



NATO Parliamentary Assembly

ECONOMICS AND SECURITY  
COMMITTEE

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THE STATE OF EUROPE'S DEFENCE  
INDUSTRIAL BASE

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GENERAL REPORT

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## I. INTRODUCTION

1. Whereas the members of the Alliance reaffirmed in Warsaw their commitment to devote 2% of their respective GDP on defence, while dedicating at least 20% of those budgets to investment, care should be taken to ensure that the state of the defence market is such that these objectives can be achieved. It is also essential to identify bottlenecks while proposing ways that would enable the Allies to form an industrial base for defence that is commensurate with their common ambitions. European countries must be capable of constituting the European pillar of NATO by creating a European defence identity that is neither redundant nor competing with NATO's posture. This is indispensable against a background where budget resources are becoming scarce, while threats are multiplying and the burdensharing debate remains high on the transatlantic agenda.

2. This development nonetheless requires that an essential prerequisite be lifted and that European states opt to share their sovereignty on this front. Defence is actually the area in which states wish to preserve their autonomy, independence and national sovereignty: soldiers fight for their country, not for a supranational entity. Countries tend to define different limits of their national sovereignty, depending notably on their history. Many turn to bilateral cooperation with their close allies and often do not raise these issues in multilateral fora. Times are changing, nevertheless, and the notion of shared sovereignty on defence stakes in the face of new threats is gaining ground in Europe, as attested to by recent Franco-German and European initiatives, including in the defence industry. The United States does not face this problem, which explains in large measure the differences that this report will outline between the US and European countries.

3. At the NATO Summit in Warsaw in July 2016, the EU and NATO outlined areas in which they might bolster their cooperation: the fight against hybrid threats, improvement of resilience, building up defence capacities, cyberdefence, maritime security and joint exercises. The importance of such close cooperation between the two organisations to develop a "global approach" to the management of crises and operations was also reiterated. This European pillar of NATO will be capable of bearing its fair share of the burden, but only if the defence industrial base enables it to secure a degree of strategic autonomy thereby allowing it to make a fair contribution to NATO's operations.

4. Defence economics is often treated as a discipline separate from economics, and therefore the defence market is at times seen as somehow operating outside of normal market constraints. This is a fallacy, even if defence markets are different because governments are essentially the sole consumers of goods produced in these markets. Enduring conditions of supply and demand, the constant need for ongoing investment, research and development, and competition among firms are all persistent features of defence markets, at least in Western societies, even if unique client-producer conditions and the important role of the state add caveats to normal market functioning.

5. Defence markets as such are also in a state of flux. The once clearly delimitation between commercial and defence markets has become less distinct as military equipment incorporates rising shares of dual use and commercially available technologies. Where defence economists once spoke of the phenomenon of "spin-off" - or technologies developed for the defence sector that were later discovered to have commercial applications - they now refer to "spin-in" - or technologies developed for the commercial sector which are found to have important military applications.

6. Another important feature of the transatlantic defence industrial landscape, is that European defence markets remain highly fragmented and, until recently, exempted from the purview of European Union market rule making. By contrast, the United States essentially enjoys a recently consolidated defence market, characterised by very significant economies of scale. Europe's overarching challenge consists of creating as seamlessly integrated a defence market as possible. The US challenge, meanwhile, is to reduce some of the inefficiencies that, at least in part, are the product of district and state-level protectionist inclinations that lead to sub-optimal deployment of

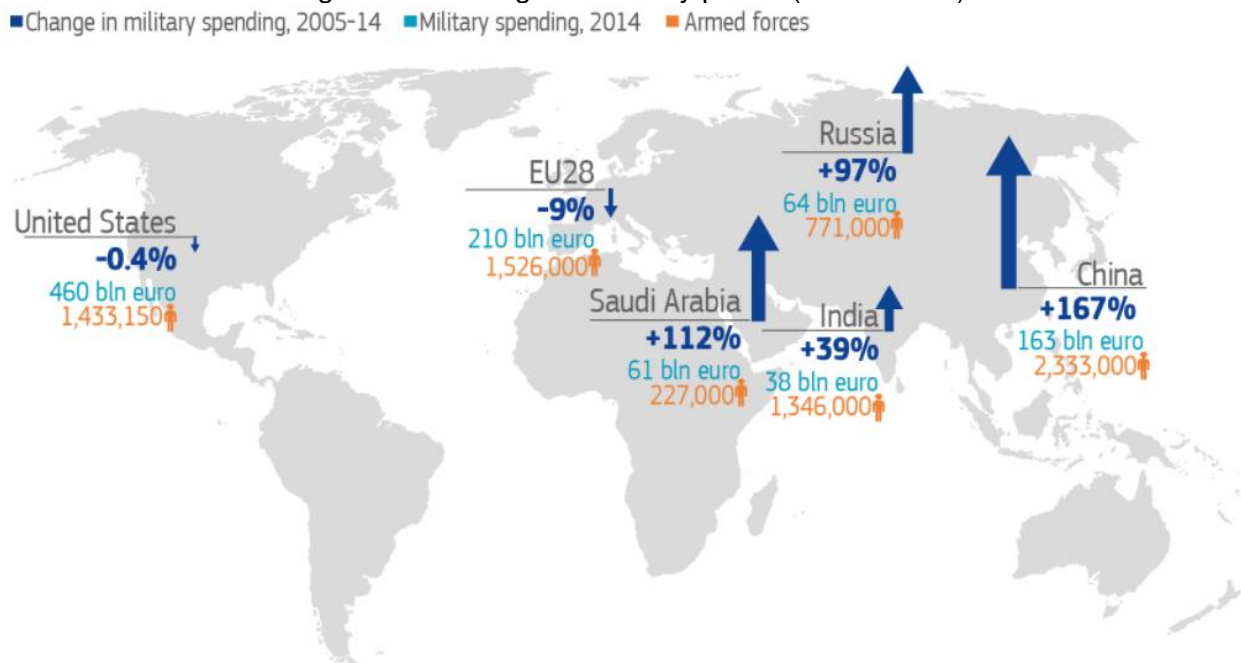
scarce defence resources for the sake of local jobs. Both Europe and the US are challenged to find ways to deepen transatlantic defence trade, which would have the virtue of mitigating the sole client phenomenon while extending scale economies. This would help lower defence equipment costs while fostering deeper defence integration and interoperability among allies.

7. This report will largely focus on the European challenge of consolidating Allied defence industrial capacities. It will not specifically address the nuclear dimension, as it is only relevant to three Allied countries, but it will include the research and development phase of the procurement cycle which is critical to the future. It will also consider how a changing threat environment has altered the politics underlying decisions about defence spending, shaped concerns about the long-term defence industrial and technological base, and revamped the discussion about market integration, pooling, sharing and interoperability.

**II. A CHANGING DEFENCE MARKET**

8. From 2005 - 2014, at a time when European countries were generally cutting defence outlays, Russian defence spending rose by 97%, while Saudi Arabia, India and China boosted their defence budgets by 112%, 39% and 167% respectively (Lazarou) (Figure 1). For Europe, the persistent gap in spending trends is not sustainable if the continent genuinely aspires to remain a major international actor. Europe embarked upon significant defence spending reductions in what it presumed to be a benign security landscape. The recent violations of international law by Russia and its use of hybrid tactics and cyber-attacks have raised alarm bells throughout Europe and clearly indicate that the environment is not as benign as was previously thought. At the same time, mounting instability in much of North Africa and the Middle East has triggered a massive movement of people throughout the region and into Europe, which has only added to the continent’s sense of vulnerability.

Figure 1: Shift in global military power (2005 - 2014)



Sources: SIPRI Military Expenditure Database, 2014; Military Balance 2015, International Institute for Security Studies

9. The 21<sup>st</sup> century was ushered in by terrorism, increasing threats, the return of power politics, and now a certain ambiguity about the new US President’s line on NATO and democratic alliances. In this rapidly changing threat environment, the question of transatlantic burden-sharing arises. An increasing number of US lawmakers argue that European governments must do more to ensure

that they have greater military capabilities and strategic credibility. The conclusions of the Wales and Warsaw NATO Summits show that the tendency to cut the defence budget has now unambiguously ended. Europe is beginning to increase defence outlays, although few have yet achieved NATO's minimum goals (Kington). Some analysts, however, have pointed to the limitations of the 2% defence spending target as the sole measure of Allied solidarity and burden sharing (Lunn and Williams). Identifying and addressing capacity shortfalls will, in any case, remain a priority for all NATO members. At the 2017 Munich Security Conference, Chairman Wolfgang Ischinger suggested introducing a new foreign policy guideline such as a "three percent criterion" including crisis prevention, development assistance and defence that would better express the will of all Allies to remain relevant strategic protagonists and good Allies.

10. In retrospect, we now understand that the recent economic crisis challenged the foundations of Allied military power and adversely affected transatlantic institutions. This has both trade and defence market implications. Nationalist and mercantilist notions are gaining ground, at a time when greater integration unambiguously offers the best and most efficient way forward. While the economic logic of protectionism is highly tenuous and far more costly than some politicians suggest, its political appeal cannot be discounted. The siren song of protectionism and mercantilism continues to haunt discussions of both transatlantic and European defence market opening. The temptation to focus inward is ever present and this makes the discussion on burden-sharing all the more complex, as protectionism means that some share of limited defence resources become deadweight economic losses due to the costs of restricting competition. Those costs undermine capabilities and burden-tax payers.

### **III. REVAMPING THE EUROPEAN DEFENCE INDUSTRIAL AND TECHNOLOGICAL BASE**

11. Many of these dilemmas are acknowledged in the strategic assessment that Federica Mogherini, the High Representative of the Union for Foreign Affairs and Security Policy, presented to the European Council in June 2016 (European Commission, Shared Vision, Common Action, 2016). That document, which was approved by the European Council on 15 December 2016, lays out the EU's core interests and principles for engaging with the international community. It suggests that deeper European cohesion will be critical to effective action on energy security, migration, climate change, violent extremism and hybrid warfare. The Mogherini report importantly lays out a possible legal framework for deeper cooperation in the defence industrial sector, which the Commission now identifies as fundamental to European security (Krause).

12. At the end of 2016, the EU countries therefore decided to upgrade their cooperation on a range of security and defence matters. They agreed on a European Defence Action Plan that, among other things, offers financial assistance for member states which are engaged in joint procurement and capability development projects, and which are undertaking measures to implement the EU-NATO Joint Declaration agreed upon in Warsaw (European Council). The Action Plan represents the most recent in a long series of initiatives to galvanise Europe into a higher level of defence industrial cooperation.

13. The European Treaties constructed a common internal market that, over time, was strengthened and extended into difficult areas like public procurement which, as a general rule, now must be conducted in an open, transparent manner and on an EU-wide basis. According to the European Commission, public procurement alone accounts for 16% of Europe's GDP and, by extension, affects a substantial share of world trade flows, amounting to EUR 1,000 billion per year (European Commission, "Public Procurement"). The defence market itself generated EUR 96 billion in revenue and employed roughly 400,000 workers within the EU in 2012. According to Aerospace and Defence Industry Association (ASD) data, the defence industrial sector now has a total turnover of EUR 100bn per year and employs, directly and indirectly, 1.4 million highly skilled people. In deference to national sovereignty concerns, however, EU law has long accorded

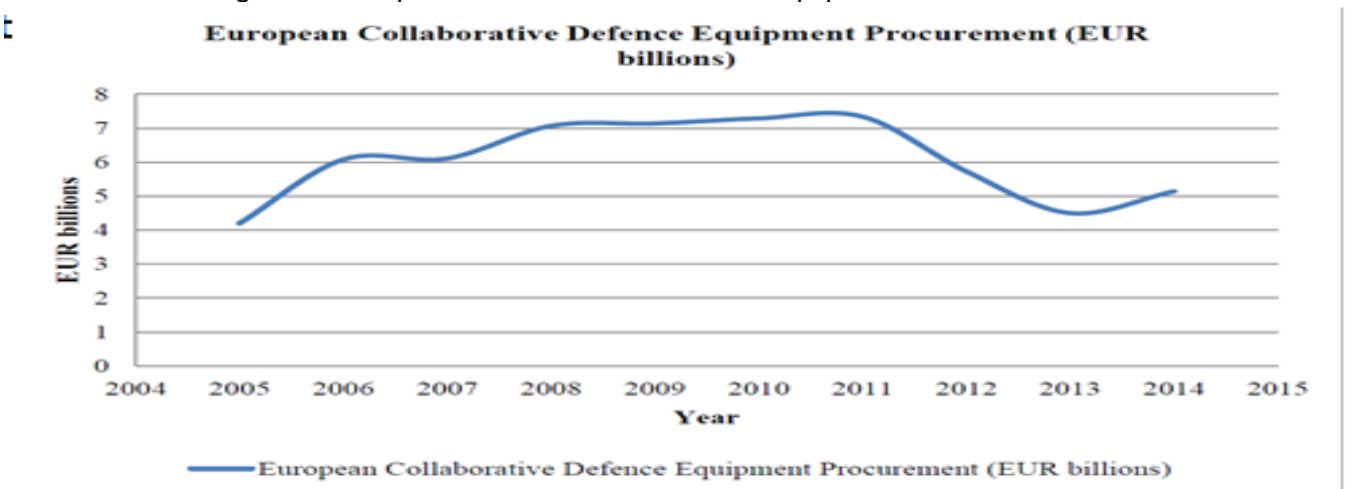
member states opt-outs which have allowed governments to exempt defence procurement from market integration rules.

14. Because security remains the core prerogative of the nation-state, Common Market principals and rules were never extended to the defence industrial sector. Under Article 346 of the Treaty on the Functioning of the European Union (TFEU) (formerly article 296 of the original European Community Treaty), member countries can take measures they consider necessary for the protection of their essential security interests in connection with the production of and trade in arms, munitions and war material. Measures taken under this article, however, may not adversely affect competition on the Common Market for products not specifically intended for military purposes (European Commission, “EU Law and Defence Procurement”).

**IV. STRUCTURAL FRAGMENTATION**

15. We need to be aware that the defence of sovereignty in Europe requires Allies to act jointly. European countries, in particular, must find the means to combine their power and resources effectively. Economies of scale in defence reduce the cost of military equipment considerably whilst improving the capacity of national armies to cooperate on the battle field, in the air and at sea (Braw). Broadly exempting defence markets from EU market construction has therefore exacted a high cost. Europe’s defence markets have long lacked the scale to reduce the cost of military equipment. The preservation of national champions has led to a relative proliferation of firms making essentially the same products for relatively small and, over the last decade, diminishing markets. Whereas the United States, the world’s largest defence market, has only one supplier of fighter aircraft, Europe has three suppliers: Dassault’s Rafale, Eurofighter’s Typhoon and Saab’s Grippen. Europe produces far more kinds of main battle tanks, armored vehicles, submarines and frigates than does the US, with only one third of the defence budget. The transatlantic gap has widened over the past 20 years. US firms prompted by declining defence spending after the fall of the Berlin Wall, engaged in serious restructuring to reduce capacity and hedge risk. This transformed the US defence industrial landscape. Consolidation of small firms into larger firms meant these companies were less dependent on conditions in any given sector and more competitive in national and global markets (Shalal et al.). Of course, consolidation risks creating monopolies so there has been a certain challenge linked to striking a balance between essential competition and fragmentation in the US. Europe, however, clearly confronts the problem of fragmentation even though the pace of mergers has begun to increase (Figure 2).

Figure 2: European Collaborative Defence Equipment Procurement



Data source: European Defence Agency

16. The preservation of a European national defence industrial sector is generally defended in the name of strategic autonomy, respect for sovereignty and the related need to maintain national defence industrial bases. Job protection is also at play, particularly civilian jobs linked to defense contracting. The job argument can be nuanced, as purchasing over-priced military equipment is a drag on national budgets and resources that could be better invested in sectors which create more jobs.

17. Defence industrial protectionism also places enormous burdens on European tax payers, whose governments are often purchasing equipment from boutique firms that do not enjoy scale economies. Firms operating in this fragmented landscape are less able to drive down unit costs, and governments thus purchase less capability with scarce government funds than they might have in a more integrated European market (Balis).

18. This fragmentation has also created problems of Europe-wide coordinated defence planning which is also essential to bolstering military capabilities at reasonable costs. A report by the French Court of Auditors in 2013 attributes a sizeable portion of the costs in the European defence sector to production overcapacity, as countless very similar programmes pursue practically identical objectives, while demand for marketed weapons systems remain low (Denoyel).

19. Market fragmentation is further exacerbated by the sheer variety of European states and their diverse strategic outlooks. These outlooks are conditioned, in part, by geography, but also by different national political histories and military cultures. Britain is a great trading nation which embraces a liberal approach to markets, while harboring a historically conditioned concern about foreign entanglements (Balis). France and Germany have undoubtedly a less liberal model, but recognise that cooperation and integration are superior to exacerbated competition and strife. While Europeans share elements of a common history, they also have distinct national and regional histories, which define national approaches to defence markets and the role that the state plays in them.

20. The size of countries matters as well. Smaller states have more difficulty in attaining the critical conditions of their own credible defence, and may wish to live under the protective umbrella of an alliance. This does not stand in the way of rapidly rising defence spending in the Baltic states in particular. These countries live under an acute sense of threat, conditioned by historical memory and this has helped them build a public consensus in support of greater defense spending. Within a more deeply integrated framework, the differences between small and large countries could become sources of strength and specialisation. There are potential divisions of labour, in which, for example, countries with long coastlines might be inclined to assume a greater share of the continent's maritime defence, while smaller inland countries might focus on niche ground missions, assuming that larger states would provide critical support in areas like air defence. To some extent, this has already unfolded although there is far more that could be done on this front (Black).

21. Early efforts to build a more consolidated lower cost defence industrial structure in Europe initially focused on establishing joint ventures, as these were easier to manage politically than trans-border mergers. Joint ventures provided the illusion of integration with none of the difficult transformations that were actually needed to consolidate the sector. Unfortunately, the expected benefits are often watered down. Joint ventures have suffered from what are known as *juste retour* arrangements, based on a sharing of the work designed to guarantee "fairness" among the countries concerned. This has proved costly and not very efficient. Work-share arrangements in the Eurofighter programme, for example, undermined the agility of that programme and added sizeable extra costs. The determination to defend national champions in the 1980s undermined the joint project of the French producer of the Leclerc tank and the German producer of the Leopard tank.

22. At the time of writing, EU member states collectively constitute the world's second largest defence spenders after the US. But fragmentation has contributed to Europe's serious capabilities deficit. A more integrated European market, characterised by coordinated defence requirements definition, harmonised planning, shared procurement, and larger more integrated firms would be essential to overcome these deficits at reasonable cost. Since 2005, Europe's defence industrial landscape has been moving in precisely this direction, although slowly and in fitful steps. Consolidation of the defense sector is also slowly unfolding. The very important merger between the German firm Krauss Maffei Wegmann and its French competitor Nexter, for example, could succeed where earlier efforts have failed (Balis). It has produced a firm with around EUR 2 billion (USD 2.2 billion) in turnover and 6,000 employees. This marks a more genuine transformation of the tank industry in Europe and will both boost competitiveness and reduce costs (Pohle). Some critics, however, have noted that even this deal has fallen short of a genuine fusion of the two companies, although it will invariably foster synergies in areas like research and development. That said, once firms assume a genuinely European, as opposed to a strictly national character, the temptation of national governments to fight over work-share diminishes and the focus should turn to more critical issues of requirements, capabilities and costs. Ensuring that requirements are defined in a broader European framework and that contracts are awarded on the basis of best value for money will go far to affecting long-term improvements in capabilities.

## V. EUROPEAN RESPONSES

23. In implementing the Lisbon Treaty in 2009, the EU extended the Petersberg tasks, as they are known, to include disarmament efforts, humanitarian, evacuation and military advice missions, conflict prevention and peace-keeping, crisis management and stabilisation at the end of conflicts. It also adopted a series of new mechanisms, including a mutual assistance clause, and permanent structured cooperation, optimised to confer greater flexibility for the EU to adopt the European Common Security and Defence Policy (CSDP). Whilst affirming that defence and security remains an inter-governmental policy, EU Member States adopted measures to support defence industrial cooperation.

24. In 2009, the European Parliament and the Council adopted the directive on defence public contracts which defines essential rules for competition, transparency and non-discrimination of national programmes for the acquisition of military equipment. Directive 2009/81/EC subjected arms purchases to broader EU standards for open public procurement, and created a framework for single and non-discriminatory EU tendering and bidding. While reassuring governments that defence ultimately remained a national responsibility, the directive sought to encourage member states to engage in more transparent and competitive bidding procedures for defence contracts. It did so recognising that the EU as a whole, as a result of CSDP, has taken on certain new defence responsibilities and that there would now be an even more compelling collective interest in cooperative project development and open procurement. During the period 2011 - 2015, the total value of defence and security contracts awarded under Directive 81 stood at EUR 30.85 billion (European Commission, 2016). In another Directive (2009/43), the EU now requires only one license for the transfer of arms within the EU. This directive thereby lowers administrative burdens that have done their part to hamper defence market integration in Europe. Previously all such transfers had to be reported to the United Nations as international transfers. Now they will be treated as internal market transactions with no additional reporting requirements. This renders security of supply arguments for protectionist approaches less convincing and thus less defensible under Article 346 of the TFEU. Despite an initial increase of competition, transparency and non-discrimination in Europe's defence procurement market, the degree of application of both directives remains uneven across Member States, particularly with regard to high-value and strategic defence systems.



25. EU Member States have thus embarked upon the development of a more genuine European-wide Defence Technological and Industrial Base (EDTIB), another explicit goal of the EU and its member governments. One goal here has been to phase out offset arrangements. The Commission has also sought to discourage state aid to defence firms and to undertake investigations when member states invoked Article 346 of the TFEU. Exceptions to these rules were made for international contracts with the UN and NATO or when the contracts stemmed from cooperative programmes under the aegis of the European Defence Agency (EDA) and the Organization for Joint Armament Cooperation (*Organisation conjointe de coopération en matière d'armement* - OCCAR) (Black). The goal here has not only been to open the defence bidding process to producers from all member governments, but also to encourage more integration on the demand side. Putting out multinational rather than single country tenders was to become the new normal. This requires far more coordination at earlier stage of the defence planning process. Article 42(6) of the Lisbon Treaty on the Functioning of European Union recognises that like-minded member states can decide to deepen defence and defence industrial cooperation and states that: "member states shall undertake progressively to improve their military capabilities. The Agency in the field of defence capabilities development, research, acquisition and armaments (EDA) shall identify operational requirements, shall promote measures to satisfy those requirements, shall contribute to identifying and, where appropriate, implementing any measure needed to strengthen the industrial and technological base of the defence sector, shall participate in defining a European capabilities and armaments policy, and shall assist the Council in evaluating the improvement of military capabilities".

26. The Treaty also introduces the possibility for member states to deepen defense integration through Permanent Structured Cooperation (PESCO). PESCO seeks to foster cooperation in five core areas: financing, equipment, operational, capabilities and defence industry (European Council Briefing). The process is open to all member states on a voluntary basis prepared to make more binding commitments to one another. It thus puts the EU at the center of the process of building a more resilient civil-military architecture in support of Europe's security as defined by the Treaty. It also requires participating states to: "intensively develop defence capacities through the development of national contributions and their participation in multinational forces, in the main European equipment programmes and in the activities of the European Defence Agency in the field of defence capabilities development, research, acquisition, and armaments." It calls on participating states to develop the capacity to supply combat units and support logistics for the tasks referred to in Article 43 of the TEU within a period of 5 to 30 days and, depending on needs, for a period of 30 to 120 days (EUR-Lex).

27. The ambitions for PESCO are noteworthy. It is designed to help member countries screen and better-align national defence procurement policies. It supports joint military training among PESCO members, reinforces existing cooperation agreements among national military academies and supports effective planning, command and control for future CSDP missions. PESCO members are also empowered to set up a joint operational headquarters in Brussels—a goal that is currently under discussion in Brussels. Eventually PESCO could take on more important operational tasks if an air mobile rapid reaction capacity were developed to support the existing Battlegroup concept (European Commission, 15/06/2015).

28. One enduring paradox, however, is that the European Union itself is not the consumer of these military products. The ultimate consumers continue to be national governments (Black) and these directives still recognise the primacy of the nation state in security matters and accordingly acknowledge the rights of members to opt out of cooperative ventures if national security or sovereignty concerns are at stake. In any case, there has been both some unhappiness about the pace at which the Lisbon Treaty has been implemented and lack of enthusiasm to move quickly among some states. The economic and financial crisis was certainly one factor as governments were even more reluctant to cede control of national procurement at a time of both falling defence budgets, recession and soaring unemployment.

29. The recent interpretation of Article 346 of the TFEU entrusts the Member States with the task of showing that protectionist measures and public aids are related to security concerns that justify access restrictions to their national defence market. This is a potentially important development, as it suggests that Europe is taking legal measures aiming to create a more unified, less discriminatory defence market that would begin to meet the conditions needed to drive down procurement costs (Randazzo). The logic behind the push for deeper integration is compelling. Objectively Europe's fragmented defence market is costly, weakens Europe's security posture, places enormous pressure on budgets and creates an unnecessary disparity between the resources put into defence and the capabilities that are ultimately developed and deployed.

30. One needs also to consider that defence markets constitute an important share of many allied country economies and exempting this sector from European wide market rules deprives the continent of the full benefit of integration. With commercial technologies increasingly integrated into defence platforms, the potential cost of defence market fragmentation becomes even higher. It makes eminent sense that the EU promote the integration of its defence markets. Europe possesses many of the market making tools that facilitate market consolidation. The EU makes rules that structure commercial markets, including trade policies that now spill over into defence market rules. It also generates funding for basic and applied research including scientific research in programmes like the European Space Agency, Galileo, Copernicus, and the Horizon 2020 EU Research and Innovation Programme. All of these will yield technological insights with potential military implications.

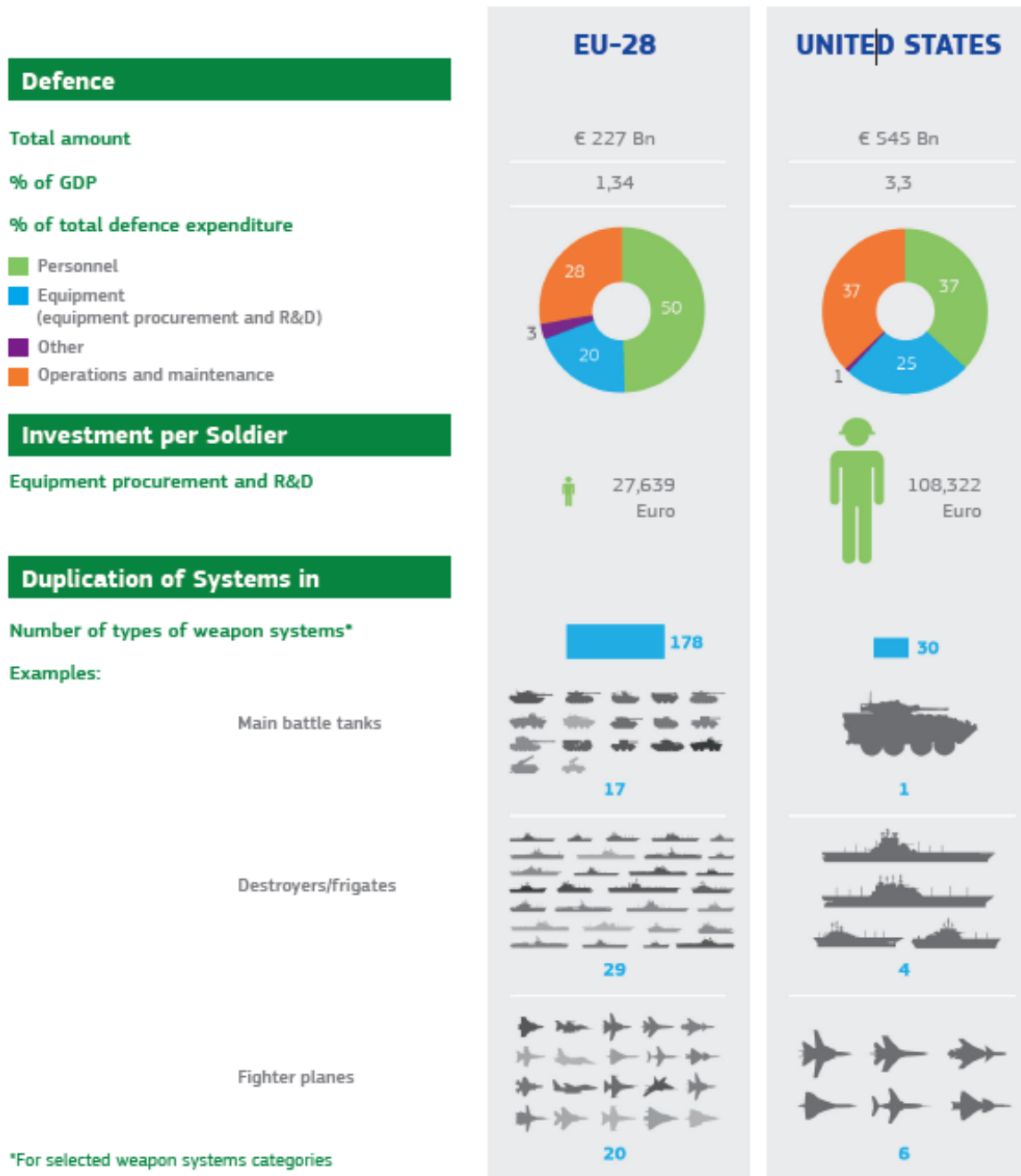
## **VI. THE INTEGRATION AMBITIONS OF THE EUROPEAN MARKET AND THE ESTABLISHMENT OF A EUROPEAN DEFENCE INDUSTRIAL BASE**

31. Ad-hoc groupings are also playing a part in defence industrial consolidation and reinforcement of the European Defence Industrial and Technological Base. In 1998, Germany, France, the United Kingdom, Italy and Sweden signed a Letter of Intent (LOI) to pursue these ends collectively. Their goal was to deepen collaboration in the security of supply, transfer and export of arms, procurement, security of information, research and development, treatment of technical information and harmonisation of military requirements. Beyond the goal of rationalising the European defense secure, another underlying ambition was to make participating countries somewhat less dependent on US supplies of critical defence materials. Working groups were created in all of these areas and consolidation has occurred among the LOI countries particularly in missile, armoured vehicles, military transport and aerospace production. Perhaps not coincidentally, US military exports to LOI countries have fallen since the group was established, while other European countries have grown more dependent on US imports (Black).

32. This movement has subsequently accelerated and important changes are unfolding at the corporate level. Evolving European politics and market conditions have begun to drive defence industrial integration in Europe. National defence firms responsible for constructing large defence platforms have found it ever more difficult to maintain profitability due to their lack of size and market reach. Multilateral solutions and restructuring are thus needed and mergers provide one possible solution to the conundrum. Shrinking defence spending, mounting global defence industrial competition and the rising cost of large defence platforms have made it essential for firms to enhance their size and reach. A number of European companies have consequently embarked upon significant mergers and joint ventures. Again, this restructuring has been slow and laborious, but the trend is clear. One result has been the emergence of several genuinely European rather than national defence firms including Augusta/Westland, EADS, and MBDA Eurocopter. It is worth noting that US defence firms embarked on this kind of restructuring earlier than their European counterparts, although largely within the framework of the huge US market. The structural changes in the US market have also been more profound than in Europe. US industry not only provided a model of transformation, it also posed and continues to pose a serious competitive challenge to which European firms must react (Figure 3). The United States is also leveraging export markets to

reduce unit costs. US exports jumped from 17% of total defence manufacturing in 2010 to 34% in 2015 (Mehta). This is clearly a challenge for Europe, and its first response must be to create larger and more competitive defence firms.

**Figure 3: Duplication in European Spending – A Comparison with the United States**



Source: Stockholm International Peace Research Institute (2016 data), International Institute for Strategic Studies (Military Balance 2017), European Political Strategy Centre, Munich Security Report 2017

33. European firms are also confronted with growing competition in international markets from new players like South Korea, Israel, Brazil, Japan and India. Defence firms from those countries have moved swiftly from being relative passive absorbers of foreign technology to becoming producers of their own innovation in the defence field. They too pose a serious challenge to European and US defence firms. In short, as Europe’s internal defence markets have shrunk over the last decade, world export markets became even more critical to sustaining the defence industrial base. But competition in those markets has grown fiercer, and Europe’s defence market

players are accordingly compelled to increase their competitiveness if only to maintain market share. This too has become a catalyst for greater defence market integration.

34. A number of bridging institutions have been constructed to encourage deeper defence industrial cooperation in Europe. These groups create frameworks for cooperation, foster information exchanges, and serve as catalysts for project development.

35. OCCAR was founded outside the EU framework in 1998 and was intended to facilitate deeper defence cooperation in Europe. It essentially reflects an intergovernmental approach. OCCAR is an international organisation, founded by a convention, which seeks to facilitate the through-life management of cooperative defence equipment programmes. It currently engages Germany, France, Italy, the United Kingdom, Spain and Belgium as members. Finland, Lithuania, Luxembourg, the Netherlands, Poland, Sweden and Turkey participate in OCCAR administered programmes as non-member participants.

36. OCCAR's original ambition was to encourage defence projects that would no longer include *Juste Retour* clauses, an expensive "trade diverting" practice in which defence contracts were unnaturally and inefficiently linked to commercial deals. OCCAR's members sought to premise purchasing decisions on quality and cost considerations alone. It invited non-member contractors to apply the same rules. Today, OCCAR facilitates and manages cooperative European armaments programmes through their life cycle-project preparation, definition, development, production, in service and disposal. It is also a centre of excellence for European defence cooperation and develops technology demonstrator programmes to help kick off cooperative projects. OCCAR is currently managing 13 critical defence industrial programmes: A400M, BOXER, COBRA, ESSOR, FREMM, FSAF-PAAMS, LSS, MALE RPAS, MMCM, MMF, MUSIS, PPA and TIGER.

37. OCCAR, however, has confronted difficulties. The A400M programme, for example, was saddled with long delays due to changes of the specifications. This added cost, slowed the project and led some countries to withdraw from the programme, which obviously reduced the scope of the market and added to unit costs. The NH 90 Helicopter project suffered similar problems. Twenty different versions of that helicopter were sought and this imposed enormous burdens on the project (Braw). The proliferation of unique national specifications and the costs this imposed on the project illustrates the need to begin coordination very early in the planning process in order to hammer out and agree on common requirements and specifications. While the EU has built a common market, in part, by imposing common standards that facilitate the seamless movement of goods within that market, standardisation has proven an elusive goal for the European defense market.

38. Established in 2004 to galvanise the process of defence market integration in Europe, the European Defence Agency (EDA) is an intergovernmental agency of the European Council. All EU member states, except for Denmark, participate in its activities. Its reach is therefore broader than that of OCCAR. The EDA seeks to help member states cooperate in the defence industrial sector, develop capabilities needed for future battle fields and integrate the European defence markets. Its predecessors included the European Armaments Agency and the Independent European Group, neither of which succeeded in restructuring European defence markets to the degree their founders and early supporters had hoped. The EDA has sought to deepen military capabilities by fostering cooperation in armaments development, crisis management and through efforts to strengthen the defence industrial and technological base. It also links up Europe's defence equipment market with the European Union's research activities in strategic technologies with implications for defence markets.

39. The EDA has had some success fostering European defence cooperation in areas like force protection technology development, joint training, munitions projects and air-to-ground missiles deployed in Bosnia. It helped establish a framework agreement for a multinational effort to meet a

need for anti-tank ammunition in the Baltic States, Poland and the Czech Republic. It has also supported regional development strategies to facilitate geographical clustering, a phenomenon that can put technology development on a long-term footing. In recent years, the EDA has supported projects related to air-to-air refueling, cyber defence, remotely piloted aircraft systems and satellite communications. Future programmes are planned on deployable biological laboratories, medivac and anti-tank weapons. The Agency is also working with the Commission to facilitate access to EU funds for European companies developing relevant dual use technologies (Lazarou). In July 2016, OCCAR and the EDA signed a Memorandum of Understanding to deepen cooperation between the two institutions.

40. European governments have engaged in several transnational projects that illustrate a new movement on the demand side aiming to build a more open and integrated European defence market. But some of these projects continue to confront difficulties. The most prominent of these are large projects which are generally considered too big for any one European country to undertake alone. The A400M transport plane has been touted as the future transport aircraft for many European national militaries. However, this large project has confronted unanticipated problems, including the withdrawal of Italy from the programme, the shrinkage of orders from 220 to 174 and significant cost overruns and technical problems which European countries are now trying to solve (Tovey).

41. The aforementioned Eurofighter engages Germany (DASA), the United Kingdom (BAES), Italy (Alenia) and Spain (Casa). The project, like the above-mentioned the NH 90 Helicopter Programme, has been burdened with too many nationally defined requirements. The plane was originally conceived as an interceptor fighter. In the post-Cold war, those requirements shifted to a ground support role. Fighter aircraft cost is such that it is essential to generate long production runs to keep unit costs down and to reduce commercial risks. These multinational ventures become significantly less profitable and more costly when clients impose varying capabilities requirements or slash orders as each undermines the advantages of scale. Exports can mitigate these risks and the Eurofighter has been sold to Kuwait, Oman, Australia, and Saudi Arabia for both strategic purposes and to offset costs.

42. Pre-existing industrial cooperation arrangements established by and between European countries, aimed at the convergence of their strategic interests and needs for the long term must be maintained: Examples of successful rapprochement attest to the pool of financing and implementation: in the field of missiles, MBDA started in 1996 by becoming Franco-British and gradually extended its alliance and its industrial presence in four countries. In 2016, the Franco-British agreement in the missile systems sector enabled the group to take a further step towards operational efficiency by creating centres of excellence and by implementing the specialisation of the countries. Similarly, the German Tank manufacturer *Krauss Maffei Wegmann* has merged with the French company Nexter to produce tanks for the European market. This is yet another market that requires consolidation. In the area of shipbuilding, there has been more resistance to integration, although some firms such as Naval Group (formerly known as DCNS) France and Navantia in Spain have begun to share designs to begin cooperative relations. It is important to note that consolidation has also occurred at the national level—a process with important implications for broader European consolidation. In Italy, Finmeccanica, now known as Leonardo S.p.A., has emerged as a large integrated defence firm that covers Augusta Westland, Alenia Aermacchi, Selex ES, OTO Melra and WASS. The company is far more agile and profitable than its fully state-owned predecessor and seems to be in a better position to engage in trans-border projects. It is now working with Dassault and Airbus with an equal work allocation to develop a Medium-Altitude Long-Endurance Unmanned Aerial Vehicle (MALE UAV) under the auspices of OCCAR.

43. It is important to note that industry itself is also driving the process of defence industrial consolidation not only in response to political signals but also to objective market conditions. Indeed, these companies have little choice as national defence markets in Europe are simply too

small and platforms are too expensive for these companies to survive as strictly national firms. Multinational consolidation has been essential. Airbus Group SE has been on the leading edge of this process. It is now a genuinely European aerospace and defence corporation that grew out of the merger of Aerospatiale-Matra, DaimlerChrysler Aerospace AG (DASA) and Construzione Aeronauticas SA (CASA). In 2014, EADS was restructured as Airbus Group NV, integrating the development and marketing of civil and military aircraft, missiles, communications systems, rockets, helicopters, and satellites. The following year it was listed on Eurostoxx 50 as a Societas Europaea.

44. The European transformation movement appears to be picking up pace: The European Commission initiated, for the first time in 2016, a system of financing for research in defence, which is essential for autonomy in armament strategy, and the creation of a European Defence Technological and Industrial Base (EDTIB). The European Defence Action Plan proposed by the Commission in November 2016 and approved by the European Council on 15 and 16 December 2016, provides that the European Defence Fund can receive and manage contributions from the Member States for the joint development of defence capacities. The Member States approved these guidelines during the European Council meeting last June.

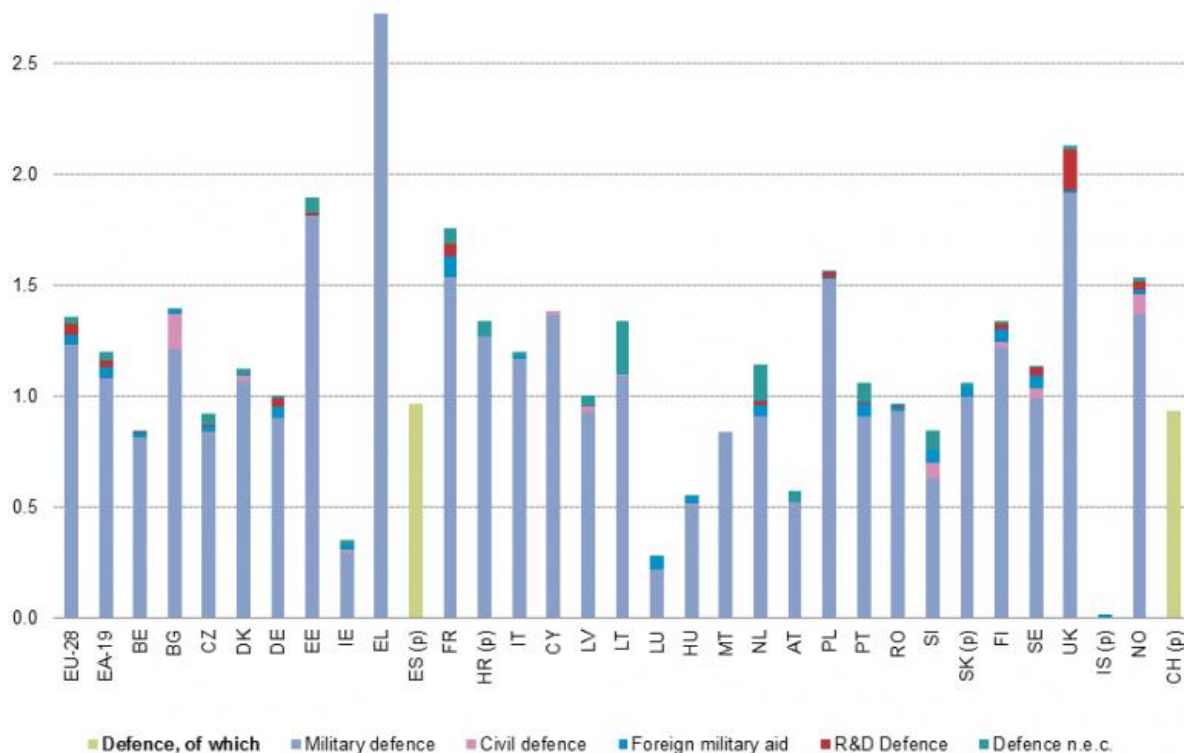
45. The Fund is intended to support investments in joint research and development on defence technologies and equipment. It comprises two complementary “components” which nonetheless differ in their legal structure and the financing source of their budget:

- A “research component,” intended to finance collaborative research in innovative defence technologies such as electronics, metamaterials, encrypted software and robotics. In this context, €25 million have been allocated to the Union’s budget for 2017. The allocation to research for defence should reach €90 million by 2020. Under the multiyear financial framework for the European Union after 2020, a research programme devoted to defence has been proposed, with an annual estimated budget of €500 million;
- A “capacities component,” which would serve as a financial instrument to enable the participating Member States to acquire certain goods while reducing their costs. The capacities would be defined by mutual agreement by the Member States, which would be the owners of the technology and equipment. For example, the Member States could join forces to invest in drone technology or acquire helicopters in large quantities in order to reduce costs. This component should be able to mobilise ca. €5 billion per year.

46. Nearly €10.5 billion could thus be earmarked for defence by the European Union at the end of the next financial period.

## **VII. DEFENCE RESEARCH**

47. Research and development (R&D) constitute yet another challenge for Europe. Between 2006 and 2013, defence R&D fell an estimated 21% in EU member states (EUISS Yearbook) and represented a negligible part of government expenditure in all countries except the United Kingdom (0.2% of GDP) and France (0.1% of GDP). Defence budgets in many European countries have been over-weighted on personnel outlays and vastly underweighted in investment spending. In the long run, this is a formula for strategic catastrophe and it is why both NATO and the EU have sought to reverse the trend. Ensuring proper funding for R&D and undertaking efforts to cooperate across borders to reduce redundancies and costs are essential. The level of transnational research cooperation has also been insufficient leading to all manner of redundancies and failures to exploit potential synergies. For this reason, the European Council and Commission, like NATO, are strongly advocating for increased defence R&D spending and deeper trans-border collaboration.

**Figure 4:** Total general government expenditure on defence, 2015 (% of GDP)

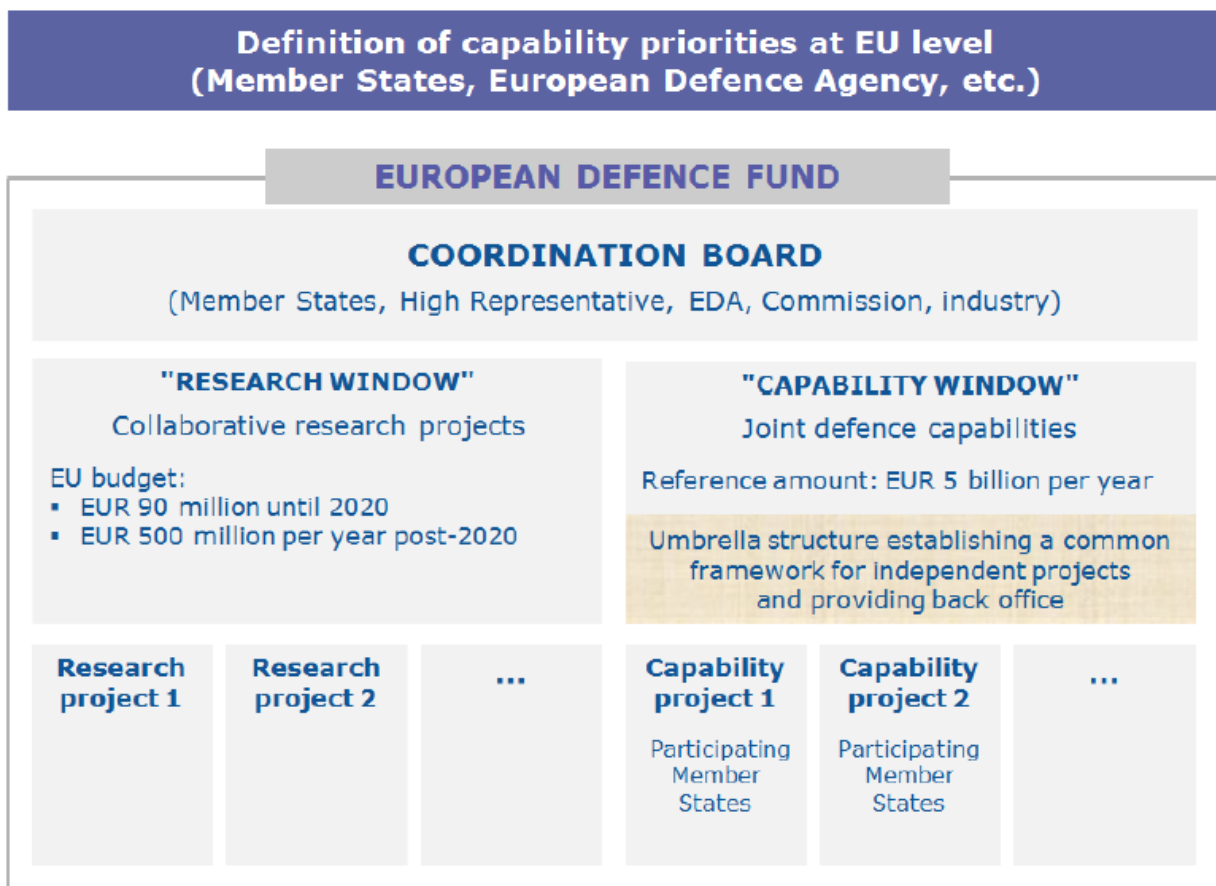
Source: Eurostat, 2017

48. The EU is also working to foster European wide technical standards particularly for dual use civil technology with military applications. It sees this as part of a broader effort to forge new links among civilian and defence industries. The Commission will also work to ensure that the 1,350 critical small and medium sized firms playing a central role in the European defence supply chains are engaged in strategic partnerships and have access to funding for critical research projects. High levels of competition and a decade of low defence spending have burdened Europe's defence-related small and medium sized firms, which should function as key enablers of innovation and growth. This has created an opening for US firms which have acquired many cash strapped smaller European firms both to build up their own presence in European markets and to gain access to unique technologies (Denoyel). A number of financial instruments based on European Investment Bank (EIB) lending, such as the programme for the Competitiveness of Enterprises and small and medium-sized enterprises (COSME), will provide loans, guarantees and equity products for the expansion of current dual-use defence-related activities. Most defence-related SMEs have become increasingly dependent on commercial markets, with estimated commercial sales constituting between 39% and 62% of the total sales of these firms (European Commission, 2014).

49. The EU's recent focus on dual use technology development is interesting. Obviously, the Commission has specific powers in structuring commercial markets but long lacked a legal mandate to shape defence markets. These distinctions, however, are fading. By some estimates as much as 60% of research dedicated to the defence sector has civilian applications, while 20% of commercial market research spins into the defence sector (ANAJ-IHEDN). Almost by default, this has increased the EU's capacity to structure a key element of the defence market and to endow that market with a more European rather than a strictly national character. Accordingly, efforts have been made to link up the EU's Horizon 2020 security research efforts and the EDA research programme (Lazarou). As countries in Europe ramp up defence spending, more money will be available for underwriting research and development. NATO communiqués have recently stressed the importance of dedicating at least 20% of defence budgets to new equipment and R&D. The question now is how best to spend these precious funds. Trans-border cooperative efforts are one important answer.

50. The European Commission initiated a financing system for defence research for the first time with the EDA, essentially to achieve strategic autonomy in armaments while fostering the creation of a defence technological and industrial base. This “preparatory action” should lead to an ambitious budget line at the next multi-year financial framework. The European defence action plan proposed by the Commission at the end of 2016 provided that the European Defence Fund could receive and manage contributions from Member States for joint defence capacity building. This Fund, launched on June 7<sup>th</sup>, 2017 by the Commission, consists of a “research component” to underwrite collaborative defence research projects at the EU level, and a “capability component” to support joint development of defence capabilities commonly agreed by Member States. While the “research component” would be financed by the EU budget, the “capability component” will depend on the pooling of national contributions, supported by the EU budget (figure 5).

**Figure 5: Towards a European Defence Fund**



Source: European Commission, 2016

51. It is worth noting also that the Commission proposed that such contributions should not be subject to the constraints of the Stability Pact. The most recent beneficiary of EU state aid aimed at supporting R&D&Innovation activities is the Franco-German development of Airbus’ X6 helicopter project. Announced by Brussels on 19 June 2017, the support will amount to a total of €377 million in repayable advances granted over a period of eight years (€330 million by France and €47.25 million by Germany). The project, in line with the Europe 2020 flagship initiative for an Innovation Union, entails significant research, development and innovation to develop an innovative and high-technology civil heavy duty helicopter (European Commission, 2017).



## VIII. THE TRANSATLANTIC ANGLE

52. The United States continues to play a major role in European markets as a producer of defence goods. Furthermore it is essential within the limits imposed by national sovereignty, that it grants the European nations real reciprocal access to its defence markets without which the Alliance cannot function optimally. The restructuring of US markets has brought considerable consolidation. This makes it a highly competitive player both in European and global markets. European firms cooperate with and compete against US companies both in European and in the global markets. While the aforementioned LOI countries have generally lowered their imports from US manufacturers, this is not the case for many other European countries. The United States plays a particularly important role in the Italian, British and Spanish markets as well as in many smaller European countries. It remains the key producer of many kinds of missiles, electronic equipment, radars and communications equipment purchased in Europe. It is a highly competitive supplier of fighter aircraft and has posed a real competitive challenge to European producers with its sales of the F-18 and the F-16 fighters. It is also very competitive in intelligence and surveillance platforms including the P-3 Orion naval surveillance ships.

53. While some European firms, notably BAE Systems, have acquired key US companies and established a strong presence in that market, US firms have, in turn, recently acquired several important European market players. General Dynamics is now a genuine force in the European market as a producer of armored vehicles and has acquired firms in Switzerland, Spain and Austria to cement its position on the continent. Lockheed Martin is sub-contracting with several European firms to support F-35 production and sales on the continent. The presence of US firms in Europe is important. First of all, it provides an industrial dimension to transatlantic defence solidarity. It also generates a competitive spur to European armaments manufactures and helps keep prices in check while inspiring technological advances.

54. NATO itself has built important bridges between the European and North American defence markets. It encourages common requirement definitions, cooperation on the planning front (NATO Defence Planning Process-NDPP), technology sharing and collective approaches to innovation. The Conference of National Armaments Directors (CNAD) is the NATO Committee directly responsible for promoting defence industrial cooperation. It seeks to identify collaborative opportunities for research, development and production of military equipment and weapons systems needed by Allied countries. CNAD plays a key role in fostering interoperability and alliance-wide harmonisation of military equipment to help ensure that NATO militaries are sufficiently equipped to carry out core NATO missions and can work together. It is currently working on projects that involve Joint Intelligence, Surveillance and Reconnaissance (JISR) and ballistic missile defence.

55. The NATO Industrial Advisory Group (NIAG) provides a direct link between defence industries, CNAD and other NATO departments. It links the defence industry into discussions at NATO on procurement and capabilities issues. NIAG conducts an annual programme of studies to inform the work being carried out at NATO. The studies engage industrial experts who bring their specialised knowledge directly into Alliance discussions on requirements and capabilities. The current NIAG Strategy focuses on supporting newer NATO members as they align their defence industrial sectors with NATO standards and priorities. It plays a similar role with partner country defence industries and it is actively engaged in the Smart Defence and Connected Forces Initiative. NIAG has also worked on cyber security and cyber defence issues among many others.

56. The Luxembourg based NATO Support and Procurement Agency (NSPA) is the Executive body of the NATO Support and Procurement Organisation (NSPO). It brings together NATO's logistics and procurement support activities and seeks to generate integrated multinational solutions to meet member country military needs. Formed in 2012 from the merger of three NATO agencies dealing with maintenance and supply, pipeline management and airlift, it now has a portfolio which includes the Central Europe Pipeline System, the NATO Airlift Management

Programme and Logistic Operations. NSPA works to complement national and international project organisations by advising them on acquisition, logistics for new systems and provides logistics support for the in-service phase. It also supports procurement for expeditionary operations.

57. In 2015, NATO issued a Framework for Future Alliance Operations (FFAO) which would offer broad guidelines for defence planning in the areas of operational agility, security networking, shared resilience, strategic awareness and strategic communications. It is also increasingly reaching out to the European Union at a moment when the EU's role in shaping defence markets is on the rise. At the Warsaw Summit, NATO and the EU signed a joint declaration which furthered the partnership between these two important institutions and outlined ways to strengthen defence industries in the Alliance, promote defence research and spur defence industrial cooperation both within Europe and across the Atlantic (NATO-Industry Forum).

58. NATO's role in structuring defence markets is more about information sharing, is advisory in nature, and it obviously does not stray deeply into trade matters as such. The fact that the US and many EU members are both allies and competitors also plays into this dynamic. Finally, it should be noted that US export controls under the International Traffic in Arms Regulations (ITAR) place a potential limit on transatlantic defence market integration. This does not mean that cooperation across the Atlantic is not desirable and that it should not be extended. It should be and there is ample scope for doing so, but there are some daunting political limits, and these need to be frankly acknowledged as well.

## **IX. POTENTIAL IMPLICATIONS OF BREXIT**

59. Although the British government has made a great effort to convince its European allies that Brexit will have very few implications for the defence and security sectors, there are still concerns. A genuinely European defence market defined in part by EU law, rules and institutions is beginning to emerge. Which role the United Kingdom will play in this market is not yet fully clear. Much will depend both on the final form Brexit takes and the political and economic relations that the UK maintains with its European partners. Britain's defence firms obviously play an important role in the European market, and these companies can ill afford to lose market share there without opening new markets elsewhere. Defence industries in the United Kingdom have a turnover of GBP 54 billion a year, and the United Kingdom is the world's fourth and Europe's largest arms exporter followed closely by France. There are very compelling reasons for it to remain a central player in European markets and in the policies that help shape those markets.

60. For all NATO member countries whether inside or outside the European Union, defence integration will continue to be a factor in achieving higher levels of interoperability. Such considerations are likely to play as Britain negotiates the separation. Tariff structures will matter in this regard, but it is far too early to say what kind of tariff structure is to be put in place between the United Kingdom and the EU. If these structures impose additional costs on British firms, these companies could lose a competitive edge in bidding for contracts (Black).

61. Of course, Britain will remain a NATO ally and participate in certain groupings like OCCAR and the LOI which are helping to shape the future European defence market. But it will no longer have a voice in the Common Security and Defence Policy although it could participate in some of its initiatives as a partner, nor will it have a place at the table as the European institutions help redefine Europe's defence market. Its firms will not be positioned to bid on EU sponsored defence projects unless there are derogations to the rules. Despite these obstacles, the United Kingdom should remain a consequential player in the European defence industrial scene as it has much to offer and is a key partner. Although the British have played a key leadership role in discussions about defense, they have also sometimes been sceptical about European defense integration. Their departure therefore could also create new opportunities for a higher level of defense and security policy integration in Europe with important implications for the defense industrial base.

62. The French and British governments have confirmed that the important Franco-British partnership forged in the Lancaster House Defence Treaties (2010) will endure. Cooperation at the defence industrial level continues. The United Kingdom has agreed with France to develop a combat drone which is destined to be Europe's most advanced combat air system. France is also considering a large order of the MBDA Brimstone guided missile for its Tiger attack helicopter. MBDA began as a Franco-British venture growing out of the Anglo-French Defence Treaty of 2010. The United Kingdom also provides strategic airlift to French soldiers deploying to Africa (Tran).

63. British officials have signaled their intention of remaining a key defence industrial partner with its European allies. At the Bratislava Summit of EU leaders, heads of government, convened without the UK and approved the creation of a permanent Military Planning and Conduct Capability (MPCC). This structure will be in charge of planning and conducting the EU's non-executive military missions, i.e. currently EUTM Somalia, EUTM Mali and EUTM RCA, at the political level. London is against creating any European army, which in any case, is not on the agenda of the EU. Germany's Defence Minister Ursula von der Leyen warned Britain not to block EU efforts to build closer security ties within the Union (Wagstyl).

## **X. CONCLUSIONS**

64. Critical changes are underway in European defence markets that will have implications for transatlantic relations. Europe needs far greater capabilities to ensure that member states are positioned to credibly defend national and collective security interests. The continent needs the capacity to operate militarily in an increasingly complex and threatening security environment. How exactly these capabilities will be achieved is not yet clear, but the political and strategic pressures to achieve them essential are. They include mounting instability around Europe, the consequent need to maintain an adequate degree of security and to ensure ongoing Transatlantic comity and unity of purpose, the rising cost of large military platforms, the inadequacy of strictly national approaches to defence planning and procurement, and the increasing importance of technological spin-ins generated by the commercial sector, which is rendering distinctions between defence and commercial industries less pronounced.

65. The pressure on NATO's European members to boost defence spending and investment is everywhere apparent. It is rooted in genuine security concerns which now dominate Alliance diplomacy. US leaders of both parties are unified in their commitment to encourage Europe to dedicate a greater share of national budgets to bolstering defence capabilities. But increased spending will mean little if this is squandered in the fragmented landscape of Europe's national defence markets. The European Commission has estimated that the cost of non-coordination in defence planning and procurement approaches EUR 24.6 billion a year (Serfati). While Europe will never be an entirely integrated military power, there is nonetheless ample scope to reduce the level of fragmentation and achieve far greater levels of defence spending efficiency. The problem of overcapacity must also be tackled if costs are to be driven down. The European Commission has framed the challenge this way: "A strong European defence market and industrial base can only be achieved with a move away from the existing focus on national markets. Europe can no longer afford the inefficiencies of duplication and overcapacity that our existing fragmented market entails" (Shalal et al.).

66. Creating a genuine European wide defence market requires far more coordination among the consumers of defence goods. Engaging partner countries in the very early stage of defence planning is needed to extend the depth of the European defence market, define shared requirements, agree on common technological solutions and ultimately collectively engage in large multi-national orders that drive down unit costs. Europe is headed in the right direction but it needs to do far more.

67. European defence remains essentially an intergovernmental policy. As such, the Franco-German initiative of September 2016, cited in the letters of the French, German, Spanish and Italian ministers for defence, is an encouraging sign in favour of a robust European defence based on inclusive, reinforced cooperation and an ongoing political dialogue so as to develop a concerted voluntary approach to budget and defence capacity planning at the level of governments and headquarters by way of a “coordinated annual defence review.” Somewhat premised on the model of a European semester for defence and security, it would enable states to cooperate voluntarily on capability investment projects, and in so doing to pool their efforts in order to maximise the impact of the resources allocated to defence. This mechanism is intended to encourage participating countries to reach the 2% GDP goal and fill the identified capability gaps such as air-to-air refueling, cybersecurity, drones or satellite communication.

68. The drafting of a Defence White Paper to build a broad strategic vision about European wide security interests and military requirements represents an essential step in the right direction. A White Paper could help provide a framework shaping not only for defence planning and requirements definition but also to serve as a catalyst for further defence industrial consolidation. Europe needs a broad spectrum of capabilities if it is to position itself to defend its security interests at national, European and NATO levels while maintaining key technological and industrial capacities in Europe itself (Drent and Zandee). Drafting and agreeing on a White Paper will allow leaders to begin to map out strategies for achieving capability goals at reasonable costs. European governments can only manage costs if defence purchases are made in a more collective fashion, if its forces are better integrated, if equipment is more standardised and fit for deployment and a clearer division of labor is defined (Drent and Zandee).

69. To prosecute its interests and defend its borders, Europe as a whole needs the capacity to engage in high end conflict and to be able to sustain its operations. European members of NATO and the EU require better intelligence gathering capacities as well as strategic reconnaissance, force mobility, air-to-air refueling, precision munitions and deeper cooperation among its industries, militaries and governments to ensure that these capabilities are developed and procured in a far more cost-effective manner. More effective cooperation and defence industrial consolidation are two critical ways to get at the problem.

70. Because Europe remains a continent of sovereign states, there is not likely to be a one size fits all solution to this enduring dilemma. But there seems to be a greater willingness to do more. Flexible approaches will be needed and should engage both EU and NATO member and non-member governments. Bilateral and multilateral partnering becomes all the more important with the United Kingdom, a key European military power, definitively leaving the European Union. Britain and France will continue to pursue cooperation as laid out in their bilateral Lancaster House Treaty. This is all for the good. Sweden and Finland have developed a joint Naval Task Force. Bulgaria, Croatia, Hungary and Slovenia have agreed to cooperate closely on developing the aerial capabilities of special forces and will use joint procurement programmes to achieve some of these aims. Poland and Germany are developing an amphibious armored personnel carrier. Germany and France are working on a new battle tank while France and the United Kingdom are seeking to develop a new UAV. At the same time, national programmes are increasingly drawing on international supply chains to bolster capabilities and drive down costs (Kington).

71. The United Kingdom, a NATO member, should remain deeply engaged in cooperative military projects as should other non-EU members like Norway and Turkey and non-NATO members like Sweden and Finland, which are two particularly important NATO partner countries. Brexit should not be allowed to undermine pooling and sharing efforts. Brexit negotiations will focus particular attention on these issues. There are calls that special arrangements should be studied to keep the United Kingdom at the heart of several critical European defence projects in areas like fighter aircraft, surveillance drones, aerial tankers, communications satellite and cyber defence (Weisgerber). British defence firms enjoy special access to the US market, and, in this sense, the

United Kingdom will continue to play a special bridging role between the two continents in the defence industrial field. This is an asset for all sides.

72. Other trans-national projects through Nordic Defence Cooperation (NORDEF), Benelux and a multitude of bilateral arrangements also pave an interesting path for deepening cooperation. The European Union has a role to play not only in providing finance for key projects, but also in laying out a strategic vision that helps shape and guide these initiatives in harmony with NATO. These regional and bilateral arrangements, however, should be informed by a broader vision of security and a game plan for achieving this. This is precisely why the [NATO-EU relationship](#) must continue to be deepened.

73. Twenty-two countries are currently members of both NATO and the EU, and it is crucial that the strategic partnership between these two essential institutions is deepened. However, in order to utilise these efforts to the fullest extent, deeper engagement of non-EU Allies in the EU's security and defence efforts would also be very helpful. NATO is critical to deterrence on the continent and its hard Article 5 commitment to collective defense is vital to transatlantic peace and security. The strategic partnership between these two organisations has developed significantly over the past ten years and represents a win-win proposition which is essential to trumpet.

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