the European states increasingly overlap with those in Ukraine. Certain types of ammunition provided by supporting nations can only be used on very specific artillery systems. NATO has recognized that although the projectiles are the same size, the control technology is often different. In the past, harmonization has failed because of the military bureaucracy of European member states (Jacqué, 2023).

While an industrial giant like Rheinmetall can finance investments relatively quickly from its own reserves, it is not as easy for many smaller companies to get started. Alliance member states have pledged to invest at least two percent of their gross domestic product in the armed forces. To ensure that smaller defense companies also increase production, the government should offer more procurement guarantees in the future. As western countries spend more on defense to support Ukraine and its forces amid worries about future Russian aggression and a Nato-sceptic Donald Trump being re-elected as US president, space and defense industries revealed a record number of greenfield FDI projects last year (Simola, 2022).

FDI into space and defense encompasses a wide range of activities, including R&D into robotics, satellites, and technology utilized in contemporary conflict, as well as the production of weapons, ammunition, and drones. It is necessary for the defence industry to have long-term contracts and purchase guarantees for significant investments, such as new plant installations.

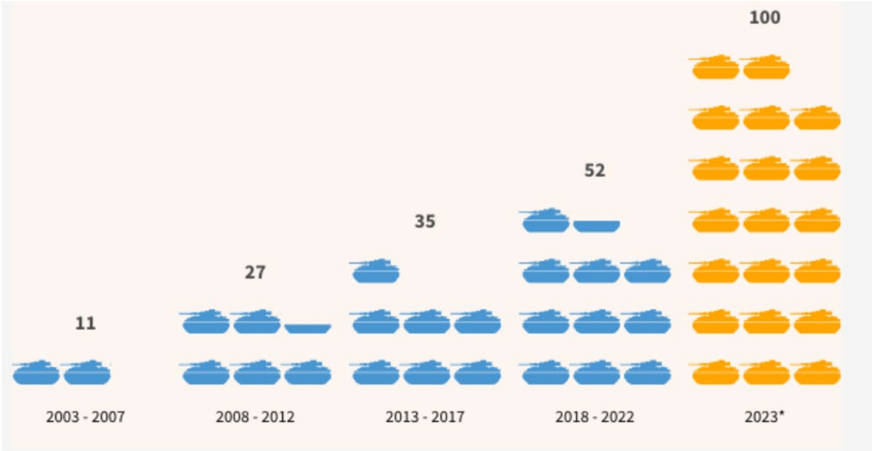

Figure no. 4: *FDI projects in the space and defence industry*
(Source: Irwin-Hunt, 2024)

4. Conclusions

In the context of the events of the last two years, the global challenges of a pandemic nature, but above all the invasion of Ukraine by the Russian Federation, both the USA and the European Union have substantiated updated strategies for the revitalisation and development of the defense industry and have decided to consolidate specific supply chains.

The analytical approach of identifying the main aspects that define the internal and international context of the evolution of the national defense industry is concretized by presenting the characteristics of the new geopolitical security framework and especially the difficulties, failures and challenges that economic operators have faced and are still facing, especially the state ones. The significant increase in both the number and the intensity of the turbulences, which are otherwise increasingly interconnected, has reached the highest level in modern history.

According to NATO and EU observations, new and disruptive technologies present opportunities and risks that are changing the nature of conflicts and are becoming increasingly important from a strategic point of view and in the increasingly complex global competition between states. Ultimately, these technologies will determine the outcome of conflicts fought indirectly, as well as those fought on the ground. The defense research component and associated security and defense industries must be integrated in the perspective of the need to adapt and embrace a new, modern generation of conflict-adapted weapons in the 21st century.

The national strategy for the defense industry is based on the identification of the main problems of the defense industry and the establishment of general and specific objectives to address these problems. The objectives are supported by concrete measures and financing programs aimed at the modernization and sustainable development of the defense industry, increasing competitiveness, training and qualification of the workforce. The intervention is essential from the perspective of the balanced and sustainable development of the sector in the context of current and future challenges.

The development of bilateral initiatives based on European industrial cooperation helps the participation of each state in cooperation programs based on research and development, carried out jointly by at least two member states and aimed at developing a new product, in accordance with European legislation.

The development of clusters in which economic operators from the national defense industry, with public and private capital, work together with profiled research institutions, with faculties in the field and with independent specialists help to develop and manufacture competitive platforms for both the military and the civil one. Analyzing the possibilities of providing state aid schemes, grants and counter-guarantees to companies and SMEs that develop and produce within the arms industry is also essential for development.

REFERENCES

Banca Națională a României. (2023). *România – Zona Euro. Monitor. Final de pandemie și economii care rezistă la șocul Războiului, Nr. 12, An 5, 2023*. Available at: https://storage1.dms.mpinteractiv.ro/media/1/1481/22466/21823250/2/euro-monitor-editia-12-aprilie-2023.pdf.

Borin, A., Conteduca, F.P., & Mancini, M. (2022). The impact of the war on Russian imports: A counterfactual analysis. *VoxEU*. Available at: https://cepr.org/voxeu/columns/impact-war-russian-imports-counterfactual-analysis.

Borrell, J. (2023). Ammunition to Ukraine Foreign Affairs Council. *European Union External Action.* Press Release, available at: https://www.eeas.europa.eu/eeas/hrvp-josepborrell-foreign-affairs-council-%CE%B1mmunition-ukraine_en.

EFAMA. (2022). *Trends in the European Investment Fund Industry in the Third Quarter of 2022*. Available at: https://www.efama.org/sites/default/files/files/Quarterly%20Statistical%20Rel ease%20Q3%202022.pdf.

Euronews. (2024). *Europe's arms imports nearly double, France overtakes Russia as world's second-largest exporter*. Available at: https://www.euronews.com/business/2024/03/11/europes-arms-imports-nearly-double-france-overtakes-russia-as-worlds-second-largest-export

Eurostat. (2022). *Government expenditure on defence*. Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Government_expenditure_on_defence.

Giegold, S. (2023). The Federal Government's policy on exports of military equipment in 2022. *Federal Ministry for Economic Affairs and Climate Action*. Press Release, available at: https://www.bmwk.de/Redaktion/EN/Pressemitteilungen/2023/01/20230104-the-federal-governments-policy-on-exports-of-military-equipment-in-2022.html.

Irwin-Hunt, A. (2024). Defence FDI and military spending hits record highs. *fDi Intelligence*. Available at: https://www.fdiintelligence.com/content/news/defence-fdi-and-military-spending-hits-record-highs-83607.

Jacqué, P. (2023). EU agrees to fast-track military support to Ukraine. *Le Monde*. Available at: https://www.lemonde.fr/en/europeanunion/article/2023/03/20/eu-agrees-to-fast-track-military-support-toukraine_6020007_156.html.

Simola, H. (2022). War and sanctions: Effects on the Russian economy. *CEPR / VoxEU.* Available at: https://cepr.org/voxeu/columns/war-and-sanctionseffects-russian-economy.

SIPRI. (n.d.). *SIPRI Arms Transfers Database*. Available at: https://www.sipri.org/databases/armstransfers.

Strategia Națională pentru Industria de Apărare 2024-2030. Available at: https://sgg.gov.ro/1/wp-content/uploads/2024/11/ANEXA-44.pdf.

Walter, B.F. (2022). *How civil wars start. And how to stop them*. New York: Crown.