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## **Defence Procurement: When Political Will Needs Pairing With Legislative Changes**

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**Adapt** Long Read



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# DEFENCE PROCUREMENT: WHEN POLITICAL WILL NEEDS PAIRING WITH LEGISLATIVE CHANGES

*Viliam Ostatník*

## SUMMARY AND RECOMMENDATIONS

- More than a year after the Russian invasion of Ukraine and after Germany announced Zeitenwende, signalling a substantial change in modern German politics and security, the German armed forces remain in no better condition.
- The backbone of the Zeitenwende was to be an extra-budgetary fund of €100 billion, which would help with the procurement of the (most pressing) new equipment for the armed forces. The reality is that the procurement process in Germany is slow and over-bureaucratized. Additionally, the current economic situation is decreasing the actual amount of money available in the special fund.
- The Federal Armed Forces Procurement Acceleration Act is a new law aiming to enable defence contracts to be awarded more easily and rapidly. This is a step in the right direction but provides only a temporary solution. Furthermore, whether it will deliver on its promises will be seen in the course of 2023 and beyond, as it also remains to be seen how this national law will hold against the EU law.
- Some practical inspiration for the German government (and, perhaps, other EU Member States) can come from the US, as well as from certain EU clusters (namely in Eindhoven).
- First, there is a case of the US Congress establishing an independent Commission on Planning, Programming, Budgeting, and Execution Reform in 2022, which aims at overhauling the system of procurement, reflecting on the new and changing reality. Bundestag could contemplate a similar move.
- Secondly, there is a practice of advanced (partial) payments in defence contracts exemplified by the Pentagon and Lockheed Martin during the Covid-related crisis in 2020-2021. Such practice could help maintain the whole ecosystem of suppliers and thus help the national (or EU)

economy, as opposed to the German practice of making payments strictly after the product or service is fully delivered.

- A specific case of Rheinmetall's Panther MBT concept presents an example on which the new, more lasting and stable ecosystem of defence procurement, more effective public-private partnerships, as well as better coordination and cooperation on the EU level could be tested.

## INTRODUCTION

This short analysis is about finding ways to address the ineffective and fragmented German (and, with it, the European) defence industry. I tend to write quite a lot about political will as a necessary element to move forward towards a more capable, stronger, secure, and competitive EU. Such political will encompasses courage (to act), decisiveness, and the vision that would lead towards finding ourselves in the EU in the position of strength, whether we mean economic or military- or, in fact, both.

While I stand by this call, it is fair to point out it is not the only condition that needs to be met to fulfil the above-mentioned vision for the EU and its member states. In other words, the political will of crucial (national) actors is a necessary but not sufficient precondition. It needs to go hand in hand with certain legislative and institutional changes.

I assume at least some readers will be tempted to think this is going to be about a reform deemed necessary by many nowadays - that of moving from the unanimity voting procedure in questions of the EU's CFSP/CSDP towards qualified majority voting. But no. This is about the defence industry, more specifically, about the procurement process.

## ZEITENWENDE, OR ZEITLUPE?

In February 2023, Bavarian minister-president Markus Söder criticized the German federal government regarding the modernization plans of the Bundeswehr. This, of course, was not the first time. But it was the first time he tried to capture his critique with the word *Zeitlupe* (Spiegel 2023). This word, which we could translate as a "slow motion", or something moving slowly or lagging behind, stands in contrast with Olaf Scholz's rhetorical weapon of *Zeitenwende*, a "turning point in time," pompously used by the

German Chancellor shortly after Russian invasion to Ukraine<sup>1</sup>. With it, Scholz wanted to signal a substantial change in modern German politics, one that would address systematically and with enough resources the many weaknesses of the German armed forces.

Of course, Söder's critique can be seen primarily through a political lens. But it does seem like Zeitenwende is indeed moving very, very slowly.

The backbone of the often repeated German word for turning point was to be an extra-budgetary fund of €100 billion, which would help with the procurement of the (most pressing) new equipment for the armed forces as well as with achieving the pledge to allocate 2% of the national GDP to defence. However, as we tend to realize every time, again and again, paper can take anything, and the talk is cheap unless it leads to action. Zeitenwende can truly be a Zeitenwende only if it delivers.

The reality is that the procurement process in Germany is slow and over-bureaucratized. Additionally, the economic situation is not helping. In the original plan, the German government counted on €8 billion for the interest payments (as it had to take out a loan for the special fund). But because of the rising interest rates, interest is now estimated at €13 billion. This alone would mean that the actual amount of money from the pompously announced package would not be €100 billion, but only €87 billion. But then there is inflation, relatively volatile dollar-euro exchange rates, as well as VAT. After that, we are left with somewhere between €50 to €70 billion as the actual money to be spent on the new equipment and modernization (Knight 2023).

While it is true that the previous German defence minister, Christine Lambrecht, was a catastrophically inefficient political figure, it is clear that this slow motion is caused mainly by the inefficiency in the procurement process. Existing legislation, embedded processes and procedures, as well as institutional structures - these are the main elements why after one year since the Russian invasion of Ukraine, German armed forces are hardly in any better state than they were before.

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<sup>1</sup> Done so in Scholz's his policy statement on February 27, 2022. The new special fund was to be created on the basis of the new Article 87a(1a) German Basic Law (Grundgesetz) which came into force on July 1, 2022.

The German military procurement system is often dubbed a "bureaucratic colossus" that "suffers from a 'perfectionism' in its regulations," which then results in the forces not getting what they need or not getting it on time. It is a "very complex ecosystem between parliament as the budget holder, the Defence Ministry, procurement agencies and the armed forces" (Knight 2023).

On a February 22, 2023, press conference, a German army colonel and a Press Section Chief at the German Federal Ministry of Defence, Arne Collatz, confirmed that a total of "around" €30 billion from the special fund has been contractually tied so far (Bundesregierung 2023). Furthermore, colonel Collatz informed that the ordered equipment would be paid from the fund in full after delivery. In other words, the regulations do not allow the government to pay either in two or several tranches, so to pay at least partially in advance. He hinted at the fact that such prolonged procedures are due to the size and nature of the orders saying that if it were smaller purchases, it would go faster. Collatz then provided at least some details on what has been contracted already, namely the complete and full new outfitting for soldiers, armed drones, F-35A fighter jets, and heavy transport helicopters. He also mentioned the new Federal Armed Forces Procurement Acceleration Act as a means to improve the procurement process (Bundesregierung 2023).

### **MOVING SLOWLY. BUT MOVING.**

The Federal Armed Forces Procurement Acceleration Act is a law which was passed on July 7, 2022, in the Bundestag<sup>2</sup>, aiming to enable defence contracts to be awarded "more easily and rapidly for a limited period and to have these contracts audited" (Federal Government 2022). The new law allows "deviations from the provisions of the German Anti-Trust Act if justified by economic, technical, or time-related reasons" (Federal Government 2022).

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<sup>2</sup> The Act will initially apply until the end of 2026 and will also cover all award procedures already commenced but not yet completed prior to its entry into force on July 19, 2022. It also clearly states that the term "military equipment" must be broadly defined to include e.g., software. (Gleiss Lutz 2022).

In theory, it should now be faster to procure new military equipment and acquire necessary and needed capabilities. Section 3(7) of the Act explicitly calls upon identifying products and services already available on the market that would fulfil the requirements. If a product or a service is to be procured that is not already available on the market, a comprehensive study is to be conducted to prove why such a service is to be procured, putting forward arguments for the added value provided by it given the extra costs (financial, or other, e.g., time) (Gleiss Lutz 2022).

Furthermore, according to the law, it should also be easier to lead collaboration programmes within the EU, thus promoting enhanced cooperation in the defence sector and subsequently strengthening collective defence as well as helping to create a common industrial and technological base. This is the goal of section 4, which aims at making it simpler to carry out cooperative procurement with other EU Member States (Gleiss Lutz 2022). Moreover, under section 7(2), the contracting party (government) may specifically exclude applicants or tenderers from non-EU states (Gleiss Lutz 2022).

This does seem like a step in the right direction, also given that the scope of the products and services that should be procured under such special conditions is rather vast (it includes, for instance, also procurements for intelligence activities in general, including most probably, capabilities necessary for military intelligence operations; Gleiss Lutz 2022). However, as with the whole *Zeitenwende*, it remains a paper tiger for now. Whether it will deliver on its promises will be seen in the course of 2023 and beyond. In addition, it remains to be seen how this new German national law will hold against the EU law (specifically, how it will be compatible with the TFEU, with Directive 2009/81/EC and with the EU Directives on legal remedies in public procurement law; Gleiss Lutz 2022).

## **RECOMMENDATIONS AND INSPIRATIONS FROM ACROSS THE POND**

Given such uncertainty on the ability to deliver in reality and not just on paper, we can have a look at two specific cases in the US that regard the procurement process. One reflects the more general changes in the nature of modern warfare as well as the concrete situation the West finds itself in

after the brutal Russian invasion of Ukraine in February 2022, the other reflects changes brought by the Covid pandemic.

In 2022, US Congress decided to establish the Commission on Planning, Programming, Budgeting, and Execution Reform, an independent commission in the US legislative branch (Commission on PPBE Reform 2022). Its main purpose is threefold: first, to examine the effectiveness of the planning, programming, budgeting, and execution process and adjacent practices of the US Department of Defence, particularly with respect to facilitating defence modernization; second, to consider potential alternatives to such process and practices to maximize the ability of the US Department of Defence to respond in a timely manner to current and future threats; and third, to make legislative and policy recommendations to improve such process and practices in order to field the operational capabilities necessary to outpace near-peer competitors, provide data and analytical insight, and support an integrated budget that is aligned with strategic defence objectives (Commission on PPBE Reform 2022).

This new body is part of a much broader US defence acquisition system, or, more specifically, its overhaul in light of the current global geopolitical and geoeconomics developments. This commission is the first effort in decades to re-examine how the US federal legislative branch and the government allocate resources in the process of defence procurement (Chase 2023).

This presents the first case of possible inspiration for the German (or other European) government and parliament. Commission with a similar purpose and scope would constitute a systemic and systematic effort to overhaul the national defence procurement processes that would (unlike the above-mentioned German law with temporary effect) have long-term effects and would reflect the current security and economic environments (thus breaking from the embedded modes of functioning characterized by the post-Cold War priorities).

The second case of potential inspiration comes from the Covid pandemic time. During Covid-related lockdowns and other restrictions, Lockheed Martin Corporation, a US defence company, was facing several problems (as were, indeed, many other companies). These included delays from sub-contractors, shortage of certain materials, etc. Many suppliers, especially

small and medium enterprises (SMEs), that the company worked with in the process of F35 fighter jet production found themselves in a very difficult situation (Losey 2022). Unlike the giants, these smaller companies could not hold long without a contract and capital. Having a contract, in other words, was one thing, while having capital was quite another. One needed to go hand in hand with the other in a timely manner.

So, to address this situation in such a challenging, uncertain, and complex environment, Lockheed adopted a so-called "forward-funding strategy" of paying these SMEs three or four months early (Losey 2022). At the same time, in March 2020, the Pentagon upped its progress payment rates to large conglomerates and corporations (such as Lockheed) from 80% to 90%. This enabled Lockheed to forward these payments to its own supply chain (Losey 2022). A year after, in 2021, Lockheed claimed that it "averaged about \$400 million in accelerated payments each week to its suppliers, particularly small and vulnerable businesses" (Losey 2022). Such a scheme allowed a large corporation to maintain a strong and healthy ecosystem of subcontractors, as these were able to plan and produce, buy parts, make orders, etc., as they knew there is a product or a service to be delivered and that it was already (partially) bought, thus limiting, or eliminating the risk of sudden ruptures, changes or turns.

This means that first, it is essential for the (national, EU) economy to have companies awarded both contracts as well as a certain amount of capital, at least, before the final product or service is delivered - especially in volatile and uncertain times. It is mostly about the vast net - an ecosystem - of suppliers and subcontractors (which are, optimally, European SMEs in the case of the European defence industry). But even in regard to the large corporations and conglomerates, it is very helpful to be provided with the capital at least partially before the final product is delivered, as that can help maintain the whole ecosystem. Essentially, private companies need to be awarded, figuratively speaking, with trust, stability, and predictability. They need to know in order to plan and deliver, and they need to be as sure as possible about the given contract. Paying partially in advance can help.

It is, perhaps, similar to the energy sector in that without proper government support, it would be so risky to invest in certain technology, infrastructure, products, or services, that it would become practically unbearable for

private companies, no matter their size (e.g., without government support, building new LNG terminals or investing in coal or oil business would simply be untenable).

And that brings us to the last point: nurturing public-private partnerships. Financial Times recently published an article on a very special European tech cluster: Eindhoven (Bounds 2023). There, the EU and its Member States do not need to go across the pond to find inspiration, as the Eindhoven ecosystem seems to be an example par excellence of how public-private partnerships (including in the defence sector) could work: flexibly, key actors being in constant communication with each other, collective planning, maintaining mutual trust. And, of course, all that is happening ideally on the edge of technological and technical knowledge<sup>3</sup>.

### **PANTHER, ANYONE?**

Given what we have said, one very specific example comes to mind: Panther. Not the animal but the German prototype of a new tank. Rheinmetall unveiled it at Eurosatory in June 2022, and it is now undergoing thorough testing. Information is already out there with certain data and stats mapping its potential capabilities<sup>4</sup> (Valpolini 2023a).

Panther can indeed become the next pan-European (and even global) tank, similar to Leopard 2. Alexander Kuhrt, Vice President for the Next Generation Main Battle Tanks at Rheinmetall Landsysteme said that the company is already in discussion with a number of countries to determine specific Panther configurations (Valpolini 2023b). Some technical commonalities between Panther and Leopard tanks (e.g., in the chassis) might also prove to be a good argument for the potential buyers, given the

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<sup>3</sup> The key point here is that modern capabilities that enable national militaries to attain technological superiority come largely from the private sector (Chase 2023). Governments should thus focus on integrating cutting edge technology faster and at scale in order to maintain a competitive advantage (ibid).

<sup>4</sup> It is worth mentioning, in particular, that the Panther can be understood as a platform rather than just a tank, similar to the F35 fighter jet, reflecting the multidomain nature of the modern warfare. However, this also comes with certain disadvantages given some technical limits (e.g., the weight). Engineers thus came up with some “offloaded supporting capabilities,” such as air defence, which would potentially be outsourced to unmanned ground vehicles, forming a combined arms team. Other such “outsourcing” might concern target handover capacities, supported by on-board micro-UAVs for close reconnaissance (Valpolini 2023b).

relatively high number of states using Leopards as their MBTs. The company now considers there is a market "of 500 to 800 units within 2035, and between 5,000 and 8,000 units after 2035" (Valpolini 2023b).

This is a particularly interesting example for our case, since the German government is in the process of developing a new MBT together with the French and the Italian governments – the project is called Main Ground Combat System (MGCS). Kuhrt says that Rheinmetall does not "necessarily see the Panther as an MGCS competitor" and that they "consider that for some countries it is a bridging technology, as it contains technologies that we are also putting forward for the MGCS" and "see a market beside the MGCS" (Valpolini 2023b). In order to avoid unnecessary and inefficient duplications that would, moreover, increase the fragmentation of the EU defence sector, one would need to wonder if the German government should not support the already existing technology in the manner described in this analysis. Panther MBT could become the first "testing ground" for the new procurement system.

## CONCLUSION

This analysis has briefly mapped out the current state of German defence procurement in light of the announced Zeitenwende. A year into Ukraine's full-scale war with Russia, Berlin has not moved decisively in modernizing its armed forces and procuring new equipment. At the same time, the analysis addressed a certain, albeit a rather slow, movement in that direction, mainly through new German law on faster procurement (Federal Armed Forces Procurement Acceleration Act).

However, that is a temporary law – say, an exemption, not a rule. Also, so far, it remains on paper, and its deliverables are yet to be seen. Thus, the analysis presented some practical inspiration for the German government and, perhaps, other EU Member States aiming to make their national defence procurement processes more efficient as well as enable more efficient collective (EU) cooperation in this area.

First, there is a case of the US Congress establishing an independent Commission on Planning, Programming, Budgeting, and Execution Reform in 2022, which aims at overhauling the system of procurement, reflecting on the new and changing reality. Secondly, there is a practice of advanced

(partial) payments exemplified, for instance, by the Pentagon and Lockheed Martin during the Covid-related crisis in 2020-2021. Such practice can help maintain the whole ecosystem of suppliers – both contractors and (their) subcontractors, as opposed to the German practice of making payments strictly after a product or service is fully delivered.

Lastly, the specific case of Rheinmetall's Panther MBT concept was presented as an example on which the new, more lasting and stable ecosystem of defence procurement, and more intensive public-private partnership could be tested (first, in Germany, but with effects and inspiration on the rest of the EU).

What happens in Germany has a profound effect on the whole of the EU – security and defence are no exception. On the contrary, without Germany, one can hardly talk of a more capable and stronger EU (and NATO, for that matter). Hence, this analysis focused mainly on the developments there.

If one was to adapt a rather controversial motto for the EU: Make Europe Great Again, one could indeed start with systematically and politically supporting the EU's industrial basis – whether we speak about the automotive sector or the defence industry. In the latter case, that is impossible without overhauling the (national, German) defence procurement process so it will be more efficient, less bureaucratic, would help the EU's domestic economy (including the SMEs), and would be able to deliver – in a timely manner.

Together with Germany's and EU's closest allies, such as Japan, the US, or the UK, the EU can once again become home to some world-leading companies, technologies, and even whole industries. The EU and its Member States, including Germany, however, need to adapt to the new global geopolitical and geoeconomic environment. They need to capture the dynamics of reshoring and friend-shoring. The ability to adapt is, in essence, a question of balanced flexibility. Overhauling defence procurement processes that are inefficient, slow, over-bureaucratized and that do not support the domestic industrial ecosystems is one, albeit a large piece in the mosaic of how to create a stronger, more prosperous, and more competitive EU.

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