



EDIRPA/EDIP: RISKS AND OPPORTUNITIES OF FUTURE JOINT PROCUREMENT INCENTIVES FOR THE EUROPEAN DEFENCE MARKET

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The Armament Industry European Research Group (Ares Group) was created in 2016 by The French Institute for International and Strategic Affairs (IRIS), who coordinates the Group. The aim of the Ares Group, a high-level network of security and defence specialists across Europe, is to provide a forum to the European armament community, bringing together top defence industrial policy specialists, to encourage fresh strategic thinking in the field, develop innovative policy proposals and conduct studies for public and private actors.

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ABSTRACT

For most EU member states, the Russian invasion of Ukraine has acted as an awareness-raising of insufficient stockpiles and of an undersized European defence industry to deal with a sharp and sudden increase in demand. This situation has led to a disorganised and uncoordinated reconstitution of stockpiles on a national basis, including multiple foreign off-the-shelf purchases, which could in the long term weaken a European Defence and Technological Industrial Base (EDTIB) designed for peacetime.

To avoid fragmentation, an inflation of prices and potential supply shortages, as well as to give the EDTIB the necessary visibility to ramp-up, the European Commission has proposed two incentives: EDIRPA (short term) and EDIP (long term). These tools should both consolidate the European demand, by encouraging joint acquisitions, and make the EDTIB more competitive, by increasing the European defence industry's production capacity.

However, despite the urgency, negotiations are dragging on and the adoption calendar of both texts was delayed. The holding of European elections in May 2024 calls for speeding up the adoption of EDIRPA by the European Parliament and pleads for a quick adoption of EDIP too, at the latest in March 2024, before the European Parliament's recess. If EDIP negotiations take as long as for EDIRPA, its adoption before the next elections could seriously be compromised, as the draft regulation is only scheduled for June 21, 2023.

Moreover, the relaxation of the initial EDIRPA proposal, and the possible opening of the instrument to third states, which some MEPs call for, weaken the instrument's legal basis (Art. 173 TFEU), which relies on supporting the EU industry's competitiveness.

As short-term choices will have decisive long-term effects, it is crucial to ensure coherence between short-term objectives (replenishment of stockpiles) and long-term objectives (strengthening the EDTIB). Decisions to be taken in the coming months will undoubtedly shape the future of the European defence market.

This paper presents the main risks and opportunities for the European defence market of the future EU joint procurement incentives, which have been announced by the European Commission (EDIRPA/EDIP). It also makes recommendations on how these tools should be used to strengthen the EDTIB.

Keywords: EDTIB / European defence market / Joint procurement / Ramp-up / Consolidation/ Cooperation.

INTRODUCTION

The Russian invasion of Ukraine on February 24 has acted as a wake-up call for most EU member states. Indeed, the scale of the Russian deployment, the quantity of equipment consumed or destroyed, the long-term nature of the conflict and the volume of equipment transfers to Ukraine, raised awareness of insufficient equipment stockpiles and of an undersized European defence industry to cope with a sharp and sudden increase in demand.

While this situation led to significant rises in defence budgets and especially in equipment spendings in most member states – which are more than welcome after decades of defence spending cuts – the disorganised and uncoordinated way the reconstitution of stockpiles was initially carried out, has led to a multiplication of off-the-shelf purchases which risk weakening the European Defence and Technological Industrial Base (EDTIB).

To remedy this situation, avoid supply shortages, an inflation of equipment prices, duplications, and a multiplication of defence systems within the EU – which is detrimental to European armed forces' efficiency and interoperability – member states mandated the European Commission and the European Defence Agency (EDA) to carry out an analysis of existing capability shortfalls and to propose concrete measures to strengthen the EDTIB.¹

Thus, in a joint communication on the "Analysis of defence investment gaps and the way forward"², on May 18, 2023, the European Commission has announced several measures, such as the implementation of a *Defence Joint Procurement Task Force* (DJPTF) to map needs and identify major gaps between supply and demand, as the well as regulatory incentives (EDIRPA and EDIP) to encourage joint procurement.³

While these measures were more than necessary and are therefore to be welcomed, the direction of current debates in the European Parliament on the EDIRPA draft regulation and the significant delay in the adoption of the text are of major concern, as they could well distort the original objectives of the instrument.

As the decisions, to be taken in the coming months on EDIRPA and EDIP, will shape the future of the European defence market, this paper provides an analysis of the main risks and opportunities at stake for the EDTIB.

¹ *Informal meeting of the Heads of State or Government, Versailles Declaration*, European Council, March 11, 2022, page 5.

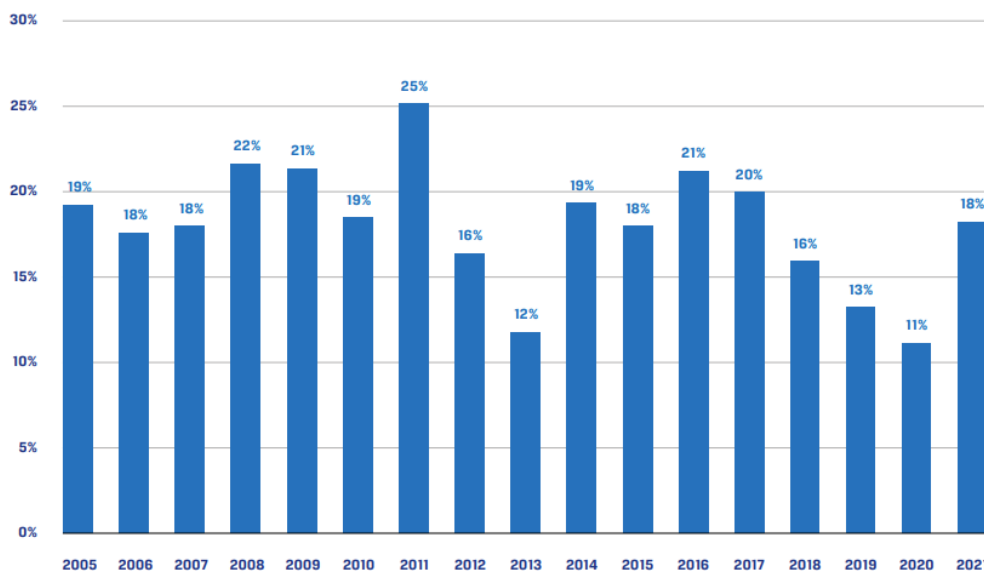
² *Joint Communication (...) on the Defence Investment Gaps Analysis and Way Forward*, European Commission, May 18, 2022.

³ While the setting up of these tools has been accelerated by the Russian aggression war, it should be noted that the idea of completing existing instruments such as the European Defence Fund (EDF) – which is limited to the R&D phase – by an incentive dedicated to the procurement phase, has been in the pipes for a while.

OPPORTUNITIES: A NEW IMPETUS FOR A MORE COMPETITIVE EDTIB?

The implementation of incentives to encourage joint procurement offers several advantages. In the short term, supporting joint procurement should allow to consolidate the European demand and make it more predictable, thus giving the European industry the needed visibility for ramping-up its production, while more than 80% of defence procurement in the EU is still carried out on a national basis. Indeed, despite recent increases, in 2021 only 18% of equipment procurement within the EU were carried out jointly, a figure that remains well below the 35% objective agreed by member states. Joint procurement should also allow member states to achieve economy of scales, limit the inflation of equipment prices, and prevent smaller states from being disadvantaged or last served.

Figure 1: European collaborative defence equipment procurement as % of total defence equipment procurement



Sources : *DEFENCE DATA 2020-2021 Key findings and analysis*, European Defence Agency, Dec. 2022, page 16.

In the longer term, these tools should encourage an increase of the production capacity of the European defence industry, to be able to cope with a significant increase in demand, and thus strengthen the EDTIB' competitiveness. **While EDIRPA only encourages the consolidation of the demand side, EDIP should focus on supporting the supply side, by creating a framework favourable to the development of the European defence industry, enabling it to produce more, better, and faster.** This could for example be achieved through measures to support

the specialisation of companies, by facilitating certification, or by encouraging the resizing of production chains through measures supporting the modernisation or the construction of new industrial facilities for example.

Moreover, for the sake of coherence, rationalisation, and efficiency, these tools should be linked to existing instruments. Thus, projects which have been supported under the EDF could for example benefit from an additional financial incentive in the acquisition phase through EDIP, while future capability projects supported by the long-term instrument should be based on the priorities and capability gaps identified through the CDP and CARD⁴. It would also make sense to use one part of EDIRPA's funding to support the joint purchase of ammunition through the EDA *Collaborative Procurement of Ammunition* project⁵, which has just been approved (March 23, 2023), to provide an extra incentive based this time on community funding. Finally, these tools could also help reduce existing external dependencies, by using for example EDIRPA to identify components that are not produced in the EU to date and support their development through the long-term instrument (EDIP).

However, although these measures are more than welcome, EDIRPA's impact will probably be limited, due to a low budget (500M€) and of significant delays in the adoption of the regulation, leading most countries to replenish their stocks without waiting for the text to be adopted. Moreover, such instruments will not be easy to implement for several reasons.

First, because member states do not share the same vision of their final objective, mainly due to differences in strategic culture, threat perception, level of external dependencies and of existing capability shortfalls. On the one hand, a little group of countries, especially France, consider that these tools should exclusively serve the European defence industry and support in priority the development of the EDTIB, since they are based on Art. 173 of the TFEU (support to the competitiveness of European industry). The aim here is to develop an appropriate and sustainable source of supply. On the other hand, most member states - especially those close to the front line - give priority to the quick replenishment of stockpiles, considering the development of the EDTIB as a secondary objective. This is clearly reflected by current debates which take place in the European Parliament on the EDIRPA draft regulation, some MEPs calling for an opening of the instrument to third countries and to lower the restriction safeguards set in the initial proposal. This is also reflected in the version adopted by the

⁴ Respectively *Capability Development Plan* and *Coordinated Annual Review on Defence*

⁵ *Delivery and joint procurement of ammunition for Ukraine*, Council of the European Union, March 20, 2023.

Council on Nov. 18, which considerably relaxed the initial criteria proposed by the Commission, which were considered by most member states as too restrictive.⁶

The second difficulty lies in the fact that increasing the EDTIB's production capacity should necessarily involve national and/or transnational industrial mergers, which are the only way to achieve higher production volumes, in a European market which remains highly fragmented and mainly structured around national small-size players. Although necessary, to achieve the necessary critical size and strengthen the EDTIB's competitiveness, such mergers could create tensions due to the issue at stake, whether political (*i.e.* sovereignty) or economical (*i.e.* employment, technology transfer).

Last but not least, developing the production capacity of the European defence industry also implies to reduce critical dependencies and strengthen the security of supply of several raw materials necessary for the production of military equipment, such as certain metals (*i.e.* aluminum, titanium), powders, or minerals that are not always available in Europe. This means first being able to identify our dependencies, then agreeing to work together to reduce them, and finally avoiding the opposite pitfall of renationalising what is already produced in Europe. Linking these instruments to existing initiatives addressing the EU's external dependencies, such as the European Critical Raw Materials Act, would also be relevant.

⁶ *Proposal for a regulation on establishing the European defence industry Reinforcement through common Procurement Act*, Council of the EU, Nov. 18, 2023.

MAIN RISKS AT STAKE: A DECORRELATION BETWEEN SHORT- AND LONG-TERM OBJECTIVES WHICH COULD JEOPARDISE THE FINAL PURPOSE OF THESE INSTRUMENTS?

When looking at the current evolution of debates on the EDIRPA draft regulation, two main risk can be identified: a use of the short-term instrument (EDIRPA) which would primarily benefit non-European companies, thus missing the objective of strengthening the EDTIB (1), and a development of joint procurement that would contribute to a fragmentation of the European defence industry, thus missing the objective of consolidating the EDTIB (2).

Risk 1: Supporting third countries' industry instead of supporting the European industry

While supporting the development of joint procurement at EU level appears to be a relevant response to the risks induced by the current uncoordinated increase in demand for military equipment in Europe, the fact that the EDTIB is currently undersized to respond rapidly to a consolidated demand for equipment and does not produce all the products which are needed by member states represents a risk, in the sense that it makes the recourse to non-European suppliers and the acquisition of foreign off-the-shelf equipment inevitable in the short term.

Although the compromise found by the European Council limits this possibility, as eligible equipment must be produced in Europe, by an entity that is not controlled by a third country, or that has been subject to a prior screening mechanism, and must not contain more than 30% foreign components, an opening by the European Parliament is not excluded, in view of some of the amendments discussed in the different committees responsible for examining the text.⁷

While in the short term the impact of such off-the-shelf purchases from third countries would be limited, in the long term, if they were to be supported by EDIP, they would contribute to a lasting weakening of the EDTIB for several reasons. On the one hand, they would lead to a loss of market share for European manufacturers offering equivalent systems, by taking up part of member states' resources and reducing their possibilities of renewal in the medium term. On the other hand, opening this financial incentive to third countries would offer an additional comparative advantage to foreign competitors who already benefit from a certain attractiveness, whether for political reasons (*i.e.* the U.S. security guarantee) or industrial reasons (*i.e.* quicker availability of the equipment, such as for South Korea). This could lead to the long-term establishment of these products on the European market and to the

⁷ AMENDEMENTS 14 – 142, Projet d'avis Ivars Ijabs, European Parliament, Feb. 2023.

establishment of foreign production sites in Europe, the search for interoperability leading other member states to acquire the same equipment. Beyond perpetuating the EDTIB's shortcomings *sine die*, in the longer term, it may result in the disappearance of equivalent European capabilities. While many member states have not waited for such an incentive to purchase non-European equipment, an incentive exclusively reserved to European equipment could have led states with the most limited defence budgets to favour such purchases.

Finally, the fact that several member states are already using foreign equipment in areas corresponding to the priorities identified by the DJPTF⁸, such as anti-tank missiles or ground-air defence, may encourage joint procurement of such equipment through the instrument, if it were to be opened to third countries. This is for example the case of Israeli *Spike* and of U.S. *Javelin* anti-tank missiles, which are in service in a dozen of member states, despite the existence of equivalent European capabilities, such as the Swedish *NLAW* and French *Akeron*.

Risk 2: Fragmenting the EDTIB instead of consolidating it

The European Commission's current approach of putting member states in competition with each other through calls for projects, instead of direct awards, to access EDIRPA funding could also pose a risk. While it allows keeping a certain *level playing field*, this approach makes the selection process slower and more difficult, which seems contradictory to the urgency inherent to the instrument and its goal of quickly restoring stockpiles. Moreover, the duration of the instrument as foreseen in the draft regulation - less than 15 months if the instrument enters into force in September 2023 - makes a complex project selection process (like the evaluations carried out in the framework of the EDF) unrealistic.

Another issue, which does not seem to have been decided yet, is linked to the number of projects selected. Could two competing consortia offering different solutions in the same field be funded? On the one hand, the concentration of the demand with a single European company could contribute to reinforce its production capacity in such a way as that it would widen the gap vis-à-vis its European competitors and give it competitive advantage that would put other European competitors at risk. On the other hand, the funding of several competing projects may represent a risk of scattering resources around micro-consortia which would miss the expected scale effect and would not give companies the necessary visibility to ramp-up and durably invest in their production tool. One solution could consist in encouraging two competing consortia to come together by making the allocation of funds conditional on this.

⁸ *Joint procurement: EU Task Force presents conclusions of first phase*, EEAS, Oct. 14, 2022.

In any case, it will be necessary to find the right balance between encouraging consolidation and maintaining a certain level of competition in the consortia selection.

CONCLUSION

Despite the implementation in recent years of several measures to encourage and facilitate cooperation among EU member states, such as the 2009 directives on defence procurement (2009/81) and on intra EU-transfers (2009/43), or the European Defence Fund (2021) and its precursors (PADR/EDIDP), whose effect on the market are not yet measurable, cooperation levels remain insufficient. Although the share of cooperative programmes (18% in 2021) is on the rise again, after several years of decline (2017-2020), it has not returned to its 2011 level (25%) and remains far from the 35% target to which member states are committed.

Consequently, the European defence market remains highly fragmented and mainly organised around small-sized national stakeholders. This situation leads to a European defence industry that is undersized to cope with the massive and sudden increase in equipment demand linked to the war in Ukraine and the urgent need to replenish stockpiles. This mainly results in uncoordinated purchases of foreign off-the-shelf equipment, which further weakens an EDTIB designed for peacetime.

Therefore, the establishment at EU-level of tools to encourage joint procurement and to strengthen European production capacities is more than welcome. Provided, of course, that they serve to support European industry, in accordance with their legal basis (Art. 173 TFEU). Strengthening the competitiveness of the European defence industry will also require industrial consolidation and the reduction of external dependencies. Member states therefore need to decide together what they want to be able to produce independently within the EU and what they concede to be purchased from outside. On the industry side, ramping-up and sustainable investments in production tools requires long-term visibility, which includes the guarantee of sufficient public procurement levels for the decades to come, beyond the war in Ukraine, without which the EDTIB would go from being undersized to oversized. It also calls for a long-term strategy setting out a roadmap to increase Europe's comprehensive defence industrial base, which would enable Europeans to better respond to possible future crises.

Finally, while the EU can play an incentive role, the effectiveness of these tools and their impact on the competitiveness of the EDTIB will ultimately depend on the goodwill of member states and notably on their political willingness to cooperate.

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