



Working towards successful European defence cooperation

By Robert Wester, Ronald Vuijk
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The role of Europe in the area of military cooperation and the development of common defence capabilities is in constant development. In recent years the importance of Europe in the area of defence and security has increased notably. The fact that for the first time ever the European Commission will include a Commissioner for defence and space is indicative of the ambitions of the European Union. Within the development of the European defence policy, the European Defence Fund (EDF) represents an incredibly important step forward. Berenschot EU spoke to a many institutions and organizations involved in this development. The knowledge and insights obtained through these interviews form the basis of this article, in which we detail the development of the EDF so far and give insight into possible future hurdles the EDF might face.

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The creation of the EDF means that, for the first time, European funds will be available for the development of new defence technologies and products.¹ Through the EDF the EU wants to address the large-scale duplication of defence capabilities within Europe by incentivizing the common development, procurement and maintenance of defence material among the member states. The investment in European defence capabilities also contributes to the European ambition of strategic autonomy and the European ambitions put forward in the EU Global Strategy and the planned European Strategic Compass. As the next step forward in the European field of security and defence, the European Strategic Compass will further define the scope of the European Union's involvement in the area of security and defence. As with many initiatives concerning European defence, the French-German axis plays an important and growing role in the development of the Strategic Compass. Under the German Council presidency, the development of the Strategic Compass was given priority with the creation of the European threat analysis. This year a consultation with the member states concerning the Strategic Compass is planned, followed by the finalization and adoption of the Strategic Compass under the French Council presidency in 2022.²

The European Union's Defence policy has reached a fork in the road. If the current course is maintained, the future may see the formation of a truly European Defence Technological and Industrial Base. It is important for defence industries in all member states to take part in this development if they wish to maintain their current market position. The Dutch government is acutely aware of the importance of this participation. However, it is also aware that in the current industrial situation in Europe participation may be detrimental to the position of the Dutch defence industry, as larger European competitors could push Dutch companies out of the market. This entails a precarious balancing act: while cooperation may bring economies of scale and the possibility of European funding, the autonomy and interests of national industries must be protected as well.

Berenschot EU studied defence developments in Europe and how the Dutch government and other member states anticipate and react to these developments, with a detailed focus on the EDF. The main question of this research was: how does international cooperation emerge and which factors are crucial for cooperation to be successful?

¹ EDIDP and PADR are considered to be prerequisites to the EDF
² <https://www.berenschot.nl/adviseurs/adviseur/ronald-vuijk/blog/eu-strategisch-kompas-en> <https://www.berenschot.nl/adviseurs/adviseur/ronald-vuijk/blog/eu-strategische-dialogoog-veiligheidsbeleid>

The European Defence Fund

The European Defence Fund is an incredibly important step for the European defence market. For the first time European funds will be available for the development and collaborative procurement of defence goods. The goal of the EDF is to alleviate some of the current shortfalls of the European armies by promoting multilateral cooperation in the field of security and defence. Through the EDF the European Union hopes to stimulate both investment in research and development and multilateral collaboration in the defence industry.³

The Fund will hold EUR 8 billion for the next Multiannual Financial Framework (MFF) period. A considerable amount of this money will be made available for the promotion and financing of ground-breaking research and development initiatives. To be eligible for financial backing from the EDF, projects must adhere to the precondition that at least three companies from three different member states partake in the participating consortium. The funds from the EDF will be awarded through a system of calls whereby a consortium has to bid on and win a call to receive funding (as is standard practice for a number of other European funding mechanisms). Thanks to extensive lobbying by Dutch representatives, consortia that include small and medium-sized enterprises (SMEs) will be eligible for additional funding.

The EDF does not fully fund research or procurement initiatives but provides co-financing for the development of highly technological and value adding defence capabilities for European armed forces. Naturally, these funds are also beneficial for the industries involved. The EDF therefore strengthens both the defensive capabilities and the economies of the member states. In theory, cooperation on the development and procurement of defence systems should be cheaper than when countries act independently. In practice, however, most of the benefits that result from economies of scale and larger production runs are nullified by the extra costs incurred by cooperation. In the past the need to reach agreement with all parties involved slowed down the process which, in turn, lead to the projects overrunning on time and budget, causing reputational damage to multinational defence cooperation.⁴ Due to these pitfalls it is important to consider upfront which projects have a chance of success and how to ensure that a project will add value to the Dutch armed forces and economy alike. Cooperation for the sake of cooperation should be avoided at all costs.

The situation in the Netherlands

The Dutch government coordinates its efforts relating to European defence cooperation through an interministerial group known in Dutch as ICG EDS. The ministries of Defence, General Affairs, Foreign Affairs, and Economic Affairs and Climate Policy are represented in the ICG EDS. Other parties taking part include Dutch knowledge institutes such as the Netherlands Association for Applied Scientific Research (TNO), the Maritime Research Institute Netherlands (MARIN) and the Netherlands Aerospace Centre (NLR) as well as representatives from interest groups such as the Netherlands Industry for Defence and Security (NIDV), the Association of Mechanical and Electrical Engineering (FME) and the Confederation of Netherlands Industry and Employers (VNO-NCW).

In the past this ICG approach was applied successfully to coordinate the Dutch participation in the F35/Joint strike fighter-project. Tom Middendorp is the ICG's Special Envoy on European Defence Cooperation and is tasked with making contacts in Europe and fostering cooperation between Dutch and European partners. Within the ICG a 'multi-strand approach' is applied, (commonly referred to in Dutch as the 'gouden drie hoekjes' or golden triangles). The three corners of the triangle represent the Dutch government, Dutch industry and the knowledge institutes. Dutch efforts on different aspect of European defence cooperation are coordinated within these triangles.

In relation to the EDF, ten thematic topics of interest have been identified in which Dutch industry is able to contribute to European partners; seven of these topics have been identified as areas in which Dutch industrial actors can take a leading role in Europe. The remaining three topics represent areas where it would be favourable for Dutch companies to join European consortia. Clear lessons have been learned from previous European defence programmes such as the European Industrial Development Programme (EDIDP). One of these lessons is that Dutch EU representatives should be actively involved in the promotion of the thematic topics of interest during the formulation of the programme calls for the EDF. The aim of this involvement is to ensure that the final calls closely reflect areas of Dutch industrial competence. This proactive approach is commendable and increases the chances for successful participation of Dutch companies in EDF projects.

³ https://ec.europa.eu/commission/presscorner/detail/pl/memo_17_1476

⁴ Clingendael and HSSC, 'Internationale Materieelsamenwerking Rapport ten behoeve van het Interdepartementaal Beleidsonderzoek (IBO) naar internationale samenwerking op het gebied van defensiematerieel, January 2015, 19-21 (in Dutch only)

The Dutch defence industry

The Dutch defence industry is characterized by the existence of very few ‘Original Equipment Manufacturers’ (OEMs): companies which manufacture end products such as naval vessels or armoured vehicles. These companies are sometimes referred to as system integrators or prime contractors. The Dutch defence industry mainly consists of small-and-medium-sized enterprises (SMEs) dedicated to developing and producing very specific technologies. A number of these small high-tech companies are world leaders in the field of radar and sensor technologies. The Dutch defence industry is highly regarded in the field of naval technologies, due to its capability and know-how to independently develop and produce high-tech naval vessels. The Dutch company Damen is one of the industry leaders in the European naval industry and one of the few Dutch OEMs mentioned earlier. The Netherlands is also home to some highly regarded technological institutes which are involved in the development and research of technologies with military applications.⁵

International cooperation

The Netherlands has an extensive track record when it comes to cooperation on procurement and development of defence goods. The Dutch were involved in a number of European cooperation success stories such as the procurement of the Multi Role Tanker Transport (MRTT) fleet project in which the Netherlands was the lead nation. The Netherlands also developed and procured the Fennek and Boxer armoured vehicle together with Germany.⁶ When it comes to operational cooperation, the Netherlands and Germany maintain a mixed Dutch German armoured brigade and have integrated parts of their marine corps. Similar operational cooperation exists with Belgium and the United Kingdom.

Why some multinational cooperative projects succeed while others fail due to budget overshoots and delays has been the subject of research by both the Clingendael Institute and The Hague Centre for Strategic Studies (HCSS). In 2015 these institutions published a joint analysis of factors influencing the chances of success for these kinds of multilateral defence projects. They concluded that thorough and intense cooperation from an early stage of the project is one of the most important

reasons for success.⁷ This means that participating countries work together from the outset, starting with the formulation of a common need of the armed forces involved, through to the formulation of common product specifications and the creation of a common timetable for the entire development and procurement period. Besides the need for close cooperation throughout, the choice of partner countries, the presence of one ‘lead nation’ and the number of demands for separate specifications for the end-product are important factors for determining the chances of success.⁸

The need for timely planning of these large-scale cooperative projects is an essential part of European defence cooperation. In 2020 the AIV (Advisory Council on International Affairs, an independent body which advises the Dutch government and parliament on foreign policy) reiterated the importance of harmonizing procurement timetables and advised the creation of a binding European procurement planning process to accommodate successful European defence cooperation.⁹ From our secondary and primary research (the Clingendael and HSSC report, the Netherlands Defence Industry Strategy memorandum, Defence White paper and the interviews we conducted), we see a picture emerging that there are still many gains to be made in both Europe and the Netherlands when it comes to the planning of defence procurement. For instance it appears that the Dutch government has no clear picture of which future procurements detailed in its Defence Industry Strategy (DIS) memorandum will lend themselves to European or multilateral procurement. The DIS does mention in which areas of defence the armed forces would like to cooperate but, to our knowledge, no overview exists of which European member states share this desire to cooperate. This means that cooperation will be ad hoc, which hampers the desired structural cooperation in Europe.

Small- and medium-sized enterprises

The Netherlands has pushed hard in the negotiations surrounding the EDF for the inclusion of SMEs in the projects financed by the EDF. This has resulted in the inclusion of an incentive in the form of a ten percent increase in the cost covered by the EDF if the consortium includes SMEs. This is important to the Netherlands given the makeup of the Dutch defence industry described above.

⁷ Clingendael en HSSC, ‘Internationale Materieelsamenwerking,’ (in Dutch only)

⁸ Clingendael en HSSC, ‘Internationale Materieelsamenwerking,’ 29 (in Dutch only)

⁹ Advisory Council on International Affairs, advies 112: Europese veiligheid: tijd voor nieuwe stappen, June 2020

⁵ Ministry of Defense, Defence Industry Strategy 2018, , 26

⁶ Clingendael en HSSC, ‘Internationale Materieelsamenwerking,’ 10 (in Dutch only)

Although the inclusion of SMEs was at the centre of Dutch negotiating efforts surrounding the EDF, in practice research shows that the inclusion of these companies remains a difficult task. Multiple interviewees mentioned the problems surrounding SME participation in EDF projects. SMEs do not have enough financial means to finance the long review process of European calls, including those for the EDF. The possibility for SMEs to piggyback on EDF projects submitted by the larger Dutch companies was mentioned multiple times. For this piggybacking to work, a much more active approach is needed to promote this method and incentivize this cooperation between Dutch companies. The DIS also refers to the possibility to promote SME participation in this way. However, to date, we have seen no clear indications that this method is bringing results.¹⁰

During the interviews two opposing views emerged regarding the inclusion of SMEs in EDF projects. On the one hand, the inclusion of these companies is always at the centre of negotiations regarding any multilateral project. This means that contracts for Dutch SMEs are often negotiated before any cooperative project takes place: these agreements are referred to as offset agreements in which the cost of procurement is offset by the inclusion of national industries. On the other hand, however, even in cases where the inclusion of Dutch SMEs is part of the procurement agreements it is difficult for small companies to actually become part of the supply chain of the larger OEMs. The MRTT project referred to above is one example: although the inclusion of Dutch SMEs was guaranteed under the purchasing agreement with Airbus, the actual inclusion of these companies proved much harder and faced difficulties in practice.

The two main challenges to be addressed by the Dutch government are the inclusion of SMEs in European defence projects and ensuring that Dutch companies are on an equal footing with their European competitors. The most important actor in the Netherlands for SMEs looking to enter the European defence market is the Netherlands Enterprise Agency (RVO). Employer's organization VNO-NCW also plays a role in representing Dutch industrial interests in Europa. For the defence industry, the NIDV is also an important actor, although this organization represents the interests of its members rather than broader national interests. These organizations can provide SMEs in the defence sector with some help and expertise when they want to join calls or initiatives surrounding the EDF. Since the review and approval period for EDF calls can take up to two years, many of the smaller companies do not have the financial means to fund such a long process. They also lack the size to maintain in-house

experts who know how to write EDF calls or how to piggyback on calls from larger firms. There is an opportunity here to improve the access of Dutch companies to the EDF. The position of Dutch SMEs should be a top priority not only in discussions with other states or during negotiations on procurement projects, but also at home. The cooperation between SMEs and larger Dutch firms should be strengthened. The provision of adequate knowledge on how to organize cooperation and how to apply to European calls should also be a priority in this regard.¹¹

Level playing field

If Europe wants defence cooperation to succeed, there must be a level playing field between the member states. In Germany, France and the United Kingdom the defence markets are both the largest producers and consumers of defence goods. To a lesser extent Italy, Spain and Sweden also belong to this group. Together they represent 90% of European defence expenditure and defence industrial turnover. French-German defence cooperation has gained importance since the UK's departure from the EU. Because of the big differences between the member states when it comes to the size of their defence industries, the European defence market is characterized by inaccessibility. Smaller firms need to connect with a small number of large multinationals and OEMs. The stark differences between member states are also what drive certain member states to protect their own industries by giving them preferential treatment and other forms of state aid. As the Policy and Operations Evaluation Department of the Ministry of Foreign Affairs (IOB) noted in an evaluation published in August 2020, although European laws prohibiting these measures have been in effect since 2009, there is no real fair competition within the European defence market.¹²

The creation of a truly level playing field in the European defence market has been the goal of the Dutch government for some time. The absence of a level playing field gave rise to a change of attitude towards the domestic defence industry which was outlined in the Defence Industry Strategy memorandum in 2018. No longer were market forces and efficiency to be the leading forces in all procurement decision making. In a number of strategic areas the Netherlands would need to become self-sufficient, and the capabilities to be self-sufficient in these areas would have to be protected. The paradox of trying to be a proponent of a level playing field in a European defence market without protectionism on the hand and protecting domestic

¹¹ Ministry of Defence, Defence Industry Strategy 2018, 25-26

¹² Policy and Operations Evaluation Department of the Ministry of Foreign Affairs, IOB, De kloof gedicht? Evaluatie van het Nederlandse beleid ten aanzien van EU civiele en militaire capaciteitsontwikkeling, augustus 2020, 47

¹⁰ Ministry of Defense, Defence Industry Strategy 2018, 26

industries on the other hand was noted by the IOB.¹³ As yet, there is no level playing field. Many of the interviewees noted that the state aid and preferential treatment by other member states skew the relationships when European cooperation takes place.

Cooperation with countries such as Germany, France and (despite Brexit) the UK will be needed in the future. The AIV underlined this need by advising the Dutch government to seek alignment with German-French defence projects and initiatives for European defence cooperation. However, from the interviews it seems that this view is not yet broadly shared: cooperation with countries such as France is seen as unwanted, due to the state aid mentioned above and perception that in cooperation projects with France, French interests always seem to prevail over the interests of partners.

Co-financing

Co-financing is the most important condition for receiving EDF funds. The EDF only funds a percentage of the eligible costs of a project and member states have to fund the remainder. The level of funding, and therefore the amount of financing required from other parties, depends on the type of project. In the Netherlands, the Ministry of Economic Affairs and Climate Policy (EZK) and the Ministry of Defence are both responsible for co-funding European defence projects. Projects that cater to direct needs of the Dutch armed forces are eligible for funding from the Ministry of Defence while projects that do not cater to a direct need, but represent important interests to the Dutch industry or economy, are eligible for funding from EZK. A number of interviewees see this system of divided options for financing as an area for improvement.

Financing from the Ministry of Defence is linked to the 'life cycle plan', which means that investments in projects on short notice is not possible. By not providing financing options for short notice projects that do represent important opportunities for Dutch industry the Ministry of Defence is unable to perform its important role as main contracting authority to its full potential. This hampers the potential for successful European cooperation between the Netherlands and other member states.¹⁴

One alternative to the financing of cooperative projects by member states would be that large European firms with enough financial means step up and fund part of a project. Smaller firms would then be able to tag on. This alternative does not seem to have much backing though. It would mean that Dutch SMEs would have to look to foreign OEMs if they want to piggyback. This could pose a risk that the smaller firm becomes subservient to the larger foreign company.

Co-financing for knowledge institutions

Actors which have received little attention in this respect are the Dutch knowledge institutes. The Netherlands is home to a number of renowned knowledge institutes like TNO and MARIN, some of which are already quite active on a European level. For them, the EDF is a very interesting instrument, especially as research activities carry a high percentage of EDF reimbursement. Yet the problems surrounding co-financing also plague the knowledge institutes. Funding from the EDF is based on eligible costs raised by a set percentage for overhead. The use of this method to determine the funding a project receives means that many of the Dutch knowledge institutes would have work below their standard prices. Co-financing and the condition attached to this financing therefore also play a major role in making European projects appealing for these knowledge institutes.

Conclusion

The EDF is one of the most important developments when it comes to security and defence in the European Union. The Fund is meant to both increase the military power of the block as well as improving the industrial capacities of the member states. Attaching the need for cross-border cooperation to the ability to receive funding could cause a true European Defence Technological and Industrial Base to emerge. While this European ambition provides opportunities for Dutch industries, at the same time it could pose a threat to the market position of these companies, if larger foreign companies are able make better use of the funds to strengthen their own position. This requires effective communication between all Dutch actors involved as well as a unified decision on how to move forward.

¹³ Policy and Operations Evaluation Department of the Ministry of Foreign Affairs, IOB, *De kloof gedicht? Evaluatie van het Nederlandse beleid ten aanzien van EU civiele en militaire capaciteitsontwikkeling*, augustus 2020, 47

¹⁴ Ministry of Defence, *Defence Industry Strategy 2018*, 25-26

Our research showed that the much-needed coordination is well established on the national level. The ICG EDS adequately responds to developments surrounding the EDF. However, the coordination of Dutch efforts can be improved in a number of areas. The link seems to be missing between the direct needs of the Dutch armed forces and the needs of other European member states in the coming decennia, despite the fact that identifying and formulating collective needs has been identified as one of the most important factors for success in multilateral defence cooperation. In the field of co-financing, improvements can be made if the Ministry of Defence (as the primary end user of defence goods) is able to act with flexibility and able to participate when presented with promising opportunities to cooperate, either due to developments from Dutch companies or from European cooperative projects.

An important issue for the Dutch industrial sector is the preservation of domestic industrial capabilities. The way in which SMEs are supported is of vital importance here. This need for SME support is sufficiently safeguarded on a policy level. During negotiations surrounding the EDF this support has resulted in strong incentives pertaining to the inclusion of SMEs in EDF projects. In practice, however, there are a number of major impediments to the successful participation of Dutch SMEs in European consortia. All actors involved seem to be aware of the fact that without outside support SMEs do not have sufficient financial means to participate in the long and uncertain review process of EDF calls. Neither do they possess the in-house expertise to find suitable European partners and consortia to join. The responsibility for supporting these companies in this endeavour is divided among a number of organizations including VNO-NCW, NIDV and the RVO. To ensure that these companies are able to successfully participate in EDF projects, a more proactive approach is needed. In this regard the fostering of cooperation among Dutch SMEs and OEMs should also remain an area of attention.

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The Berenschot EU team knows the European market: we support and advise our clients on complex questions relating to the EU. Berenschot is continuously looking for opportunities for businesses to participate in the European policy making process. To come to effective and strategic cooperation in Europe, it is important to map the capacities of potential partners. The multi-stakeholder approach provides a practical framework for cooperation between companies, organizations and institutions. This approach is geared to tackling issues of common concern by facilitating cross-sectoral and cross-border communication. Through this approach cultural differences and national paradigms on defence can be used to strengthen international cooperation.

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