HEINRICH BÖLL STIFTUNG
ECONOMIC + SOCIAL ISSUES

E-PAPER

EU defence industrial policy in a new era

Taking stock and looking ahead

Author: Sophia Besch
Published by the Heinrich-Böll-Stiftung European Union, March 2025

THE AUTHOR

Sophia Besch

Sophia Besch is a senior fellow in the Europe Program at the Carnegie Endowment for International Peace. Her area of expertise is European defence policy. Dr. Besch also teaches as an adjunct lecturer at Johns Hopkins SAIS.

Before joining Carnegie, Sophia was a senior research fellow at the Centre for European Reform (CER) in London and Berlin, where she led research on European armament policy, the EU's role in European defence, transatlantic relations, German defence policy, and the security implications of Brexit.

Sophia has also worked with the American Institute for Contemporary German Studies and the Atlantic Council's Europe Centre, where she served as co-chair of the US-Germany Renewal Initiative. Earlier in her career, Sophia was a Carlo Schmid fellow in NATO's Policy Planning Unit and a researcher for the NATO Parliamentary Assembly.

Sophia regularly comments on political and defence issues in print and broadcast media and has published opinion pieces in the *Atlantic, Foreign Affairs, Foreign Policy, Internationale Politik, Politico, Project Syndicate, War on the Rocks*, and others. She has served as an expert witness for the UK House of Commons Defence Select Committee, the German Bundestag EU Committee, and the European Parliament Subcommittee for Security and Defence.

She holds a doctorate in European Studies from King's College London, and degrees in international relations and international security from Sciences Po Paris and the London School of Economics.

The author would like to thank Erik Brown for his research assistance.

Contents

Executive summary

The 2024 re-election of Donald Trump as US president, and the realignment of US security strategy that is expected to follow fundamentally changes Europe's security outlook. The European Union (EU) cannot become Europe's security provider, but it can, through its defence industrial policy, support the funding and organization of the rearmament effort.

The EU has over the last 10 years steadily expanded its role in European defence industrial policy, particularly in the fields of defence research and development and joint procurement. Russia's full-scale invasion of Ukraine in February 2022 especially led to a dramatic increase in both the intensity and rate of EU-level initiatives and proposals to support Europe's defence industrial base. Yet, the reality is that, for all the initiatives launched, so far, the EU has not been able to convince Member States of its added value in ramping up Europe's readiness and defence industrial production capacity.

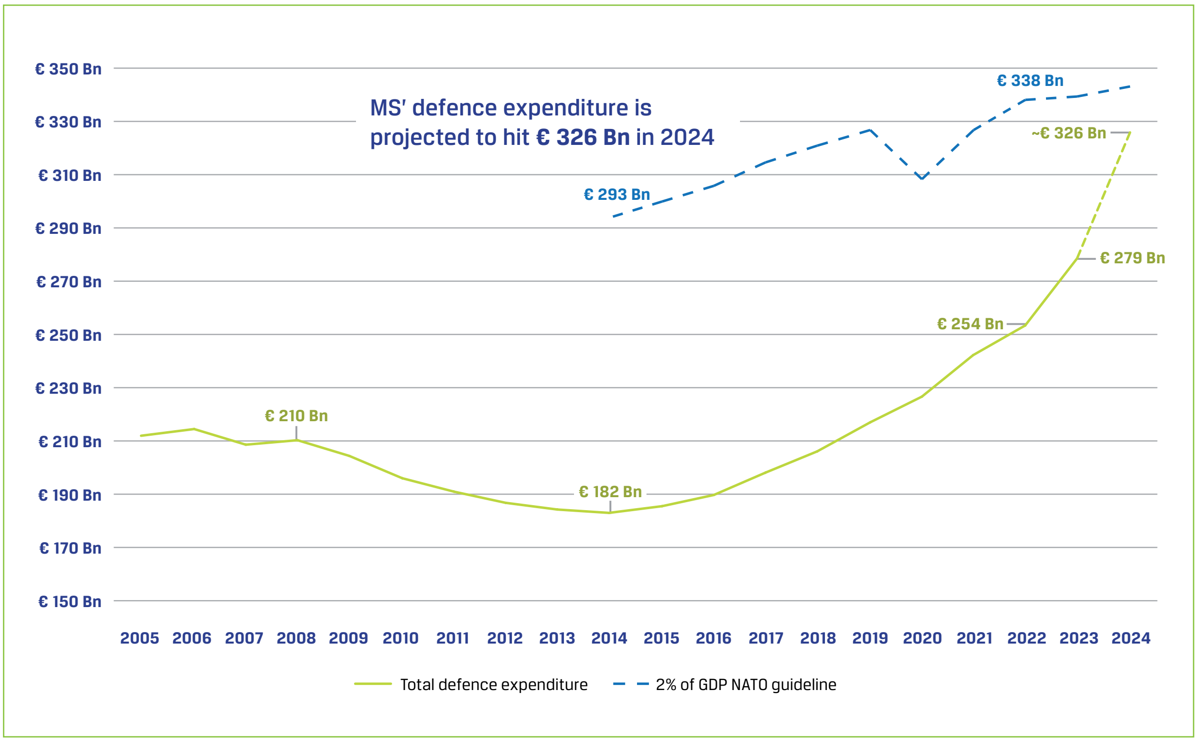
Despite the EU's heightened involvement in European defence in recent years, the European Commission is still a relatively new player in this realm, and underlying tensions between Brussels and EU Member States remain unresolved. EU Member States and firms are reluctant to share sensitive information with each other, let alone the European Commission, and disagree on the appropriate amount of third-country involvement in European defence industrial policy. EU countries have yet to reach an agreement on how to finance any substantial increase in defence spending, although some possible funding avenues exist. Most importantly, it is not clear to Member States that channelling defence policy decisions through the EU is cheaper and/ or more effective than going it alone or working out deals between governments directly. All this has been true for years. Nevertheless, the re-election of Donald Trump creates openings for compromise between Europeans where before there were none.

A second Trump term could provide momentum to unlock sufficient funding and shape a useful role for the EU.

1. Introduction and context

When Russia launched a full invasion of Ukraine in February 2022, European governments were keen to send military aid to Ukraine and strengthen their own defences. But they quickly had to confront dwindled and aging materiel stocks, minimal defence industrial production capacity and brittle supply chains. In the two and a half years since, Europeans have undertaken important steps to ramp up defence industrial production and sent billions in military support to Ukraine. EU defence spending is expected to reach €326 billion – equivalent to a record 1.9 per cent of gross domestic product – in 2024.[1] This surge in demand – paralleled at the global level – is felt by European defence firms that are recruiting at fast rates to deliver on near-record-high procurement orders.[2]

Fig. 1 : Total Defence Expenditure vs the 2% of GDP NATO guideline



Source: European Defence Agency
"Defence Data 2023-2024", European Defence Agency,
https://eda.europa.eu/publications-and-data/brochures/eda-defence-data-2023-2024

But the re-election of Donald Trump as US president once again changes the security outlook for Europeans.[3] It should be read as proof that Trump's first term was not an aberration but an expression of a structural realignment in US foreign policy. As a consequence, the United States could relinquish its role as Europe's security guarantor. Although US membership of NATO and the American nuclear umbrella are not (yet) up for discussion, the NATO standby clause will likely be called into question under Trump, and US troops and military equipment could be withdrawn from Europe.

Already Trump's demand to take over Greenland and his refusal to exclude military or economic force to "get it", imply a view of NATO as a protection racket, in which the strongest member of the alliance can dispose of territories at will. In the process of this Presidency, NATO's credibility could be permanently damaged, creating a security vacuum in Europe for Russia to exploit. Europeans are already faced with constant hybrid attacks and threats from an emboldened Russia. And without US military support of security guarantees for Ukraine, Europeans are currently unable to provide the military security guarantees that would prevent Putin from achieving his war aims of subjugating Ukraine or turning it into a failed state.

To prevent this scenario, Europeans must proactively take on the European security burden.

The shifting foreign policy of the United States also has implications for the policy space of the European Union in the defence sector. Washington has always been concerned that an EU defence independent from NATO could channel resources away from the alliance, undermine US defence industrial interests in Europe, and weaken US influence over European defence policy making. Some administrations have openly opposed EU initiatives, others have chosen to instead set out very narrow parameters for any EU action. In many cases, Europeans have been all too happy to oblige, and leave the bulk of their strategy development, defence capability supply, and operational presence to the United States, while keeping their own defence spending low. Occasional frustrations and grandstanding aside: European autonomy in exchange for US protection was a fine deal for both sides. Now that the US threatens to give up on their side of the bargain, Europeans find themselves unprepared.

In order to meet the major challenge posed by the realignment of US security strategy, Europeans must fundamentally rethink their responsibility for their own defence. In the defence industrial policy space this means that European defence spending must increase further and sustainably, Europeans must continue to increase their defence industrial production capacity and procure equipment and weapon systems that meet both short-term needs, chiefly in Ukraine, and long-term European deterrence, defence and projection capacity objectives. They must develop a plan for the foreseeable replacement of those US capabilities that are militarily relevant in the Indo-Pacific, including both weapons systems and personnel within NATO.

The EU should play a part in these efforts and the European Commission has put forward proposals on how the Union could support EU Member States in their defence industrial policy ambitions. So far, most EU initiatives have remained under-resourced and disconnected from defence planning at the Member State level. The European Commission is now faced with the question of whether it can build on the momentum provided by the war in Ukraine and the US elections to expand on its defence ambitions beyond the immediate needs of Ukraine, and to what extent it will be able to exert supranational authority over defence industrial policy. In this context, this article examines the EU's objectives, assesses the record of its flagship initiatives, highlights the main challenges and points of tension with EU Member States, and provides an outlook into the dynamic of the coming months.

It argues that Europeans must address important strategic disagreements and tensions before they can advance EU defence industrial policy. But funding remains the sine qua non of Europe's defence industrial success. It is time to move on from debates over abstract sums of money and instead agree on capability projects. In the four years ahead, the EU should do its best to win the support of the Trump administration. But if this does not succeed, it should not let itself be cowed in its ambitions by DC.

2. A shared level of ambition?

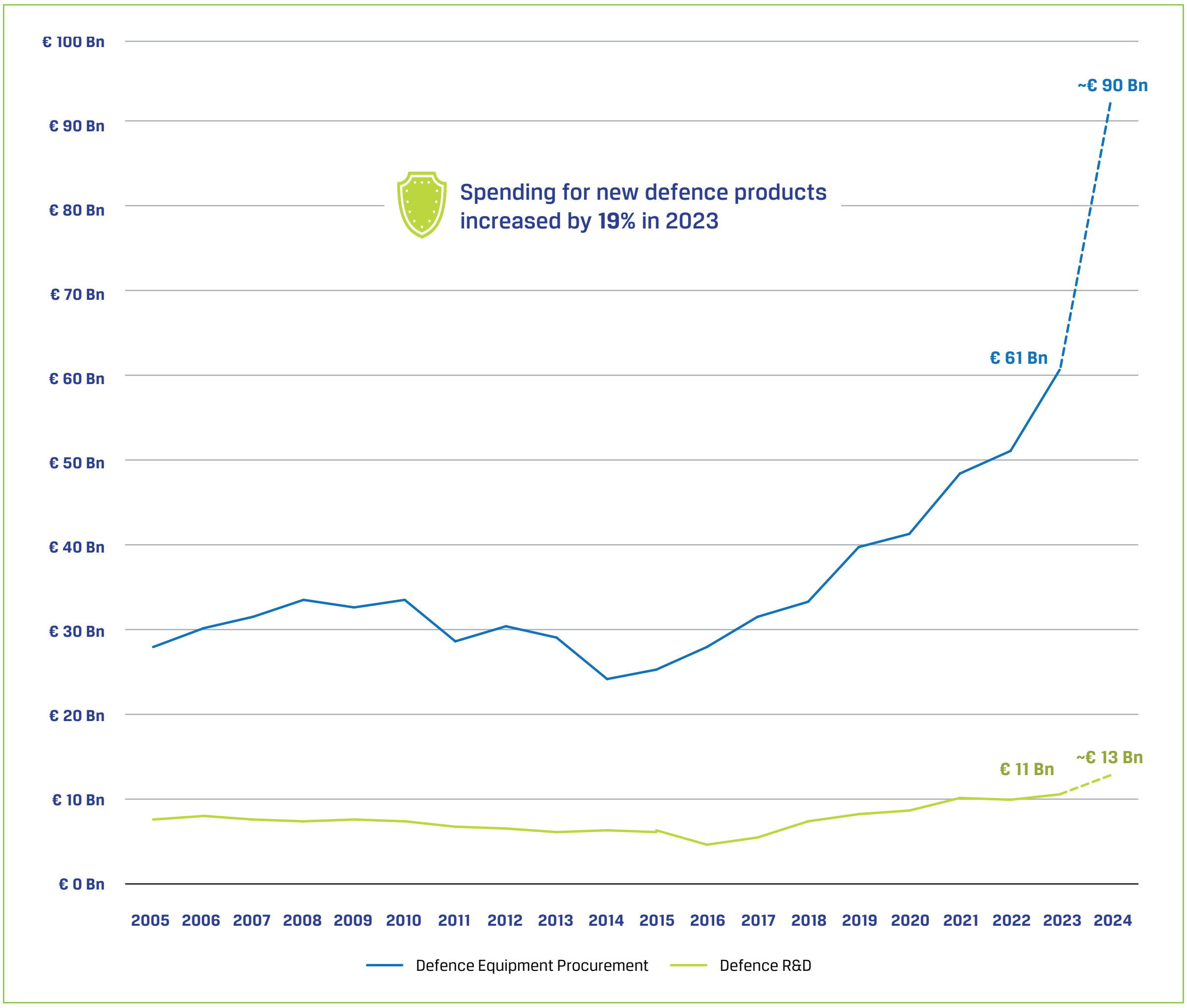
Any piece of research that sets out to assess the EU's record on EU defence industrial policy must first be clear about the objectives and ambitions of the EU and its Member States. This is not a straightforward undertaking. The EU has published several strategy documents in recent years. But some, like the March 2022 Strategic Compass, which focused on crisis management rather than high-intensity conflict, have been overtaken by events.[4] Others, like the Versailles Declaration, which outlined steps to bolster EU defence capabilities after the Russian invasion of Ukraine, have responded narrowly to a specific contingency.[5]

The first EU Defence Industrial Strategy (EDIS), published in March 2024, set a vision for European defence industrial policy until 2035 under the headline: 'spend more, better, together and European'.[6] It includes ambitious, detailed proposals on strengthening the European defence technological and industrial base, improving the responsiveness of Europe's defence industry, and 'mainstream[ing] a defence readiness culture'.[7] It formulated strategic objectives, however, that did not necessarily align with EU Member State thinking, and it outlined ambitions that required much higher funding than currently available to the EU.[8] The September 2024 Draghi report on the future of European competitiveness highlighted the impact of the defence sector's significant fragmentation, its lack of scale and demand aggregation on wider EU competitiveness, and picked up on many of the European Commission's recommendations from the Defence Industrial Strategy.[9] But it too received a mixed reception from key EU Member States.[10]

More key strategic documents are on the way. European Commission President Ursula von der Leyen has tasked her new EU Commissioner for Defence and Space Andrius Kubilius and new High Representative for Foreign Affairs and Security Policy Kaja Kallas with preparing a white paper on the future of European defence within the first 100 days of von der Leyen's second term.[11] In her political guidelines from July 2024, she stressed the importance of developing a 'European Defence Union', but the term continues to lack a clear definition.[12] A cumulative analysis of these various documents and statements at least gives an idea of the EU's ambitions and the problems it is trying to solve.

From the EU's perspective, European national defence budgets are not sufficient, considering the capability requirements that emerge from the retreat of the United States. The European defence industry is fragmented on both the supply and demand side, which impedes large-scale production, and, so the argument goes, increases costs and undermines the interoperability of equipment, and thus EU Member States' ability to conduct joint operations. Private funding for defence remains stigmatised and the defence sector is missing out on essential access to loans. EU defence supply chains are not sufficiently open to small and medium-sized enterprises (SMEs). Europeans do not spend enough on technological defence development and innovation – as a result, European militaries encounter substantial challenges in leveraging the potential of emerging and disruptive technologies, and European firms risk falling behind on the global market. The EU defence industry faces critical dependencies in supply chains (raw materials, components, goods and finished defence products) for certain weapon systems. And finally, too much European defence money is going to off-the-shelf purchases from non-EU suppliers, undermining the European defence industrial base and increasing dependencies.

Fig. 2 : Defence Equipment Procurement and Defence R&D



Source: European Defence Agency
"Defence Data 2023-2024", European Defence Agency,
https://eda.europa.eu/publications-and-data/brochures/eda-defence-data-2023-2024

The EU's diagnosis is contested among Member States, and three fundamental tensions stand out. First, at a basic level, the added value of cooperating through the EU is not always obvious to European defence firms and defence ministries. The economic benefits of cooperation are clear in theory: by working together, governments could reduce equipment duplication, increase production scale and reduce unit costs. Larger outputs could enable 'fixed' R&D costs to be spread over greater numbers and lower the expenses for development, production and maintenance.[13] In reality, however, cooperation between nations and their defence firms is often difficult and has always been limited. Cooperation requires firms to share knowledge, skills and intellectual property, and states aim to preserve their defence industrial autonomy, and to keep jobs and knowhow as a military good within their borders.[14] When they do cooperate, inefficient workshare and bureaucracy arrangements, different budget timelines, technical specifications, and operational requirements often undermine these benefits.[15] This is perceived to be the case especially in bureaucratically complex projects managed by the EU or European Defence Agency (EDA), which often include many participants. Thus, despite the theoretical benefits of scale, cooperative defence projects can often be costlier and take more time than those pursued by just one country.

Second, Member States remain reluctant to involve the EU in defence industrial policy, a field of high politics that is considered a core state power. In recent years, the European Commission has undertaken a qualitative shift away from its earlier attempts at defence policy intervention that concentrated on regulatory convergence and competition, focusing instead on making available common resources as financial incentives for cooperation in a 'strategic' policy area, and thus going beyond its regulatory remit to become more 'geopolitical'. This approach has culminated at the institutional level in the creation of a Directorate-General for Defence Industry and Space (DG DEFIS), which heads the European Commission's activities and initiatives in the space and defence industry sectors.[16] Creating defence-specific EU institutional structures matters in the context of building institutional memory. EU timelines are lengthy, and while the first defence DG may not achieve immediate breakthroughs, it could create bureaucratic momentum and foster expertise, paving the way for the European Commission to expand its defence competencies and resources in the future.[17]

But DG DEFIS remains limited in its potential by the fact that EU Member States and industries, sceptical of greater EU reach into national core competencies, fail to supply the critical information needed to assess the condition and characteristics of the defence industrial base. For instance, the European Commission wants to create an EU-level security of supply regime for defence.[18] Before it can contemplate measures such as the stockpiling of critical materials and components or financial support measures, the institution needs to be able to map and monitor the key suppliers and supply chains of defence production in the EU – a controversial proposition as this requires access to sensitive information from Member States and defence firms.[19]

Third, there is ongoing disagreement between EU Member States over what degree of industrial 'strategic autonomy' the Union should strive for and to what degree defence interdependences and dependencies with third countries are acceptable. The European Commission has taken a particularly restrictive view: third-country firms can participate in EU-funded cooperative projects, but their participation is subject to constraints. Crucially, intellectual property rights tend to be restricted to European subsidiaries and cannot be transferred to a parent company outside the EU, which makes participation in EU-funded projects less attractive for third-country firms.[20]

The rationale is that buying from third countries involves minimal European technology and intellectual property content and poses a risk to local skills and knowledge. It can also be harder to justify to European taxpayers who are asked to accept higher defence spending. But several non-EU countries are closely integrated in the European defence market. In practice, the two 'third' countries that are most contentiously debated are the UK and the United States. EU Member States are particularly concerned over further alienating the United States, based on the assumption that arms sales are a precondition for continued US engagement in Europe, especially under a second Trump administration. Others also believe that to fill capability gaps, Europeans should prioritise the short-term availability of off-the-shelf products over the long-term build-up of the European defence capability base.[21]

The EDIS envisions that by 2030, at least 50 per cent of EU Member States' procurement budget (60 per cent by 2035) should go to EU-based suppliers and that at least 40 per cent of defence equipment should be procured in a collaborative manner.[21] The European Commission has referenced research by the French think tank IRIS, which posits that more than three-quarters of the defence acquisitions by EU Member States between the start of Russia's invasion and June 2023 were made from outside the EU, with the United States alone representing 63 per cent.[22] This assessment has been questioned recently by the International Institute for Strategic Studies (IISS), however, which finds that 52 percent of platform-procurement contracts signed by European NATO countries between February 2022 and September 2024 was spent on European systems and only 34 per cent on US systems (with 14 per cent going to systems from Brazil, Israel and South Korea).[23]

3. Taking stock

In spite of these unresolved tensions, the EU has forged ahead. However, the intensity and rate at which the EU has launched initiatives and proposals to support Europe's defence industrial base can at times distract from the fact that the European Commission is still a relatively new player in this field. As the institution is attempting to prove to EU Member States its value in solving their defence industrial challenges, it is important to take stock of its track record of engagement and map how the institution has attempted to resolve the tensions outlined above in its existing programmes. Two fields of activity stand out: defence research and development, and defence procurement.

3.1. Defence R&D: the European Defence Fund

The EU has sought to address defence market fragmentation and national industry preference through two flagship programmes launched after the first Trump election and Brexit vote: the European Defence Fund (EDF) and Permanent Structured Cooperation (PESCO). Agreed to in 2017 and formally launched in 2021, the EDF is the European Commission's primary instrument to support defence research and development, with b8 billion invested under the EDF in the period 2021–2027.[24] With the Fund, the European Commission set out to address a number of the underlying problems facing European defence at the same time: from cuts in national defence budgets and uncoordinated spending, which lead to inefficiencies and reduce the availability of defence equipment, to the EU's decreasing ability to develop new defence technologies and systems. EU budget rules forbid investment in the production of weapons systems or ammunition. Thus, legally, the EDF is founded on Articles 173 and 182 of the Treaty on the Functioning of the EU (TFEU), which relate to the EU's economic activities. Article 173 of the TFEU states that the EU 'shall ensure that the conditions necessary for the competitiveness of the Union's industry exist', including cooperation on innovation and research and technological development.[25]

With the EDF, the European Commission gained new competences and took on tasks that European governments had historically guarded at the national level or assigned to the Member State–controlled EDA But budgetary deliberations between Member States resulted in a halving of the EDF's allocated financial means, thus considerably limiting its ambition and impact.[26] Member States also restricted the European Commission's involvement in especially sensitive policy areas and accorded the European Parliament only a limited oversight role.[27]

A recent IISS review of evidence from the first three rounds of EDF calls, covering 2021-2023, finds that the EDF has the potential to shape EU defence market dynamics.[28] The EU defence industry is interested in participating in EDF-funded projects, and the EDF is tackling a wide spectrum of military capabilities across all domains and is engaging with some of the most demanding defence technology sectors. The review also showed that the Fund prioritised large consortia, a result of EU-level inclusivity considerations of geographic balance and legitimacy.

At the same time, however, interviews with defence firms show that participation in the EDF is seen as overly complex and costly to navigate.[29] Member States also complain about the bureaucratic burden of an annual work programme. In practice, because application deadlines are short, SMEs without existing cooperation networks are disadvantaged in applying for grants, and smaller and medium-sized Member States especially lack the personnel resources to deal with short timelines. The European Commission has at least in part responded to this complaint and now issues a nonbinding multiannual planning document for guidance.[30]

The creation of the EDF laid the foundation for follow-up initiatives on ammunition and equipment production. Created before the Russian invasion of Ukraine, the EDF remains relevant today: despite the recent increases in most EU members' defence spending, EU Member States spend most of the money on equipment acquisitions rather than on R&D.[31] But it also shows that the European Commission is still in the early stages of learning to balance the needs of firms and ministries, defence primes, and SMEs. Several EDF projects are set to conclude in the coming years and it will be a priority for the European Commission to transition the resulting technologies, ranging from the design and systems of a new European main battle tank to a series of technologies to defeat drones into competitive products. Whether states are willing to commit to procuring these products will be an important indicator of government buy-in and ultimately Commission success.

3.2. Joint procurement: EDIRPA and ASAP

The European Commission has long considered joint procurement a crucial step for the EU's defence industrial ambition. Throughout the EDF decision-making process, however, EU Member States signalled to the European Commission that an EU role in joint defence procurement was off the table. In response, the European Commission compromised and lowered its ambition in this field.[32] The Russian invasion of Ukraine once again put the issue of EU-supported defence procurement on the agenda. It has prompted the European Commission to put forward several different initiatives to pursue coordinated EU defence procurement. First, it proposed the creation of the 'European Defence Industry Reinforcement Through Common Procurement Act' (EDIRPA), a €300-million short-term joint defence procurement instrument to incentivise EU Member States to procure defence products jointly, co-financing joint procurement up to 15 per cent (20 per cent if SMEs are involved).[33] The European Commission explicitly linked the EDIRPA procurement initiative to the EDF. It argued that the Fund was used for 'pre-commercial procurement', meaning research and development services, and that an EU procurement instrument was the logical follow-on instrument, crucial to the long-term success of the EDF.[34]

As EDIRPA was still in the process of being negotiated, the European Commission put forward its Act in Support of Ammunition Production (ASAP), which was adopted in an urgent procedure after three months in July 2023, to support and accelerate the immediate ramp-up of production capacity of ammunition and missiles in the EU and associated third countries. ASAP mobilises €500 million from the EU budget, with the aim of reaching a production capacity of two million shells per year by the end of 2025. The EU has so far missed its ammunition delivery targets, but production capacity has significantly increased.[35]

Crucially, before common EU-funded joint procurement is possible, Member States must agree on what to buy. The Russian invasion of Ukraine has led to a degree of strategic alignment of threat perceptions among EU Member States and highlighted urgent gaps to fill in the ammunition field especially. Beyond these short-term needs, countries continue to have different views. They differ, for instance, on the importance of building up naval power projection capacity beyond Europe while at the same time continuing to invest in deterrence and defence. From the European Commission's perspective, it makes most sense for the EU to support programmes and platforms that individual Member States are currently unable to finance, such as the platforms and equipment to protect critical subsea infrastructure.[36]

The EU Commission does not currently have access to crucial national intelligence and does not have in-house planning capabilities. The EU did in the past develop several elements of defence planning, such as the 'Headline Goal', which defines defence objectives, and the EDA's capability development plan (CDP) or the Coordinated Annual Review on Defence, which detail the European defence capability priorities and shortfalls. Concerns over duplicating NATO's Defence Planning Process (NDPP), and reluctance from Member States to empower the EU, meant that these were never deliberately integrated into a coherent capability development planning process.[37] New EU mechanisms, like the Coordinated

Annual Review on Defence, are not adequately integrated into the national defence budgeting and procurement plans of EU Member States or NATO. Partly as a result, NATO-EU relations remain strained, as reflected in recent comments by former NATO Secretary General Jens Stoltenberg.[38] New leadership in both institutions must urgently address this challenge and work to integrate the EU's instruments to support NATO's defence capability planning process.

EDIRPA and ASAP can be seen as precursors to plans for a longer-term instrument called the European Defence Industry Programme (EDIP). EDIP is a proposed regulation, which the European Commission put forward in March 2024, for an instrument to co-fund Member States' costs at the later stages of product development and during the production of new military equipment.[39] EDIP is envisioned to bridge the gap between the short-term goals of ASAP and EDIRPA, and ensure the EU's defence industrial readiness for the future. EDIP was initially proposed with a budget of €1.5 billion, redeployed from an increase of the EDF.

EU officials know that this is not nearly enough money to fulfil their ambitions. The European Commission estimates that additional defence investments of around €500 billion ($530 billion) are needed over the next decade.[40] At an EU Member State level, many countries will likely struggle to come up with the significant amounts of money required. Take Germany, for instance: if it wanted to reach 3 per cent of GDP defence spending by 2030, this would amount to an extra €70 billion per year, in addition to its regular defence budget.[41] Realistically, it will take an enormous effort to arrive at these sums.

The European Commission suggests joint EU-level spending on procurement as one solution to help with national spending challenges. EU spending alone will not be able to make up for the national spending shortfalls. It might, however, ease the burden on Member States' capitals. But so far, the EU has not been able to mobilise resources of the magnitude required. While there is widespread consensus that Europe needs to increase defence spending, EU countries have yet to reach an agreement on how to finance it.

4. Funding avenues

There is a range of avenues the EU could take to access the financial resources it needs.

The first option is funding through the regular EU Multiannual Financial Framework (MFF). EU budget negotiations are notoriously challenging, as each Member States' prioritises its own strategic goals and domestic interests. For example, convincing Member States grappling with farmers protests to reduce EU agricultural spending in favour of defence or persuading those without major defence industries that they stand to gain from the EU's initiatives, will be a significant hurdle.[42] What is more, spending EU money on the procurement of lethal equipment is legally problematic: Article 41.2 of the Treaty on European Union (TEU) forbids Common Security and Defence Policy (CSDP) operations with military and defence implications from being financed from the EU budget.[43]

The EU has thus in recent years resorted to an off-budget funding instrument to avoid these political and legal difficulties. The European Peace Facility (EPF) allows for the procurement of military material to support partner countries.[44] Following Russia's aggression, the EPF has effectively become a security assistance fund.[45] The EPF operates under the authority and direction of a Facility Committee, composed of representatives of each EU Member State, chaired by a representative of the Presidency of the EU Council. All Member States pay into the fund proportionally to their economic size and can then request reimbursements for any equipment they send.[46] Former EU High Representative Josep Borrell has stated that the passing of the EPF was a breakthrough, and that with it, another 'taboo was broken'.[47] But this mechanism relies on Member States' willingness to keep topping up the facility's fund and it can be blocked by an individual Member State's veto, which happens often.[48] And crucially, as it stands, the EPF is limited to financing procurement for third countries and cannot be used to support EU Member States directly.

A third option is EU defence bonds, which would allow the Union to pool resources for large-scale defence programmes. These have been the subject of contentious debate over the last year. Then-EU Commissioner for the Internal Market Thierry Breton proposed a debt-financed €100-billion fund to boost joint procurement of defence products.[49] The idea was supported by countries in Central and Eastern, as well as in Southern, Europe.[50] However, it faces resistance from fiscally conservative, wealthier nations opposed to joint debt.[51] There are several options for how joint borrowing for defence could work, laid out in detail in a recent paper by the Centre for European Reform (CER).[52]

First is a defence fund modelled on the EU's €800-billion Recovery and Resilience Facility (RRF), agreed during the COVID-19 pandemic. Disbursements from such a fund would not require consensus among EU Member States. But including all 27 EU Member States in a defence RRF could render the initiative vulnerable to opposition or delays. What is more, funds from such a facility could probably not be used directly to finance the purchase of defence capabilities. Another option involves utilising the European Stability Mechanism (ESM) to provide low-interest defence loans to EU Member States, as suggested in a report on the future of the single market by former Italian Prime Minister Enrico Letta.[53] However, as the CER paper notes, the ESM can only provide loans, not grants, which would primarily benefit countries with higher borrowing costs than the ESM.[54] What is more, the governance structure is cumbersome, with every disbursement decision requiring approval from national parliaments, potentially causing delays and inefficiencies.

Third is the option of a defence-related special purpose vehicle (SPV), which would issue bonds backed by national guarantees from participating countries rather than the EU as a whole. Participation in the fund would be voluntary and open to non-EU states like Norway and the UK. Such a European guarantee fund is limited to a borrow-to-lend model, however. It may slightly reduce funding costs for some participating countries or provide relatively affordable credit to defence firms but cannot independently carry debt.[55] National guarantees supporting the SPV would still count directly toward the debt levels of the participating countries.

Crucially, even if and when funding can be provided, the strategic debates outlined in this paper would still need settling before it could be used for joint EU defence development and procurement spending. It is easier said than done, but common funding will find sufficient support only if Member States can agree on and commit to specific flagship projects that serve the security and defence interests of Europe and, currently most urgently, of the eastern flank states. This could include European integrated air defense, ammunition, missiles, drones and unmanned aerial vehicles (UAVs) and deep- and precision strike capabilities. Those Member States that have so far been reluctant to grant the EU more authority and resources, can only be won over if EU funds are pitched not as charity to those who have neglected national defence investments, but instead as targeting shared capability gaps.

5. Outlook

The 2024 election of Donald Trump could, in the coming months, provide momentum to resolve some persistent points of tension and unlock joint EU action, including on funding, third country involvement and European Commission competency.

On funding, according to recent reporting, EU Member States are mulling the SPV option.[56] For the reasons listed above, this will not solve the national funding challenges but shows that there is new momentum behind EU funding ambitions. In this context, of German fiscal policy positions domestically and at the EU level. If Member States cannot agree on joint EU financing, it may well be the case that most of the necessary increase in European defense spending will be financed by nationally, rather than through EU funds. In this case, the European Commission could loosen EU fiscal rules to allow for the special treatment of military expenditures, exempting defence spending from deficit procedures. At the sidelines of the EU Informal Leaders' Summit on 3 February 2025, European Commission President von der Leyen stated, "for extraordinary times, it is possible to have extraordinary measures also in the Stability and Growth Pact. And I think we live in extraordinary times."[57]

She later added that she would trigger the EU's national escape clause, under which military expenditures would not be counted, in a "controlled and conditional way".[58] There has also been some movement on the question of European Investment Bank (EIB) involvement in EU defence funding. The EIB has historically focused exclusively on civilian initiatives, with strict lending and funding policies prohibiting support for most military projects or procurements. However, these restrictions have been significantly relaxed over the past five years, particularly following the war in Ukraine. To help with private sector investment in the defence sector, the European Commission wants the EIB to invest in defence and for EIB loans to stimulate private investments in the European defence industry, and invited the EIB to review its lending policy in 2024.[59] An updated agreement between the EIB and the EDA was concluded in the fall of 2024, with the EIB now receiving industry guidance from the EDA.[60]

On third-country relations, the election of a Labour government in the UK has potentially cleared the path for a closer defence relationship between the UK and EU Member States, as well as closer alignment between Brussels and London, through a UK-EU defence pact.[61] The strategic necessity of keeping the UK close could lead the EU to adopt a less rigid approach to third-country collaboration. The long-planned EU-UK Summit will take place in the UK in mid-May. The United States, however, will likely be a *sui generis* case in this context.

The approach adopted by the incoming Trump administration on EU defence will be key to the future of EU defence industrial efforts. In the first Trump administration, after the EU announced plans for a new European Defence Fund, US officials strongly objected to the 'poison pills' in the EDF regulation that would preclude third-country participation by non-EU headquartered companies.[62] They aggressively lobbied for US companies to have access to the EU funds. This US intervention came too late in the process to significantly change the EDF regulation, but EU Member States that identify as particularly economically liberal and in favour of open markets, or highly value close defence industrial ties with the United States – in some cases because of the security guarantees they perceived to be attached to those ties – managed to negotiate a compromise.

Under the Biden administration, the Russian invasion of Ukraine led policymakers on both sides of the Atlantic to recognise the EU's potential to boost European defence industrial production capacity. The United States took a more pragmatic approach then and showed some openness to a greater EU role in defence (while still encouraging Europeans to work mostly through NATO and negotiating PESCO and EDA cooperation agreements).

If under Trump 2.0, US officials decide to again lobby EU Member States ahead of the MFF negotiations over the next Defence Fund's or EDIP's budget, this could lead capitals to further hobble the EU's ambitions. In anticipation of the new government, France has already reportedly dropped its opposition to non-EU companies accessing EU-funded financial incentives for Europe's defence industry, supporting a proposal that would allow for up to 35 per cent of EU budget–financed cash incentives to be spent on defence products from outside the Union.[63] If, on the other hand, EU Member States and officials can persuade the United States that their initiatives contribute to filling European capability gaps, which would in turn allow the United States to take on less of the European security burden, US support for EU initiatives might provide momentum.

While it is still unclear which position the Pentagon will take, there are certainly those in the MAGA orbit who advocate for more leniency vis-à-vis EU initiatives.[64] This group is essentially in favour of a new European security order with only minimal US involvement. They want to transfer responsibility for the majority of Europe's conventional defence to the Europeans and are open to the EU contributing to this effort. The question is whether these political objectives will trump longstanding defence industrial interests. Europeans should make the case for a transatlantic defence industrial win-win scenario: if the overall defence industrial pie gets bigger, firms on both sides of the Atlantic can benefit.

The newly established post of EU Defence Commissioner might be helpful in this context. In the United States, politics revolves around personnel. An EU 'defence czar' who can effectively engage partners on the EU's defence industrial strategies, explaining their objectives and how they might be beneficial to transatlantic security, and highlighting big ticket purchases that the US President can sell at home would be valuable in Washington – if he is not consistently undermined by national governments.[65] If Europeans find, however, that in spite of their best efforts to show that investing in European defence firms benefits transatlantic security interests, the Pentagon follows the script of the first Trump Presidency and sends another 'poison pill'- letter, they may need to strengthen their spines and carry on regardless. A United States that withdraws from European security and NATO solidarity cannot expect to be granted the same defence industrial boons as the security guarantor of past decades.

The persistent efforts by Russia to undermine European security, and the potential for further disruption under a second Trump presidency, underscore the need for Europe to invest in its defence industrial base. After years of incremental bureaucratic initiative that progressively undermined the legal, ethical and political taboos that long prevented a greater EU role in defence industrial policy, the European Commission has over the course of the last year raised its level of ambition to meet the challenges at hand. So far, it has had a mixed record of convincing Member States of the EU's added value in industrial policy.

But whereas in previous years, debates over the strategic direction of the EU's initiatives have often been abstract, Member States, faced with serious resource constraints and capability gaps, may now agree on concrete paths forward. They may move forward on greater EU flexibility to allow national spending increases. If they want to access common funding for capabilities – they should – they must first identify useful projects that plug shared gaps. Once they can jointly agree what capabilities to develop and find the resources to pay for them, they must then solve questions of defence planning (e.g. regarding how the EU can usefully slot into NATO and national processes), geographic balance and inclusion (e.g. regarding how the EU can preserve the legitimacy of its efforts with all EU Member States while at the same time achieving more effective governance of its initiatives), and supranational competence and authority (e.g. regarding how the European Commission can gather data on the state of EU's defence industrial base, or if it should be able to enforce security of supply measures in a crisis). Much hinges on the forthcoming European Commission White Paper on Defence. If it can resolve the challenges outlined here, the EU can play an important niche role in Europe's rearmament, through targeted defence industrial programs.

REFERENCES

1 "EU defense spending projected to boom to €326B" Joshua Posaner, Politico, December 4, 2024, https://www.politico.eu/article/eu-defense-spending-projected-boom-326b-european-defence-agency-russia-war-security/

2 Sylvia Pfeifer et al., "Global Defence Groups Hiring at Fastest Rate in Decades Amid Record Orders," *Financial Times*, June 16, 2024, https://www.ft.com/content/9625dbaa-5d36-4bee-8610-f16ab7ad6b1d

3 Sophia Besch and Leonard Schütte, "Drohender Rückzug der USA. Die NATO muss europäisiert werden" [Impending Withdrawal of the USA. NATO Must be Europeanized], *Tagesspiegel*, July 3, 2024, https://www.tagesspiegel.de/internationales/drohender-ruckzug-der-usa-als-sicherheitsgarant-die-nato-muss-europaisiert-werden-11851304.html

4 "Strategic Compass for a Stronger EU Security and Defence in the Next Decade," European Council, March 2022, https://data.consilium.europa.eu/doc/document/ST-7371-2022-INIT/en/pdf

5 "Versailles Declaration," European Council, March 11, 2022, https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf

6 "A New European Defense Industrial Strategy: Achieving EU Readiness Through a Responsive and Resilient European Defense Industry," European Commission, March 5, 2024, https://defence-industry-space.ec.europa.eu/document/download/643c4a00-0da9-4768-83cd-a5628f5c3063 _ en?filename=EDIS%20Joint%20Communication.pdf

7 Ibid.

8 Guntram Wolff, "Memo to the Commissioner Responsible for Defence," Bruegel, September 2024, https://www.bruegel.org/memo/memo-commissioner-responsible-defence; Sascha Ostanina and Thierry Tardy, "Turbo-Charging the EU's Defense Industry and Security Posture," Jacques Delors Centre at the Hertie School, April 2024, https://www.delorscentre.eu/en/publications/detail/publication/turbo-charging-the-eus-defence-industry-and-security-posture

9 Mario Draghi, "The Future of European Competitiveness – A Competitiveness Strategy for Europe," European Commission, September 9, 2024, 61, https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961 _ en?filename=The%20future%20of%20European%20competitiveness%20 _ %20A%20competitiveness%20strategy%20for%20Europe.pdf

10 Janan Ganesh, "Why Europe Will Not Catch Up With the US," *Financial Times*, September 18, 2024, https://www.ft.com/content/298008a0-b75d-4062-9cb1-86b12ac30fbd

11 Ursula von der Leyen, "Mission Letter to Andrius Kubilius," European Commission, September 17, 2024, 5, https://commission.europa.eu/document/download/1f8ec030-d018-41a2-9759-c694d4d56d6c _ en?filename=Mission%20letter%20-%20KUBILIUS.pdf; Ursula von der Leyen, "Mission Letter to Kaja Kallas," September 17, 2024, 5, https://commission.europa.eu/document/download/1fd85a66-b89a-492b-8855-89499106c1d4 _ en?filename=Mission%20letter%20-%20KALLAS.pdf

12 Ursula von der Leyen, "Europe's Choice. Political Guidelines for the Next European Commission 2024-2029," 13, https://commission.europa.eu/document/download/e6cd4328-673c-4e7a-8683-f63ffb2cf648 _ en?filename=Political%20Guidelines%202024-2029 _ EN.pdf; Elena Lazarou, "White Paper on the Future of European Defence," European Parliamentary Research Service, November 2024, https://www.europarl.europa.eu/RegData/etudes/BRIE/2024/766229/EPRS _ BRI(2024)766229 _ EN.pdf

13 Keith Hartley, "The Economics of European Defense Industrial Policy," in *The Emergence of EU Defense Research Policy: From Innovation to Militarization*, eds. Nikolaos Karampekios, Iraklis Oikonomou, and Elias G. Carayannis (Cham: Springer International Publishing, January 2018), 77-92; Ron Matthews, "European Collaboration in the Development of New Weapons Systems," in *The Emergence of EU Defense Research Policy: From Innovation to Militarization*, eds. Nikolaos Karampekios, Iraklis Oikonomou, and Elias G. Carayannis (Cham: Springer International Publishing, January 2018), 111-130.

14 Daniel Fiott, "The US Role in Furthering/Pushing European Defence R&D Development," in *The Emergence of EU Defense Research Policy: From Innovation to Militarization*, eds. Nikolaos Karampekios, Iraklis Oikonomou, and Elias G. Carayannis (Cham: Springer International Publishing, January 2018), 291; Christian Mölling and Torben Schütz, "European Armament Collaboration: What We Can Learn from History and Concepts," in *The Emergence of EU Defense Research Policy: From Innovation to Militarization*, eds. Nikolaos Karampekios, Iraklis Oikonomou, and Elias G. Carayannis (Cham: Springer International Publishing, January 2018), 131-146.

15 Hartley, "The Economics of European Defense Industrial Policy"; Christian Scheinert, "European Defence Industrial Development Programme (EDIDP)," European Parliamentary Research Service, June 2018.

16 "Directorate-General for Defence Industry and Space (DG DEFIS)," European Commission, https://commission.europa.eu/about/departments-and-executive-agencies/defence-industry-and-space_en

17 Sophia Besch, in "Taking the Pulse: Is Having a European Commissioner for Defense a Mistake?" Carnegie Endowment for International Peace, September 26, 2024, https://carnegieendowment.org/europe/strategic-europe/2024/09/taking-the-pulse-is-having-a-european-commissioner-for-defense-a-mistake?lang=en

18 "Factsheet: European Defence Industry Programme," European Commission, 2, https://defence-industry-space.ec.europa.eu/document/download/638c4482-0715-4aef-ac86-6529ce2dfd4b_en?filename=DEFIS_EDIP_factsheet.pdf

19 Tim Lawrenson and Ester Sabatino, "The Impact of the European Defence Fund on Cooperation with Third-Country Entities," International Institute for Strategic Studies, October 24, 2024, https://www.iiss.org/research-paper/2024/10/the-impact-of-the-european-defence-fund-on-cooperation-with-third-country-entities/

20 Sophia Besch and Luigi Scazzieri, "European Strategic Autonomy and a New Transatlantic Bargain," Centre for European Reform, December 11, 2020, https://www.cer.eu/publications/archive/policy-brief/2020/european-strategic-autonomy-and-new-transatlantic-bargain

21 European Commission, "A New Defense Industrial Strategy."

22 Jean-Pierre Maulny, "The Impact of the War in Ukraine on the European Defence Market," Institut de Relations Internationales et Stratégiques (IRIS), September 2023, https://www.iris-france.org/wp-content/uploads/2023/09/19_ProgEuropeIndusDef_JPMaulny.pdf

23 Ben Schreer, "Europe's Defence Procurement Since 2022: A Reassessment," International Institute for Strategic Studies, October 23, 2024, https://www.iiss.org/online-analysis/military-balance/2024/10/europes-defence-procurement-since-2022-a-reassessment/

24 "The European Defence Fund in Detail," European Commission, https://defence-industry-space.ec.europa.eu/eu-defence-industry/european-defence-fund-edf-official-webpage-european-commission_en

25 "Consolidated Version of the Treaty on the Functioning of the European Union," 2012, OJ (C 326) 126.

26 Raluca Csernatoni, "EU Security and Defense Challenges: Toward a European Defense Winter?" Carnegie Endowment for International Peace, June 11, 2020, https://carnegieendowment.org/research/2020/06/eu-security-and-defense-challenges-toward-a-european-defense-winter?lang=en&center=europe

27 Raluca Csernatoni and Yf Reykers, "The Role of National Parliaments in EU Defense," Carnegie Endowment for International Peace, December 20, 2021, https://carnegieendowment.org/research/2021/12/the-role-of-national-parliaments-in-eu-defense?lang=en&center=europe

28 Tim Lawrenson and Ester Sabatino, "The Impact of the European Defence Fund on Cooperation with Third-Country Entities," International Institute for Strategic Studies, October 24, 2024, https://www.iiss.org/research-paper/2024/10/the-impact-of-the-european-defence-fund-on-cooperation-with-third-country-entities/

29 Besch, "No Copernican Revolution," 165-166.

30 Tim Lawrenson and Ester Sabatino, "The Impact of the European Defence Fund on Cooperation with Third-Country Entities," International Institute for Strategic Studies, October 24, 2024, https://www.iiss.org/research-paper/2024/10/the-impact-of-the-european-defence-fund-on-cooperation-with-third-country-entities/

31 "Defence Data 2022. Key Findings and Analysis," European Defence Agency, 2023, 11, https://eda.europa.eu/docs/default-source/brochures/2022-eda_defencedata_web.pdf

32 Besch, "No Copernican Revolution," 187.

33 "MEPs Vote to Strengthen EU Defence Industry Through Common Procurement," European Parliament, September 12, 2023, https://www.europarl.europa.eu/news/en/press-room/20230911IPR04908/meps-vote-to-strengthen-eu-defence-industry-through-common-procurement

34 "Defence: €500 Million and New Measures to Urgently Boost EU Defence Industry Capacities in Ammunition Production," European Commission, May 3, 2023, https://defence-industry-space.ec.europa.eu/defence-eu500-million-and-new-measures-urgently-boost-eu-defence-industry-capacities-ammunition-2023-05-03_en

35 Alexandra Brzozowski, "EU Months Late on One Million Ammunition Target for Ukraine," Euractiv, January 31, 2024, https://www.euractiv.com/section/defence-and-security/news/eu-months-late-on-one-million-ammunition-target-for-ukraine/

36 Sophia Besch and Erik Brown, "Securing Europe's Subsea Data Cables," Carnegie Endowment for International Peace, December 16, 2024, https://carnegieendowment.org/research/2024/12/securing-europes-subsea-data-cables?lang=en

37 Viktor Szép et al., "The Current Legal Basis and Governance Structures of the EU's Defence Activities," Envisioning a New Governance Architecture for a Global Europe (ENGAGE), December 2021, https://www.engage-eu.eu/publications/the-current-legal-basis-and-governance-structures-of-the-eus-defence-activities

38 Jens Stoltenberg, "Reflections on a Challenging Decade," North Atlantic Treaty Organization and German Marshall Fund of the United States, https://www.nato.int/cps/cn/natohq/opinions_228915.htm

39 "The European Defence Industry Programme at a Glance," European Commission, https://carnegieendowment.org/research/2024/12/securing-europes-subsea-data-cables?lang=en

40 Lili Bayer and Andrew Gray, "EU Must Find Billions for Arms Within a Year, Defence Chief Says," *Reuters*, December 9, 2024, https://www.reuters.com/world/europe/eu-must-find-billions-arms-within-year-defence-chief-says-2024-12-09/

41 Sarah Brockmeier-Large, "Klarer Block vonnöten," *Internationale Politik und Gesellschaft*, November 14, 2024, https://www.ipg-journal.de/rubriken/aussen-und-sicherheitspolitik/artikel/klarer-blick-vonnoeten-7920/

42 Sophia Besch, "Understanding the EU's New Defense Industrial Strategy," Carnegie Endowment for International Peace, March 8, 2024, https://carnegieendowment.org/posts/2024/03/understanding-the-eus-new-defense-industrial-strategy?lang=en

43 "Consolidated Version of the Treaty on European Union," 2012, OJ (C 115) 37.

44 "European Peace Facility," European Commission, https://fpi.ec.europa.eu/what-we-do/european-peace-facility_en

45 Max Bergmann et al., "The European Union Charts Its Own Path for European Rearmament," Center for Strategic and International Studies, March 8, 2024, https://www.csis.org/analysis/european-union-charts-its-own-path-european-rearmament

46 "European Peace Facility," European Council, https://www.consilium.europa.eu/en/policies/european-peace-facility/#establish

47 Henry Foy, "Arming Ukraine: How War Forced the EU to Rewrite Defence Policy," *Financial Times*, February 27, 2023, https://www.ft.com/content/1b762ff1-2c7f-40a1-aee9-d218c6ef6e37

48 Giorgio Leali, "EU's Breton Accuses Germany of Going 'Solo' on Ukraine Aid," *POLITICO*, January 15, 2024, https://www.politico.eu/article/europe-thierry-breton-germany-ukraine-war-aid/; Maria Psara, "What is the European Peace Facility and Why Hungary is Blocking the Disbursements to Ukraine," *Euronews*, October 14, 2024, https://www.euronews.com/my-europe/2024/10/14/what-is-the-european-peace-facility-and-why-hungary-is-blocking-the-disbursements-to-ukrai

49 Sebastian Clapp et al., "Financing the European Defence Industry," European Parliamentary Research Service, September 2024, https://www.europarl.europa.eu/RegData/etudes/BRIE/2024/762383/EPRS_BRI(2024)762383_EN.pdf

50 Bjarke Smith-Meyer, "France Pitches Radical Joint EU Borrowing Plan to Pay for Defense," *POLITICO*, March 20, 2024, https://www.politico.eu/article/france-pitch-radical-joint-eu-borrowing-plan-pay-defense/

51 Ibid.

52 Luigi Scazzieri and Sander Tordoir, "European Common Debt. Is Defence Different?" Centre for European Reform, November 2024, https://www.cer.eu/sites/default/files/pb_LS_ST_defence_bonds_5.11.24.pdf

53 Enrico Letta, "Much More than a Market. Speed, Security Solidarity. Empowering the Single Market to Deliver a Sustainable Future and Prosperity for all EU Citizens," European Commission, April 2024, https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

54 Scazzieri and Tordoir, "European Common Debt," 8.

55 Ibid., 9.

56 Paola Tamma et al., "Europe Races to Set Up €500bn Defence Fund," *Financial Times*, December 5, 2024, https://www.ft.com/content/169816b5-39e9-4f05-ae84-43ef8e277c76

57 Opening remarks by President von der Leyen at the joint press conference with President Costa and Polish Prime Minister Tusk following the Informal EU leaders' retreat Brussels, 3 February 2025, https://ec.europa.eu/commission/presscorner/detail/en/statement _ 25 _ 402

58 Paola Tamma, "Brussels to Free Up Billions of Euros for Defence and Security from EU Budget," *Financial Times*, November 11, 2024, https://www.ft.com/content/eb0de7f4-5ba1-460a-a83d-1a7302fc1536 https://www.ft.com/content/eb0de7f4-5ba1-460a-a83d-1a7302fc1536

59 Clapp et al., "Financing the European Defence Industry," 4.

60 "EDA and EIB Deepen Partnership in Support of Financing for Defence," European Defence Agency, October 3, 2024, https://eda.europa.eu/news-and-events/news/2024/10/03/eda-and-eib-deepen-partnership-in-support-of-financing-for-defence

61 Nick Alipour, "Germany, UK Look Past Tensions to Strengthen Post-Brexit Defence Collaboration," *Euractiv*, April 25, 2024, https://www.euractiv.com/section/global-europe/news/germany-uk-look-past-tensions-to-strengthen-post-brexit-defence-collaboration/; Isabella Antinozzi and Simon Brawley, "UK-EU Relations and European Security," UK Parliament Horizon Scanning, October 7, 2024, https://post.parliament.uk/uk-eu-relations-and-european-security/

62 Ellen M. Lord and Andrea L. Thompson, "Letter to Her Excellency Federica Mogherini, High Representative of the European Union for Foreign Affairs and Security Policy, and Vice-President of the European Commission," United States Department of Defense and United States Department of State, May 1, 2019.

63 Henry Foy and Paola Tamma, "France Drops Buy-EU Demand for Brussels Defence Fund," *Financial Times*, November 25, 2024, https://www.ft.com/content/f556667f-c2c2-4111-8dda-bc5b6ed9ce10

64 Mark Leonard, host, Mark Leonard's World in 30 Minutes, "The World after the West: Alex Velez-Green on the United States," European Council on Foreign Relations, August 23, 2024, https://ecfr.eu/podcasts/episode/the-world-after-the-west-alex-velez-green-on-the-united-states/

65 Rym Montaz, "Taking the Pulse: Is Having a European Commissioner for Defense a Mistake?" Carnegie Endowment for International Peace, September 26, 2024, https://carnegieendowment.org/europe/strategic-europe/2024/09/taking-the-pulse-is-having-a-european-commissioner-for-defense-a-mistake?lang=en

Notes

Imprint

Published by

Heinrich-Böll-Stiftung European Union, Brussels
Rue du Luxembourg 47-51, 1050 Brussels, Belgium

Contact: Anton Möller, Head of Programme – Green Economic and Social Policy in the EU,
Heinrich-Boll-Stiftung European Union, Brussels
E Anton.Moeller@eu.boell.org

Place of publication: https://eu.boell.org

Release date: March 2025

SCAN ME

Proofreading: Chris Meikle

Edition: Joan Lanfranco, Head of Communications and Outreach,
Heinrich-Boll-Stiftung European Union, Brussels

Layout: Micheline Gutman, Brussels