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THE IMPACT OF THE WAR IN UKRAINE ON THE EUROPEAN DEFENCE MARKET

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September 2023



AUTHOR'S PRESENTATION



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EXECUTIVE SUMMARY

The main trends characterising the European defence market since the beginning of the war in Ukraine are as follows:

- EU countries' defence budgets globally show a sharp increase in 2023, significantly accelerating a trend visible since 2014.
- Budget increases are particularly steep in Austria, the Baltic states, Finland, the Netherlands, Slovakia, Slovenia, Sweden and Poland, representing a spectacular 46% increase in real terms in the latter from 2022 to 2023.
- Total equipment acquisitions contracted by European countries from 2022 to mid-year 2023 reach close to €100 billion, representing an increase of €21.5 bn (or some 33%) from 2022 to 2023. Some 5% of those are linked to stock replenishments. With military orders in the amounts of some €28 billion and €16 billion respectively, Germany and Poland account for about a third and 17% of the increase.
- Considering that some 70-75% of the acquisitions contracted since 2022 can be linked to purchases initiated after the launch of the war, European defence spending is unlikely to be maintained at the same level beyond 2024-2025. Looking ahead, equipment budgets will depend on a number of factors, including: a) developments on the Ukrainian battlefield and/or at the negotiating table; b) EU countries' national assessments as to whether the (qualitative and quantitative) capability improvement achieved through the 2023-2025 surge is sufficient; c) and the financial sustainability of the effort – among others in relation to the gradual return into force of the EU Stability Pact as of 2024.
- Regardless, defence acquisitions are expected to remain more sustained in the next few years than prior to the war, pursuing the slow but steady trend visible since 2014.
- Acquisitions from outside the EU account for 78% of EU countries' 2022-2023 commitments, with the US alone representing 63% of this share. Among EU countries, Germany is the main provider, with about 50% of the sales.
- Acquisition from the US are made mainly via the Foreign Military Sales (FMS) programme, a Government-to-Government channel that is lighter to manage than commercial contracts, and is therefore preferred by European buyers.

- Weapons are acquired from the US for four purposes:
 - To replenish ammunition stocks;
 - To fulfil equipment needs for which no competitive systems exist in Europe;
 - To procure air defence systems;
 - To procure combat aircraft and helicopters.
- Agreements between US companies and European suppliers are developing fast to manufacture US defence systems in Europe, particularly in Germany.
- South Korea's share of the European defence market is growing quickly, filling a gap left in European and US short term manufacturing capacity.
- A structural gap is visible between current Brussels-led EU initiatives in the field of armaments, which focus on the development of defence R&D, and EU member states' immediate priorities, which focus on acquisitions. As a result, most equipment is purchased off-the-shelf and EU initiatives have had little impact on the structure of the European defence market so far.
- Assistance measures to support Ukraine with ammunition replenishment through the European Peace Facility and forthcoming measures to foster joint European procurement weapon manufacturing through the 'European Defence industry Reinforcement through Common Procurement Act' (EDIRPA) could have a more direct impact. EDIRPA, in particular, could lead to joint acquisitions up to an amount of €1.5 billion over 2023-2025.
- Taking over from EDIRPA, the future European Defence Investment Programme (EDIP) may have yet a stronger structuring impact on the European Defence Industrial and Technological Base (EDTIB). However, this will only occur if EU countries themselves commit to acquiring more equipment from the EDTIB in the future.

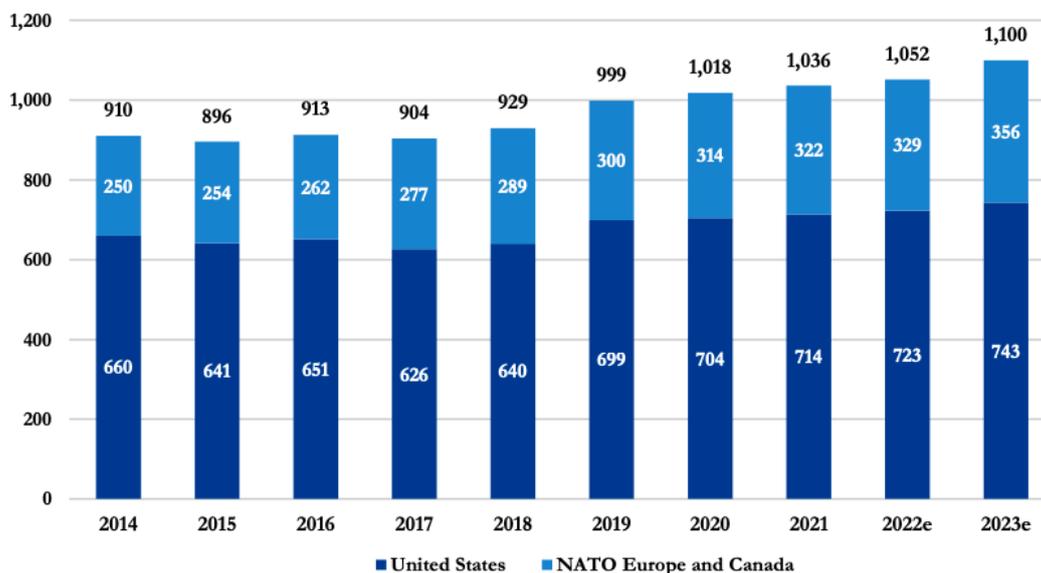
The aim of this note is to analyse the consequences of the war in Ukraine on the structuring of the defence market in Europe. The analysis is based on an open source review of weapon acquisitions recorded since the beginning of the war on 24 February 2022, as well as an analysis of the defence budgets of European Union (EU) member states.

THE IMPACT OF THE WAR ON EUROPEAN DEFENCE BUDGETS

Budget trends prior to the war

Analyses of trends in the years prior to the war demonstrate that, following the sharp drop that had characterised European defence budgets after the end of the Cold War, those budgets were again on an ascending slope, albeit a slow one. Even if NATO and European Defence Agency (EDA) data are not fully comparable in the sense that the NATO set of ‘European’ countries is larger, both indicate that the curve had begun to reverse as soon as in 2014, motivated in part by Russia’s move to annex Crimea and in part with the rise of the terrorist threat associated by the surge of the Islamic State as a global strategic actor. At the same time, EDA data indicate that EU defence spending in 2021 was still 31% below the 2% GDP target to which NATO member states re-committed in 2014.

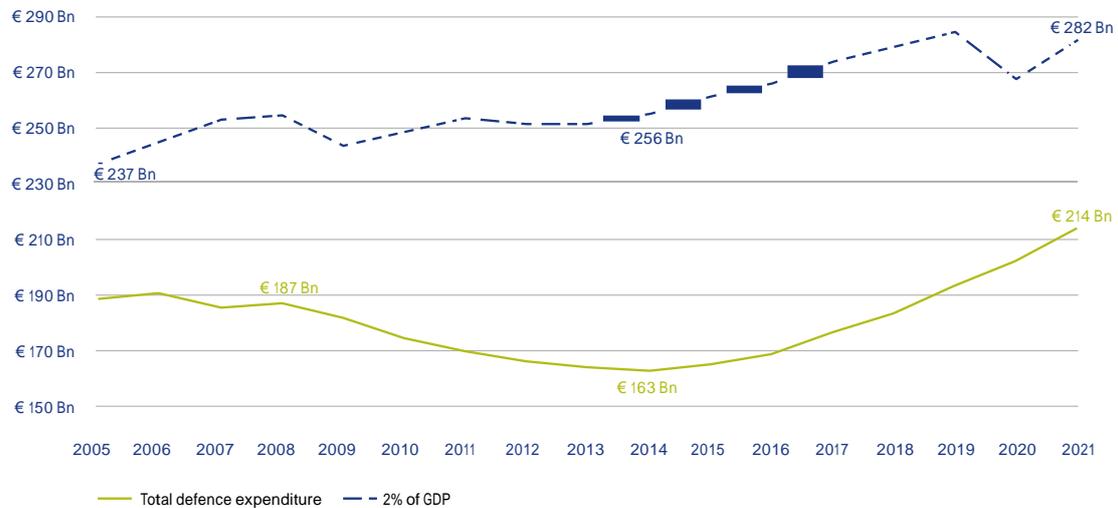
Figure 1 – NATO members’ defence expenditure
(billion US dollars, based on 2015 prices and exchange rates)¹



Source : NATO, ‘Defence Expenditure of NATO Countries (2014-2023)’

¹ The data include, from 2017 onwards, Montenegro (NATO member since 5 June 2017); from 2020 onwards, North Macedonia (NATO member since 27 March 2020); and from 2023 onwards, Finland (NATO member since 4 April 2023). Data for 2022 and 2023 are estimates.

Figure 2 – Total defence expenditure vs 2% GDP target (2021 constant prices)



Source: European Defence Agency, ‘Defence data 2020 – 2021’

Budget trends since the launch of the war

National data published by 25 EU countries,² the United Kingdom (UK) and Norway in 2023 show that:

- 1) In **25 out of the 27 countries surveyed**, the nominal defence budget increased from 2022 to 2023. The only two exceptions are Hungary and Greece, which saw a decrease, even in nominal terms (see Table 1).
- 2) In 18 of these 25 countries, the percentage increase was higher than the inflation rate, indicating a rise in real terms. This increase was particularly high in northern and central European countries, reaching in some cases **twice the inflation rate or above (Latvia, Netherlands, Poland, Slovakia, and Slovenia)**. In Poland, the rise represented a **spectacular 46% increase in real terms from 2022 to 2023**, whereas in nominal terms, rises of **20% or above were recorded in Austria, the Baltic states, Finland and Sweden**. In all of those countries, the rise obviously reflects a very strong fear of Russian aggression.
- 3) A similar, although more moderate trend was visible in Germany, where the defence budget will also grow well above inflation in 2023, following an appropriation of €8.3

² No data have been published by Cyprus and the Czech Republic.

billion from a new Bundeswehr Special Fund of €100 billion earmarked in reaction to the war.³

- 4) In general, increases in defence budgets reflected an increase in equipment expenditure, except in Estonia and to a lesser extent in Latvia, where a large part of the otherwise significant rise is largely explained by additional infrastructure expenditure to accommodate soldiers and equipment.
- 5) Based on national data, the increase in equipment expenditure of European countries from 2022 to 2023 would amount to €21.5bn, with Germany representing a third of that total and Poland 17.5%. By contrast, EU countries' defence investment the previous year only grew by €8.4bn.⁴

**Table 1 – Defence and investment budgets (2022-2023):
the European Union, the United Kingdom and Norway⁵**

	Evolution of defence budgets				Evolution of defence investments				Inflation 2022
	Budget 2022 ⁶ excluding extensions (Billion €)	Budget 2023 (Billion €)	Evolution (Nominal values)	Evolution (Real values)	Invest. 2022 (Billion €)	Invest. 2023 (Billion €)	Evolution (Nominal values)	Evolution (Real values)	
Austria	2.71	3.38	+24.3%	+12.26%	0.428	0.712	+66.2%	+49.73%	11.1%
Belgium	4.40 (Estimated)	4.77	+8.5%	+0.38%	1.29	1.42	+10.6%	+1.92%	8.0%
Bulgaria	1.14	1.295	+13.9%	-2.86%	0.306	0.322	+5.2%	-9.98%	16.9%
Croatia	1.00	1.04	+4.0%	-8.05%	0.066	0.070	+6.1%	-6.22%	13.1%
Cyprus									7.1%

³ « Regierungserklärung von Bundeskanzler Olaf Scholz am 27. Februar 2022 », Die Bundesregierung informiert | Startseite, s. d., <https://www.bundesregierung.de/breg-de/suche/regierungserklaerung-von-bundeskanzler-olaf-scholz-am-27-februar-2022-2008356>.

⁴ Defence data 2021, European Defence Agency, December 2022, <https://eda.europa.eu/publications-and-data/defence-data>

⁵ Based on national data.

⁶ The UK budget runs from 1 April to 31 March. The comparison here is between FY21-22 (1 April 2021-31 March 2022) and FY20/21 (1 April 2021-31 March 2020).

Czech Republic	3.93	Law to be adopted							17.5%
Denmark	3.76 (DKK 27.965)	4.36 (DKK 32.438)	+16.0%	+7.67%	0.576 (DKK 4.289)	0.856 (DKK 6.375)	+48.6%	+37.99%	7.7%
Estonia	0.77	1.10	+41.3%	+20.45%	0.126	0.133	+5.5%	-11.0%	18.6%
Finland	5.10	6.10	+19.6%	+9.63%	0.621	1.60	+157.7%	+136.16%	9.1%
France	40.9	43.9	+7.3%	+1.26%	14.5	15.4	+6.0%	+0.20%	6.0%
Germany	50.3	50 + 8.3 (Special fund)	15.9%	+6.58%	9.6	8.1 + 8.3 (Special fund)	+70.8%	+57.16%	8.7%
Greece	6.43	5.65	-12.3%	-18.03%	3.40				7.2%
Hungary	1.00	0.756	-24.4%	-39.86%	0.322	0.124	-61.5%	-69.36%	25.7%
Italy	25.90	27.720	+6.9%	-2.79%	5.41	6.10	+15.3%	+2.41%	10.1%
Latvia	0.76	0.98 (Provisional)	+29.4%	+6.13%	0.241	0.272	+12.9%	-7.11%	21.5%
Lithuania	1.20	1.78	+47.7%	+21.88%	0.236	0.304	+28.5%	+5.85%	21.7%
Luxembourg	0.39	0.509	+30.5%	+23.83%	0.017	0.024	+41.2%	+33.94%	5.4%
Netherlands	12.30	15.04	+22.3%	+13.64%	4.95	6.521	+31.7%	+22.43%	7.6%
Norway	6.33 (NOK 69.000)	6.95 (NOK 75.800)	+9.9%	+2.61%	1.87 (NOK 20.346)	2.22 (NOK 24.143)	+18.7%	+10.95%	7.0%
Poland	12 (PLN 57.052)	20.49 (PLN 97.400)	+79.7%	+46.44%	3.89 (PLN 18.515)	7.70 (PLN 36.616)	+97.8%	+69.76%	16.6%
Portugal	2.39	2.584	+8.3%	-0.26%	0.413	0.430	+4.2%	-3.95%	8.4%
Romania	5.98	7.104	+17.3%	+2.06%	2.13	3.136	+47.2%	+26.49%	16.4%
Slovakia	1.33	2.11	+58.7%	+37.48%	0.189	0.346	+83.1%	+58.64%	15.4%
Slovenia	0.69	0.896	+29.9%	+18.05%	0.132	0.223	+68.9%	+53.58%	10.0%

Spain	11.34	12.825	+13.1%	+6.90%	4.58	5.869	+28.1%	+21.12%	5.8%
Sweden	6.90 (SEK 76.600)	8.47 (SEK 93.953)	+22.7%	+9.31%	1.85 (SEK 20.518)	2.08 (SEK 23.112)	+12.6%	+0.12%	12.3%
United Kingdom	47.8 (£42.3)	51.8 (£45.9)	+8.5%	-1.93%	21.2 (£18.8)	23.6 (£20.9)	+11.1%	+0.74%	10.5%

Prospective trends in European defence spending

Although the defence budgets of European countries will have increased significantly by the end of 2023, the sustainability of this defence effort over the long term has yet to be confirmed. For this, four factors need to be taken into consideration.

- **The strength of national governments’ political commitment to NATO**

At the Vilnius summit in July 2023, NATO countries pledged to ‘make an enduring commitment to invest at least 2% of [their] Gross Domestic Product (GDP) annually on defence’.⁷ The wording chosen to reiterate what is after all a long-standing vow, represented a compromise between those who would have liked to see a higher target (Poland, Baltic countries) and those who wanted less than a formal commitment.

- **The relationship between short term increases and defence planning**

The proportion of European defence budgets dedicated to investment currently and for the immediate future reaches above 20% – the benchmark agreed by EU member states in 2007, and incorporated into the 20 common objectives of the Permanent Structured Cooperation (PESCO) in 2017.⁸ The meaning of this proportion, however, is significantly different for countries that develop their own armament programmes – whether nationally or through cooperation – and those that primarily purchase equipment off-the-shelf. In the case of the former, defence investment will be sustained over time – at the price of a certain rigidity in procurement, since programmes stretch over long periods (up to 40 years at times). Countries that buy most of their equipment off-the-shelf, by contrast, will have greater flexibility in the use of their budget appropriations but, barring any major equipment acquisition plans already in the pipeline, there is no certainty that their defence budget increases will be sustained.

⁷ Vilnius Summit Communiqué. https://www.nato.int/cps/en/natohq/official_texts_217320.htm

⁸ EU Ministers Adopt Framework for Joint European Strategy in Defence R&T, European Defence Agency, 19 November 2007. <https://eda.europa.eu/news-and-events/news/07-11-19/>
Council Decision (CFSP) 2017/2315 of 11 December 2017 establishing permanent structured cooperation (PESCO) and determining the list of participating Member States, 11 December 2017. <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017D2315&rid=6>

From this perspective, European countries present quite different profiles, which are important to keep in mind in any medium-term forecast.

France is undoubtedly the country with the most incompressible, but also the most predictable, defence budget, considering that off-the-shelf acquisitions account for no more than 10% of its defence investment. This also explains why the country has a 7-year military programming law. For the current period, covering the years 2024-2030, the national programming law foresees a budget increase of 3% per year over 2024-2027 in comparison with 2023, followed by a 4.3% increase per year over 2028-2030.

Italy has a 3-year rolling planning tool.⁹ **Sweden**, for its part, has a 5-year planning sequence; however, plans do not specify the capabilities to be acquired.¹⁰ Thus, when the Swedish Defence Commission – which wields significant influence on government decisions – sets out capability targets, these are not linked strictly speaking with budget resources or recommendations on armament types.¹¹ Indeed, the only forecast relevant to defence planning in the latest Defence Commission’s report (April 2023) was a recommendation that the next defence bill be adopted one year earlier than planned, in 2025 instead of 2026.¹²

Another loose form of defence planning is that of the **Netherlands**, which uses the instrument of White Papers. The latest White Paper, published in July 2022, foresees a €6 billion defence budget increase during the period 2022-2026 above the previous period, combining €4 billion from the regular budget, and a €2 billion special appropriation. This will bring the budget to €19.5 billion in 2024, or 2% of GDP, compared with 1.6% in 2022. From 2026 onward, the defence budget is meant to be given ‘a structural boost of €5 billion per year’¹³ – a prospect that is difficult to construe.

Similarly, in **Germany**, the sustainability of the current massive effort in defence is less than ensured. In the period up to 2026, Germany’s defence spending will benefit from the Bundeswehr Special Fund, from which €8.5 billion were allocated in 2023, as indicated earlier, to be followed by €19.2 billion in 2024. In parallel, the defence budget itself will increase

⁹ Italian Ministry of Defence, ‘Documento programmatico pluriennale della difesa per il triennio 2022-2024’, 2022. https://www.difesa.it/Il_Ministro/Documents/DPP_2022_2024.pdf

¹⁰ Swedish Ministry of Defence, ‘Main elements of the Government bill Totalförsvaret 2021-2025 - Total defence 2021-2025’, 2020. <https://www.swedenabroad.se/globalassets/ambassader/nederlanderna-haag/documents/government-bill-totalforsvaret-20212025.pdf>

¹¹ Swedish Defence Commission's White Book on Sweden's Security Policy and the Development of the Military Defence 2021-2025

¹² The Commission also upheld the agreement reached by the eight parties represented in the Riksdag in March 2022 to reach the target of 2% of GDP in the budget allocated to defence as soon as practically possible

¹³ ‘A stronger Netherlands, A Safer Europe: Investing in a Robust NATO and EU, 2022’, Defence White Paper, p56, Ministry of Defence, 19 July 2022, <https://english.defensie.nl/downloads/publications/2022/07/19/defence-white-paper-2022>

gradually, from a low of €50.1 billion in 2023 – €300 million below that of 2022¹⁴ – to around €60 billion in 2027.¹⁵ Although the new National Security Strategy, issued in June 2023, does entail a pledge that Germany will allocate 2% of its GDP to reach the NATO capability goals, this remains far from the €75 billion that would be necessary to achieve that target. The careful wording of the pledge in the Strategy (‘as an average over a multi-year period’[...] ‘initially in part via the newly created Special Fund’) raises doubts as to the firmness of future commitments.¹⁶ Given the uncertainty, Germany’s armament acquisition scenarios over the next few years will most likely continue to consist in off-the-shelf purchases rather than result from engagement in long-term build-up programmes.

Poland’s defence budget trends are in some respect similar to Germany’s, although with even greater uncertainty as to future commitments. Decisions made by Warsaw since 2022 entail the promise of a doubling of defence spending in real terms by 2024. Like in Germany, the increase will be financed by an extra-budgetary allocation (‘Armed Forces Support Fund’), foreseen in the *Homeland Defence Act* adopted in February 2022.¹⁷ At around €8 billion, the Support Fund will be financed in part by *Bank Gospodarstwa Krajowego (BGK)*, a development bank owned by the Treasury and operating outside the framework of the Government budget, in part through agreements signed with equipment-supplying states, notably through loans granted by national development banks, and, in the last instance, through government bonds.¹⁸ No information is available on how the loans will be reimbursed.

- **Budget sustainability of the defence effort over time**

A country’s determination to increase its defence spending is always the result of a trade-off between its spending on defence, as informed by strategic considerations, and its spending on other public policies. It is also conditioned by its capacity to take up debt to finance additional equipment acquisitions. From this perspective, not all European countries are equal. First, not

¹⁴ German Parliament, ‘Verteidigungsausgaben steigen, Verteidigungsetat’, 11 August 2022. <https://www.bundestag.de/presse/hib/kurzmeldungen-905912>

¹⁵ German Federal Ministry of Defence, ‘Verteidigungshaushalt 2024 wächst und NATO-Quote wird erreicht’, 5 July 2023. <https://www.bmvg.de/de/presse/verteidigungshaushalt-2024-waechst-5649432>

¹⁶ German Federal Government, ‘National security strategy’, June 2023. <https://www.nationalesicherheitsstrategie.de/National-Security-Strategy-Executive-Summary-EN.pdf>

¹⁷ Chancellery of the Polish Prime Minister, ‘More troops and more money for defence – the Council of Ministers adopted a draft Homeland Defence Act’, 22 February 2022. <https://www.gov.pl/web/primeminister/more-troops-and-more-money-for-defence--the-council-of-ministers-adopted-a-draft-homeland-defence-act>

¹⁸ Interview of Finance Minister Magdalena Rzeczkowska, reported in ‘Poland Seeking Defence Funding ‘Outside the Market’. Defence24, 29 December 2022. <https://defence24.com/defence-policy/poland-seeking-defence-funding-outside-the-market-commentary>

all are located at the same geographic distance of Russia and the Russian-Ukrainian frontline, and second, not all have the same fund-raising wherewithal.

Presumably, no major budget increase in defence equipment can be expected from the countries of southern Europe, in particular Greece, Italy and Spain, in the next few years, given both their distance from the frontline and their relatively fragile economic conditions, characterised by a high level of indebtedness overall. In addition, for all EU countries, the gradual return to the benchmarks of the Stability Pact as of 2024 (public debt below 60% of GDP, government deficit below 3% of GDP), even if applied with greater flexibility than in the past, will reduce the margin for budget increases. Addressing one of the EU's strategic priorities, to which the Strategic Compass for Security and Defence belongs, may be a cause for temporary leniency from the Commission in monitoring member states' compliance. However, this will not absolve them from the constraint of reaching the targets.¹⁹

Financial sustainability constraints will not spare Poland itself, despite its proximity to Russia and Ukraine. Thus, as a good observer of Polish defence policy comments, it is unlikely that the country's effort in dedicating 4% of its GDP annually to defence can be sustained beyond 2024.²⁰ In the short term, the impact of the commitments of the Armed Forces Support Fund on the country's financing capacity remains hidden, as Fund spending is not included in the calculation of the public debt and not subject to parliamentary scrutiny. It is also not on the political agenda, since the level of Government's indebtedness remains well under the EU's threshold.²¹ However, as indicated above, it is no clear that a plan exists to guarantee the reimbursement of the loans contracted from the Support Fund. Once these loans gradually come to maturity, Poland will be facing hard questions as to sustainability of the model.

- **The length of the war in Ukraine**

Short term European commitments to increase defence budgets clearly come in reaction to Russia's war of aggression. In a way, they are comparable to the rise in US military spending after September 2001 in that both are a response to an existential trauma. How durable the

¹⁹ Member states will have a period of four years to reach the targets, based on 'Fiscal-Structural Programmes' (FSPs) agreed with each of them, to be reviewed every six months. In some cases, the four years could be extended by another three, reaching a maximum of seven. Although extra-investment made by member states to achieve the EU's strategic priorities will be a cause for consideration, there is no automatism, and this will be only one of the criteria among many. ANNEXES to the Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the effective coordination of economic policies and multilateral budgetary surveillance and repealing Council Regulation (EC) No 1466/97, 26 April 2023, https://economy-finance.ec.europa.eu/system/files/2023-04/COM_2023_240_1_EN_annexe_proposition.pdf

²⁰ Raphael Minder, 'Who will pay the bill?: Poland's defence spending spree raises questions over funding', *Financial times*, 23 April 2023, <https://www.ft.com/content/91590a6d-2739-42c6-bb29-4d2aeac21bf7>

²¹ 49.1% in the fourth quarter of 2022

trend will be will therefore also depends on the length it takes to come to a war settlement, as well as the form this settlement takes. Should an agreement be found to re-establish a Europe-wide security order based on consensual rules, EU's current defence budget trends will likely be reversed. Should the conflict be simply frozen, relatively high levels of spending on defence will endure, even over the long term. Given the current lack of predictability of the conflict outcome, the most likely scenario is that, with a few exceptions, European countries will continue to sustain a commitment that most have by now genuinely made to reach the NATO 2% of GDP defence spending target.

- **Conclusion on defence budget trends**

The significant increases in European countries' defence budgets in 2023 and commitments for 2024/2025 are indicative of the pursuit of the course taken by many of them as of 2014 to reverse historical post-Cold War cuts. They also signal a sharp intensification of that course. Whether they will be sufficient to achieve and sustain the 2% NATO target, however, will depend on many factors, whereby national decisions may differ. Factors at play will include events on the battlefield themselves, countries' degree of commitment to NATO, the existence of competing national priorities and, for those that belong to the EU, the degree of pressure imposed on their national economies by the gradual return to budget orthodoxy as of 2024. Last but not least, the existence of a linkage between crisis response decisions and long-term defence planning will have an important impact. From this perspective, it is only in France, and to a much lesser extent in Sweden and the Netherlands, that increases announced in the short term bear any form of long-term commitment to increase the defence investment. Germany's commitments up to 2027 do bode well for the next few years, but they do not entail any certainty beyond that date. Poland's effort, even though remarkable in 2023-2024, is even less the mark of a commitment for the future given its uncertain economic sustainability.

EQUIPMENT ACQUISITION OBJECTIVES

A qualitative breakdown of weapon acquisitions registered since 24 February 2022 is useful to better understand the sustainability of the effort. For this, acquisitions can be classified in three categories, even though those categories cannot be clear-cut since the reasons behind purchase decisions may be multiple and they are not necessarily transparent.

- 1) Acquisitions formally concluded after 24 February 2022 but that were planned before the start of the war. In some cases, the war accelerated the procurement process and may have entailed slight modifications to previously agreed specifications, but no fundamental change. Germany's acquisition of F-35A in replacement of its Tornado fighter aircraft is such a case. For analytical purposes, the war is not considered as having influenced this acquisition, although its announcement three days after Russia's launch of its 'special military operation', and its financing through the Bundeswehr Special Fund, are clearly a political response to the event.
- 2) Acquisitions aiming at the reconstitution of stocks linked to the supply of arms or ammunition to Ukraine. These are clearly linked to the war, but it is not always easy to identify them in practice, for two reasons:
 - Ammunition acquisitions are not always reported, especially when they relate to small arms or artillery;
 - For reasons of political or security sensitivity, some countries do not wish to communicate all or part of their arms deliveries to Ukraine.
- 3) Acquisitions coming directly from ramp-up decisions resulting from the war. Even if governments rarely qualify the purpose of their arms acquisitions, all procurement contracts announced after 24 February 2022 that led either to an increase in the volume of capabilities held by a country or the acquisition of new capabilities can be classified as such. Many of the arms acquisitions carried out by Poland fit into this category.

Based on this differentiation, a gradual shift is clearly visible from the former category to the latter two over the period early 2022-mid-2023. **Thus, acquisitions made between September 2022 and mid-2023 to strengthen the defence capabilities of European countries²² – quantitatively or qualitatively – accounted for around 70% of the total for the period, reaching €75 billion, whereas acquisitions made from the beginning of 2022 to September reached only €23 billion, including some €15 billion resulting from decisions made prior to the start of the war.** Another €5 billion were linked to replenishments.

This ratio could further evolve yet, for two reasons:

- Some of the acquisitions designed to increase capacity in quantitative terms also took into account the need to rebuild stocks;

²² Including the UK and Norway

- A number of Central European countries may yet carry out new acquisitions to replace the ex-Soviet combat aircraft they have delivered to Ukraine.

MAIN BUYERS

In the short term, the main buyers of defence equipment are also those countries that have announced the largest increases in their defence expenditure, primarily Germany and Poland, in addition to a few other states.

Germany's main acquisitions are:

- The 35/F-35A and related equipment, acquired from the US. The approval in principle by the US State Department of the Foreign Military Sale (FMS) covering this acquisition was made public in July 2022²³ and the purchasing plan confirmed by the German Ministry of Defence in December 2022. The maximum amount of the contract is US\$8.4 billion (€7.9 billion).
- The 60 CH-47F Chinook Helicopters and related equipment, also from the US, for an estimated cost of US\$8.5 billion (€8billion) in May 2023. Although the source of funding has not been made public, it is likely to be the Bundeswehr Special Fund.

Poland, for its part, announced or concluded arms acquisitions for a cumulative value of nearly €28 billion in one year (July 2022-June 2023), including tanks, armoured vehicles, combat aircraft, artillery, missiles, UAVs, and warships. This represents more than three times its 2023 defence investment budget, which itself was twice that of 2022. More could come if Warsaw confirms its decision to acquire 96 AH 64-E Apache helicopters. Within those €28 billion, purchases from non-European countries amount to more than €25 billion, from the UK to €1.9 billion, and from the EU only to around €500 million (mainly from Airbus, for the purchase of satellite capacity). The remainder comes from Polish companies.

Other noticeable buyers are mainly Finland, the Baltic States and Romania, with purchases encompassing ammunition, artillery and missiles as well as, in the case of Romania, F-16 refurbished combat aircraft from Norway.

²³ Defence Security Cooperation Agency, 'Germany – F-35 Aircraft and Munitions', 28 July 2022. <https://www.dsca.mil/press-media/major-arms-sales/germany-f-35-aircraft-and-munitions>. On the FMS, see further below.

PROVIDERS: EU VS NON-EU COUNTRIES

The value of defence acquisitions announced by EU countries from the start of the war to June 2023 is of just above €100 billion. Over the 12 months from June 2022 to June 2023, they amounted to €75 billion, compared with €52 billion euros for the year 2021.²⁴

From this total, **78% is being procured from outside the EU**, including 80% from the US, 13% from South Korea, 3% each from the UK and Israel, and 1% from other countries. This leaves €21 billion for EU countries themselves. Alone, **the US accounts for 63% of EU countries' acquisition plans.**

The pivotal role of the US Foreign Military Sales (FMS) programme

Ninety-five percent of EU countries' equipment orders from the US since the beginning of the war have been made through the Foreign Military Sales (FMS) programme, amounting to an expenditure above US\$ 60 billion. The FMS is a Government-to-Government arrangement, exonerating contracting parties from the requirements of EU Directive 2009/81, which covers defence and security markets.²⁵ It is therefore a flexible tool, which both the US and EU countries prefer to commercial sales as a means to acquire US military equipment quickly. The approval for the sales itself, which is given by the US Defence Security Cooperation Agency (DSCA), is relatively light.

Categories of US armament purchases

Acquisitions from the US encompass four main types of weapons:

- Ammunition for replenishment purposes. This includes, for example, anti-tank Javelin and Hellfire missiles (Poland and France) and various types of air-to-air missiles, such as the AMRAAM (Bulgaria, Czech Republic, Germany, Netherlands, Norway Romania and Sweden).
- Weapons for supply to Ukraine where no competitive equipment of the same type is available in Europe. This includes High Mobility Artillery Rocket Systems (HIMARS) (Poland, Estonia, and Lithuania), Switchblade loitering munitions (Lithuania), and UAV MALE Reapers (Greece and Netherlands).

²⁴ EDA Defence Data 2021. <https://eda.europa.eu/publications-and-data/defence-data>

²⁵ Art. 13 of the Directive foresees that certain market rules applying to defence acquisitions do not apply to 'contracts awarded by a government to another government relating to: (i) the supply of military equipment or sensitive equipment, (ii) works and services directly linked to such equipment, or (iii) works and services specifically for military purposes, or sensitive works and sensitive services; []' <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009L0081>

- Air defence systems. This includes Patriot Advanced Capability 3 (PAC 3) launchers (Poland, Switzerland, Finland, and Germany), Guided Multiple Launch Rocket systems (GMLRs) (Netherlands and Poland), and Stinger missiles.
- Combat aircraft and helicopters, in part to replace ex-Soviet combat aircraft handed over to Ukraine. For combat aircraft, this includes F-35s (Germany and Czech Republic), F-16s (Bulgaria), and upgrades of F-16 provided by Norway (Romania); for helicopters, CH-47 Chinook (Germany), multi-mission MH-60s (Spain²⁶ and Norway), and AZ-12 Viper (Slovakia).

A new trend: manufacturing US defence systems in Europe

While the US may have initially benefited from its ability to generate greater quantities of weapons than Europe, notably because of its larger stocks of ammunition, it does not seem to have a significantly greater industrial capacity to scale up its production to replace equipment delivered to Ukraine and some European countries. Moreover, the US Army will be prioritised in the future as it needs to replenish its own stockpiles.

To take the example of the HIMARS, only 20 had been delivered by the US to Kiev by fall 2023, drawing from existing stocks, out of a total order of 38. The remaining 18 had yet to be manufactured. Lockheed Martin did announce in late 2022 that it intended to increase its production of HIMARS from 60 to 96 systems per year.²⁷ However, it takes more than a year to produce one system (similar to the Caesar gun). It is therefore hard to imagine how the company could ever deliver the 500 HIMARS Poland ambitions to buy in the short to medium term. Even the acquisition of 48 Patriot M903 launch stations and 644 PAC 3 launchers is far from imminent, although the sale has already been approved by the DSCA.

This situation explains Rheinmetall's proposal in early 2023 to manufacture the HIMARS in Europe.²⁸ The proposal was taken up by Lockheed-Martin, leading the two companies to announce in June 2023 that they would team up to offer European customers a European-made rocket launcher based on the HIMARS.²⁹ This partnership is set to expand as the two

²⁶ Acquisition decided before the beginning of the war

²⁷ Valerie Insinna, 'Lockheed making moves to increase HIMARS production to 96 per year, breaking news', *Breaking Defense*, 18 October 2022, <https://breakingdefense.com/2022/10/lockheed-making-moves-to-increase-himars-production-to-96-per-year/>

²⁸ Inder Singh Bisht, 'Rheinmetall in Talks With Lockheed to Produce HIMARS in Germany: CEO', *The Defence Post*, 31 January 2023. <https://www.thedefensepost.com/2023/01/31/rheinmetall-lockheed-himars-germany/>

²⁹ Vivienne Machi, 'Lockheed, Rheinmetall pair up to build Europe-made rocket launcher', *Defense News*, 23 June 2023, <https://www.defensenews.com/global/europe/2023/06/23/lockheed-rheinmetall-pair-up-to-build-europe-made-rocket-launcher/>

companies have also agreed that Rheinmetall would build the second F-35A Centre Fuselage integrated assembly line. Prior to this, only Northrop Grumman ran such an assembly line in Palmdale, California.³⁰

The so-called 'Ramstein group', mobilised by the US to coordinate military support to Ukraine, serves as the framework umbrella for such arrangements.³¹

South Korea: a new defence provider to Europe

The saturation of American and European defence industrial capacity largely explains the irruption of South Korea as a major equipment provider on the European market.

The main buyer of South Korean defence systems is Poland with the acquisition of K2 battle tanks, K9 artillery systems and FA-50 combat aircraft. The first 10 K2 tanks were delivered already in 2022, to be followed by an expected 170 more, at a rate of approximately 60 each year. Overall, the deliveries over the various systems are scheduled to spread until 2025-2026.

Mariusz Błaszczak, Poland's Minister of Defence, has stated that three factors explained the choice of Korean manufacturers, 'the efficiency of the equipment, the pace of deliveries and the benefits for the industry.'³² With regards to the latter, Polish experts note the Korean lead companies' readiness to grant manufacturing licences to Polish contractors, stressing that this is an opportunity for Poland to develop its national Defence Technological and Industrial Base (DTIB).

Although at a lesser volume than Poland, Romania and Estonia have also purchased Hanwha 155 mm K9 howitzers from South Korea.

The EU's humble share of the European defence market

As indicated earlier, purchases of defence equipment from EU manufacturers only amounted to €21 billion since the beginning of the war, or about 22% of the market.

Germany has been the main beneficiary, with about €11.5 billion in sales, or more than 50% of the total, its main buyers being Norway, Greece, and Ukraine itself. Not all purchases, however, are linked to the war. For example, contracts placed by Greece in the amount of €4

³⁰ Inder Singh Bisht, 'Rheinmetall to Build F-35A Center-Fuselage Plant in Germany', *The Defence Post*, 5 June 2023, <https://www.thedefensepost.com/2023/07/05/rheinmetall-f-35a-germany/>

³¹ <https://www.defense.gov/News/News-Stories/Article/Article/3370267/following-ukraine-defense-contact-group-austin-reminds-members-of-their-impact/>

³² Jędrzej Graf, 'Polska kupi 1000 czołgów. Błaszczak: planujemy pozyskanie dodatkowych F-35 lub F-15', *Defence 24*, 26 July 2022. <https://defence24.pl/polityka-obronna/polska-kupi-1000-czolgow-blaszczak-planujemy-pozyskanie-dodatkowych-f-35-lub-f-15-wywiad>

billion for several big ticket items (modernisation of Leopard 2A4 main battle tanks, purchase of new Lynx KF-41 type armoured combat vehicles, modernisation of four MEKO frigates), resulted from negotiations that begun well before the war, but only came to fruition in October 2022.

Behind Germany, Sweden accounts for €4.7 billion of the sales. A large proportion of the total relates to the purchase of CV-90 armoured fighting vehicles manufactured by Hägglunds, a Swedish subsidiary of British company BAE Systems, by Slovakia and the Czech Republic.

France, for its part, only holds 12% of the market share, with €2.5 billion in sales.

EU PRIORITIES AND EUROPEAN DEFENCE MARKET TRENDS

The gap between EU initiatives and the current structure of the European defence market

EU's current initiatives in the field of armaments have little immediate impact on the structure of the European defence market. These initiatives, supported by the European Defence Fund (EDF) are focussed on research and development (R&D), whereas member states' priorities today are on the acquisition of capabilities. To fill that gap, EU countries have no other option than buying off-the-shelf. The European Peace Facility (EPF), the only form of EU support to the acquisition of weaponry, is limited to arsenal replenishment, which does not represent more than 5% of the market in 2022-2023 (see above). In other words, there is a discrepancy between Europe's urgent needs and the common policies intended to have a long term impact on the European Defence Technological and Industrial Base (EDTIB).

The EDIRPA, a catalyst for change?

Based on instructions issued by the European Council in March 2022, in May 2022, the European Commission and the EDA published a joint communication including a set of proposals to address EU countries' defence investment gaps, defence industrial gaps, and capability gaps. The communication proposes to proceed via a succession of increasingly ambitious initiatives meant to reduce Europe's strategic dependencies via the strengthening of the EDTIB.³³ The first initiative is meant to reinforce EU countries' defence industrial

³³ Joint Communication to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the regions on the Defence Investment Gaps Analysis and Way Forward, 18 may 2023, https://commission.europa.eu/publications/defence-investment-gaps-and-measures-address-them_en

capabilities in the relatively short term by boosting joint procurement efforts. Called the 'European Defence Industry Reinforcement through common Procurement Act' (EDIRPA), its key features were endorsed by the EU Council and the Parliament in June 2023. Endowed with a €300 million budget over 2023-2025, EDIRPA is tailored to stimulate up to €1.5 billion in joint acquisitions for the purpose of stock replenishment, considering that its contribution may cover up to 20% of the costs of such acquisitions.

In terms of next steps, the Commission is preparing a second initiative, baptised the 'EU framework for Defence Joint Procurement' (EDIP), which will succeed the EDIRPA and be endowed with a larger budget. The objective of the EDIP, which will be laid out in a draft regulation expected in December 2023, is to develop a permanent mechanism to further incentivise EU member states to collaborate on equipment procurement. At the political level, the EDIP is meant to steer member states on a course where common procurement will be the rule, rather than the exception. In terms of resources, this would ensure that the money invested by the EDF in R&T and R&D is not wasted but results in cooperative armament programmes leading to actual acquisitions by EU member states in the future. The EDIP is therefore meant to lead to a re-balancing of the European defence market in favour of the EDTIB, with the further strategic aim of reducing Europe's strategic dependency. Whether EU Member States later act in accordance with the commitments they have made through the EDIP, however, is another matter. Their national-level decisions, in the end, will determine the strength of the EDTIB.

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