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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN  
ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE  
REGIONS**

**European Defence Action Plan**

## 1. Introduction

President Juncker stressed in his 2016 State of the Union Speech<sup>1</sup> the need for a Europe that protects, empowers and defends. Taking greater responsibility for their security means that Europeans must invest in the development of key defence capabilities to be able to deter, respond, and protect themselves against external threats. The European Union must demonstrate that it can act as a provider of hard as well as soft security, addressing calls for greater solidarity in security and defence.<sup>2</sup> The Bratislava roadmap,<sup>3</sup> the European Parliament<sup>4</sup> and the Council of the European Union<sup>5</sup> have also recently underlined this priority.

A stronger European defence requires Member States' joint acquisition, development and retention of the full-spectrum of land, air, space and maritime capabilities. The Global Strategy for the European Union's Foreign and Security Policy<sup>6</sup> ("Global Strategy") identifies a number of defence capability priority areas in which Europe needs to invest and develop collaborative approaches: intelligence-surveillance reconnaissance, remotely piloted aircraft systems, satellite communications and autonomous access to space and permanent earth observation; high end military capabilities including strategic enablers, as well as capabilities to ensure cyber and maritime security.

The European defence market suffers from fragmentation and insufficient industrial collaboration. A more efficient use of public money and a stronger industrial base could be achieved by strengthening the Defence Single Market, reducing duplications and improving the competitiveness of the EU defence industry.

### **The need to invest in strategic capabilities**

For Europe to be able to deliver on these capability priorities, it must create the conditions for more defence cooperation to maximise the output and the efficiency of defence spending. This should go hand-in-hand with a strong, competitive and innovative defence industrial base and, to the benefit of the broader economy: investments in the defence sector have a significant economic multiplier effect in terms of creation of spin-offs and technology transfers to other sectors, as well as the creation of jobs.<sup>7</sup>

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<sup>1</sup> The State of the Union 2016: "Towards a Better Europe – A Europe that Protects, Empowers and Defends", 14 September 2016.

<sup>2</sup> On 14 November 2016, the Foreign Affairs Council concluded that the potential of inclusive Permanent Structured Cooperation (PESCO) should be explored. President Juncker called for such an initiative in his Political Guidelines in July 2014. He stated: "even the strongest soft powers cannot make do in the long run without at least some integrated defence capacities. The Treaty of Lisbon provides for the possibility that those Member States who wish to, can pool their defence capabilities in the form of a permanent structured cooperation."

<sup>3</sup> Work programme proposed by the President of the European Council, the Presidency of the Council and the President of the Commission at the meeting of the 27 Heads of State or Government on 16 September 2016, <http://www.consilium.europa.eu/en/press/press-releases/2016/09/16-bratislava-declaration-and-roadmap>

<sup>4</sup> European Parliament report on "the European Defence Union" (2016/2052(INI)) adopted on 22 November 2016.

<sup>5</sup> Foreign Affairs Council Conclusions, 14.11.2016.

<sup>6</sup> See: <https://europa.eu/globalstrategy/en/global-strategy-foreign-and-security-policy-european-union>

<sup>7</sup> It is estimated that each euro invested in defence generates a return of 1.6, in particular through skilled employment, research and technology, and exports (See Europe Economics, "The Economic Case for Investing in Europe's Defence Industry", 2013).

As called for by the Council,<sup>8</sup> this European Defence Action Plan contributes to ensuring that the European defence industrial base is able to meet Europe's current and future security needs and, in that respect, enhances the Union's strategic autonomy, strengthening its ability to act with partners. This Action Plan is closely linked with the Global Strategy's Implementation Plan on Security and Defence, which sets out a new level of ambition for the Union and identifies actions to fulfil it, as well as with the implementation of the EU-NATO Joint Declaration<sup>9</sup> signed by the President of the European Council, the President of the Commission and the Secretary-General of NATO. The actions proposed in this European Defence Action Plan will lead to a stronger European Union in defence, which ultimately means a stronger NATO.

The Council welcomed the Implementation Plan on Security and Defence and took note of the current priority areas in which Europe needs to invest adequately and develop collaborative approaches.<sup>10</sup> It encouraged the Commission to support Member States in implementing the identified capability priorities. Through the actions developed in this Action Plan, the Commission is committed to support the entire cycle of defence capabilities development – from research and development to the production of the capability.

### **The challenges of the European defence**

Collectively, Europe is the world's second largest military spender. However, it still lags behind the US and suffers from inefficiency in spending due to duplications, a lack of interoperability and technological gaps. Moreover, defence budgets in Europe have been shrinking in recent years, while other global actors (China, Russia and Saudi Arabia) have been upgrading their defence sectors on an unprecedented scale. Without a sustained investment in defence, the European industry risks lacking the technological ability to build the next generation of critical defence capabilities. Ultimately, this will affect the strategic autonomy of the Union and its ability to act as a security provider.

The defence industrial sector is not only of strategic importance for Europe's security. With a total turnover of EUR 100 billion per year and 1.4 million highly skilled people directly or indirectly employed in Europe,<sup>11</sup> it is also a major contributor to the European economy.

The defence industry is dependent on the launch of capability development programmes by governments and more generally on the level of public spending and investment in defence. As end-customers for defence equipment, governments specify the requirements and act as contracting authorities, regulators and, often, as supporters of exports. In addition, defence system development takes place with a long term perspective and implies high risks, as operational needs may change over the course of product development. This means defence companies will not invest in military technologies without a commitment from public authorities to buy them.

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<sup>8</sup> Foreign Affairs Council Conclusions, 17.10.2016.

<sup>9</sup> Signed in Warsaw in July 2016.

<sup>10</sup> Further to the defence capability priorities welcomed by the European Council in 2013 and those in the 2014 Capability Development Plan and the EU Global Strategy; Foreign Affairs Council Conclusions, 14.11.2016.

<sup>11</sup> Aerospace and Defence Industry Association (ASD) data.

Many Member States have cut their defence budgets over the last decade. From 2005 to 2015, EU27<sup>12</sup> defence spending has decreased by nearly 11 %, to reach an overall amount of EUR 200 billion. The share of defence expenditure in GDP has also dropped to the lowest recorded level of 1.4% in 2015. In real terms, defence budgets in the EU have decreased by EUR 2 billion per year over the last decade.<sup>13</sup> Today, only 4 out of 28 Member States reach the NATO spending target of 2% of GDP set at the 2014 Wales summit: Estonia, Greece, Poland and the United Kingdom.

By way of comparison, the US invested more than twice as much as the total spending of EU Member States on defence in 2015. China has increased its defence budget by 150% over the past decade. In 2015, Russia has invested 5.4% of its GDP in defence.<sup>14</sup>

Despite indications of a reversing trend over the last two years, the persisting lack of investment has had an impact on the European defence industry, from prime contractors to suppliers. There has been a general lack of opportunities in terms of new major defence industrial projects, including a lack of European collaborative programmes.<sup>15</sup>

The trend of shrinking defence budgets has been aggravated by inefficiencies in the way those budgets are used. The fragmentation of European markets leads to the unnecessary duplication of capabilities, organisations and expenditures.<sup>16</sup> The majority of defence expenditure is spent through national procurement, while the share of collaborative equipment procurement represented only 22% of the total equipment procurement in 2014.<sup>17</sup>

EU-wide competition and increased cooperation, which are the two means to enhance the efficiency and innovative capacity of the European defence industrial base, are still too limited. The decrease in defence budgets across Europe has not led to more cooperation, rather the contrary. There are fewer cooperative programmes today than 20 years ago.

### **The added-value of the European Union**

The decision to sustain investments in defence and launch capabilities development programmes remains the prerogative and the responsibility of Member States. The mobilisation of EU instruments and policies, within the limits of the Treaties, must not be a substitute for low levels of Member States' defence investments. However, the Commission is committed to complement, leverage and consolidate collaborative efforts by Member States in developing defence capabilities to respond to security challenges as well as to support the European defence industry.<sup>18</sup>

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<sup>12</sup> EDA participating Member States.

<sup>13</sup> EDA, defence data 2014 and 2015- 7.6.2016. Other figures in this paragraph come from this source.

<sup>14</sup> SIPRI Military Expenditure database 2014, Military Database 2015, International Institute for Security Studies.

<sup>15</sup> Group of Personalities report on European Defence Research (GoP), European Union Institute for Security Studies, February 2016.

<sup>16</sup> For example, there are 154 types of weapons systems in the EU compared to 27 in the US EU-US Defence Data 2011, European Defence Agency.

<sup>17</sup> For EDA Member States. See EDA defence data 2014 and 2015- 7.6.2016.

<sup>18</sup> In its study on "The Cost of Non-Europe in Common Security and Defence Policy" from 2013, the European Parliament considers that "the spread for the cost of non-Europe in defence is thought to range from EUR 130 billion, at the higher end, to at least EUR 26 billion, on a more conservative calculation". It is important to note that the figure of EUR 26 billion per year corresponds to the combined defence budget of 15 EU Member States (Belgium, Bulgaria, Croatia, the Czech Republic, Denmark, Estonia, Greece, Hungary, Latvia, Lithuania, Luxemburg, Portugal, Romania, Slovakia and Slovenia).

In particular, the Union's policies and instruments may provide added-value through: (i) improving the competitiveness and functioning of the defence industry in the single market; (ii) further stimulating defence cooperation through positive incentives, and targeting projects that Member States are not able to undertake; (iii) reducing unnecessary duplications, and therefore promoting a more efficient use of public money at a time of budgetary constraints.

The Commission has already developed strategies to support the competitiveness of the European defence industry and the creation of a more integrated defence market in Europe. The adoption, in 2009, of two defence Directives<sup>19</sup> contributed to the progressive establishment of a European defence market. In 2013, a toolbox of market opening and industry support measures was proposed: the Commission identified a list of actions<sup>20</sup> to further strengthen the single market for defence and promote a more competitive defence industry.

For the first time, the Commission is now tabling a European Defence Action Plan which focuses on capability needs and supports the European defence industry. This Action Plan has three main pillars that address different but complementary needs along the capability development cycle, focusing on technologies and products:

- Launching a European Defence Fund;
- Fostering investments in defence supply chains; and
- Reinforcing the single market for defence.

Furthermore, the Commission will promote civil / military synergies within EU policies, wherever appropriate.

In many of the areas concerned, the initiatives announced in this Action Plan will benefit from the work of the European Defence Agency (EDA), notably on the Capability Development Plan,<sup>21</sup> R&T priorities and the Key Strategic Activities.<sup>22</sup>

## **2. Launching a European Defence Fund**

In his State of the Union speech of 14 September 2016, President Juncker called for the creation of European Defence Fund. This Fund would consist of two distinct financing structures ('windows'), which are complementary and would be phased in over time:

(i) A **"research window"** to fund collaborative defence research projects at the EU level. This would be developed through the launch of a Preparatory Action and should

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<sup>19</sup> Directive 2009/43/EC of the European Parliament and of the Council, simplifying terms and conditions of transfers of defence-related products within the Community, OJ L 146, 10.6.2009, p. 1; Directive 2009/81/EC of the European Parliament and of the Council on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, OJ L 216, 20.8.2009, p. 76.

<sup>20</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions "Towards a more competitive and efficient defence and security sector", COM(2013)542 final.

<sup>21</sup> See EDA at: <https://www.eda.europa.eu/what-we-do/eda-priorities/capability-development-plan>

<sup>22</sup> i.e. technologies, skills, industrial manufacturing capacities.

result in a dedicated EU programme in the post-2020 EU multiannual financial framework.<sup>23</sup>

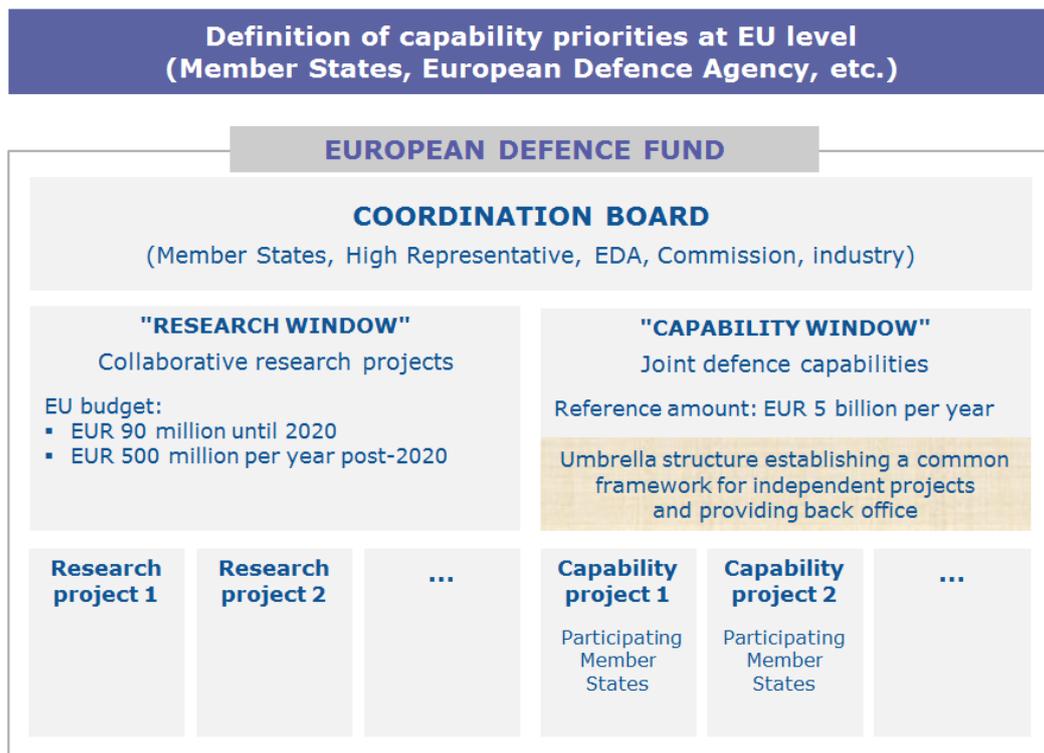
(ii) A **"capability window"** to support the joint development of defence capabilities<sup>24</sup> commonly agreed by Member States. This would be financed through the pooling of national contributions and, where possible, supported by the EU budget.

The "research window" and the "capability window" will be complementary but distinct in their legal nature and sources of financing.

The "windows" will be complemented by a coordinating mechanism in the form of a **Coordination Board**, bringing together the Commission, the High Representative, the Member States, the European Defence Agency, as well as industry as appropriate.

The primary task of the Coordination Board will be to ensure consistency between the research and the capability "windows" to better support the development of capabilities agreed by the Member States. These capabilities are identified according to separate processes, including those of the European Defence Agency and the Member States-driven Coordinated Annual Review on Defence to be proposed by the High Representative in line with Council Conclusions.

**Graph 1. Towards a European Defence Fund**



<sup>23</sup> The relationship with the multiannual research framework programme foreseen in Article 182 TFEU will be determined as part of the new multiannual financial framework.

<sup>24</sup> For the purpose of this Action Plan, defence capabilities refer to military assets, including the necessary material equipment and technologies spanning all relevant domains. It does not include defence operations or other elements necessary to manage defence capabilities such as training, personnel and logistics.

## **The "research window": funding research in defence technologies and products**

Defence research in innovative technologies, products and services is key to safeguarding the long-term competitiveness of the defence sector and, ultimately, Europe's strategic autonomy. However, defence Research and Technology (R&T) expenditure has suffered from significant cuts in national budgets.<sup>25</sup> Between 2006 and 2013, defence R&T expenditure in the 27 Member States participating in the EDA has been reduced by 27%.<sup>26</sup> In 2014, EU27 defence R&T expenditure amounted to circa EUR 2 billion. This has not been compensated by greater cooperation: over the same period, collaborative defence R&T has decreased by more than 30%.

During the period 2006-2011, the US spent an average of EUR 9 billion per year on defence R&T and an average of EUR 54.6 billion per year on defence R&D. The US effort will continue and even increase as a consequence of the 3<sup>rd</sup> Offset Strategy. Between 2012 and 2015, Russian R&D in defence has doubled, while China, according to available data, is also increasing its investment in R&D.

More investment in defence research is required both at the national and the EU levels to strengthen the EU scientific and technological base in the area of defence technologies, products and services. The Commission is therefore ready to mobilise EU funds to support defence research at the EU level. However, such funds must complement and catalyse national efforts, and not duplicate or substitute them.

The Commission intends to launch a Preparatory Action on Defence Research in 2017, as called for by the European Council, with a budget of EUR 90 million for the period 2017-2019.<sup>27</sup> This will be a first step, limited in time and in budget, which will serve to test the added-value of the EU budget supporting defence research. The Commission will consider a delegation agreement with EDA on certain tasks related to the implementation of the preparatory action. The research topics will be established in the work programme following the comitology principles.

If Member States agree with this Action Plan, the Preparatory Action will pave the way for the "research window" to take the form of a European defence research programme within the next multiannual financial framework post 2020. This programme should be of a credible size. Given the importance of defence research investment, the scale of existing national defence research budgets and the high costs of developing cutting-edge defence technologies, such a "window" may need an estimated annual budget of EUR 500 million in order to make a substantial difference in line with the conclusions of the Group of Personalities on European defence research,<sup>28</sup> as well as with the recent report of the European Parliament on this matter.<sup>29</sup> This amount would place the EU among the top 4 of defence research & technology investors in Europe.

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<sup>25</sup> Defence Research and Development (R&D) expenditure covers any R&D projects up to the point where expenditure for production of equipment starts to be incurred. R&D includes R&T. See definition at: <https://www.eda.europa.eu/info-hub/defence-data-portal/definitions>

<sup>26</sup> European Parliament Study, "The Future of EU defence research", 2016. Other figures in this paragraph come from this source.

<sup>27</sup> European Council conclusions of 19/20 December 2013, EUCO 217/13.

<sup>28</sup> See: <http://www.iss.europa.eu/publications/detail/article/report-of-the-group-of-personalities-on-the-preparatory-action-for-csdp-related-research>

<sup>29</sup> See European Parliament report on "the European Defence Union (2016/2052(INI))" adopted on 22 November 2016 which notes that "the European Defence Research Programme will need a total budget of

The programme should focus on a limited number of key research projects linked to defence capability priorities agreed by Member States. This will ensure a cost-efficient allocation of resources, discourage unnecessary duplication and make use of economies of scale.<sup>30</sup> EU-funded research should target critical defence, as well as innovation-driven technologies, based on excellence.

The governance of the programme will be subject to EU budgetary rules and should take account of the specificities of the defence sector. Several options will be explored to structure a dialogue between the Commission, the Member States and industry on the implementation of the future "window", for instance through the possibility of technological platforms. This dialogue will benefit from EDA's activities in the areas of R&T and capabilities priorities, as well as Key Strategic Activities. As mentioned by the Group of Personalities,<sup>31</sup> the Programme Committee should be composed of Member States' representatives, work through the "comitology procedure" and assess the EU added value of projects, especially as Member States are the end-users in the defence sector.

Financing would come mainly through grants, but the possibility to use pre-commercial procurements<sup>32</sup> in the specific case of defence research will also be explored. Such projects will require the participation of research institutes and companies from several Member States and encourage the participation of SMEs, including those working on dual-use innovation. Specific Intellectual Property Rights (IPR) rules should be laid down, taking into account the experience of the Preparatory Action.

Defence technologies developed through the Preparatory Action and the future Programme may also meet civilian needs. Synergies should be encouraged to boost innovation for the wider civil economy, such as technologies on cyber defence while avoiding any duplication. Conversely, civilian research could also be used to support the defence industry. Horizon 2020<sup>33</sup> can be used for boosting fundamental research and innovation, in particular through promoting a cross-fertilisation effect. The Commission will bring together, as of 2017, defence industry and civilian innovative industries benefiting from Horizon 2020 funding to encourage spill-overs concerning potential disruptive technologies and new processes into the defence industry.

### **The "capability window": financing the joint development of defence capabilities**

Besides the importance of developing European cooperation in defence research, there is a need to go further and ensure support for the whole development cycle of defence

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at least EUR 500 million per year over that period in order to be credible and make a substantial difference".

<sup>30</sup> For instance, EU funded research could support technologies for the development in Europe of Remotely Piloted Aircraft Systems (such as drones), as well technologies to support the monitoring and security of EU borders, including to enhance border protection and maritime security (including maritime and air support assets for the necessary maritime and air security operations).

<sup>31</sup> <http://www.iss.europa.eu/publications/detail/article/report-of-the-group-of-personalities-on-the-preparatory-action-for-csdp-related-research/>

<sup>32</sup> Pre-commercial procurement (PCP) is an approach for procuring R&D services, enabling public procurers to share the risks and benefits of designing, prototyping and testing a limited volume of new products and services with the suppliers.

<sup>33</sup> Regulation (EU) no 1291/2013 of the European Parliament and of the Council of 11 December 2013 establishing Horizon 2020 - the Framework Programme for Research and Innovation (2014-2020) and repealing Decision No 1982/2006/EC, OJ L 347 of 20.12.2013, p. 104.

capabilities. Despite the obvious economic and other advantages of working together, Member States continue to face important obstacles hampering the development of collaborative programmes.

The lack of coordination and joint capability planning at the EU level reduces efficiencies in public spending and Member States' investments, while resulting in unnecessary duplications. Moreover, the lack of synchronisation of individual budget contributions leads to considerable delays in the launch and conduct of collaborative programmes. Finally, the increasing costs of complex defence capabilities may be prohibitive for Member States investing alone and therefore the pooling of national resources for capabilities would lead to budgetary savings and maximise the value for money of defence investments.

The "capability window" of the Fund would seek to address these obstacles. It would secure joint financing of the development and procurement of strategic capability priorities. These would be jointly agreed by Member States and could include dual-use priorities which are relevant to the implementation of EU policies.<sup>34</sup> This "window" would focus on the post-R&T phases, including prototypes as well as the development and procurement of products and technologies.

As a first estimate, a reference amount of EUR 5 billion per year could serve as an objective. This would correspond to 2.5% of total national spending on defence within the EU and to 14% of national spending on defence capabilities. It would also fill the gap towards the target agreed by EDA's Member States to spend 35% of their equipment spending in collaborative projects.<sup>35</sup> This reference should be further refined based on a scoping exercise to be conducted together with the Member States.

The specifics of this "capability window" will need to be developed further in close cooperation with Member States, the High Representative, including in her capacity as Head of the European Defence Agency, and other relevant stakeholders. This will be done in line with the Treaties and existing mandates and in such a way as to maximise synergies and to avoid duplications. In particular, this shall respect the work of the High Representative to explore the potential of Permanent Structured Cooperation pursuant to the mandate given by Council. The identification of priorities and the ownership of the capabilities would clearly remain with the Member States, which would also operate such capabilities. Cooperation is expected to develop over time.

The "capability window" could build on two levels:

- A first level, open to all Member States, would consist of an "**umbrella structure**". It would set out the common framework for supporting Member States, as well as provide the operational back-office for the development of specific projects through common rules and applicable legal and financial tools

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<sup>34</sup> For instance, drones which could be used for border surveillance.

<sup>35</sup> Over the period 2010-2014, EDA's Member States have spent, on average, 19.6% of their total equipment spending into collaborative equipment projects, the equivalent of EUR 7.56 billion per year. This falls short by EUR 5.84 billion per year from the agreed target.

for operating the projects. . It could also help smooth Member States' budgetary requirements and overcome the lack of synchronisation of national budget cycles.

- The second level would consist of **specific projects to develop joint capabilities** on the basis of the voluntary participation of Member States. The financial and operational decision-making related to specific projects and its financing modalities would rest with the Member States participating in each project, within the rules set out at the level of the umbrella structure. There could be different groups of Member States participating in the different individual projects.

The development of joint capabilities would be financed through the pooling of contributions from Member States deciding to participate. This will ensure their sustained co-financing over time. Each contribution would be confined to individual projects, which would be defined ex ante by participating Member States. The projects would hence be financially independent and limited in time as well as in size, thus excluding any form of financial cross-liability between projects.

If needed and agreed, the "umbrella structure" and/or the individual projects may be used to issue project-related debt instruments. Such instruments could either be backed by Member States' specific payment lines for the individual project, or through additional guarantees/paid-in capital, either at the level of the individual project, or at the level of the umbrella structure. In the latter case, the umbrella structure could be endowed with its own capital base.<sup>36</sup>

National capital contributions to the "capability window" will be treated as "one-offs" under the Stability and Growth Pact, which means that they will be discounted from the structural fiscal effort expected to be accomplished by Member States. The same treatment will apply to guarantees to the extent that they have an impact on deficit and/or debt.<sup>37</sup>

The Commission is ready to explore all financing options from the EU budget to the "capability window", in accordance with the Treaties. Such a contribution could notably be provided for the technological development and demonstration of projects, including prototypes. The Commission will also consider the possibility of supporting feasibility studies and testing facilities. The EU budget could also support dual-use products and technologies. Finally, the administrative expenditure of this "window" could be charged to the Union budget.

The Commission stands ready to support this "window" with its financial and technical expertise.<sup>38</sup> Member States' experience and ongoing work in the context of EDA for the creation of a Cooperative Facility Mechanism should also be taken into account.

*Further to President Juncker's State of the Union speech, and in light of further discussion with EU institutions, a European Defence Fund should be set up. The Commission proposes the following way forward.*

<sup>36</sup> The purpose of a permanent capital structure could be two-fold: enhancing the credit worthiness of the window and facilitating the fungibility of individual debt issuances.

<sup>37</sup> As for instance clarified for the European Fund for Strategic Investments in the Commission Communication COM(2015)12 of 13 January 2015 on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact".

<sup>38</sup> In line with the Pringle case law (ECJ Case C-370/12 (Pringle) of 27 November 2012).

*For the "research window":*

- *Upon agreement of the EU budget for 2017 by the European Parliament and the Council, the Commission will launch a Preparatory Action in 2017 with a proposed budget of EUR 25 million in the first year and an overall budget of an expected EUR 90 million over three years.*
- *Under the post-2020 multiannual financial framework, if Member States agree with this Action Plan, the Commission will propose a dedicated defence research programme with an estimated amount of EUR 500 million per year.*

*For the "capability window":*

- *The Commission will work closely with the Member States, together with the High Representative, also in her capacity as head of EDA, to develop further the modalities and governance of the capability window in order to support Member States' joint development of specific capability projects.*
- *As an order of magnitude, such window should be able to mobilise about EUR 5 billion per year. The first steps should be taken in 2017. The Commission will launch, without delay in 2017, a scoping study to refine this estimate. Based on the further discussions with the other institutions, the Commission stands ready to facilitate the development of the "capability window". The Commission will explore all financing options from the EU budget to the "capability window", under the Treaties. It also stands ready to support it with its financial and technical expertise.*

### **3. Fostering investments in defence supply chains**

The European Defence Fund will be a crucial step to support the competitiveness of the European defence industry. Additional actions are however necessary to allow the defence industrial base to remain innovative and competitive and, ultimately, be able to deliver Europe's capability needs. Particular attention must also be given to promote access to finance to SMEs and to non-traditional suppliers and foster investments in the defence supply chains.

#### **Access to finance for SMEs and investments in the defence sector**

SMEs and intermediate companies are, in many Member States, the backbone of their defence sector and central to the European defence industrial base and the value chain. European SMEs or subsidiaries of the major defence producers (prime contractors and sub-contractors) often offer dual-use goods or services in a wide range of industries.<sup>39</sup> At the same time, they are the most vulnerable part of the defence supply chain to access fresh capital needed for new investments. Innovation, and the most disruptive technological shifts, is performed outside of large groups, within an ecosystem of start-ups<sup>40</sup> and SMEs. They do not benefit from the necessary funding to further scale up, which ultimately hinders them to successfully integrate into the defence supply chains. Financial institutions often choose not to support companies in the defence sector because of the risks involved.

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<sup>39</sup> E.g. energy, telecom and ICT, automotive, material, chemical, aeronautics and space.

<sup>40</sup> Innovative civil technologies could impact directly the military sector (e.g big data analytics).

Within the limitations of the Treaties, and the decision making bodies of the European Investment Bank (EIB), the EIB group can provide loans, guarantees and equity products for the expansion of current dual-use activities, which would unlock new opportunities for certain parts of defence supply chain, notably for SMEs and mid-caps. This could also have positive spill-over effects to national financial intermediaries and development banks. A number of EU financial instruments which are based on EIB lending, for example the European Fund for Strategic Investment<sup>41</sup> (EFSI) or the Programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME) could help in dual-use defence-related activities. EFSI could guarantee EIB or EIF financing and investment operations supporting the objectives listed in the EFSI Regulation, including for projects related to the defence sector.

Adapting further the lending criteria<sup>42</sup> within the EIB Group for the defence sector, within the limitations of the Treaties<sup>43</sup> and subject to the necessary decisions by the relevant EIB bodies, would benefit Member States, whose defence industry is mainly made of SMEs.

*The Commission will support, within the decision-making bodies of the EIB, the adaptation of the EIB lending criteria to the defence sector within the limits of the Treaties. The Commission invites the Member States to support this process.*

### **Strengthening the support of EU funds to investment in defence**

European Structural and Investment Funds (ESIF) may be used by Member States in the defence sector as long as they contribute to the objectives of the fund in question to (i) co-fund productive investment projects, and (ii) support the modernisation of the defence supply chains. Defence industries can contribute to the goals and the objectives set in the ESIF, such as promoting the development of regional economics, representing a high investment multiplier on skills, jobs, technological and economic development.

Investments in defence contributing to regional development within the meaning of Article 174 TFEU, may receive regional aid. The European Regional Development Fund (ERDF) may fund defence activities and dual-use activities in research and innovation, as part of a national, or regional, smart specialisation strategy. The Commission invites local and regional managing authorities, who specify the investment calls and selection procedures the investment projects, to support SMEs and intermediate companies also active in defence supply chains.

*The Commission will promote co-financing through the European Structural and Investment Funds of productive investment projects and modernisation of the defence supply chains in the defence sector, provided that the investment strengthens economic, social and territorial cohesion. The Commission will, in coordination with Member States, further promote such funding opportunities.*

### **Encouraging the development of regional clusters of excellence**

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<sup>41</sup> Regulation (EU) 2015/1017 of the European Parliament and of the Council of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations (EU) no 1291/2013 and (EU) no 1316/2013 — the European Fund for Strategic Investments, OJ L169 of 1.7.2015, p.1

<sup>42</sup> <http://www.eib.org/about/documents/excluded-activities-2013.htm>

<sup>43</sup> Cf. Article 1 of Protocol No 5 on the Statute of the European Investment Bank.

Regional clusters specialising in industrial niches (also known as “clusters of excellence”) allow large firms, SMEs and research centres to work in close geographic proximity in order to increase R&D collaboration and specialise in a specific technology area (e.g. aircraft engines). While the decision to prioritise regional clusters rests in the hands of local and regional government actors, EU financing (including through EIB) could lead to successful technology demonstrator projects and the development of industrial and scientific partnerships between firms and research centres<sup>44</sup>.

Furthermore, the Commission has launched the European Network of Defence-related Regions<sup>45</sup> to support EU regions with important relevant industrial and research assets and to share best practices on integration defence-related priorities into their smart specialisation strategies. The Commission will encourage Member States to promote regional clusters of excellence, benefitting the defence sector.

### **Supporting skills in defence**

The European defence industry has to retain key skills and acquire new ones to be able to deliver high-tech defence products and services to meet security needs and compete in a global market long into the future. However, companies are experiencing increasing skill shortages.

Defence will be a priority sector under the Blueprint initiative of the New Skills Agenda for Europe<sup>46</sup>. Moreover, the Commission will also support the setting-up of an industry-led European Defence Skills Alliance to deliver a sectoral skills strategy. The Alliance will contribute to the development and implementation of scalable and sustainable solutions for new jobs and skills needs. This will be done by making use of the COSME<sup>47</sup> and Erasmus+<sup>48</sup> instruments to run pilot projects. The Commission will consider further measures to improve the knowledge and innovation base on dual use.

*Under the 'Blueprint for Sectoral Co-operation on Skills' the Commission will, as of 2017, support strategic cooperation between the key stakeholders in the Defence Sector.*

## **4. Strengthening the single market for defence**

Opening up financial support to investments in the defence sector cannot deliver sustainable results without an efficient defence industry operating in a genuine and innovation-enhancing Single Market. Increased financing opportunities will not deliver in a meaningful way if they are used ineffectively.

More competition, and a greater openness of the defence market in Europe, should help suppliers to achieve economies of scale, optimise production capacity and lower unit

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<sup>44</sup> Special focus could be given to priority areas, such as maritime security, cyber-security, Remotely Piloted Aircraft Systems and satellite communications.

<sup>45</sup> EDNR, [www.endr.eu](http://www.endr.eu)

<sup>46</sup> COM (2016) 381 final.

<sup>47</sup> Regulation (EU) No 1287/2013 of the European Parliament and of the Council of 11 December 2013 establishing a Programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME) (2014 - 2020), OJ L 347, 20.12.2013, p. 33.

<sup>48</sup> Regulation (EU) No 1288/2013 of the European Parliament and of the Council of 11 December 2013 establishing 'Erasmus+': the Union programme for education, training, youth and sport, OJ L 347, 20.12.2013, p. 50.

production costs, thus making European products more competitive on the global market. Competition should take place both at the level of prime contractors and suppliers.

### **Towards an open and competitive European defence equipment market**

The two Directives on procurement and on EU transfers were adopted with a view to improve the functioning of the defence market and increasing competition, while taking account the specificities of the defence sector. If fully applied, they can make a significant contribution to achieving the goal of an integrated open and competitive European Defence Equipment Market. However, much more needs to be done in this respect.

The evaluations of the two Directives show that they are broadly fit for purpose and that no legislative amendment is necessary at this stage. However, they also identify a number of shortcomings that need to be addressed.

In particular, the evaluation the defence procurement Directive<sup>49</sup> indicates that, despite a more than twofold increase in the value of the contracts published EU-wide, a very significant share of defence procurement is still done outside EU public procurement rules<sup>50</sup>. This means that there is still a significant untapped potential under the Directive to generate further public savings and opportunities for jobs and growth. Furthermore, public authorities still use, to some extent, offsets/industrial return requirements which can lead to uncertainties for the industry. Finally, the subcontracting provisions of the Directive, which enable procurement authorities to require the successful tenderer to subcontract a share of the contract to third parties via competitive tendering, are rarely used.

The Commission will focus on the effective implementation of the Directive, including through enforcement. It will clarify the interpretation of exclusions of the Directive to support procurement authorities in the application of the rules: the adoption of the notice on government-to-government contracts is a first step in this direction. The Commission will also revise the guidance on the subcontracting provisions in order to increase flexibility for procurement authorities. Finally, the Commission will provide guidance, encouraging Member States to fully use the flexibility of the Directive for cooperative procurement.

The EU transfers Directive introduces a simplified licencing system for intra-EU transfers of defence-related products, including through General Transfer Licences (GTLs). Its evaluation<sup>51</sup> shows that, despite its positive contribution to increased transparency and costs savings for companies, different licencing systems across Europe still exist, with large variations in the content of GTLs and differences in the national requirements for companies' certification and different use of exceptions. Furthermore,

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<sup>49</sup> Report from the Commission to the European Parliament and the Council on the implementation of Directive 2009/81/EC on coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security.

<sup>50</sup> In 2014, 77.9% of all equipment procurement took place at national level, thereby depriving countries of the cost savings that come with scale Source: EDA Defence booklet data 2014 with estimates on 2015.

<sup>51</sup> Report from the Commission to the European Parliament and the Council on the implementation of Directive 2009/43/EC simplifying terms and conditions of transfers of defence-related products within the Community.

most Member States have not implemented the exception from prior authorisation and transfers for collaborative programmes. The Commission will focus on the effective implementation of the Directive, including through enforcement. Together with this Action Plan, two recommendations are adopted to encourage a harmonised functioning of the GTLs for armed forces and for certified enterprises. In addition, the Commission will explore further harmonisation of the remaining two GTLs, simplify certification where possible, and promote its take-up across Member States.

*The Commission will focus on the effective implementation of the two defence Directives, including through enforcement. Starting with the adoption of the Action Plan, it will clarify the interpretation of specific provisions of the defence procurement Directive through the adoption of guidance notices in 2017-18 and adopt recommendations for a harmonised functioning of General Transfer Licences in the first quarter of 2018.*

### **Strengthening security of supply**

Security of supply is also a cornerstone to the establishment of a genuine single market for defence and is key to future cooperative programmes. Member States need to be confident that cross-border deliveries will not be disrupted. Strengthening security of supply at EU level implies enhancing mutual trust among Member States.

Certain measures, such as contract performance conditions, can help strengthen mutual trust among Member States regarding transfers of defence-related products. The Commission will therefore issue guidance on measures that Member States can take under EU public procurement law to reinforce security of supply.

The Commission supports the initiative of Member States, through the EDA, for a political commitment to facilitate transfers of defence-related and to provide mutual assistance in times of crisis. The Commission takes note of Member States' unwillingness to go beyond such a political commitment at this stage and agree on an EU-wide regime on Security of Supply.

The Commission will, within the framework of the EU Raw Materials Strategy<sup>52</sup>, identify bottlenecks and supply risks linked to the materials that are necessary for the development of key capabilities building on the findings of a recent study<sup>5354</sup>. Future EU research programmes could also be used to mitigate supply risks, including substitution of critical raw materials, building on the work in the area of Key Enabling Technologies (KETs).

Finally, the Commission's Circular Economy<sup>55</sup> principles, i.e. new technological solutions and business models with more sustainable production, consumption and waste management, should also be applied to the defence sector, in which resource efficiency

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<sup>52</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions making raw materials available for Europe's future well-being -proposal for a European innovation partnership on raw materials, COM/2012/082 final.

<sup>53</sup> Pavel, C. and Tzimas, E., Raw materials in the European defence industry. Luxembourg, European Commission, Joint Research Centre (JRC), 2016.

<sup>54</sup> E.g. beryllium is used in missiles, fighter jets, helicopters and satellites (because it is six times lighter and stronger than steel).

<sup>55</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Closing the loop - An EU action plan for the Circular Economy, COM/2015/0614.

and security of supplies are increasingly important. In addition, there are potentially major savings through greater use of energy efficiency measures and of renewable energy in the EU armed forces, which are major consumer of energy.

### **Improve cross-border market access for SMEs in the defence sector**

Fostering cross-border market access, and the opening of supply chains, is crucial for an efficient and effective European Defence Equipment Market, while ensuring respect of contractor's commercial freedom. In particular, as regards sub-suppliers, which are often SMEs, there is a need to ensure a fair chance to access defence supply chains, regardless of their location within the Single Market.

There are no “miracle solutions” to this complex issue, but gradual progress is needed. Based on the report of the *ad hoc* expert group with Member States and the industry<sup>56</sup>, the Commission will make recommendations to encourage procurement authorities to facilitate cross-border and SMEs participation in defence procurement procedures<sup>57</sup> and prime contractors to give opportunities to sub-suppliers and SMEs from all Member States to access their supply chains<sup>58</sup>. The Commission’s recommendations should be complemented by voluntary instruments, signed by relevant parties, including prime contractors and business associations.

*The Commission will adopt recommendations, by the end of 2017, encouraging procurement authorities to facilitate cross-border and SME participation in defence procurement procedures and facilitate their access to defence supply chains.*

### **Standardisation and conformity assessment**

Certification and standardisation are critical enablers for cooperation as they reinforce interoperability and lead to cost savings. The EDA already supports Member States to develop a common approach to airworthiness certification through the European Military Airworthiness Requirements (EMARs) initiative.

The Commission has developed the concept of "hybrid standards" for dual-use<sup>59</sup> products to support security-related research. In implementing the Communication on cybersecurity<sup>60</sup>, the Commission, in cooperation with Member States and industry, is developing a European certification framework<sup>61</sup> and explores a voluntary labelling

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<sup>56</sup> European Commission Advisory group on cross-border access for SMEs to defence and security contracts, Final report and recommendations.

<sup>57</sup> E.g. providing early information about long-term plans and priorities, using pre-procurement advertising, designing public procurement procedures to facilitate cross-border and SMEs participation.

<sup>58</sup> E.g. transparent strategic long-term plans, pre-procurement and subcontracting advertising, EU-wide market searches and scouting to identify potential suppliers across different Member States, being transparent about the cross-border elements of their supply chains.

<sup>59</sup> Security Industrial Policy - Action Plan for an innovative and competitive Security Industry COM(2012) 417, July 2012.

<sup>60</sup> Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Strengthening Europe's Cyber Resilience System and Fostering a Competitive and Innovative Cybersecurity, 5.7.2016, COM(2016)410 final.

<sup>61</sup> In line with the Joint Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Cybersecurity Strategy of the European Union: An Open, Safe and Secure Cyberspace, 7.2.2013, JOIN(2013)1.

framework for the security of ICT products. In view of the synergies between the civil and military sectors, the defence sector could benefit from these developments.

A new mechanism to monitor and initiate the development of defence and hybrid standards was agreed between the Commission, EDA and Member States<sup>62</sup>. One option being explored is the possible development of European standards through the processes established by the European Standardisation Organisations<sup>63</sup>.

*The Commission, within its competences, will consider supporting the development of standards that Member States have identified as necessary for co-operative projects in priority areas.*

## **5. Maximising civil/military synergies across EU policies**

There is also a need to increase the coherence and synergies between defence issues and other relevant Union policies and sectors, thereby fully exploiting the EU's added value.

In line with the European Space Strategy, investing in space capabilities will enable Europe's access to space and safe use<sup>64</sup>, ensuring its freedom of action and autonomy. The Commission is committed to contribute to ensuring the protection and resilience of critical European civil and military space infrastructure, enhancing the existing EU space surveillance and tracking (SST) support framework<sup>65</sup>.

As underlined by the Space Strategy, space services can also strengthen the EU's and Member States' capacity to tackle growing security challenges. The Commission will seek to maximise synergies and complementarity with relevant activities of the EU Satellite Centre in the area of space security and defence.

Under the currently evolving threat environment, the mismatch between governmental satellite communications (SATCOM) user needs, and timely and appropriate solutions, increasingly creates risks to key mission security operations and infrastructures of the Union and its Member States.

*The Commission, in cooperation with the High Representative, EDA and the European Space Agency, is preparing an initiative to ensure reliable, secured and cost-effective satellite communications services for EU and national authorities managing security critical missions and infrastructures by the end of 2017.*

To improve the EU's ability to respond to evolving security challenges related to border controls and maritime surveillance, the Commission will expand Copernicus<sup>66</sup> capabilities taking into account new technological developments in the sector, the need to

<sup>62</sup> <https://www.eda.europa.eu/what-we-do/activities/activities-search/materiel-standardisation>

<sup>63</sup> Regulation (EU) No 1025/2012 of the European Parliament and of the Council of 25 October 2012 on European standardisation (OJ L 316, 14.11.2012, p. 1).

<sup>64</sup> COM(2016) 705 - Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions.

<sup>65</sup> Decision No 541/2014/EU of the European Parliament and of the Council of 16 April 2014 establishing a Framework for Space Surveillance and Tracking Support, OJ L 158, 27.5.2014, p. 227.

<sup>66</sup> Regulation (EU) No 377/2014 of the European Parliament and of the Council of 3 April 2014 establishing the Copernicus Programme, OJ L 122, 24.4.2014, p. 44.

ensure adequate level of security of the infrastructure and services, the availability of different data sources and the long-term capacity of the private sector to deliver appropriate solutions.

*The Commission shall explore how Copernicus could cover further security needs, including defence. It shall strengthen security requirements and will reinforce synergies with non-space observation capabilities in 2018.*

Considering the evolving importance of the cyber domain and its dual-use nature, synergies should be sought between cyber defence efforts and wider EU cyber security policies. The Joint Communication on a Cyber Security Strategy<sup>67</sup> sets out measures to enhance the cyber resilience of IT systems, reduce cybercrime and strengthen EU international cyber security policy and cyber defence. Cyber security training should be reinforced, taking into account the work of the European Cyber Crime Training and Education Group and other similar activities.

*The Commission will work in close cooperation with Member States, the High Representative and other relevant EU bodies to establish a cyber-training and education platform to address the current skills gap in cyber security and cyber defence by 2018.*

In the field of aviation, although Single European Sky<sup>68</sup> (SES) and Single European Sky Air Traffic Management Research (SESAR)<sup>69</sup> are focused on civil aviation's objectives, military aviation's needs should be taken into consideration to avoid adverse impacts on the defence sector. The use of RPAS (drones) for security purposes requires their effective integration into the aviation system based on, amongst other things, a coordinated civil-military effort, including of R&D programmes. In this respect, the civil/military coordination mechanism between the EDA, the European Aviation Safety Agency and the SESAR Joint Undertaking should help to better exploit the results of military research activities in the context of the SESAR 2020 programme and the associated safety rules and standards.

In line with the objectives of the EU Maritime Security Strategy<sup>70</sup>, dual use capability solutions can ensure that both military and civilian authorities could benefit from relevant technologies, products and services. Such solutions developed by the defence industry could be effective in addressing security-related fields, such as maritime surveillance, risk management and protection of critical infrastructures.

*By 2018, the Commission will, in cooperation with the High Representative, EDA and Member States, develop specific actions to support a co-ordinated civil military maritime security research agenda and interoperable maritime surveillance capabilities.*

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<sup>67</sup> Joint Communication to the European Parliament and the Council, the European Economic and Social Committee and the Committee of the Regions, Cybersecurity Strategy of the European Union: an Open, Safe and Secure Cyberspace, 7.2.2013, JOIN(2013) 1 final.

<sup>68</sup> Regulation (EC) No 549/2004 of the European Parliament and of the Council of 10 March 2004 laying down the framework for the creation of the single European sky, OJ L 96, 31.3.2004, p. 1.

<sup>69</sup> Council Regulation (EU) No 721/2014 of 16 June 2014 amending Regulation (EC) No 219/2007 on the establishment of a Joint Undertaking to develop the new generation European air traffic management system (SESAR) as regards the extension of the Joint Undertaking until 2024, OJ L 192, 1.7.2014, p. 1.

<sup>70</sup> Joint Communication to the European Parliament and the Council For an open and secure global maritime domain: elements for a European Union maritime security strategy, 6.3.2014 JOIN/2014/09.

## 6. Conclusions

President Juncker called for Europe to strengthen its defence policy. Europe has to take responsibility for protecting its interests, values and the European way of life. It is facing complex security challenges and no Member State can meet those challenges on its own.

Within this context, the European Union can complement national efforts and become an important security provider in its own right. The High Representative's Implementation Plan on Security and Defence<sup>71</sup> and the related Conclusions adopted by the Council, as well as this Action Plan, support the development of key capabilities necessary for the security of the Union and its citizens. The Implementation of the EU-NATO Joint Declaration will further contribute to ensuring complementarity with NATO.

The Commission will, in close cooperation with Member States and the High Representative, including in her capacity as head of EDA, set up an Implementation Steering Group, meeting on a regular basis, to monitor and facilitate progress in the Actions. A first meeting will take place in the first quarter of 2017. It will also establish a consultation forum with the European defence industry to best align the supply and the demand sides.

The Commission is ready to engage at an unprecedented level in defence to support Member States. It will exploit the EU instruments, including EU funding, and the full potential of the Treaties, towards building a Defence Union.

However, the adoption of this Communication by the Commission is only a first step. A strong support from the Member States and EU Institutions will be required to realise the full potential of the European Defence Action Plan. The Commission will launch the implementation of the ambitious set of actions set out in this document. On basis of further discussions with other EU institutions, the Commission also stands ready to facilitate the implementation of the European Defence Fund.

Based on a strong and shared commitment between the Member States and the institutions, the European Defence Action Plan can become a game changer for more European defence cooperation and greater solidarity between Member States.

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<sup>71</sup> See Foreign Affairs Council Conclusions of 14.11.2016.