

Issue paper #4

Towards a European Defence Industrial Strategy: Enhancing our security of supply on the Internal Market

The Commission services, together with the European External Action Service in coordination with the European Defence Agency, have launched, based on a first overall consultation paper ('Issue paper #1'), a comprehensive stakeholder engagement process to inform the new European Defence Industrial Strategy. This fourth paper outlines key issues and questions for further discussion on how to ensure security of supply of defence products in the EU.

The purpose of this Issue paper is to support the informal discussions with stakeholders. It does not constitute an official position of the Commission and does not pre-empt the content of the future Strategy.

Security of Supply: why it matters

Security of Supply (SoS) is defined as a “*guarantee of supply of goods and services sufficient for a Member State to discharge its defence and security commitments in accordance with its foreign and security policy requirements*”¹. This broad concept covers a wide range of industrial, technological, legal, and political aspects². Two different levels must be taken into account: (i) the supply of raw materials, components, and goods necessary for the manufacturing of defence products, in the short term as well as through the entire life cycle of a military equipment and (ii) the supply of finished defence products. Those two levels of SoS call for different type of responses and tools. This paper focuses on the main areas where there is a substantial EU added value.

Military SoS has been primarily defined at Member States’ level since defence is a national competence and defence investment has until recently been thought predominantly under national paradigms and in relation to national supply chains. There is nonetheless an ever-stronger European dimension to SoS, as industrial supply chains have increasingly been spanning across the EU internal market and beyond.

While in principle SoS is not a major concern for Member States during peace time³, it becomes one in times of security crises and war, as the functioning of the international markets generally deteriorates in such contexts (stricter export control, higher demand, transport problems, instrumentalisation of dependencies, etc) and supplies for defence production, including delivery of defence products and services, can be significantly affected, or even disrupted.

SoS comes at a cost. Under budgetary constraints, a customer may have to buy fewer pieces of equipment or have to cancel other purchases to secure SoS for a specific equipment.

¹ [Guidance Note on Security of Supply](#).

² Idem.

³ Supply issues can occur in peace time in relation to unexpected disruptions of global production (e.g., pandemic, chips shortages), production issues at a specific supplier, obsolescence of components, transport problems, export control issues and shortages resulting from peaks in demand.

Traditionally, Member States have adopted two main strategies to achieve SoS: independence at national level or negotiated interdependence. Independence at national level has become a less sustainable strategy for any Member State in light of the increasing reliance on sophisticated defence systems and the continuous increase in external dependencies. With the increasing cost and complexity of state-of-the-art capabilities, no single Member State can afford to develop, produce, and sustain, on a purely national basis, the whole spectrum of defence capabilities. Similarly, fewer supply chains are under the control of a single Member State. Increasingly, defence supply chains often have an EU cross-border dimension, in particular in lower tiers, as illustrated by the ammunition supply chains. Therefore, any Member State's SoS strategy should increasingly integrate the EU dimension and better leverage one of the major strengths of the Union - the Single Market.

Cross-border value chains require a management mechanism to ensure Security of Supply both in peacetime and during crises

Cross-border defence supply chains at EU level, including at prime and tier 1 supplier levels, bring significant advantages to EU Member States in terms of efficiency and utilisation of the best technologies. A Europeanisation of supply chains would multiply business opportunities for defence companies, generate economies of scale, facilitate the access of prime contractors to efficient and innovative EU-based suppliers, including SMEs and start-ups, as well as benefit more widely to the European economy, generating highly skilled jobs and technological edge. A more integrated and competitive European defence equipment market would also allow the EDTIB to capitalise on economies of scale, enhancing the efficiency of its industrial organisations. By providing unfettered access to a larger pool of potential suppliers, an integrated defence Internal Market also contributes to the resilience of the EDTIB.

Paradoxically although industrial defence supply chains are largely spanning over borders in lower tiers following the integration momentum created by the Single Market, their smooth functioning is hampered by the persistence of an essentially national approach to defence industrial policy. Uncoordinated approaches to national security generate risks in terms of SoS for both supply chains and Member States, exposing the EDTIB to risks and ultimately discouraging cross-border cooperation. Indeed, cross-border supply chains which cannot rely on an appropriate governance might be subject to disruptions during crises due to uncoordinated national measures that prioritise national consumption of those inputs under national control, as illustrated by initial responses to shortages in masks during the Covid crisis. These risks for Member States can be mitigated with a European level of governance. The development of EU cross-border supply chains must bring a higher level of SoS to Member States, and not generate additional risks for them.

Cross-border supply chains imply shared responsibilities and risks mitigation to ensure the highest level of SoS to all EU Member States. As was already stressed by the European Defence Action Plan⁴, Member States need to be confident that cross-border deliveries will not be disrupted to further engage in cooperative programmes or to further procure cross-border.

⁴ COM(2016) 950, *European Defence Action Plan*, 30 November 2016.

The EU Single Market can provide instruments which would enable Member States to improve SoS between them, hence enhancing their trust in cross-border supply chains. To ensure the functioning of the Single Market not only in peace time, but also in times of crisis, it may be necessary to adopt certain measures which will ensure, in a coordinated way, harmonised rules for facilitating the SoS of defence products.

An EU-wide SoS regime can also be a key competitive advantage for the EDTIB and EU defence supply chains over their external competitors. Indeed, by providing a level of SoS that none of the latter could offer, EU defence supply chains could enjoy a ‘trust premium’ from Member States.

1. Achieving the EDTIB’s long-term ability to fulfil Member States SoS requirements

Although disruption can never be totally ruled out, its risk can be significantly mitigated. Likewise, there are ways to achieve a greater resilience of European supply chains in case of a shock.

Identifying potential bottlenecks to prevent disruption in defence supply chains

To prevent supply disruption and increased resilience along the defence supply chains, especially in times of crisis, potential bottlenecks must be identified and monitored. A detailed understanding of the composition, capacity, and operation of supply chains is necessary at both national and European level. The more efficient mapping and monitoring of critical supply chains, making them more robust and resilient, has been at the heart of several recent EU Single Market and industrial initiatives aiming to prevent and mitigate future crises and shortages (health, semi-conductor, critical raw materials).

In the case of ammunition, the work of the Defence Joint Procurement Task Force (DJPTF), followed up by on-site visits by the responsible Commissioner to all relevant manufacturers and further subsequent work from the Commission services, enabled to map and monitor 155mm ammunition capacities, including in the supply chains. This was made possible thanks to the voluntary participation of all industry and the support offered by Member States. Such a mapping has been crucial to ensuring the swift implementation of the Act in Support of Ammunition Production (ASAP) instrument and notably to target bottlenecks in the supply chains. If such an approach were to be replicated or extended, a reflection on the appropriate governance would be key. It would require a cooperative approach between EU institutions and Member States, notably to determine the scope of the sector/domain to be mapped and monitored, as well as mechanisms for the protection of classified and commercially sensitive information, and essential security interests.

Flexible manufacturing

Instruments and practices to timely secure the requisite ramp up of the EDTIB’s manufacturing capacities should be flexible enough to adapt to unforeseen events, demand surge and market developments, including possible downturns. The EDTIB must be agile enough to allow for timely scale-up of production, but also to handle a fast decrease in Member States’ demand and potential market implications. Measures which ensure that manufacturing slots are immediately available to face the surges in demand due to a crisis, may increase the robustness of defence supply chains. Likewise, ramp-down processes must

be available when needed, to preserve the EDTIB's competitiveness by securing its fast adaptation to any market development.

For several years now, the EU has developed tools and frameworks to increase industrial readiness to face future crisis situations. However, such measures are not available to support the EDTIB.

In the public health domain, Council Regulation (EU) 2022/2372⁵ provides for an emergency framework which, in the event of a public health emergency, can be activated by the Council, and lead to the use of measures supporting the capacity of industry to react to a specific crisis, such as: activation of the Network of Ever-warm Production Capacities for Vaccines and Therapeutics manufacturing ('EU-FAB'), use of Advance Purchase Agreements to de-risk private investments for the development, production and supply of medical countermeasures, etc.

Similarly, the Chips Act⁶ includes a security of supply and resilience pillar which provides for similar measures, with the 'integrated production facility' (IPF) and 'open EU foundry' (OEF) statuses⁷. To reach security of supply in the Union, Member States may offer public support to such facilities. The Commission will take the positive effects of such facilities for the European ecosystem into account for its State aid assessments, where relevant.

Security of supply in defence procurement

The Defence and Security Procurement Directive 2009/81/EC (Article 23 in particular) includes specific provisions on SoS that the Member States may require economic operators to include in their tenders and to commit to during the execution of the contract. The evaluation of the Directive⁸ concluded that although no specific problem has been identified with regard to these provisions, these only address part of a much more complex problem and cannot, by themselves, be sufficient to fully guarantee Member States' SoS.

Questions:

- ⇒ *How can we build upon the experience of the EU in developing emergency frameworks and policy measures, notably in sectors like health or semiconductors to improve the resilience of defence supply chains?*
- ⇒ *Building upon the lessons drawn from the DJPTF's work and other EU initiatives, how can we better anticipate potential bottlenecks and disruptions in defence supply chains in order to address them as swiftly as possible, hence supporting the resilience of defence supply chains?*
- ⇒ *Are provisions on Security of Supply of Directive 2009/81/EC bringing sufficient guarantees to Member States? Should they be reinforced?*

⁵ Council Regulation (EU) 2022/2372 of 24 October 2022 on a framework of measures for ensuring the supply of crisis-relevant medical countermeasures in the event of a public health emergency at Union level.

⁶ Regulation (EU) 2023/1781 of the European Parliament and of the Council of 13 September 2023 establishing a framework of measures for strengthening Europe's semiconductor ecosystem (Chips Act).

⁷ OEFs are facilities that design and produce components mainly for other industrial players. IPFs are factories that design and produce components that serve their own market. The status of IPF or OEF entitles undertakings to a streamlined approach to administrative applications and a priority access to pilot lines set up under the "Chips for Europe Initiative".

⁸ COM(2016)762, *Report on the implementation of Directive 2009/81/EC, to comply with Article 73(2)*, 30 November 2016.

2. Enabling the prioritisation of Member States defence orders when required

When defence supply chains were predominantly national, Member States could exercise significant and direct control over the manufacturing capacities of the industry based on its territory. With the development of cross-border supply chains, Member States must rely on the capacity and therefore the cooperation of non-domestic players to get reliable access to necessary inputs and final products.

End-product level: enhancing intergovernmental cooperation to secure SoS

In times of crisis, EU Member States may compellingly need their defence products orders (new, existing, or additional) to be served as a matter of priority. Several Member States have developed specific tools (e.g., priority rated orders, requisition, etc.) to address such situations at national level. These tools sometimes even foresee the possibility to address the needs of other EU Member States or allies. However, the scope of application of such tools is limited to the territory of the concerned Member State. Thus, they do not assist the Member State using such tools if necessary inputs or final products are provided from outside their jurisdiction. Moreover, other Member States' industries may be impacted if their orders from suppliers in that Member State are requisitioned/reprioritised. These tools are not adapted to the operation of cross-border supply chains.

Faced with the increasingly cross-border nature of the supply chains and the ensuing interdependence, Member States have sought to support urgent orders from other Member States, notably through prioritisation mechanisms (e.g., in the framework of the Letter of Intent Framework Agreement⁹, or of the European Defence Agency¹⁰). However, such initiatives often rely on principles and non-binding and/or non-enforceable commitments. They offer limited responses to crisis situations, as supplies are not guaranteed by any binding mechanism or follow-up process.

Against this backdrop, consideration should be given to the opportunity of equipping the EU with a legal framework ensuring that each Member State has access to the necessary tools providing a satisfactory level of SoS in a cross-border context. For instance, the European Commission proposal for the ASAP Regulation included a Priority Rated Order mechanism in order notably to enable the reprioritisation of certain Member States' orders of defence products. Although the proposed mechanism was not retained due to the urgency to get the ASAP Regulation adopted, it remains necessary to discuss how best to secure the requisite prioritisation or orders in the context of a security crisis.

Along supply-chains in crisis times: Ensuring that defence supply prevails over civilian supply where necessary

As illustrated by the ammunition initiative, cross-border interdependence is already a reality for the lower tiers of supply chains (or in the equipment chains for a factory) where defence

⁹ [Framework Agreement concerning Measures to Facilitate the Restructuring and Operation of the European Defence Industry](#), 27 July 2000. LoI subcommittee on SoS is now 'dormant'.

¹⁰ The Framework Arrangement for SoS between subscribing Member States, that was approved by the EDA Steering Board of 19 November 2013 and the Code of Conduct on Prioritisation adopted by the EDA Steering Board on 15 May 2014.

companies compete with companies from civilian sectors having major demand volumes. It can result in the crowding out of a defence industry with more limited market power (see Issue paper #3 – *Adapting the Union’s defence industrial base to the new security environment*). Moreover, difficulties in accessing one single raw material or a specific component can hamper a whole supply chain.

This is further exacerbated in crisis situations, especially if no contingency plan was established beforehand. Tensions can arise on specific components or raw materials and defence orders are not necessarily prioritised due to competition with the civil sector. This can be a significant disadvantage compared to partners and allies (e.g., the US can and does activate relevant provisions of the Defence Production Act).

Existing EU initiatives in the health¹¹ and semiconductor¹² sectors provide for the possibility to prioritise certain orders in case of crisis, with well-balanced safeguards. The Priority Rated Order proposed by the Commission in the framework of the ASAP Regulation would also have been applicable at each stage of the supply chain. Such a mechanism would have enabled, with the prior agreement of Member States, the prioritisation of concerned defence supply chains’ orders of dual-use or civil components or machine tools over civilian ones, hence facilitating the ramp up of defence supply chains and reducing their delivery lead time in case of need.

Finally, and as the EDF supports the development of future cross-border supply chains, the issue of security of supply may need to be considered from the outset, for example for the most promising funded projects. For instance, it could be envisaged to include SoS requirements i.e., requirements that consortia (possibly including supporting Member States) should have plans/arrangements for strengthening the SoS.

Questions:

- ⇒ *How can we support the further development of Member States’ cross-border security of supply at EU level, and notably the prioritisation of urgent defence products orders in crisis times? Would an action at EU level beyond the existing EDA initiatives (e.g., a binding prioritisation mechanism based on the one included in Commission’s ASAP proposal, a coordination mechanism of national efforts) add value?*
- ⇒ *How can we build upon the potential of the Internal Market framework to make sure that defence supply chains can access the inputs they need in times of crisis? Would a prioritisation mechanism of defence supply chains over civilian ones in times of crisis bring a significant advantage to the robustness of defence supply chains?*
- ⇒ *Should Security of Supply considerations be built into EDF development projects and/or in procurement programmes?*

¹¹ Regulation (EU) 2022/2372 on the emergency framework regarding medical countermeasures foresees the activation of the EU FAB network (see also previous chapter), production capacity reservation contracts enabling the EU to obtain a priority right for manufacturing of vaccines in case of a public health emergency.

¹² The ‘Chips Act’ emergency toolbox foresees the possibility to use, for instance, priority orders, when the crisis stage is activated.

3. Ensuring that defence products can effectively circulate throughout the Internal Market during times of crisis

A key factor to ensure SoS is the ability for cross-border defence supply chains to reach the delivery point, both in peacetime and in times of crisis. This can prove particularly challenging for certain Member States affected by geographical remoteness.

Further simplifying Intra-EU transfers

The transfer of defence products within the Internal Market is subject to national licensing schemes. Hence, the security of EU cross-border supply generally depends on obtaining *ex ante* transfer licences for the initial purchase as well as for follow-on supplies during the entire product life cycle (notably for maintenance and repair).

The Defence Transfers Directive 2009/43/EC has precisely been adopted to reduce the barriers to the circulation of defence-related products within the Internal Market stemming from diverging national licensing schemes. The harmonisation of the relevant laws and regulations of Member States and the promotion of General Transfer Licences (based on *ex post* verification) were intended to considerably simplify intra-EU transfers, hence supporting Member States' SoS on the Internal Market. It was also supposed to improve the competitiveness of the defence industry by considerably reducing administrative burden.

However, almost 15 years after its adoption, Directive 2009/43/EC did not fully deliver its expected benefits. General Transfer Licences are still the exception rather than the norm¹³. Their low uptake and number, as well as their narrow and non-harmonised scopes undermine their potential benefits. As underlined by the Commission's evaluation the framework provided by the Directive "*is still left sufficiently open and flexible enough to interpretation to mean that there are still essentially 30 non-harmonised licencing systems across Europe*"¹⁴. Commission's recommendations on the harmonisation of the scope of and conditions for general transfer licences developed with Member States following this evaluation have so far produced positive but limited and heterogeneous effects.

Another matter of concern is the frequent imposition by Member States of export limitations attached to the transfers licences of sub-components, even for their mere integration in a final product. In addition, the fragmentation of national approaches with regard to the conditions of re-exports further complexifies the situation.

Mitigating the consequences of geography

The problems affecting Member States' security of supply are similar throughout the EU. Some Member States, however, depend more on supply routes which could be more easily disrupted, especially in case of a major security or defence crisis. The geographical position of certain Member States may entail additional risks and difficulties in ensuring their

¹³ In 2016, the Commission estimated that less than 10% of transfers were done through a GTL (SWD(2016)398, Evaluation of Directive 2009/43/EC). While the situation may have slightly improved, a more recent study suggest that the use GTL is still marginal.

¹⁴ *Idem*, section 6.1.1.

security of supply of defence products from EU cross-border supply chains in all circumstances and without disruption.

So far, these risks were mitigated mainly on a national basis often through direct purchases from national suppliers or through offset (or industrial participation) policies, in particular by requiring the localisation on the national soil of certain activities. However, these approaches offer limited and often costly solutions to security of supply concerns and do not capitalise on potential cooperations at regional or EU level.

Solutions to improve security of supply on a cooperative basis at regional level (e.g., the Nordic Defence Cooperation (NORDEFECO) initiatives) remain the exception and are often limited even though they could address more efficiently and effectively issues (e.g., consolidating costly maintenance and repair activities through stockpiling, reserves, flexible manufacturing capacities, etc.). Incentivising regional initiatives of pooling and sharing of certain industrial capacities (e.g., centres of excellence), or of strategic stockpiling (e.g., critical spare parts, ammunition), such as those provided by RescEU in the context of civil protection, could improve the Union's resilience and readiness as a whole. It could also address and help mitigating the consequences of geography, hence further supporting the case for EU cross-border supply chains for all Member States.

The Joint Communication on Defence Investment Gaps Analysis considered the possibility to establish dedicated and VAT-exempted European Defence Capability Consortia. Such EDCC would bring efficiency gains over the life cycle for operation, maintenance, repair, and overhaul, tapping economies of scale (EDCC – see Issue Paper #2 '*Investing better and together*'). The eligibility of joint procurement of maintenance and repair services could, for instance, be considered which would improve Member States' SoS, including those affected by their geographical position. Such initiatives, notably in remote areas, could also prove of value for the Union as a whole in case of a direct high-intensity conflict.

In addition to regional cooperation, the EU and its Member States are also tackling (infrastructural and procedural/regulatory) shortcomings in military mobility which can hinder the transportation of certain defence products or materials considered dangerous goods (explosives, lubricants, fuel etc.) across the Union. Although it is not their prime objective, the Military Mobility Action Plan 2.0 as well as the PESCO projects on Military Mobility and Network of Logistic Hubs in Europe and Support to Operations (NetLogHubs) may result in improving the transportation of defence products, thus contributing to the SoS of Member States, including those affected by their geographical position.

Questions:

- ⇒ *How can we increase the impact of Directive 2009/43/EC on the smooth functioning of the Internal Market? Should we consider a revision of the Directive?*
- ⇒ *How can we further mitigate, at EU level, risks related to certain Member States' geographical position? Could EDCCs offer an adequate framework for regional initiatives ensuring security of supply of Member States, in particular those affected by their geographical position?*
- ⇒ *Building on progress made so far and against the backdrop of the Military Mobility Action Plan 2.0, are additional steps needed to enhance the EU-wide cross-border transportation of defence products thus improving the security of supply?*