



JUNE 2018

## More European defence cooperation: the road to a European defence industry?

In 2017 European defence cooperation has been given a boost by the launching of Permanent Structured Cooperation, the Coordinated Annual Review on Defence and the European Defence Fund. In particular the latter aims at stimulating European collaborative research and development projects while at the same time its purpose is to strengthen the European Defence Technological and Industrial Base. This Policy Brief provides an assessment of the potential impact of the 2017 initiatives on the EDTIB, paying particular attention to Small- and Medium-sized Enterprises.

### Introduction

For several years representatives of European defence industries have been complaining about declining defence budgets and the lack of large new investment programmes. They have warned against the loss of key technological and industrial capacities. A serious political boost has been needed to prevent this from happening.

Driven primarily by the deteriorating security environment, the European Union took important initiatives in 2017 to turn the tide for European defence cooperation. Permanent Structured Cooperation (PESCO) was launched to seek the commitment of member states to realising common projects instead of sticking to the voluntary approach that produced too little, too late in the past. The Coordinated Annual Review on Defence (CARD) has the purpose of harmonising the national defence and procurement plans of the EU member states, thus creating better opportunities for common European programmes. Last but not least,

the European Commission launched the European Defence Fund (EDF), offering up to € 1.5 billion annually in the 2020s to stimulate collaborative defence research programmes and industrial development projects.

Will these new initiatives – by many commentators labelled as breakthroughs or game changers – lead to a quantum leap in European defence cooperation and in creating a well-functioning European Defence Technological and Industrial Base (EDTIB)? This Policy Brief aims to answer this central question. What are the chances of realising a more consolidated and healthy European industrial base? How can one engage Small and Medium-sized Enterprises (SMEs), in particular those in smaller countries experiencing great difficulties in becoming suppliers to prime defence companies located in larger member states? After a brief description of the main characteristics of the EDTIB, this Policy Brief will provide an assessment of the potential impact of the PESCO and CARD initiatives

on improving European military capabilities. This is followed by an analysis of the EDF's potential. The authors then turn to the impact of the new initiatives on the EDTIB. Particular attention will be paid to SMEs and how their engagement in cross-border industrial cooperation could be improved. Conclusions and recommendations complete the Policy Brief.

## The complexity of the EDTIB

Europe's defence industrial landscape is characterised by a mix of large transnational firms – in particular in the aerospace, electronics and missile sectors – and nationally-based companies. Fragmentation still dominates in the naval and land sectors. In statistical terms the EDTIB represents a very small part of Europe's economic base, but it is an important contributor to innovation and technological development. The number of employees is relatively small, but well educated. In the three largest European countries over half of the defence industrial market is purely national. Figure 1 provides key data on the EDTIB.

Due to declining demand in Europe over the last decade or more, large defence companies have adapted their business strategies. Two major trends were: (i) increasing exports to non-European buyers and (ii) focusing more on dual-use production. Naturally, the latter is only possible when civilian customers – such as border and coast guards, the police, customs and also commercial parties – can make use of the same or comparable equipment as their military colleagues (e.g. for reconnaissance, communication, transport, etc.). Regarding exports, France and the United Kingdom have been successful in stepping up their military sales, predominantly to countries in the Middle East and Asia. Most analysts consider this success to be a temporary matter as countries like India demand intellectual property rights when buying military kit from European countries. In due course they will produce high-tech military equipment themselves. The orientation on dual-use production has provided both large companies and SMEs with expanding

markets: civilian security has been a growth sector as a result of increasing counter-terrorism activities, the fight against transnational crime and the priority given to border security in response to the migration flows into Europe.

The challenges for European defence industries are manifold. Staying at the edge of technological innovation is perhaps the most daunting one. Against the backdrop of declining home markets large defence companies had to channel their technological development to the most promising equipment sales. As a consequence, European defence industries are not up to speed in new technology areas such as artificial intelligence, quantum technology and micro/nano electronics. They are increasingly dependent on innovation in the civilian-commercial sector, such as for the use for big data, robotics, blockchain technology and advanced materials – all of which can also lead to a technological revolution in military applications. With regard to large drones, Europe has to catch up with the United States and Israel. While the US launched the Defence Innovation Initiative in 2014<sup>1</sup>, Europe has no up-to-date Defence Technology or Innovation Strategy.

Anno 2018 an open European Defence Equipment Market is still absent. The attempts of the European Commission to break the deadlock of the national protection of defence industries has failed. Directive 81 on Defence Procurement has not resulted in demolishing the barriers. In 2016 the Commission itself concluded that the percentage of cross-border awarded contracts had remained the same – about 10 percent – compared to the period before the Directive entered into force.<sup>2</sup> Instead, the Commission has focussed its efforts on creating financial incentives for multinational cross-border defence research

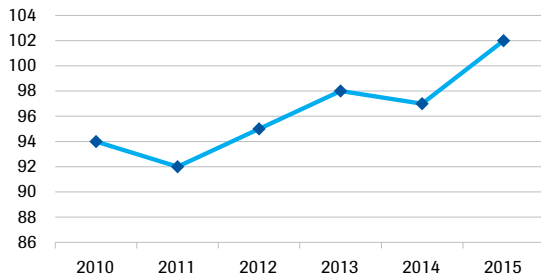
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1 Originally called the Third Offset Strategy.

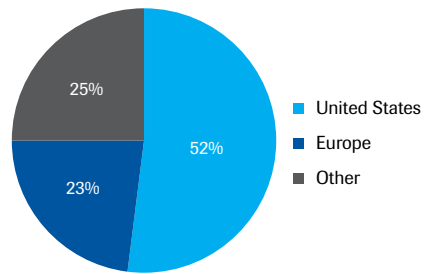
2 *Report from the Commission to the European Parliament and the Council on the implementation of Directive 2009/81/EC on public procurement in the fields of defence and security, to comply with Article 73(2) of that Directive*, COM (2016)762 final, Brussels, 30.11.2016

**Figure 1 Key EDTIB data**

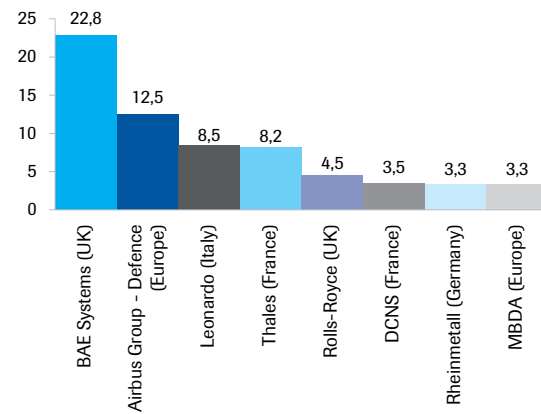
**Turnover in billion euros<sup>a</sup>**



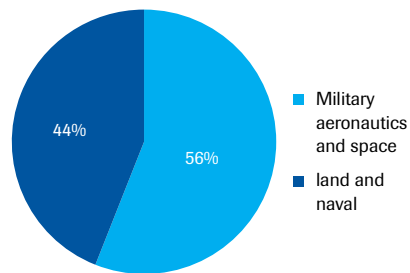
**Share of global turnover<sup>b</sup>**



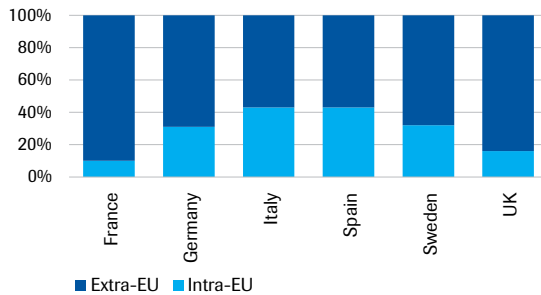
**2016 Turnover in billion euros (Top prime companies)<sup>c</sup>**



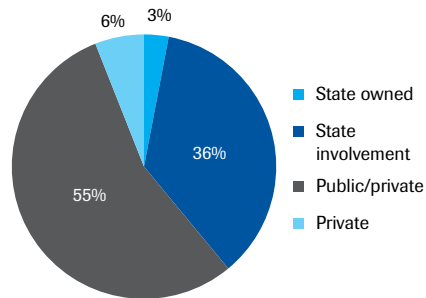
**Breakdown per sector<sup>d</sup>**



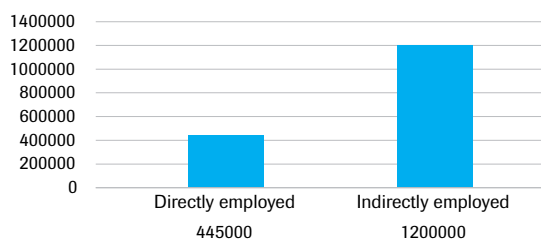
**Export markets<sup>e</sup>**



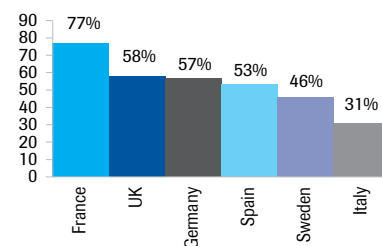
**Ownership<sup>f</sup>**



**Employees<sup>g</sup>**



**Reliance on national market<sup>h</sup>**



a. Aerospace and Defence Industries Association (ASD), *Key facts and figures 2015*.  
 b. SIPRI Top 100 arms producing companies (excluding China), 2016.  
 c. SIPRI, 2016.  
 d. ASD, 2015.  
 e. Eighteenth Annual Report according to Article 8(2) of Council Common Position 2008/944/CFSP defining common rules governing the control of exports of military technology and equipment, 2017/C 153/01.

f. European Parliament Directorate-General for External Policies – Policy Department, *The development of a European Defence Technological and Industrial Base (EDTIB)*, June 2013.  
 g. Eurostat, SBS Annual detailed enterprise statistics for industry.  
 h. European Parliament, 2013.

and industrial development programmes, which resulted in the EDF (see the section below on Financing). However, Article 346 of the Treaty still applies. It provides member states with the opportunity to call in national security considerations for exempting defence industrial orders from cross-border competition. It is a practice that is widely used by member states – not primarily for reasons of national security but rather for economic interests. The European Commission has already sent several cases to the European Court to find a legal solution. But it will take years before the legal procedures will be completed, not to speak of amending the Directive which might indeed be required. Thus, for the foreseeable future a European defence industrial level playing field will not come into existence. This is simply a fact of (political) life.

### **Small and Medium-sized Enterprises**

In particular SMEs suffer from the absence of a European level playing field to obtain access to cross-border markets. Prime companies in larger countries are used to cooperating with national supply-chain companies. It is difficult to change this culture, also because language can become a barrier to conducting business with SMEs based in other countries. Also, SMEs are not well equipped to play a proactive role in looking for cross-border defence orders. This requires sustained marketing efforts, human resources for time-consuming tendering procedures and other administrative tasks. In most cases this is beyond the staffing capacities of SMEs.

Another challenge is the lack of a European export control regime. If SMEs deliver products to larger companies in other EU countries and these firms sell equipment to third countries, then the national export control regime of the SME host country applies to such exports. Countries such as the Netherlands have very strict export

control laws.<sup>3</sup> Sales of military equipment containing Dutch (sub-)systems by prime companies located in other European countries, such as France, to non-European customers could create serious problems. Prime companies will try to avoid such a risk. In Flanders the situation is even more dire. The so-called Van den Brande Directive of 1999 excludes Flemish participation in technology research and development programmes if these have military applications. Thus, Flemish research institutions and SMEs are not in a position to join cross-border programmes or projects, including those that are (co-)funded by the EDF. This is all the more problematic as SMEs produce predominantly dual-use technologies, many of which find applications in military equipment. So, SMEs in countries like the Netherlands face a double challenge: a level playing field is absent in terms of a real open European Defence Equipment Market; but even if that issue were to be resolved – which is unlikely to happen in the foreseeable future – even then Dutch and Flemish SMEs could still be blocked from operating cross-border due to their strict national export control regimes.

### **The demand side: the impact of PESCO and CARD**

The other side of the coin to the consolidation of the European defence industry is the demand side where the EU member states play the largest roles. Higher available budgets for procurement, a better consolidated demand for defence industrial products and greater synchronisation of the defence planning cycles would go a long way towards a healthier EDTIB.

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3 Export control laws can also restrict defence industrial cooperation between prime companies in larger European countries. For example, Germany has a stricter arms export control regime, which could limit bilateral armaments cooperation with France. See: Interview with Dirk Hoke – CEO, Airbus Defence and Space, in *Jane's Defence Weekly*, 18 April 2018.

## CARD

To this effect, in 2016, the EU Global Strategy (EUGS) called for the “gradual synchronisation and mutual adaptation of national defence planning cycles and capability development practices”. This led in May 2017 to the Coordinated Annual Review on Defence (CARD) which has a slightly less ambitious objective: “*to develop, on a voluntary basis, a more structured way to deliver identified capabilities based on greater transparency, political visibility and commitment from Member States*”. A trial run of the CARD ‘Review’ started in the autumn of 2017, leading to a first CARD report in November 2018. A first full CARD-cycle will run in 2019-2020. The EDA-run CARD exercise is basically a gap analysis of member states’ current capabilities, procurement plans and the priorities identified in the Capability Development Plan (CDP). One of its largest added values is that it also serves as input for identifying the potential for cooperative projects between member states. Some countries are already attuned to finding cooperation potential with other states they have experience in working with, but tend not to look beyond their usual partners.

The voluntary nature of the CARD exercise leaves the responsibility for its success to the member states’ willingness to contribute. This requires top-down political involvement in the CARD process. CARD needs to be fed with up-to-date and detailed information, not only about current spending and procurement programmes, but also about their longer-term capability plans. Only then can CARD contribute to mapping what is needed for the synchronisation and alignment of future capability plans.

## PESCO

In December 2017, a Permanent Structured Cooperation in the area of defence was established by 25 EU member states. Only Denmark, Malta and the United Kingdom are not part of PESCO. It has two elements: an agreement on binding commitments and specific projects. Binding commitments are pledges made by member states through yearly National Implementation Plans (NIPs), such as to regularly increase defence budgets in real terms and to invest

20% of these increased budgets in defence procurement and 2% in research and technology.<sup>4</sup> In June 2018 the Council is set to adopt the common set of governance rules for the projects, as well as a recommendation to sequence the fulfilment of the more binding commitments and to specify more precise objectives. There is a pledge in the PESCO notification to harmonise requirements for capability development projects. Also, PESCO member states have to ensure that their industrial policies will avoid overlaps and that cooperation programmes will demonstrably provide added value on EU territory and have a positive impact on the EDTIB.

Both commitments and projects will be the object of regular assessments. With CARD and PESCO, each participating member state will be faced with individual reviews. Despite ‘binding’ commitments, it is however questionable whether any sanctions will be forthcoming for participating member states that fail to fulfil their pledges. Still, the combined transparency, peer review and top-down pressure from the European Council together constitute a better prerequisite than has so far been the case.

It is clear that the first round of PESCO projects did not have much defence industrial significance. Of the seventeen projects only a few could be industry-relevant such as Unmanned Maritime (semi-) Autonomous Systems for Mine Countermeasures and the Italian-led Armoured Vehicles project. The absence of armaments projects involving the two largest defence industrial states in the European Union after Brexit – Germany and France – is striking. Apparently, the two countries prefer to conduct ‘business as usual’ in a direct bilateral context or in multinational programmes with other European partner countries such as Italy and Spain. Protecting national defence industry interests by applying the traditional principle

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<sup>4</sup> These targets were already agreed upon by the EDA Ministerial Steering Board in 2007 as collective benchmarks. The PESCO decision text also refers to collective benchmarks.

of *juste retour*<sup>5</sup> or industrial work shares could explain this behaviour. Furthermore, President Macron's European Intervention Initiative (EII) also points to little French faith in operational cooperation formats in the PESCO context.

### Trend changing on the demand side?

After the A400M, the Eurofighter and the NH-90 the order portfolio of the European defence industries dried up concerning large new programmes. There are, however, signs of change with France, Italy, Germany and Spain as launch partners for a European next generation large drone, including industrial cooperation between Airbus Defence and Space, Dassault Aviation and Leonardo. This proposal, now called the EuroMALE2020, is currently in an early design phase. Moreover, in July 2017, Germany and France announced at their bilateral summit that they will engage in long-term cooperation on a number of significant programmes. Among them were plans to jointly develop a future-generation tank. More concretely, in April 2018 Paris and Berlin agreed on the common military requirements for the Future Combat Air System (FCAS) that is to replace the Eurofighter and the Rafale in the 2040s.<sup>6</sup> Dassault Aviation and Airbus Defence and Space are the leading companies in the programme.<sup>7</sup> The two countries also signed an agreement to develop Future Maritime

Airborne Warfare Systems together.<sup>8</sup> When the initiation of the programmes was launched, German Defence Minister Ursula von der Leyen underlined that they had learnt from their past mistakes: "regardless of how many countries take part, there will be one design, one set of requirements – and no national specifications."<sup>9</sup>

Best practice can be found with the Benesam cooperation, in which the Netherlands and Belgium are now harmonising the requirements for the replacement of their M-frigates and minehunters in a common procurement process. Both countries want to retain near to identical capabilities to be able to continue to be fully integrated on maintenance, training and education, workup and logistics.<sup>10</sup> Key to the success of the Belgium-Netherlands defence cooperation is the trust that already exists on all levels of cooperation and the fact that there are only two countries involved. The lessons learned from good practices in defence cooperation should play a role in designing instruments for incentivising defence cooperation.<sup>11</sup>

5 The principle of *juste retour* implies that the percentage of the national spending part of multinational programmes is mirrored by the same percentage for national industries contributing to such programmes.

6 Giovanni de Briganti, 'France, Germany launch future fighter and other programs', *Defense Aerospace.com*, 27 April 2018, <http://www.defense-aerospace.com/articles-view/feature/5/192835/france%2C-germany-launch-future-fighter.html>

7 It is envisioned as a complex 'system of systems' comprising a new-generation fighter aircraft, unmanned combat aircraft, future air-launched missiles, and swarms of small drones, all interconnected with satellites, other aircraft, NATO networks as well as national and allied ground and naval combat systems.

8 Other examples are: France and the UK will continue to work on Future Combat Aircraft Systems with a focus on an Unmanned Combat Aerial Vehicle (UCAV), as well as cooperation on anti-ship missiles through MBDA. Also, Germany and Norway have a conventional submarine programme lined up with the possible participation of Italy, Poland and the Netherlands.

9 Ursula von der Leyen, in: 'Germany, France present new military aircraft plans in Berlin', *Deutsche Welle*, 26 April 2018, <http://www.dw.com/en/germany-france-present-new-military-aircraft-plans-in-berlin/a-43554242>

10 Dutch Ministry of Defence, 'Replacement M-frigates', A Letter to Parliament, 4 May 2018, <https://www.rijksoverheid.nl/documenten/kamerstukken/2018/05/04/kamerbrief-met-a-brief-project-%E2%80%98vervanging-m-fregatten%E2%80%99>

11 For further reading, see: Dick Zandee, Margriet Drent, Rob Hendriks, *Defence cooperation models – Lessons learned and usability*, Clingendael Report, October 2016.



**Figure 2 European Defence Fund**

	Until 2020	Post 2020
Research (EU budget)	€ 90 mln <sup>a</sup>	€ 500 mln / year <sup>b</sup>
Capability development Co-financing EU budget 20% <sup>c</sup>	€ 500 mln <sup>d</sup>	€ 1 bln / year
<b>Total EU budget</b>		€ 1.5 bln/year
Capability development (member states' budget 80%)	€ 2 bln	€ 4 bln
<b>Total EU &amp; member states</b>		€ 5.5 bln/year

- a. Preparatory Action for Defence Research (PADR, 2017-2019)
- b. European Defence Research Programme (EDRP, 2021-2027)
- c. There is an additional 10% for PESCO projects
- d. European Defence Industrial Development Programme (2019-2020)

## New financing: the European Defence Fund

In June 2017 the European Commission launched the European Defence Fund, following up on earlier proposals made in the context of the European Defence Action Plan of the previous autumn.<sup>12</sup> The European Defence Fund has two elements, or 'windows': one for joint defence research and one for joint capability development. In fact, the latter can better be described as the industrial development phase of military equipment production. Both elements are in a pilot or forerunner phase before the new EU Multi-annual Financial Framework (MFF) 2021-2027 starts. Figure 2 depicts the financial volumes of the EDF.

The pilot on technology research – the Preparatory Action for Defence Research – is up and running. The regulation on the European Defence Industrial Development Programme for the years 2019-2020 should be formally approved by the European Parliament and the Council in June. On 22 May the Bulgarian Presidency reached a provisional agreement with representatives of the European Parliament

on the draft regulation.<sup>13</sup> In theory, the conditions for drawing from the EDF's capability window are geared towards the aim of enhancing cooperation between member states. According to the proposal a project is only eligible for funding if it has at least three "undertakings" based in at least two different member states. Another condition is that there should be agreement on common technical specifications and a commitment by member states to jointly produce and procure the final product. Additionally, a proportion of the overall budget should benefit actions enabling the cross-border participation of SMEs. Finally, award criteria will be based on the extent to which they contribute to innovation and the technological development of defence industries, as well as the security and defence interests of the EU.

12 European Commission, Communication launching the European Defence Fund, 7 June 2017, <https://ec.europa.eu/docsroom/documents/23605>

13 *European defence: Council and European Parliament reach provisional agreement on a regulation establishing the European Defence Industrial Development Programme (EDIDP)*, Council of the EU Press Release 274/18, 23/05/2018. The Press Release refers to a number of amendments to the draft regulation, relating to "the regional and international priorities that should inform the programme, its sources of financing, the eligible entities and eligible actions, and the implementation of the work programme." As the text of this Policy Brief was concluded at 30 May no further details on these amendments could be provided.

### Theory vs. practice

As can be expected, the aim of boosting defence research and ending fragmentation in the demand and supply of defence capabilities is in practice fairly complex. A European Defence Research Programme (EDRP, 2021-2027) should be informed by an EU defence innovation strategy in order to focus on the right research priorities. Such an innovation strategy is lacking. In comparison to the US Defence Innovation Strategy (\$ 70 bln in 2017), the funds earmarked for defence technology research in the EU are very low. To what extent will the EDRP be able to contribute to a less fragmented defence technological research landscape with only a maximum of € 500 mln per year in the budget? Added to this, whether the member states and the European Parliament will agree to the proposed € 10.5 bln<sup>14</sup> that is now earmarked for the EDF for the period 2021-2027 remains uncertain. The debate might be influenced by the lack of concrete results in the pilot phase. The existing Horizon2020 research projects have a poor result in terms of industrial application. How can one ensure that defence research projects, financed by the EU budget, will have a practical application? A balance will have to be found between technological forward leaning and directly applicable projects, in particular to sustain high-level political support for investing European taxpayers' money in defence research.

The capability window's problem is that most procurement plans have already been decided upon, which will make it difficult to find short-term multinational capability programmes that are not now already in the procurement pipeline. For the sake of political and military relevance, the focus has to be shifted to the medium term for larger collaborative projects (possibly those on a European Future Combat Air System or a future tank). Also, the EDF does not account for the problem of a lack of synchronisation in the defence planning of member states.

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14 In the MFF period 2021-2027: 7 x € 500 mln annually (EDRP) = € 3.5 bn, plus 7 x € 1 bn annually (defence industrial development) = € 7 bn, amounts to a total of € 10.5 bn.

The Commission rightfully steers towards multinational projects in its conditionality. However, it will take time and money for an industry that has been very much dominated by national governmental demand to develop cross-border partnerships and developing new supply chains outside the trusted national suppliers. The question is whether the additional 20 or 30% co-financing will outweigh the complications that this entails. Similarly, opening up supply chains for SMEs in other member states is in theory possible, but will the instruments of the Commission suffice to put a halt to the excessive reliance on Art. 346 when the survival of national industries and jobs are at stake?

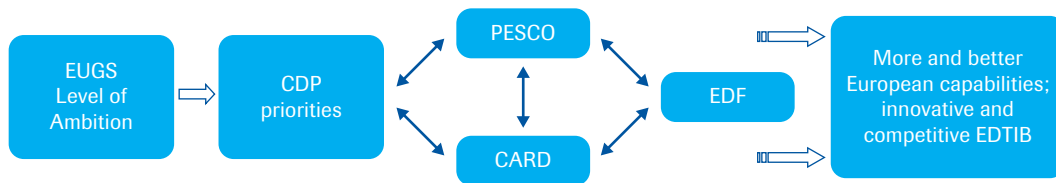
### Interlocking instruments

CARD, PESCO and the EDF taken together have the potential to coax member states into initiating more multinational projects. In theory, the various instruments of the Common Security and Defence Policy are geared towards facilitating this with the eventual objective of strengthening European defence capabilities. The EU Global Strategy of 2016 and the Implementation Plan for Security and Defence (November 2016) set the Level of Ambition; the CDP should prioritise capabilities; CARD can highlight capability gaps and the potential for collaboration; PESCO provides a binding framework for operational and capability cooperation; while the EDF can provide incentives for relevant research and capability projects. These various instruments should be interlocking and should strengthen each other to lead to improved European capabilities, supported by an innovative and competitive EDTIB (see the flowchart below in Fig. 3).

EDA has a pivotal role in knitting the various initiatives together. It is involved in mapping the capability requirements through the CDP (together with the EU Military Committee/Military Staff), it has a CARD secretariat role, is also in the secretariat of PESCO and is therefore important to make sure that the EDF is capability- and output-driven and not a subsidy instrument for an industrial branch. Much depends on the member states and the mandate they entrust to the EDA and the extent to which the member states themselves are able to



**Figure 3 Interlocking instruments**



treat these instruments as complementary and interlocking: stove piping in Defence Ministries has prevented this in the past with different parts of Ministries dealing with matters relating to PESCO, CARD and EDF. Therefore, Ministries of Defence will have to adapt their internal structures and procedures for optimising the use of these new EU instruments.

However, none of the larger programmes that are in the pipeline have been brought into PESCO as a project. Nor is it clear whether they will apply for EDF funding (either through co-funding for research or through EDIDP financial incentives). Apparently, at the moment, member states are sitting on the fence and are waiting to see what the added value of either PESCO or the EDF will be. The involvement of the Commission (and the European Parliament) in the EDF and the unproven PESCO framework could make member states wary of losing control and of too complicated bureaucratic hurdles in the precarious early phases of a new capability programme.

Another matter that is looming over both PESCO and EDF is the third-country matter. A decision on this contentious issue has now been postponed until after 2018. If no feasible solution is found to involving non-EU countries in capability programmes, a number of member states could circumvent these EU instruments. In particular, catering for the possibility of United Kingdom research and industrial participation is important to make sure that PESCO and EDF formats live up to their full potential. For the EDIDP a complex formula might apply, requiring, for example, information from European-based defence firms with non-European ownership on how their contribution to EU-(co)funded projects will not be detrimental to the EDTIB.

### Potential for defence industrial consolidation

European defence industries seem to be caught in between the Scylla of national protection as a guarantee of a limited amount of orders and the Charybdis of expanding markets through stepped-up multinational armament programmes. More common demand through a growing number of European projects, preferably generated by CARD and part of PESCO commitments, should lead to increased defence industrial cooperation across Europe. By offering financial incentives based on the conditions for cross-border technological and industrial development cooperation, the EDF intends to stimulate European cooperation in both demand and supply. But what can industry itself contribute in order to strengthen the EDTIB, in particular to maintain or acquire key industrial and technological capacities that are needed for European strategic autonomy?

The plea of industries for new, large multinational programmes was mentioned before. Most of these new programmes have parallel high-political and industrial cooperation tracks. For the Franco-German-Italian-Spanish EuroMALE2020 project an industrial consortium has been established consisting of Airbus Defence and Space, Dassault Aviation and Leonardo. For the future tank, Kraus-Maffei Wegmann and Nexter have formed a holding company. In shipbuilding the Italian Fincantieri and the French Naval Group are investigating the potential for a naval alliance. So it seems that the prime companies are already moving in the direction of closer cooperation, common programmes or even merging. Nevertheless, defence industries in other European countries remain excluded from the large

future projects. Many European countries will have to procure a future tank to replace the current generation of the Leopard 2 tank and other types. Early involvement in the Franco-German project would be desirable. Industrial interests, for example to participate in the supply chain, could then be taken into account before the large prime companies have arranged all supplies through their national chains. Clearly, such a proactive stance requires at least two conditions to be fulfilled: first, governments should create and sustain a political framework for multinational projects; second, their industries should be involved from the very start – the drawing board – to seek the best opportunities for their involvement.

Existing clusters of defence cooperation seem to offer the best chance of success, as partners have been working closely together to intensify their cross-border military cooperation. The Franco-British Lancaster House cooperation, the Belgian-Netherlands Benesam (naval cooperation) and the German-Netherlands army integration are excellent examples. Paris and London have launched common projects on anti-ship missiles and on Future Air Combat Systems. Benesam is the format for the two neighbouring countries to procure the same successor to replace the M-frigates and the same counter-mine warfare capacity in the 2020s. The integration of Dutch tanks in a German tank battalion – which can only work if the equipment is one hundred percent identical – requires The Hague to line up with Berlin and Paris for the future tank project.<sup>15</sup> In simple terms: bring industry on board in bilateral or regional clusters that work – this creates the best possibility for persuading industries to work together across national borders. In that sense the Netherlands now has another chance. The current conventional Walrus-class submarines have to be replaced by a successor in the 2020s. Instead of opting for a purely national solution, which will be expensive and risky from an investment point of view, The Hague could choose to join the

already established project of Norway and Germany. Both countries are considered to be ‘strategic partners’ of the Netherlands – thus the submarine cooperation would be embedded in well-functioning, existing defence cooperation formats. For the Dutch Damen Schelde Naval Shipbuilding company an industrial arrangement would have to be agreed with its German counterpart, TKMS. This tripartite submarine project would strengthen European defence cooperation through standardisation – thus also opening up huge potential for multinational training, maintenance and future upgrading – while at the same it would positively impact defence industrial cooperation.

If such defence industrial clustering could be done through PESCO and using EDF (co-)funding, that would be the preferable ‘royal route’ to be taken. PESCO commitment would bind the participating countries and EU money could assist in the early phases of technology research and passing the well-known ‘valley of death’ into development and production. Thus, the best working model for multinational defence cooperation – bilateral or regional clusters – would be combined with EU-level instruments. After all, PESCO is an instrument that has been launched by EU member states and which is being used and controlled by the same member states. The EDF should benefit the maximum amount of member states, but the Fund’s provisions allow for money to be spent on projects with different groups of participating countries. Defence companies would profit from industrial clustering – not only from EDF (co-)funding as such but, more importantly, by increasing their markets. Finally, this model of clustering military and defence industrial cooperation would strengthen both European military capacities and the EDTIB.

## Conclusions & recommendations

1. European defence companies continue to face serious challenges, of which staying on the technological edge is the most daunting. Dependencies on the civilian commercial sector have grown, in particular in areas such as big data, robotics, blockchain technology and advanced materials.

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<sup>15</sup> Currently the Dutch Army is leasing tanks from Germany in exactly the same configuration. Any replacement of the Leopard 2 by a future tank would thus affect the Dutch tank unit.

2. Both larger and smaller EU member states will continue to use Article 346 of the EU Treaty to exempt defence industrial orders from cross-border competition. Directive 89 has not changed this situation. The absence of a European defence industrial level playing field is a fact of life, which will prevent the creation of an open European Defence Equipment Market in the foreseeable future.
3. In particular, Small and Medium-sized Enterprises bear the negative impact of the lack of a level playing field as they have the greatest difficulties in entering cross-border defence markets due to limited staff and other disproportionate burdens. Culture and language issues seem to reinforce the obstacles between larger companies and cross-border SMEs.
4. National export control regimes can also limit the options for cross-border defence sales if importing countries have more liberal defence export rules. This can restrict their own defence sales to third countries. Thus, countries like the Netherlands face a double challenge: the need for a level playing field and for an EU defence export regime.
5. The Coordinated Annual Review on Defence (CARD) and Permanent Structured Cooperation (PESCO) offer the potential for a better harmonisation of demand in multilateral capability projects. Continued high-level political involvement will be needed to maximise the chances of achieving concrete results.
6. Outside the EU context, member states are already establishing new bilateral or multinational programmes, such as for the EuroMALE2020, a new generation tank and Future Combat Air Systems. In most cases political and industrial initiatives are running in parallel, which is a prerequisite for success.
7. The European Defence Fund (EDF) offers financial incentives for collaborative defence research and defence industrial development, with substantial amounts of money being proposed for the period 2021-2027. However, the Commission's conditions are complex and it seems that member states are waiting for implementation before they will be willing to bind larger projects to the Fund's set of conditions.
8. It is essential that CARD, PESCO and EDF are treated as complementary by member states in order to generate the best results in connecting the capability-driven demand to defence technological and industrial output. Ministries of Defence might have to adapt their often stove-piped structures to treat the three instruments in an interlocking way.
9. Existing clusters of deepening defence cooperation offer the best potential for planning common procurement programmes. Defence industrial cooperation should be part of that process from the start. The Belgian-Netherlands naval cooperation programmes for procuring the same frigates and counter-mine warfare capacities may serve as examples.
10. The Netherlands should opt for joining the German-Norwegian programme for a next generation conventional submarine instead of pursuing a national solution which will be more expensive and entail a greater risk, as well as reducing the options for the standardisation and rationalisation of training, maintenance and future upgrading.

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www.clingendael.org  
info@clingendael.org  
+31 70 324 53 84

 @clingendaelorg  
 The Clingendael Institute  
 The Clingendael Institute

### About the authors

**Margriet Drent** is Senior Research Fellow at the Clingendael Institute's Security Unit. She specialises in European security and defence with a specific focus on EU Common Security and Defence Policy.

**Dick Zandee** is Head of the Security Unit at the Clingendael Institute. His research focuses on security and defence issues, including policies, defence capability development, research and technology, armaments cooperation and defence industrial aspects.

*This Policy Brief has been commissioned by the Netherlands Ministries of Foreign Affairs and Defence within the PROGRESS framework agreement, lot 4, 2018. Responsibility for the contents and for the opinions expressed rests solely with the authors; publication does not constitute an endorsement by the Netherlands Ministries of Foreign Affairs and Defence.*