

# Scaling up European Defence

## How can competition policy contribute to Europe's security?

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Amongst the pressing topics regarding the Defence Industry and the current challenges it faces is the question how competition policy can contribute to Europe's security.

### Fragmentation as Europe's core problem?

The Draghi Report on European competitiveness identified fragmentation as one of Europe's main problems: Europe has 27 national defence markets, each with a few dominant players. These national markets are too small to yield the necessary scale – sales volumes are simply insufficient for the growth of stable value chains. In contrast, the U.S., for example, has a much lower number of different platforms for tanks, fighter jets, etc. The cost of this fragmentation is visible on the battlefield: In Ukraine, the delivery of ten different types of 155mm howitzers created a logistical nightmare, proving that a lack of standardization is not just a cost issue – it is a threat to security.

The Draghi Report indeed blames competition enforcement for the lack of scale. However, a look at the decision-making practices of the competition authorities does not actually confirm this:

- The German *Bundeskartellamt* has dealt with 22 merger cases since 2022, half of which involved joint ventures. None of these cases ended with a prohibition or even went into phase II. Just a few weeks ago, the authority cleared a joint venture for the production of artillery ammunition between German defence company Diehl and the Norwegian player Nammo Raufoss.
- The European Commission has also approved several cases under the merger control framework and under the Foreign Subsidy Regulation – recent examples include Leonardo/Iveco, but also Rheinmetall/NVL or Safran/MBDA/Cilas. The picture on a member state level is similar.

All in all, competition authorities seem to signal that they have understood the sense of urgency and are striving to deliver their part in reaching a certain level of – if not consolidation, at least – integrated approaches.

The real driver of fragmentation lies somewhere else: What ultimately prevents an integrated European market are the national industrial policy mindsets of the member states (which Draghi concedes as well). Competition authorities do not have the appropriate tools to overcome these roadblocks.

## Entry barriers through national procurement?

In fact, the *Bundeskartellamt* has repeatedly concluded that defence markets are national in scope due to the very reason that defence technology is effectively sourced nationally. The Commission has also based its competitive assessments on national defence markets. Effectively, this creates entry barriers because according to that logic, companies can only gain access to national defence contracts through cross-border joint ventures. From a competition law perspective, this is counterintuitive, because it ignores supply-side substitutability of players simply based on their location of production and allows collaboration between competitors which would normally be prohibited under antitrust rules but for capacity constraints or complementarity. Even though, by law, procurement must generally be based on European tenders, the practical reality of direct awards to national champions or of national security requirements and member state preferences for local industrial involvement often make standalone bids from foreign European entities politically and legally unviable. The real key to overcoming market fragmentation therefore lies in removing these entry barriers.

## The Monopolies Commission's call for courage

One year ago, the German Monopolies Commission sent an open letter to the European Commission and the German federal government calling for greater courage in promoting competition in European defence spending. Besides the need for a European rather than a nation-state approach, it also highlighted the leverage available through simplifying and accelerating procurement procedures to the benefit of more innovation.

Specifically for young tech companies developing innovative solutions for modern warfare, procurement procedures can indeed create market entry barriers – which is rather paradoxical, as public tenders are intended to create market access opportunities. A primary obstacle in European procurement is the so-called *gold-plated solution approach*: instead of issuing open R&D tenders that reward the most innovative outcome, public tenders in Europe are often designed with hyper-specific, rigid project specifications, fixed deadlines, and exhaustive requirement lists. This results in several systemic failures:

- Public contracting authorities are not always best placed to define the most innovative and up-to-date solution for a given purpose. Technological changes in modern warfare are already hard to keep pace with for industry players, let alone state actors. This leads to absurd results: Armed Forces are supplied with outdated technologies because suppliers can only deliver exactly according to the tender specification (and hence, the award specification). Even though battle testing (e.g. in Ukraine) leads to significant real-time improvements, the rigid nature of the contract prevents the military from benefiting from such advancements.

- The current system structurally favors established suppliers. These incumbents often benefit from long-standing working relationships with military agencies, especially during the needs assessment phase preceding a formal tender. While service regulations expressly forbid any distortion of competition, these *pre-tender* dialogues allow incumbents to subtly influence the formulation of specifications in line with their existing product portfolios. The risk of structural advantages of the preferred suppliers through *tailor-made* tenders that effectively exclude innovative outsiders from competition is evident.

In contrast, empirical research in the U.S. and Germany has shown that open R&D tenders – defining the *mission goal* rather than the *technical method* – are significantly more likely to trigger follow-up investments from venture capital and to drive patent applications.

To resolve the barriers of the European *top-down* model, a fundamental shift in the design of procurement procedures from ex-ante technical micromanagement towards *bottom-up* innovation competition has been suggested, which allows (and tasks!) the industry to come up with the most promising solutions. Moreover, to incentivize SME participation, the Monopolies Commission recommended additional measures, such as cost reimbursement for high-ranked, unsuccessful bidders, leveraging experimental clauses in tenders and utilizing specialized advisors like the German SPRIND Agency to provide the necessary legal space to test agile, innovation-friendly formats outside of rigid procedures. Other noteworthy examples of an innovation centered procurement frameworks in this context are the Competence Center for Innovative Procurement (KOINNO) and the Cyber Innovation Hub.

On the European level, neither the European Defence Agency nor the European Investment Bank have been leveraged to their full strategic potential, either. While the EIB has significantly expanded its lending scope (reaching EUR 4.5 billion in 2026 in defence-related financing with the exception of weapons and ammunition due to its mandate) and the EDA has proven its value in aggregating demand for ammunition, both institutions remain underutilized. Optimizing their impact would require shifting the EDA from a purely intergovernmental facilitator to a leading innovation hub to enable more agile, bottom-up project groups. By aligning EIB financial firepower with EDA technical expertise, the EU could provide the long-term planning certainty and capital necessary for innovative SMEs to challenge established incumbents while simultaneously providing European scale.

### **Lack of competitive pressure and “lock-in” effects**

Another factor why competition does not unfold its full potential in the defence sector is the structural lack of competitive pressure due to a high level of vertical integration. Modern defence goods are complex, interconnected systems, and they are procured as

such (rather than as isolated products). Large system providers typically act as prime contractors managing the entire lifecycle of a system, from development to commissioning, which creates significant structural risks for competition and European strategic autonomy. These providers determine how subsystems (such as sensors, weapons, software) are configured, and thereby effectively control downstream markets and the entire technological ecosystem.

This can create bottlenecks for downstream competitors: For example, where the interfaces between vehicle, sensor, and weapon remain proprietary to the prime contractor, competition is stifled at the sub-system level. Foreclosure effects are enhanced by the rather long contract terms, which locks-in the chosen sub-contractors for lengthy periods of time (including for maintenance, upgrades, and spare parts).

For this reason, one of the key demands of the Monopolies Commission was the call for open system architecture and interoperability: Only if we strive for a certain level of harmonization in terms of technical specifications and common certification, which lays the foundation for interoperability, can we shift from numerous national to a truly European system. This would in turn allow specialized SMEs to compete for sub-components across different national platforms, increasing both innovation and resilience.

Competitive pressure could furthermore be enhanced from dual-use products if the Commission were to consider them part of the relevant markets in its market definition practice. Despite emphasizing synergies between civilian and military technologies to bolster the European Defence Technological and Industrial Base, the Commission's market definition practice rarely reflects this so far. Instead, the Commission tends to define defence markets so narrowly that civilian products are mostly excluded as viable substitutes due to military-specific requirements like encryption or extreme environmental durability.

In essence, antitrust laws should be utilized to ensure that system architecture remains open (preventing vertical market foreclosure), interfaces remain accessible to new and smaller market entrants, and interoperability is guaranteed, ensuring that speed today does not lead to technological lock-in tomorrow. While it goes without saying that, in emergency situations at the battlefield, speedy delivery is crucial and overrides all other considerations, competition generally yields a higher degree of security in the long run.

### **Do we need defence-specific rules?**

Worldwide tensions have sparked a debate whether we need defence-specific competition law rules, such as specific safe harbors or even sector specific exemptions in merger control (similar to the exemption for hospitals in Germany). However, what is really needed is the right application of existing tools.

- Competition law is not in the way of consolidation, as shown above. Where needed, the Commission has signaled that efficiencies in merger reviews can be interpreted through the lens of *defence readiness* to give greater weight to security of supply and resilience. Whether and to what extent this will find its way into the revised merger guidelines remains to be seen.
- Similarly, there are currently no indications that the upcoming amendment to the German Competition Act will include any defence-specific carve-outs. The prevailing view is that competition remains a primary driver of innovation, and total exemption would risk creating inefficient national monopolies.

Hopefully, more movement can be expected in procurement law on top of the changes that have already been introduced (e.g. increase of thresholds for the Defence Procurement Directive to reduce administrative red tape for smaller contracts). This includes more agility of the public contracting authorities to use tools already available to them, like open (“functional”) tenders. However, process optimization must not come at the cost of market entry possibilities. If the system is optimized only for speed (e.g., via direct awards or limited tenders), it entrenches first mover advantages of incumbent suppliers and effectively eliminates competition at the expense of innovation. As called for by the Monopolies Commission, the goal should be a shift toward mission-oriented procurement defining the purpose (*bottom-up*) rather than the technical specification (*top-down*). Only by keeping the “how” open to competition can we avoid the stagnation of old structures.

### **Moving forward: How to deal with the tension between speed and security?**

In the current climate of massive government investment on the EU and national level, failing to address structural shortcomings in fund distribution leads to a significant risk of misallocation. Without the pressure of competitive markets, increased public spending can lead to artificial price spikes if capital is funneled solely toward existing incumbents. The only effective safeguard against such inefficiencies is effective competition. When the right framework conditions exist, high levels of government investment hold the potential for a surge in innovation – a surge that is currently urgently needed. Therefore, the priority must be to design frameworks that are actively conducive to competition and future-proof innovation.

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