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European Defence Fund

The real test is yet to come

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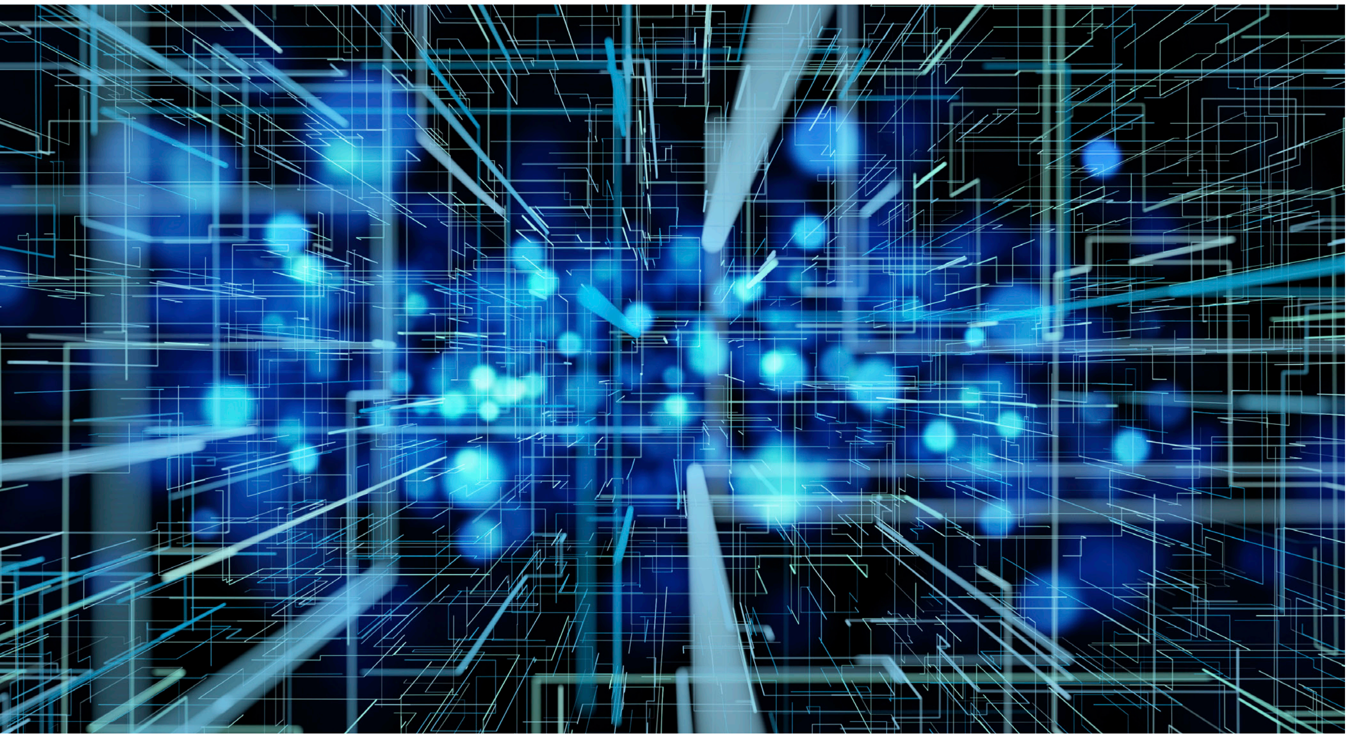

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The European Commission's proposal of November 2016 to establish a European Defence Fund (EDF) was characterised by many commentators as a *game changer*. After all, investing in defence had always been a taboo in the European Union. The Juncker Commission took the initiative to break with the past. The acceptance of the proposal by the member states and by the majority of the European Parliament showed that times had changed. Launching the Fund is part of the wider process of the European Union's search for its geopolitical role and strengthening its security and defence policy. More than four years later, a question to be asked is whether the Fund has been successful so far. The initial pilot phase is approaching its end, although the delivery of results will take a few more years. Do the results match expectations? This year the fully-fledged EDF will start for a period of seven years with a larger amount of money in the pot: € 8 billion. What are the prospects and which criteria have to be met in order to guarantee the EDF's success?

Launching the EDF

In the past, the European Commission made several attempts to break defence companies' chains of national protection.

Governments in European capitals relied on the EU Treaty's clause exempting the defence industry from the common market rules.[1] The *perpetuum mobile* of national demand to supply cycles has resulted in industrial fragmentation, intra-European duplication and a waste of money. As a result the armed forces of the member states often operate with different equipment, which limits the potential for multinational defence cooperation and integration while increasing procurement and maintenance costs. In the early years of the 21st century case law of the European Court of Justice emerged, which ensured that member states could no longer invoke the Treaty's exemption clause without the burden of proof falling on governments. With the EU Directive on Defence Procurement – which entered into force in 2011 – the Commission aimed to narrow the scope for activating the Treaty's exemption clause. However, in its own evaluation in 2016, the Commission concluded that the percentage of cross-border contracts had remained the same – about 10 percent – compared to the period before the Directive entered into force.[2]
The launching of the EU Global Strategy (EUGS) in June 2016 provided an opportunity to develop an alternative approach.
Several steps were taken to implement the EUGS; one of them was prepared by the Commission, resulting in the proposal for the European Defence Fund (EDF) with a financial volume of € 13 billion for the period 2021-2027, which was launched in 2017.

The EDF is not meant to buy military kit for the EU, but to stimulate member states to jointly procure the same equipment while at the same time strengthening the European defence technological and industrial base through common defence research and innovation. It offers financial incentives connected to conditions for cooperating in multinational consortiums of technology institutes and defence industries. In other words: by using the Fund, participants are forced to establish cross-border cooperation formats, consisting of at least three different entities in three different member states. Furthermore, the EDF offers additional funds for the inclusion of Small and Medium-sized Enterprises (SMEs) and for projects launched under Permanent Structured Cooperation (PESCO).[3] The percentage of financing can vary from 100% for feasibility studies to 20% in the case of the development of demonstrators. In essence, the financing percentage is lowered when a project leaves the drawing board and enters the factory floor. Co-financing by member states and/or industry is essential to carry the project forward from the development phase into full-scale production.

Trial, not much error

In order to test the EDF the Commission launched two pilot programmes, together worth € 590 million: the *Preparatory Action on Defence Research* (PADR, 2017-2019) with a € 90 million budget and the *European Defence Industrial Development Programme* (EDIDP, 2019-2020) with a € 500 million budget. The implementation of the PADR was handed over to the European Defence Agency. In total 200 entities (the private sector, academia, research centres) in 22 EU member states and Norway participated in 18 projects, some of which are still ongoing. SME participation is 22% of the total financial volume. Most projects are small and vary from basic research to more mature technology levels.[4] The largest project is OCEAN 2020 with a financial grant of € 34.5 million. In November 2019 the project resulted in the successful testing

1 In the (current) Treaty of the Functioning of the European Union: Article 346.

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

3 Permanent Structured Cooperation (PESCO) is a framework and process to deepen defence cooperation between those EU Member States which are able and willing to do so.

4 *Preparatory Action on Defence Research 2017-2019*, June 2020, #EUDefenceIndustry, ec.europa.eu › presscorner › api › files › attachment

of a demonstrator for systems and multi-data integration for maritime situational awareness in the Sea of Taranto.[5]

The first EDIDP calls were launched in 2019 and the second batch still has to be awarded. The first batch consists of 16 projects for a total amount of almost € 200 million, in which 166 entities in 24 member states participate. SMEs form 37% of the total number. Larger EU member states participate in most projects: France (27 entities), Spain (23), Germany (19) and Italy (18). Countries with a smaller defence industrial base score lower, although the number for Greece (18) is remarkable. Apparently, Athens was well prepared to tender for a large number of projects while other smaller countries still had to catch up in terms of establishing coordination structures between governments and defence companies with little or no cross-border experience. Financial grants varied from € 875,000 to € 44 million. Exceptionally, two projects were granted 'direct awards' by the Commission: the Eurodrone and the European Secure Software-defined Radio (ESSOR) with € 100 million and € 60 million respectively – both addressing important European capability shortfalls. Those projects were launched several years ago and are approaching the demonstrator phase. Although such direct awards are not in line with open competition, an important argument in support thereof is the 'visibility' and concrete output in the near future. They will serve as examples for politicians and the public that European taxpayers' money has justifiably been spent on improving European capabilities. Based on the selected EDIDP projects so far, the conclusion can be drawn that they fulfil to a large extent the essential criteria: capability-driven and strengthening cross-border defence industrial cooperation.

5 See video: https://ocean2020.eu/the-mediterranean-sea-demonstration-presentation/ The Baltic Sea demonstrator is planned for August 2021.

The next phase

The pilot phase has served its purpose. Now, it is time for the next step. The EDF 2021-2027 with a total budget of € 8 billion has received criticism from two sides. Proponents argue that less money is available than the amount of € 13 billion as originally proposed by the Commission. They interpret the reduction of the budget as a sign of decreased political attention. Opponents argue that each euro from the EU budget accorded to the EDF has to be rejected as the 'militarisation of the EU'. Comparable views can be heard in member states from parties on the left of the political spectrum. Furthermore, in some countries such as the Netherlands, populist parties also object to the EDF as they reject the EU as such. These political considerations entail a future risk for the EDF. Both in the European Parliament, which has decision-making authority on the EDF budget, as well as in national parliaments considerable opposition is likely to persist in the years to come.

From the financial perspective only, the EDF is a small fund: it represents 0.74% of the total EU Multi-annual Financial Framework 2021-2027 budget of € 1.074 trillion. The (civilian-driven) innovation and research programme Horizon Europe (€ 95.5 billion) is twelve times the size of the EDF budget.[6] However, the EDF is not meant to turn the Union into the centre of defence investment. The bulk of the money has to come from the member states.[7] To a large extent the success of the EDF will depend on the investment of the member states and their national defence companies. The following five preconditions are key for positive results of the EDF.

6 In March the European Commission will launch its Action Plan on Synergies between the civil, defence and space industries. This might unlock additional money for (dual-use) related research and innovation.

7 In 2019 the EU member states spent € 41.4 billion on defence equipment procurement, including R&D. See: *Defence Data 2018-2019 – Key findings and* analysis, European Defence Agency, https://eda.europa.eu/docs/default-source/brochures/2019-eda-defence-data-report.pdf

1. The further down the road from research to the development of defence equipment, the larger the investment share of the member states has to be, up to 80% at the beginning of what is often called 'the valley of death': the phase in which research and development has to turn into industrial production. It marks the turning point for moving from relatively limited to large-scale investment. The first test to come are the multinational Eurodrone and ESSOR programmes as they are approaching this milestone. Thus, *co-financing* by the member states is a key factor for the EDF's success in the years to come.
2. In most Ministries of Defence the EU is still a strange bedfellow as for generations the military worked mainly in the NATO context. Furthermore, while capability priorities defined by the EU and NATO are taken into account, national defence planning continues to be driven primarily by national demand and defence industrial supply, even in countries with a relatively small defence technological and industrial base such as the Netherlands. In order to open the box for large-scale investment by a group of member states, the EDF has to become a major input factor for *national defence plans* and *procurement programmes*. If the train is missed here, the EDF locomotive will pull it into the wilderness sooner or later.
3. The PADR and EDIDP pilot programmes are capability-driven and it is essential to ensure that the EDF projects in the 2020s will also *address key European military shortfalls*[8]. A precondition is to connect the Fund to the activities of the European Defence Agency: on defining the military shortfalls (the Capability Development Plan); on monitoring the plans of the member states to improve European military capabilities and to explore the potential for collaboration (the Coordinated Annual Review on Defence); on the commitments and projects in the context of Permanent Structured Cooperation.
4. The Commission's financial incentives require defence industries as well as governments to increase cross-border cooperation. For the larger member states with sizeable defence companies this is increasingly becoming their bread and butter as their national markets have become too small to sustain the defence technological and industrial base within their borders. For the smaller EU member states it is still a big challenge, in particular as their business firms – often Small and Medium-sized Enterprises – have had no access to the markets in the larger European countries. More cross-border cooperation requires a synchronised and proactive attitude from both *governments and industries* in order to participate in multinational defence equipment programmes.
5. Finally, a presence in Brussels is important. Larger member states have more human resources available to participate in the activities of the international institutions. Smaller member states, whose pools of experts on defence R&D and procurement are relatively small, have to prioritise international assignments. Nevertheless, if smaller member states aim to maximise their participation in the EDF, they need to *invest in human capital* including secondment to the European Commission's new Directorate-General on Defence Industry and Space.

The EDF offers potential for breaking national defence planning and industrial production cycles, which in the past have resulted in intra-European duplication, a waste of taxpayers' money and a lack of standardisation and interoperability among the armed forces of European countries. If EU member states are serious about improving European military capabilities in order for Europe to take more responsibility for its own security, the EDF offers an important opportunity to take steps in that direction.

8 *The EU Capability Development Plan – 2018 CDP Revision*, European Defence Agency, https://eda.europa.eu/docs/default-source/eda-publications/eda-brochure-cdp

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