



### The European Defence Fund: Questions and Answers

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#### Why do we need a European Defence Fund?

The EU is facing the most severe security challenges of the past 60 years. As outlined in Commission President Jean-Claude Juncker's [political guidelines](#) in 2014 and stated in his [State of the Union Speech](#) of 14 September 2016, new threats at home and in the EU's neighbourhood as well as emerging risks like cyberattacks are making internal security and external defence lines increasingly blurred. EU citizens are increasingly looking to Europe for protection within and beyond its borders because the scale and nature of these challenges is such that no Member State can successfully address them on their own. And a strong Europe in defence requires a strong defence industry.

There is a significant economic case for greater cooperation on defence spending among EU countries. The costs of defence equipment, including development costs, are rising faster than defence budgets. The lack of cooperation between Member States in the field of defence and security is estimated to cost annually between €25 billion and €100 billion. 80% of procurement and more than 90% of Research and Technology are run on a national basis. Up to 30% of annual defence expenditures could be saved through pooling of procurement. (see [Factsheet on the case for greater EU cooperation on security and defence](#)).

There is also a strong strategic case: Dysfunctional cooperation and EU-wide fragmentation in defence contributes to the lack of deployability of our armed forces (approximately 40,000 vs 200,000 for the US). It therefore hampers the EU's ability to act and protect.

As Member States begin to increase their defence budgets, the EU can help them to spend these funds more efficiently. By pooling resources, individual Member States can achieve greater output and develop defence technology and equipment (also referred to as "capability") that may not be feasible on their own. Increased collaboration also reduces duplications, promotes standardisation of equipment and ensures better interoperability between European armed forces. It will also allow economies of scale thus reinforcing the competitiveness of the EU defence industry.

In September 2016, President Juncker announced the establishment of a European Defence Fund to help Member States develop and acquire key strategic defence capabilities more quickly, jointly and in a more cost effective way. The initiative was welcomed by EU leaders during the European Council meetings in [December 2016](#) and [March 2017](#).

The European Defence Fund is linked and complementary to the implementation of the [EU Global Strategy](#) for Foreign and Security Policy on security and defence. The Fund will contribute the implementation of the EU level of ambition in security and defence agreed by the Council in November 2016. It will also contribute to the implementation of the [EU-NATO Joint Declaration](#) signed in Warsaw in July 2016.

In parallel, the Commission has presented a longer-term [reflection paper](#) setting out possible scenarios for the future in the area of European defence. This forms part of the discussion on the future of the EU at 27 launched with the [Commission's White Paper on the Future of Europe](#) on 1 March 2017. The European Defence Fund is a power engine in support of each of the scenarios proposed.

#### What is the European Defence Fund?

The European Defence Fund will boost the EU's excellence and efficiency in defence equipment and technology by supporting the whole production chain: research, prototype development, and acquisition.

To achieve this, the Fund has two strands with different legal and funding structures (or "windows") which are complementary and are being gradually deployed:

- **Research** ("research window"): the EU will offer direct funding (grants) for research in innovative defence products and technologies, fully financed from the EU budget;
- **Development and acquisition** ("capability window"): Member States will pool financial contributions to jointly develop and acquire key defence capabilities. The EU will offer co-financing from the EU budget to incentivise cooperation and leverage national financing.

Both strands will support the priorities agreed by the Member States within the EU, notably through the Capability Development Plan, who will also ultimately own and operate the assets.

The progressive roll-out of the Fund reflects the nature of the EU budgetary planning cycles.

Until 2020, the Commission will allocate €590 million to the European Defence Fund. As of 2020, the Commission is proposing to allocate at the minimum €1.5 billion per year. The Fund is not designed to substitute Member States' defence investments, but to enable and accelerate their cooperation. Together with Member States' contributions to finance joint development projects, the Fund could generate a total investment in defence research and capability development of €5.5 billion per year after 2020.

## **How does the Fund support research in defence products and technologies ("research window")?**

The European Defence Fund will help Member States develop innovative defence products, technologies and services, which can provide strategic advantage and contribute to Europe's strategic autonomy.

Defence research is essential to address emerging and future security threats and bridge technological gaps in key areas. But defence companies do not normally invest in R&D, unless they have a commitment by the government — as the only end-customer — to procure the products they are developing. Public spending and investment is essential for the defence sector. However, EU Member States spend almost seven times less than the United States on defence research and development.

Under the "research window" of the Fund, the EU budget will fully and directly finance collaborative defence research and technology development activities across Europe, taking into account the defence capability and R&T priorities agreed by Member States within the EU. Priority areas could typically include critical and innovative technologies such as electronics, metamaterials, encryption software or robotics and explore future disruptive defence technologies and applications.

A two-step approach is being pursued:

- **Current EU budgetary cycle** ("Multiannual Financial Framework") which runs until the end of 2019: €25 million have been allocated for 2017, and a total of €90 million will be provided until end of 2019. A call for proposals is being launched today for projects in the areas of unmanned systems in a naval environment and soldiers systems. The signature of the first grant agreements is expected by the end of this year;
- **Next budgetary cycle** after 2020: Building on the experience of this preparatory phase, in 2018 the Commission will propose a dedicated EU defence research programme for post-2020 with an estimated annual budget of €500 million making the EU one of the biggest defence research investors in Europe.

The Commission, in close cooperation with Member States experts and with input from the European Defence Agency, will establish annual work programmes. The European Defence Agency (EDA) will be responsible for implementing the annual work programmes by publishing the calls for proposals, organising the evaluation of project proposals, and managing the research projects selected to receive EU funding. To this end, the Commission signed a delegation agreement with the European Defence Agency on 31 May 2017. Project proposals will be evaluated with the help of independent experts selected on the basis of a call for applications.

## **How will the Fund promote the joint development and acquisition of key defence capabilities ("capability window")?**

Currently the funding of major defence technology and equipment ("capabilities") is a challenge for even the biggest Member States. Through its "capability window", the Fund will complement, leverage and consolidate cooperation among Member States to jointly develop and purchase defence equipment and technologies. For example, Member States may jointly invest in drone technology or bulk buy helicopters to reduce costs. Contrary to the research window which is fully and directly funded from the EU budget, here the approach is one of co-financing.

The capability strand of the Fund will focus on collaborative projects to develop prototypes in strategic priority areas defined by the Member States, through the Capability Development Plan.

While financial contributions will mainly come from Member States, the EU will make a budgetary contribution which will encourage defence cooperation by reducing the risk in earlier stages of the industrial development cycle, leverage national contributions, and support the competitiveness of the European defence industry. EU funding will be provided in the form of grants through a dedicated, biannual European Defence Industrial Development Programme.

Today the Commission proposes a budget of €500 million for 2019 and 2020 for this dedicated defence

and industrial development programme. A more substantial programme will be prepared for post-2020, with an annual budget of €1 billion.

The programme will leverage national financing with an expected multiplying effect of 5. It could therefore generate a total investment in defence capability development of €2.5 billion for the two first years with the aim of mobilising €5 billion per year after 2020.

Duplication in defence across Member States amounts to at least €25 billion each year. This means that with just one fifth of this amount, €5 billion, from the Fund will generate much larger efficiency gains.

Only projects involving at least 3 companies from at least 2 Member States will be eligible. The programme should benefit both large-scale companies and SMEs in the defence sector, ensuring inclusiveness in terms of Member States and industry. It will thus enhance cross-border cooperation among industry and contribute to the competitiveness of the whole defence sector. For that reason, a proportion of the overall budget will benefit projects enabling the cross-border participation of SMEs.

Development and acquisition of defence capabilities are inherently linked, especially when it comes to financing. In order to be eligible for support under the Programme, industry will have to demonstrate that Member States have committed to jointly finance further development of the eligible action and procure the final product or technology in a coordinated way, including joint procurement where applicable. Such a commitment would ensure that a contribution from the EU budget is only provided to projects where on the one hand, there is a reasonable expectation that the development will result in procurement and on the other hand, where this is done in a cooperative manner to optimise the investments and ensure synergies.

As regards governance, the Commission will be responsible for the execution and the management structure of the programme. On the basis of the priorities identified by Member States, the Commission will draw up work programmes in close cooperation with the Member States (Programme Committee) and after consultation of the defence industry (Advisory Board). The work programme will form the basis for a call for proposals. Following the evaluation of proposals, the Commission will approve the list of selected cooperative projects in close cooperation with the Programme Committee. The Commission will consider delegating tasks related to the implementation of the work programme to the European Defence Agency (EDA). The Agency will also play a key role in identification of defence capability priorities commonly defined by Member States through the Capability Development Plan. The EEAS will be involved in the programme including in the work of its Programme Committee.

## **When can the European Defence Industrial Development Programme be operational?**

Today's initiative for a European Defence Fund consists of a Communication and a proposal for a European Defence Industrial Development Programme (EDIDP) Regulation. If the Regulation is adopted by the European Parliament and the Council early in 2018, the Development Programme will be operational in early 2019.

## **How will the Fund encourage small and medium enterprise (SME) participation to avoid that only large companies benefit?**

Contrary to common perception, the defence industry is made up not only of big companies acting as prime contractors but also of SMEs and mid-cap companies that often act as sub-contractors in a whole supply chain of interlinked contributing companies. If one element in the chain faces individual funding constraints for making the necessary corporate investments or for obtaining sufficient working capital, then this might drive up the overall costs of development and/or the marginal cost of production. Conversely, boosting the competitiveness of the European defence industry should benefit defence-related SMEs.

The Fund seeks to ensure the greatest possible cross-border participation of SMEs. A proportion of the budget of the European Defence Industrial Development Programme will be earmarked for projects enabling the cross-border participation of SMEs in support of strategic capability priorities. The Commission will explore how to mobilise new financial instruments from the European Investment Bank and other players to support SMEs and mid-caps. This will complement the vast array of EU funding programmes such as [European Structural and Investment Funds](#) and the [European Network of Defence-related Regions](#), as well as the role of national or regional promotional banks.

In parallel, the Commission is working on recommendations to Member States and their contracting authorities for measures to make procurement procedures more easily accessible for SMEs.

## **What is the link between the Fund and Permanent Structured Cooperation?**

The Fund seeks to ensure the greatest possible support to the capability pillar of the [Permanent](#)

[Structured Cooperation](#) (PESCO) – an instrument in the EU Treaty to enable willing Member States to pursue greater cooperation in defence and security. In practical terms, the Fund will allow for higher co-financing rates for defence capability projects developed within the structured cooperation, and thereby facilitating and incentivising Member State participation in this framework. However, participation in this structured cooperation will not be a pre-requisite for obtaining support under the programme.

Other projects contributing to the development of commonly agreed capability priorities, including projects conducted under the European Defence Agency framework with its VAT exemption or based on regional/multilateral cooperation, matching EU strategic priorities, can also be considered for support.

## **The ultimate procurement of defence products is in the hands of Member States, so how can the Fund help?**

The acquisition of defence capabilities after the prototype phase is and remains in the hands of Member States.

Cooperating to jointly acquire defence capabilities has numerous advantages in terms of interoperability, economies of scale, supporting a viable European industrial base, lifecycle savings in terms of maintenance, logistic support, and training facilities and command structure.

First, the Fund makes a direct link between the development and the acquisition phase: EU co-funding will apply only when there is sufficient commitment from Member States to procure the final product.

Second, the Fund could lead to the establishment of a "single knowledge hub". Naturally, each collaborative development and procurement project has its unique characteristics. However, a number of challenges encountered by collaborative projects are recurrent. At the moment, knowledge and best practice on possible financial arrangements are not being systematically recorded, standardised and shared to the benefit of all Member States. In addition, Member States have a great deal of national knowledge and expertise on how to conduct national defence procurement, yet when coming together in a collaborative project there is often a gap in terms of the necessary expertise and tools to address key challenges of a collaborative project.

Third, the Commission can support Member States' collaborative efforts in helping them deploy the most suitable financial arrangements for the joint acquisition:

- The Commission will create a flexible "**Financial Toolbox**" with ready-to-use, standardised instruments that can be deployed in a rapid manner such as for example standardised templates, draft term sheets, standard tools to set up project-related financing vehicles or templates for necessary framework agreements. The Commission will be able to draw on its expertise in using similar tools in other policy areas and help adapt those tools to the defence context. This work will be undertaken with the help of a dedicated expert group comprising representatives of Member States' Defence and Finance/Economy Ministries, other relevant stakeholders, as well as the EEAS and EDA;
- The Commission will also set up an **internal Commission Task Force** to act as a one-stop-shop providing support to Member States on specific collaborative procurement projects, including the deployment of the Financial Toolbox and other advisory, financial and administrative services.

## **What is the development cycle from research to final product, and will the Fund always cover the full cycle?**

The life cycle of defence products often differs significantly from the life cycle for civil products. A key difference is that there is no commercial market for defence products. It is national governments that play a key role in initiating the life cycle and procuring and controlling the products during their active life and finally controlling the demilitarisation, decommissioning and recycling of products at the end of the life cycle. The consequence is that it is national governments that fully finance the research and development of products. In addition, the life cycle of products is normally measured in decades rather than a few years as is often the case in modern technology used in civil products such as mobile phones. In the civil sector, it is also industry that normally takes the risk in developing the products.

The life cycle for most defence products starts with a government establishing a requirement and a set of specifications, including standards, for a product. It is then for companies to compete to win the right to research and also develop the products. The research and development includes a number of stages from preparatory studies, developing a concept, building a prototype to test the concept. Once there is agreement to proceed towards production a number of certification and qualification tests need to be completed to ensure that the defence products meet the military requirements.

Once the product is in use it is likely to be employed for many years – even several decades for platforms: There are therefore often upgrades and modernisation of the equipment to ensure that it

remains effective. At the end of the product's life the disposal and any recycling of the product is often strictly controlled depending on security and environmental risks.

While the Fund can support the full development cycle, it can also step in to support the development or acquisition phase for projects where the research was not funded by the Fund.

## **Will national contributions be taken into account under the Stability and Growth Pact?**

To the extent project-related debt instruments would be developed, national capital contributions to the capability window will be treated as "one-offs" under the Stability and Growth Pact, which means that they will be discounted from the structural fiscal effort expected to be accomplished by Member States. The same treatment will apply to guarantees under the capability window of the European Defence Fund — to the extent that they have an impact on deficit and/or debt.

## **Will the European Defence Fund be financed through European defence bonds?**

The Commission will not promote the use of any particular financial tool but simply offer a set of standardised and predefined financial tools that can be used flexibly by Member States.

The Commission can offer practical support to Member States during the procurement phase, notably by helping them deploy the most suitable and cost-saving financial arrangements for the joint acquisition of defence capabilities. To that end, the Commission will set up a Financial Toolbox that Member States can choose to use on a case-by-case basis, covering aspects such as budget spending synchronisation, risk and cost sharing, financial instruments and ownership structures.

Tools to address the challenge of fair risk and cost sharing include the possibility of setting up project-related financial vehicles. If warranted, these could also be used for a project-related issuance of capital instruments (debt or equity) to enable a more flexible structure and ensure full availability of the resources when they are needed.

## **What are the links between the European Defence Fund and the European Investment Bank?**

The capability window includes the possibility of using financial instruments to support SMEs and mid-caps in closing the gap between research and development. The Financial Toolbox also provides for the use of guarantees on project-related funding of suppliers. These financial instruments could be implemented with the European Investment Bank (EIB) group or other relevant partners.

Currently, although the European Investment Bank (EIB) group can support some relevant investments, such as i) Research development innovation for dual-use technologies, as far as these investments can be motivated by their commercialisation in civilian applications; ii) protection of physical infrastructures; and iii) telecommunications and information infrastructure.

The EIB has already announced its willingness to scale up these investments and engage with the Commission and Member States to assess if there are gaps in its policies.

Where access to finance is still limited for certain defence-related activities in light of lending restrictions, the role National or Regional Promotional Banks could play to deploy relevant financial instruments and in that way improve the access of SMEs in the supply chains to obtain necessary funding will be explored further. A number of these Promotional Banks already can and do actively support projects in the national defence context. Examples of supported projects range from Public-Private-Partnership structures for military services to military capabilities such as armoured vehicles. The Commission will look into the best ways to deploy relevant financial instruments in the next budgetary cycle.

## **How can EU structural funds be used?**

The European Structural and Investment Funds may be used by Member States in the defence sector, as long as they contribute to the objectives of the fund: co-funding productive investment projects and supporting the modernisation of the defence supply chains. Europe's defence industries can contribute to the goals and objectives set in the structural funds, such as promoting the development of regional economics, representing a high investment multiplier on skills, jobs, technological and economic development. In particular, the European Regional Development Fund may fund defence activities and dual use activities in research and innovation, as part of a smart specialisation strategy.

## **Are there synergies between the European Defence Fund and other EU policies for example in the field of space or cybersecurity?**

As outlined in the European Defence Action Plan, civil/military synergies can be beneficial in a number

of areas including space, cyber and maritime research:

- **Space:** The Commission is working on ways to ensure reliable, secured and cost-effective Satellite Communication services for the EU and Member States and is also exploring how Copernicus could cover further security needs;
- **Cyber:** The Commission aims to improve synergies between cyber defence and wider EU cyber security policies. Due to the dual-use nature of overall training and education in IT technology, technical cyber skills are relevant in both civilian and military domains. The Defence Action Plan proposed the creation of a Cyber Training and Education Platform by 2018 as a practical way of increasing the sharing of experiences and best practice in both fields. The Platform would also build on the experience of the existing European Cyber Crime Training and Education Group;
- **Maritime research:** Potential benefits of civil/military synergies in the field of maritime security include areas such as surveillance, risk management and protection of critical infrastructures. There is considerable investment in both the civil and defence research in the maritime field and the Defence Action Plan proposed to create a Co-ordinated civil/military Maritime Security Research Agenda by 2018 to improve synergies. This is also in line with the [EU Maritime Security Strategy](#).

## For More Information

[Press release](#): A European Defence Fund: €5.5 billion per year to boost Europe's defence capabilities

[Factsheet on the case for greater EU cooperation on security and defence](#)

[Factsheet on the European Defence Fund](#)

[Press release](#): A Europe that defends: Commission opens debate on moving towards a security and defence union

[Questions and Answers – The Future of European defence](#)

[Reflection paper on the future of European Defence](#)

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