

VETERANS

— *for* —

BRITAIN

The Battle over
Procurement:
Brexit and the New
Risks from Defence
Integration

Major General Tim Cross
Dr Lee Rotherham
David Banks

The Battle over Procurement:

Brexit and the New Risks from Defence Integration

Executive Summary

- EU Defence integration is accelerating during the process of Brexit. The Government's current withdrawal proposals actually cement UK involvement, despite consent having been provided on the basis that the UK was leaving.
- NATO now faces a threat of the EU developing a fully separate military identity and doctrine, coupled with a dangerous ambition, but with less effective resources.
- Defence procurement integration is closely and directly associated to the generation of Common EU Defence policy, structures and budgets. A real danger exists that the MoD signs up to technical and industrial cooperation without fully appreciating the long-term ambitions, direction of travel, and consequences.
- There is considerable track record of the MoD and the FCO making this mistake since 1998.
- This paper focuses on procurement within this wider context. It demonstrates that there is a risk that the MoD gradually affiliates to a Single Market in Defence by the back door. This carries considerable political, economic and even social baggage.
- Core to the process of EU Permanent Structured Cooperation (PESCO) is a central strategic role for the European Defence Agency. This expands on its original role as a procurement hub, but which has already been widening over the last few years.
- The UK should aim to have a minimalist structural level of engagement with EU Defence after Brexit. This should include observers in the European Defence Agency to identify cooperative work of some mutual interest – which can then be better pursued multilaterally.
- Helpfully, Item 18 of Annex II of the Council of Ministers agreement establishing PESCO names the multinational non-EU body OCCAR as “the preferred collaborative programme managing organization.” This direction needs to be locked in.
- The UK should apply the British Army's Principles of Logistics - Foresight, Economy, Simplicity, Co-operation and Flexibility. These reveal that UK engagement with future European procurement programmes must be entered into on a case-by- case basis; and we must not find ourselves tied into recent developments by default, wishful thinking or ignorance of what is happening.
- The UK's position and options would be enhanced by leaving the EU Defence Procurement Directive and stepping into World Trade rules which offer a broad defence exemption under government procurement rules.
- EU Defence Procurement is currently a potential weak point in UK Brexit planning. But it is readily redeemable.

Introduction

The European Union is currently undergoing a period of accelerated integration in the field of defence. This is not only a fast-paced development, but a wide-ranging one. But of the many pillars in the field that are being built up, two in particular are of critical importance. The first is known by its acronym PESCO, and encompasses the construction of structures that will run permanent and enhanced defence cooperation. The second is an entirely different area, that of integration in the area of defence industries.

Both have consequences for the UK. PESCO generates a considerable threat of duplication of NATO and indeed of undermining it over the long term. It is precisely in defence terms precisely what Adenauer reportedly offered to the French government after the Suez crisis when he said “Europe will be your revenge.” This is by and large an overt threat. The UK has, however, seemingly been reluctant to mitigate that threat by stalling development other than to seek to include wording (of uncertain lasting force) that the purpose of PESCO is not to undermine NATO but to cooperate with it.

PESCO is the overarching element that covers wider Defence ambitions by the EU. These carry major budgetary, Single Market, and institutional ambitions. This complex field is, however, addressed in two short mini-papers which can be found on the VfB website. A more detailed analysis of the various policy ambitions variously held by the EU institutions is also separately set out in another major paper by Veterans for Britain.¹

This paper however looks at a specific key pillar: defence procurement.

Historically, defence industries (including R&D) have largely escaped the Commission’s remit as they have been accepted as being areas of strategic sovereign interest. That, however, is now changing. A double pronged assault is taking place. Former caveats are being removed so that this area is being fully collapsed into the Single Market. But at the same time, greater authority is being granted to the EU’s procurement management entities and policy scribes in order to generate what amounts to a common procurement policy in a range of identified capabilities.

The threat here to the UK is less immediately obvious but very real. Industrial activity is being directly linked into EU strategic policy making. The intent includes expressly to prioritise spending under the new EU common procurement budget (which includes the prospect of common EU military assets) with the political priorities reached under PESCO. Meanwhile, procurement spending will be prioritised to encourage the rationalisation of the defence industrial base of states.

In other words, some countries will lose all their shipyards, others their helicopter factories, others their aircraft or tank lines, and so on. The idea is that this will lead to fewer producers, while suppliers are assured of more buyers across the EU marketplace. The inference is clearly that EU states will be ‘encouraged’ to “buy European” (equally inevitably, regardless of actual product capability).

But this will come at the cost of ending sovereign capability to supply the national military. The risks associated with that approach become obvious when one considers the Belgian ban on supplying ammunition to the UK during the Falklands Conflict; and the increased importance of human rights law (and the increasing risk of highly subjective and politicised interpretation) within EU institutions. Loss of sovereign production means independent

¹ <http://veteransforbritain.uk/nouvelle-vague-an-audit-of-eu-defence-union-plans/>

capability in particularly areas is lost, and sustainability of national operations is at increased risk. In effect, suppliers gain a veto over extended or high tempo conflicts.

Criticising this direction is not to oppose the idea of international cooperation in procurement. Nor is it to encourage domestic protectionism, or to prevent competition for our domestic suppliers who have occasionally demonstrated a tendency to take UK Government contracts for granted. But it is to encourage our negotiators to step back from an integrating EU Defence market that has political intentions and federalising costs, whose cousin Common Policies (such as the CFP and CAP) have long demonstrated the economic, social and sovereign risks attached to such an approach.

The issues are complex and varied, and analysis is hindered by the fact that while key documents relating to intent and preliminary authorisation are in the public domain, the talks between civil servants establishing agreed terms and who signs up to what are themselves taking part behind closed doors. We can identify risk but in most cases not the extent to which negotiators are aware of it (that said, in some areas as we shall explore, we know that pitfalls had not been spotted until we had raised them in discussion with civil servants at defence events).

Correspondingly, we have broken down this paper into three parts.

In Part 1, we generate a summary of defence integration and the significance of procurement within the EU's ambitions. Procurement forms an integral part of the wider drive towards developing an EU defence policy and capability that is independent of NATO; the more this develops, the greater the risk of NATO fracturing as the EU institutions develop a false sense of their own power without any true appreciation of the gaps that US engagement currently plugs. A review of the evolution to date of the European Defence Agency reveals the clear direction of travel into the future. This is contrasted with lessons that we should draw from the British Army's own *Principles of Logistics*.

Part 2 sets out briefly the strategic direction. It explains the EU intent and how the EDA strategy slots into it.

In Part 3 we dig deeper into the complexities, exploring the procurement mechanisms being agreed on and the legacy risks that are generated. These become more acute the closer we are institutionally and financially to them, precisely because of the wider defence ambitions and strategic integration associated with the Brussels dynamic.

We add two appendices to demonstrate the genuine intent as expressed by the EU itself.

Part One: A Snapshot of Risk

Overview

The EU is in a period of accelerated defence integration. The failure of MoD officials to explicitly indicate the UK intends to stand outside new common EU structures and budgets is generating strategic risk as well as expectations of EEA-levels of participation. This covers all of defence, but procurement and common funding are of immediate concern.

Since November 2016, the EU has launched a range of deeply ambitious projects. These include the European Defence Fund (EDF), the European Defence Research Programme (EDRP) and the European Defence Industrial Development Programme (EDIDP). (One thing EU defence integration is not short of is acronyms.)

The EDIDP is being pursued alongside legislation that treats participating countries as a single market for defence, known as the European Defence Technological and Industrial Base (EDTIB). This has the corollary of extending the Commission's Single Market powers over industries held to be vital for national independence. This development should not be a great surprise: the principle was after all the motivator underpinning the original Coal and Steel plan after the Second World War.

Contextualising the EU's New Writ

Two plans were announced by the EU in November 2016 which together comprise the blueprint for EU Defence Union.

These are the Security and Defence Implementation Plan (produced by Federica Mogherini) and the European Defence Action Plan (from Jean-Claude Juncker). For context, Mogherini is responsible for heading up Common Security and Defence policy, Common Foreign and Security Policy, and running the European Defence Agency. Juncker is the Commission President.

Mogherini is thus multi-hatted with an element of responsibility both to government reps at the Council of Ministers as well as to Juncker who is her boss within the Commission; but what is striking is the widespread alignment between these plans as much of what the Commission has been proposing has also been signed off by government ministers.

Mr Juncker's European Defence Action Plan (EDAP) is critically important for the context of this paper. It contains plans for an EU defence Procurement Union, among other things which provide the financial and legislative setting for Ms Mogherini's Security and Defence Implementation Plan (SDIP).

A separate but concurrent agreement between the EU and NATO describes over forty areas in which the EU seeks to increase its participation. While the documents explicitly underline that the intent is not to weaken the NATO alliance (a concession to some of the more openly Atlanticist EU member states), a clear distinction can be made between objective and causality. The plans accept that EU activity can and will operate separately from its counterpart, for example by referencing "defence decision-making autonomy from NATO". The problem that arises over time is that duplication encourages those less wedded to

NATO as the competent underwriter of European peace to pursue their federalist ambitions by prioritising and favouring the EU counterpart.

The EU's onerous Defence and Security Procurement Directive mostly eliminates the rights of member states to guarantee the retention of defence contracts within their home market, which would be possible under WTO rules alone. Under the directive, enacted in the UK in 2011, guaranteed home-market tendering is permitted only in the most sensitive of contracts where international tender brings a provable risk to national security. The EU Commission tightened this directive with new guidance in 2016, at the same time as deepening the procurement union. In 2018 the EU Commission began enforcement action against five member states deemed to have breached it.^{2 3}

Associating Procurement

Procurement Union is shorthand for what the EU calls 'EDTIB' (European Defence Technological and Industrial Base) and a key element of what sometimes also described as an 'EU Single Market for Defence'. The EU has long been talking about EDTIB, to describe unifying and rationalising the existing landscape of disparate national defence industries.

The EU Commission and European External Action Service, working together, have been making the case for "More Europe in Defence" by asserting that their activity would bring economic benefits. Phrases such as 'harmonisation' and 'coordination' between member states are deployed alongside the terminology of 'reducing duplication' and 'economic effectiveness'.

For example, the EU Commission claims that a coordinated defence market has the potential to "save up to 100 billion euros each year", which is about the same size as combined turnover for the defence industries of EU member states, so one might question whether that is a realistic saving. What is clear is that there is a potential market gain. However, this carries downsides in terms of national build capabilities, which is precisely why until now EU member state governments have blocked moves to open these markets up.

Brexit might mean that the UK is spared these issues. However, there is a major degree of policy uncertainty here that deserves clarification. The DExEU defence paper setting out Brexit policy on Defence (no doubt largely written by the MoD itself) references the prospect of participating in these and the European Defence Agency (EDA) "closer than a third country". However, the only existing model for this is Norway, which is required to be heavily compliant with EU strictures.

The problem with continuing participation in the above is that the EU is simultaneously seeking 'European sovereignty' across defence (Juncker made this explicit in his speech of June 2017). Even if this is dismissed as merely a Commission ambition, it is an indicator of strategic direction of travel for the EU's institutions, and for the Single Market.

² EU Commission publishes results and guidance after a review of the Defence Procurement Directive. 30 November 2016. <https://ec.europa.eu/transparency/regdoc/rep/1/2016/EN/COM-2016-762-F1-EN-MAIN.PDF>

³ EU Commission begins enforcement action against five member states 25 January 2018. http://europa.eu/rapid/press-release_IP-18-357_en.htm

A delegation agreement between the European Defence Agency and the EU Commission also links the EDA to new EU funds and legal frameworks, principally for research and defence industries.

Consequently, there is a pediment straddling the various Defence Union pillars comprising of a common budget and a strategic policy. If after Brexit the UK resolves to affiliate closely with any pillar such as the defence market (a logical possibility given talk of various options about seeking close single market access), this inevitably will carry association with wider policy directions.

Ongoing Integration and Risk

Such affiliation will not be politically healthy for the UK.

The EU treaties already allowed for the development of “a common defence”, meaning that treaty change is not a prerequisite to expanding the politics associated with the Single Market in defence. Ambition in EU defence integration is now extremely wide ranging, and encompasses the following -

- o Structural: generating permanent frameworks for activity such as standing HQs and support systems;
- o Policy: increasing central/communal decision-making, and common doctrine;
- o Financial: creating common budgets;
- o Industrial: generating a common EU defence industry, at the cost of shutting national production and limiting R&D capability through regional specialisation;
- o Organisational: generating standing units, training, and pooled/commonly-funded assets.

Fundamentally, the problem comes down to the UK currently signing up to the establishment of new common structures, budgets, and decision-making which carry implied or explicit legacy commitments. At the very least these will make the task of Brexit negotiators subsequently more complicated by their later having to clarify or assert they will not pursue them.

Some proposals are easy for the UK to avoid, like signing off on a common EU Engineers Corps. Others are more complex or obscure. They include -

- o Generation of EU defence entities that duplicate and thus undermine NATO counterparts (notwithstanding explicit claims that they do not);
- o Strategic development, meaning the UK has endorsed new jointery before the Dept for Exiting the EU has reviewed it;
- o Rationalisation of procurement, generating potential Single Market obligations even after Brexit;
- o Legal implications arising from CJEU oversight, both commercially and operationally.

Mogherini's Cornerstone: the European Defence Agency

The European Defence Agency (EDA) constitutes a keystone element of the plan. Surprisingly, it is an element of the EU infrastructure that the UK Government has expressed a specific interest in remaining affiliated to. Though the precise nature of the association has been left vague, the bandwidth of options clearly does include the UK something approaching full membership.

Given that UK participation in the EDA under the existing terms has been an issue of some considerable contention within the Conservative party for a decade, this is somewhat surprising.

In terms of its scale, the EDA is not massive, but as with the other EU agencies, office size is not the point. It has an operating budget of around €30m, and a staff of 123 or so, but it is its role as a focal point and hub that is where its future importance lies. It also has a relatively open-ended mandate to expand.

The problem then is that the EDA is now becoming the vehicle of choice for anything involving even a small portion of the increasing Commission-run funds relating to R&D and construction. Fortunately, a window of opportunity does exist pre-Brexit for UK officials to suggest to counterparts the relevance of Section 18 of Annex II of the Council Agreement setting up PESCO, which stresses that the EDA should not manage programmes but that the non-EU OCCAR agency should do so. OCCAR, helpfully, does not have clear institutional crossover with the EU since only six countries are full members, while Turkey is a non-member associated state. This is a detail that may yet anchor procurement operationally in a manner that is in the UK's (and the EU's) long term interests, without much of the baggage. But it will need to be robustly underlined in the key months ahead.

From a political vantage point, the risk the EDA poses can perhaps best be seen by reviewing how its activities and mandate have evolved in the decade running up to the Mogherini initiative – that is to say, before the sudden spurt of intent in Defence procurement integration. Some of them are self-evidently far from what one might expect such an agency to be engaged in. The following table sets out some key headlines, and quite clearly show the institution sitting at a crossroads of not just R&D and construction, but also strategic policy and the EU budget.

Table 1: Key Dates in European Defence Agency Expansion

<p>2004 EDA created</p>
<p>2005 The new agency sets up a strategic framework for defence, built around three main pillars: Research & Technology Strategy; Armaments Cooperation Strategy; and European Defence Technological and Industrial Base Strategy, headed by a Capability Development Plan. EDA begins work on the creation of an European Defence Equipment Market (EDEM). Agency begins to take over the activities of the Western European Armaments Group (WEAG) and the Western European Armaments Organisation (WEAO).</p>
<p>2006 Code of Conduct for promoting competition in defence procurement is launched. Work begins on the first Joint Investment Programme (JIP) on Research and Technology. The programme set out to study 18 technologies relating to five military capabilities.</p>
<p>2007 Focus begins on the European Defence Technological & Industrial Base (EDTIB). This lays the ground work for the approval of Europe's Defence Technological and Industrial Base Strategy, demonstrating the longstanding association of the EDA with the core strategy now revolutionising EU Defence Union.</p>

2008 The Steering Board endorses the initial version of the Capability Development Plan (CDP) “The CDP intends to inform national plans and programmes, but is not a supranational plan.” A declaration of intent is signed by 12 countries to establish a European Air Transport Fleet (EATF), placing the EDA at the heart of the EU’s common assets concept.

2009 First EDA Helicopter Exercise. Work is launched on a Procurement Cell to coordinate EU Member States’ orders of commercial satellite communication services. This will later evolve into what is now known as the EU Satcom Market.

2010 Team of five admirals submits its report to the Ministerial Steering Board regarding Maritime Surveillance needs in support of CSDP, effectively paving the way for EDA’s work as part of the Marsur program. Following an initial German-Swedish paper known as the “Ghent initiative” and presented to Defence Ministers, the concept of “Pooling & Sharing” national military capabilities emerges. It will guide the Agency’s actions and projects for the following years.

2011 The European Defence Agency and the European Commission sign a European Framework Cooperation (EFC) coordination letter. Through this signature, both institutions agree to harmonise their research activities in this specific case in the field of Chemical, Biological, Radiological and Nuclear protection.

2012 The first European Air Transport Training event (EATT2012) organised by the Agency takes place in Spain, involving tactical air transport assets from six Member States. EU Satcom Market contract signed. The EDA signs an administrative arrangement with the Organisation for Joint Armament Cooperation (OCCAR) for closer collaboration between the EU agency and its intergovernmental counterpart/competitor. Defence Ministers endorse a Code of Conduct for Pooling & Sharing, thus ensuring that a cooperative approach for the entire life cycle of the product will be considered whenever a Member State is thinking of developing a new capability.

2013 The Steering Board approves an Agency initiative involving European Structural Funds (ESF) by defence actors with six dual-use pilot projects. Member States approve the establishment of a dedicated programme for the military implementation of the Single European Sky ATM Research (SESAR) Joint Undertaking. The EDA and the European Aviation Safety Agency (EASA) sign an arrangement for enhanced cooperation, specifically covering harmonisation of military aviation safety requirements with a focus on airworthiness. EDA, Italy and the Movement Coordination Centre Europe (MCCE) jointly organise the first collective European Air-to-Air Refuelling (AAR) clearance trial. EDA is given a wide range of tasks, including responsibility for four key programmes: air-to-air refuelling, remotely piloted aircraft systems, cyber defence and governmental satellite communications. The Council also gives EDA various tasks relating to defence industry - increasing SME participation and dual-use research, and improving European certification and standardisation.

2014 Restructuring of EDA into three operational directorates: Cooperation Planning & Support; Capability, Armaments & Technology; and European Synergies & Innovation. The first EDA-supported dual-use project, called “Turtle”, receives European Structural Funds. Procurement arrangement with Operation Commander of EUFOR Althea in direct support of an EU operational mission.

2015 EDA provides input to the forthcoming Commission-led roadmap for a comprehensive EU-wide Security of Supply regime.

2016 Work on military applications of Galileo satellites.

Applying the British Army's Principles of Logistics

The British military approach to logistics and the support chain in the round is to apply the principles of **Foresight, Economy, Simplicity, Co-operation** and **Flexibility**.

We have long recognised that there are certain operational imperatives that must always override 'pure' business imperatives – in particular that the intent of any serious potential enemy will not just be to destroy our logistic capabilities in a theatre of operations but to disrupt our lines of communication and logistic/procurement base. So maintaining stocks and capabilities in more than just one location – not putting all your eggs in one basket – not being dependent on others and ensuring resilience throughout the support chain are therefore critical.

Over the years we have seen considerable rationalisation and consolidation in UK defence capabilities as a whole – and international co-operation on various procurement programmes has been an important, and often (but not always) positive, aspect of enabling that. But we have come close to crossing a dangerous line.

Future developments must not come at the expense of maintaining key strategic capabilities, staying - nationally - at the cutting edge of key technologies and continuing to have the ability to conduct operations independently.

This is not just about cost-effectiveness. Joint ventures and collaborative defence programmes need to continue to be seen in the context of the wider national and sovereign interest – ensuring that the capability delivered meets national requirements and that we are not constrained in our ability to deploy the comprehensive, high intensity war-fighting power that other EU nations struggle to match. Crucially we have, thus far, always been able to operate alongside the US with a critical mass of maritime, land and air forces within a NATO or coalition operation independently of other European nations – and this must surely continue to be the case.

The EU is of course perfectly free to decide its own future in defence and security as well as in other broader political and economic areas. And it may well decide (and seemingly is deciding) to move to a fully integrated EU-wide procurement system – closing individual national capabilities down and relying on a consolidated pan-European defence industry to produce a pan-European capability. But, post-Brexit we, the UK, must not find ourselves relying on them to produce our key capabilities – or having to rely on them to provide timely logistic support when it is required.

UK engagement with future European procurement programmes must therefore be entered into on a case-by- case basis; and we must not find ourselves tied into recent developments by default, wishful thinking or ignorance of what is happening.

Part Two: Hidden Depths

Defence Procurement: the Wider Direction of Travel

The EU is heading towards what it calls 'EU Defence Union' and its plans to achieve this include defence Procurement Union. The UK has so far agreed to the proposals put forward in this area (via the EU Council) in late 2016 and early 2017. Outside of EU meetings, UK ministers have indicated that they have given their consent of the UK's imminent departure from the EU, signing off to changes that they believe will no longer affect it directly. Yet at the same time, other ministers have also said that continuing participation is not ruled out.

The plans for EU Defence Union are outlined in two documents released in November 2016 by Federica Mogherini and Jean-Claude Juncker. The documents are notable for the way they bring together multiple streams of planning, particularly:

- *Military structure and control;*
- *Procurement;*
- *Legislation;*
- *Financing;*
- *Defence research; and*
- *Military intelligence.*

The plans also include the further development of these themes in EU military planning relating to a deeper EU defence policy network;

- *Policy integration;*
- *Combined needs analysis;*
- *Political incentives to participation;*
- *'Collective ownership' of defence assets;*
- *Financial incentives for policy makers;*
- *Financial incentives for defence industries especially SMEs; and*
- *The development of transnational networks in defence manufacture.*

At more than 18,000 words, the proposals are extraordinarily broad-ranging and complex when compared to the usual incremental policy changes and directives offered by the EU institutions. It is to be noted that even at this length and complexity, the plans were still regarded only as 'outline' and that the EU Commission and European External Action Service have gone on to develop them further throughout 2017. The first elements emerged in February 2017 with the announcement of more detail around the EU military HQ for non-executive administration, the MPCC.

The EU Commission and EEAS will use many of the EU's existing structures such as the European Defence Agency, the EU INTCEN intelligence centre and the EU Military Staff. However, they will also create new ones including the EU Defence Fund and the Military Planning and Conduct Capability. Plans on procurement are not being developed in isolation.

Bringing Procurement into the Commission's Single Market Sphere

Historically, defence industrial production was largely exempt from the Commission's remit. The first attempt (over 1950-1954) to construct a European collective political entity had been based on - and foundered on – Defence. The collapse of the Pleven Plan revealed the field to be too closely identified with sovereignty and national independence for any integration to be politically achievable at that time. Following rebuff in that area, economics was chosen as the foundation instead, and the Coal and Steel Community (and later the EEC) was born. As the EU gained increasing powers, procurement though remained largely beyond the remit of the Commission.

This is now changing.

Procurement Union is first described in the context of an augmented EU regulatory environment. The EU will more stringently enforce two directives, 2009/81/EC (procurement directive) and 2009/43/EC (military equipment transfer directive) which were introduced to reduce EU member states' usage of their own domestic defence supply industries and force member states to instead accept EU-wide tendering for defence equipment. A security exemption in one of the directives enables member states to award procurement contracts preferentially within their own domestic markets. The EU reviewed the use of this exemption in 2016 and has issued guidance on how it will reduce its usage in order to enforce EU-wide procurement.

It is worth recalling that the EU has a tendency to impose political commitments on countries participating in trade arrangements, most visibly through the corollary policies orbiting its customs union or single market.

In a similar way, the EU's Defence Union plans are broadly and deeply interlinked with other political commitments for those countries that wish to take part. Procurement Union is 'packaged' with:

- Compliance with applicable EU directives
- Participation in joint research and
- Participation in the EU's developing 'defence capability' strategy

This last subject, defence capability, merits further analysis as it describes the way the EU anticipates joint or collective purchasing and possession of assets to reduce costs.

The EU prescribes that decisions about defence purchasing strategy should be taken at EU Council level by Defence Ministers and collectively among member states with the participation of the European Defence Agency.

The EU Commission in its plans approved by the EU Council has set out a "Reference amount of €5 billion per year" as funding for a defence capability 'window' within a new EU Defence Fund.

It is important to note that this €5 billion sum does not refer to a total value of jointly-procured and jointly-held EU assets, whose value will be much larger. The €5bn capabilities window of the EU Defence Fund pays for the administration of joint efforts and will in fact harness the much larger defence budget inputs of those EU member states taking part.

This is similar to the operational output of the European Defence Agency whose €36 million of annual funding orchestrates defence industry tie-ups worth more than €5 billion – 138 times its own budget size.

In this way, the funding figures stated by the EU predicate a much larger and more pervasive influence on the defence activities of member states. The EDA estimated (on 2014 figures) that 77.9% of all equipment procurement took place at national level. It is true that this means there is potential for some considerable economies of scale associated with that figure, though it should also be noted that the principle applies most to countries with much smaller defence industries, rather than to the UK, which is disproportionately likely in any excessively-close administrative link up even after Brexit to 'rationalise' a larger share of its production as it is divvied up on national rather than share of production grounds (or even share of efficiency).

The knock-on effects of this will be immense. This is a policy expansion that will not just affect 'face value' Defence fields, but also any sector engaged in the supply chain, which in turns has secondary policy implications for managing security of supply. It is already predicated that the Commission will adopt recommendations, by the end of 2017, encouraging procurement authorities to facilitate cross-border and SME participation in defence procurement procedures and facilitate their access to defence supply chains.

EU procurement therefore clearly has a number of strings attached.

The Mechanisms of Integration: Risks and Mitigation

Observers should be in no doubt that significant involvement in the new EU Defence Procurement Union would mean adhering to EU measures on 'coordination' and 'harmonisation' and that in addition to losing autonomous procurement capability, it would become less likely that the UK would / could be permitted to maintain a full spectrum of armaments manufacture.

Defence procurement decisions would be made not by the UK autonomously but collectively by members of the EU Defence market. Decision-making is likely to be by a joint committee of Defence Ministers with influence from the European Defence Agency, EEAS, EU Commission and EU Military Staff.

The strategy includes an ambition for developing national specialisations in defence, which illustrates the direction of travel in relation to strategies for "reducing duplication". This is economically quite rational, but politically dynamite as it accepts higher authority for deciding which national industries will be shut down by diktat.

It does seem rather peculiar that with an increasingly clear determination that the UK will escape from the strictures of the EU's Single Market (including avoiding the traps similarly associated with EEA membership), UK policy remains foggy over this subset, the Defence Single Market, which has even greater prospect of being driven by five year plans and quotas.

If one wishes to reflect on the opportunities and risks associated with third party affiliation, one might turn to Ukraine. The close integration of the country's defence industry with its Russian neighbour has been a significant factor in underpinning Moscow's hostility towards Kiev turning towards the EU, even over a deal running much less than full EU membership. This is certainly not to endorse Russia's policy towards its neighbour, but simply to indicate that even that weaker level of economic and military engagement can be interpreted by third parties as carrying significant long term political baggage of a strategically critical nature to supply chains, access, and capability.

Part Three: The Post-Brexit Risk

NATO

Despite caveats in the PESCO documentation that reference the continued significance of NATO, it is clear that this is papering over the cracks. Parallel and competing structures and commitments are being formed. This is particularly evident in the area of procurement, since NATO has a longstanding core role in encouraging cooperation and standardisation (in the sense of enabling interoperability, rather than in the EU sense of adding level-playing-field burdens).

The UK should have been emphasising the role of NATO in the coordination of defence procurement. PESCO plans however are likely to create a Single Market for Defence in which some UK contractors may be interested in participating in order to bid for EU funds; but where the Government will have to surrender decision-making authority in order to do so. A lack of policy clarity may have helped generate a vested interest for some businesses to lobby Whitehall to sign up to PESCO. If so, that lobby needs to be swiftly disabused (see below).

European Defence Technological and Industrial Base (EDTIB)

Parliament has long been warned of the pervasive nature of EU efforts in Defence research. EU funding in defence research is a clear duplication with NATO, which already has its own Science and Technology Organisation (STO) group.⁴

S&T activities cover not just research, but also transition, application and field-testing. It takes place through different routes. There is the forum model, where NATO and partner nations conduct cooperative research and information exchange. The In-House route uses a dedicated NATO body, with its own personnel, capabilities and infrastructure – this could be the S&T Organisation, the Science for Peace and Security Program, or the NATO agencies.

The STO is a NATO body run by a Board of Directors (the Science & Technology Board – STB) comprising the NATO Nations S&T managers. The STB is chaired by the NATO Chief Scientist who is a high level recognized S&T leader of a NATO Nation, being permanently assigned to the NATO headquarters in Brussels and also serving as the senior scientific advisor to the NATO leadership.

The STO is composed of the STB, the Chief Scientist, the Office of the Chief Scientist, the Collaboration Support Office (based in Paris), and the Centre for Maritime Research and Experimentation (La Spezia, Italy).

But now it is getting competition.

For the first time, the Commission is now tabling a European Defence Action Plan which focuses on capability needs and is designed to build up a corporate view of the European defence industry (or rather til now, industries). This Action Plan has three main pillars:

⁴ <https://www.sto.nato.int/Pages/organization.aspx>

- Launching a European Defence Fund;
- Investments in defence supply chains; and
- Reinforcing the Single Market for Defence.

Furthermore, the Commission will promote civil / military 'synergies' within EU policies, wherever appropriate. This is important in building up even further the role of case law in the civilian Single Market, but also adds a huge level of complexity by expanding the role of other EU Commissioners in areas that have always been problematic for the UK, for example Social Chapter material. An additional problem lies in the reality that the UK has a greater propensity than other EU states to turn to external supply chains, including of course the US. This raises significant questions about areas as diverse as competition law and unit costs once EU red tape is added.

It is inevitable that 28 countries are going to spend their defence funding inefficiently, particularly where countries have smaller and more inefficient sectors. An EDAP factsheet says:

The lack of cooperation between Member States in the field of defence and security is estimated to cost annually between €25 billion and €100 billion. This is because of inefficiencies, lack of competition and lack of economies of scale for industry and production

That extraordinarily sweeping guesstimate has since been reduced to a rather precise €26.4 billion by the European Parliament.

Whichever way you look, it is clear that there is some measure of waste inherent in defence protectionism. It is possible that UK exporters can benefit from a more open market. That would of course be predicated on it not just being the UK and Northern Europe playing by the rules, but Mediterranean states also opening up to competition (and more to the point, committing to Defence funding and buying the equipment). The question then arises where the key competition is within the Mediterranean EU that the UK needs the market opening up against. Moreover, comparatively it might be argued that the UK (all things considered, and with major caveats) is already relatively subject to market forces. The Westland Affair shows that market rationalisation has been going on for thirty years – indeed, the controversy was not at all over allowing the competition, but which companies would benefit.

Meanwhile, at present only the Security Clause within the EU treaty articles authorises UK Defence equipment to be made in the UK when it other materiel might be cheaper, but where there is deemed to be a strategic interest in paying that cost.

In 2016, the EU began considering how to tighten rules on defence procurement, expressly in order to reduce use of the clause. In November 2016, it laid out a series of recommendations proposing legal guidelines for the application of the directives.

Adherence to EU Single Market for Defence rules would be essential to any country operating within it. That means the Security Clause will be whittled away over time; and what survives will be increasingly vestigial as the CJEU successively reinterprets it under basic Single Market provisions.

We also need to put market access into a financial perspective. The UK has Defence industry turnover of £65 billion, of which exports are £35 billion. Less than a quarter of these UK Defence exports are to other EU countries (about £7.5 billion). While one is not in favour

of protectionism on grounds of cost-effectiveness, if the UK is one of the key purchasers of equipment on the basis of spending more money on defence than its counterparts, might not market access at least be made conditional on other countries fulfilling their obligation to meet the NATO spending minimum?

Financial Risks

In his State of the Union speech of 14 September 2016, President Juncker called for the creation of European Defence Fund. This Fund would consist of two distinct financing structures ('windows'), which are intended to be mutually supported and would be phased in over time:

- (i) A "research window" to fund collaborative defence research projects at the EU level. This would be developed through the launch of a Preparatory Action and should result in a dedicated EU programme in the post-2020 EU multiannual financial framework;
- (ii) A "capability window" to support the joint development of defence capabilities commonly agreed by Member States. This would be financed through the pooling of national contributions and, where possible, supported by EU money.

The "research window" and the "capability window" would run in parallel but be distinct in their legal nature and sources of financing. The "windows" will be run by a Coordination Board, bringing together the Commission, the High Representative, the Member States, the European Defence Agency, as well as industry "as appropriate" (a dangerous form of EU words which have generated many syllogisms over the years, as vested interests and corporate lobbying kicks in).

The Coordination Board's task will be to "ensure consistency between the research and the capability 'windows' to better support the development of capabilities agreed by the Member States". These capabilities are identified by a number of parallel mechanisms, including those of the European Defence Agency and the Member States driven Coordinated Annual Review on Defence. It is already possible to identify future tensions within these different feeds, particularly given what will inevitably be a key interpretative role by the High Representative.

What is also clear is that "capabilities" is already being interpreted as meaning decisions not just on thematics and capability but actually on kit and therefore ultimately on units, since the definition states "defence capabilities refer to military assets, including the necessary material equipment and technologies spanning all relevant domains". It does not include "defence operations or other elements necessary to manage defence capabilities such as training, personnel and logistics" – yet the EDA is already engaged on supplying precisely these very elements, so this provides a flimsy brake.

Juncker's EU Defence Fund (starting at a pot of €500m and quickly rising to €5 billion within three years) will be in a position to offer a major incentive ("free money") to UK companies who want to participate in EU-led procurement projects. This generates from the outset a financial incentive for UK Defence industries to demand involvement in the Defence Single Market, at least at the outset before Defence rationalisation kicks in. There are already real signs of turkeys voting for Christmas.

UK Policy Gaps

The way the EU Council gains agreement from member states is via a jointly-written set of 'EU Council Conclusions'. These are co-authored by the 28 EU states' leading diplomats at the EU, who are known as 'Permanent Representatives'. The UK's Permanent Representative was at the time Sir Ivan Rogers, a Cameron appointee who had previously been an adviser to Ken Clarke and Leon Brittan. The conclusions drafted with his 27 counterparts were in full and unequivocal agreement with the contents of SDIP.

EU Council process then requires the relevant EU official to ask the EU Council whether they have objections to the EU Council Conclusions. If they don't, it's taken as agreement. The 14 November 2016 EU Council at which Mogherini's SDIP was presented was attended by Defence and Foreign Secretaries – Sir Michael Fallon and Boris Johnson for the UK. They didn't object and neither did the rest of the EU.

Boris Johnson later said he took the choice not to oppose because he didn't want the UK to be "dog in the manger", in other words stifling plans in which it would play no part. There is a strong logic to thinking this, though as we shall see that statement is not necessarily true.

It does look from an outsider's vantage point that there is a disconnect in Government on this. Ministers are signing off on strategic direction on the expectation the UK will be exempt, precisely at the same time others in Government are planning to cooperate in specific programmes whose strategic direction will be guided by those same principles and mechanisms.

In the case of SDIP, Sir Alan Duncan MP (a Remainer in the referendum and now Minister of State at the Foreign Office) subsequently informed MPs of the European Scrutiny Committee about his views on 22 November. This is relevant because it was a rare chance for MPs to take a look at the plans.

Unfortunately, he left MPs with a rather favourable impression of SDIP and didn't touch on its centralising, legislating and overbearing nature, or the risk of duplication with NATO. He claimed that the UK Government "agreed with much of the content" of SDIP. However he didn't specify which parts the UK Government opposed.

The Minister also said there are "elements which will not directly affect the UK after it has left the EU" though he didn't mention elements which will affect the UK after leaving or indeed before leaving. His unwillingness to describe which parts of this EU military power-grab he didn't like, if any, is explained by his further comment that there was "support from other EU states for UK engagement in EU defence policy after Brexit" and that he therefore wanted to "avoid hampering such future cooperation".

The ambiguity here is troubling. The Foreign Secretary gave a green light to the plans because he thought the UK wouldn't be involved, but his deputy was subsequently apparently advocating approval because he thought the UK could be involved.

The European Scrutiny Committee assessed SDIP along with 12 other major pieces of EU legislation on 14 December and cleared it from further scrutiny on the basis of government information. However, the committee was wise enough to mark it as 'Politically Important' and has urged detailed expert assessment by the Defence Committee, the Committee on Exiting the EU and the Foreign Affairs Committee, as well as SDIP's inclusion in the general Brexit debates in the UK Parliament in the first quarter of 2017.

The EU Parliament is also quite upfront about CSDP in its November Defence Union report, saying that CSDP “should lead in due time to the establishment of the European Armed Forces”. It also recognises SDIP is one component element of this ambition.

It should not be too much to ask for those reflecting on whether to sign up to particular EU programmes, institutions, and budgets after Brexit, to reflect also on the strategic implications and obligations that arise.

Conclusion

Anybody with an interest in free market economics will be opposed to protectionism for the sake of it. Competition encourages value for money, makes businesses more entrepreneurial and thus likely to survive and flourish, and delivers more and better assets for the armed forces from limited budgetary resources.

Veterans for Britain is correspondingly not opposed to the principle of competition. Nor is it opposed as a basic principle to the concept of competitive tender, including where foreign companies are involved.

This is particularly the case where procurement planning can become more honest. At present, MoD budgeteers are encouraged to try to connive against the Treasury by pushing through small numbers of high-priced and under-performing kit, expecting to then lobby for more and better equipment once the assets have been signed off. The problems with that approach arise when the funds don't then arrive – often because the late bolt-ons and increased builds would now come at a considerably greater cost than if they had been honestly bid for in the first place. Even where funds are released, more and better assets could have been secured if they had been secured at the outset of the bidding process.

But those benefits from competition and cooperation do not mean that in Defence, there aren't also serious constraints. Loss of production in a given area means the loss of a strategic capability, meaning the country is dependent upon a foreign supplier. This may perhaps be inevitable to some degree in the modern world, especially for high-end equipment; but the risks can still be mitigated against.

This is why it would be preferable for the UK to retain the right to protect defence contracts for delivery within the UK strategic defence industry if Government chose to do so. The UK Government would be entitled to consider domestic economic benefit as a reason for the awarding a contract, in addition to cost alone – currently not allowed under EU rules. The United States, Japan and New Zealand are among the countries which have this right under the World Trade Organisation's Government Procurement Agreement (GPA).

Furthermore, if procurement cooperation is to happen, it needs to be with the best associate (often the US rather than a European counterpart), generating a measure of guaranteed production (rather than German-style cut backs in Eurofighter purchases); providing increased value for money for UK taxpayers; and supplying quality kit, that is relevant for UK deployments and globally useable rather than designed for short range and narrow continental environments and interests.

Locking the UK deeply into the EDA generates all these risks, to which can be added the administrative realities of a Common Procurement Policy run by the same people who delivered the CAP and the CFP. CDP risks equally being neither very Common, nor much to do with Defence, and barely meriting the title of a Policy.

The context of Procurement Integration is unambiguous. The policy fits into a bigger strategic concept, and is heavily politicised. It constitutes an inherent element of the framing of a Common European Defence, as well as increasingly forming a major jigsaw piece in EU commercial and trade policy – to which we can predict in time will be added the corresponding burdens and costs associated with Social and Employment Policy.

It was quite peculiar that the MoD did not clarify, unambiguously, that the UK will stand back from it. Now we discover that Procurement Integration is a fully-fledged part of the withdrawal proposals.

The model for UK engagement with the European Defence Agency should instead be one of observation. The new arrangement should allow just for the posting of a couple of LNOs (with the appropriate office budget) whose job is to keep an eye on what is being proposed in R+D terms, and see if anything is of use to the UK.

The deployed personnel would engage in working groups from the outset in terms of specifications. Early conversations mean there is no need to engage in costly reverse engineering later on when specs have already been agreed.

Thus, when it emerges that several countries say they are interested in finding a replacement piece of equipment and our LNOs spot a dovetailing with MoD requirements, the committee would add the UK to the list of interested parties and add our own national specifications for what the end product should be able to do – for example, we want a blue water fleet and not something that is only built for coastal patrol; and tanks that do deserts and not just the Fulder Gap. LNOs would see if the partners are credible – that is to say, will buy the units they order rather than back out and raise unit price – and can deliver quality products in the parts they construct.

The optimal situation would then be, having generated a working party of four or five countries, to move the programme away from the EDA. This already happens in perhaps one in four programmes generated through the EDA. Such a multilateral programme might correspondingly in fact be run through OCCAR, NATO offshoots, or as a stand alone – an example in point being how PanAvia was set up.

The key to planning for future procurement is not about whether or not to cooperate. It is to avoid the double price of subscribing to the political commitments an unwanted EU Policy, and to an increasing share of budget contributions underpinning a Common Defence.

By doing so, and demonstrating a major European power stands by NATO, we may yet even after Brexit shape the argument away from military integration – this time, by the mere and enduring example of our absence.

Appendix A: European Commission Press Release on EDAP

European Defence Action Plan: Towards a European Defence Fund

Brussels, 30 November 2016

The European Commission proposes a European Defence Fund and other actions to support Member States' more efficient spending in joint defence capabilities, strengthen European citizens' security and foster a competitive and innovative industrial base.

The European Commission proposes a European Defence Fund and other actions to support Member States' more efficient spending in joint defence capabilities, strengthen European citizens' security and foster a competitive and innovative industrial base.

In his 2016 State of the Union speech, President Jean-Claude Juncker highlighted the importance of a strong Europe that can defend and protect its citizens at home and abroad - an ambition which cannot be achieved without innovating and pooling resources in the European defence industry. The European Defence Action Plan adopted by the Commission today delivers on that vision.

*European Commission President Jean-Claude **Juncker** said: "To guarantee our collective security, we must invest in the common development of technologies and equipment of strategic importance – from land, air, sea and space capabilities to cyber security. It requires more cooperation between Member States and greater pooling of national resources. If Europe does not take care of its own security, nobody else will do it for us. A strong, competitive and innovative defence industrial base is what will give us strategic autonomy."*

Under the European Defence Action Plan, the Commission proposes to:

1 - Set up a European Defence Fund to support investment in joint research and the joint development of defence equipment and technologies: *the proposed Fund would include two "windows" which are complementary but different in their legal structure and budget sourcing.*

- *A "research window" to fund collaborative research in innovative defence technologies such as electronics, metamaterials, encrypted software or robotics. The Commission has already proposed €25 million for defence research as part of the 2017 EU budget, and expects that this budget allocation could grow to a total of €90 million until 2020. Under the post-2020 EU multiannual financial framework, the Commission intends to propose a dedicated defence research programme with an estimated amount of €500 million per year.*
- *A "capability window" which would act as a financial tool allowing participating Member States to purchase certain assets together to reduce their costs. The capabilities would be agreed by the Member States, who would own the technology and equipment. For example, Member States may jointly invest in drone technology or bulk buy helicopters to reduce costs. As an order of magnitude, this window should be able to mobilise about €5 billion per year. The Commission will launch a scoping study to refine this estimate.*

2 - Foster investments in SMEs, start-ups, mid-caps and other suppliers to the defence industry: *The European Structural and Investment Funds and European Investment Bank (EIB) group already provide financial support for the development of a*

number of dual-use activities. The Commission will support EIB efforts to improve access to funding by the defence supply chains. It will promote EU co-financing of productive investment projects and the modernisation of the defence supply chains. Under the 'Blueprint for Sectoral Co-operation on Skills' the Commission will support cooperation in the defence sector to ensure people have the right skills and technological ability to generate innovation.

3 - Strengthen the Single Market for defence: The Commission will strengthen the conditions for an open and competitive defence market in Europe to help companies operate across borders and help Member States get best value for money in their defence procurement. To do so, the Commission will push ahead with the effective application of the two Directives on defence and security procurement and on EU transfers, facilitate the cross-border participation in defence procurement, support the development of industry standards, and promote the contribution of sectoral policies, such as EU space programmes, to common security and defence priorities.

Next steps: The Commission will now present and discuss these proposals, in particular the creation of a European Defence Fund, with all stakeholders. The European Council on 15-16 December will be a key milestone.

Appendix B: Background Notes on the Political Direction

In his political guidelines in June 2014, President Juncker stated "I believe that we need to work on a stronger Europe when it comes to security and defence matters. Yes, Europe is chiefly a 'soft power'. But even the strongest soft powers cannot make do in the long run without at least some integrated defence capacities."

In his State of the Union speech from 14 September 2016, President Juncker announced that "Europe can no longer afford to piggy-back on the military might of others or let France alone defend its honour in Mali. (...) "For European defence to be strong, the European defence industry needs to innovate. That is why we will propose before the end of the year a European Defence Fund, to turbo boost research and innovation."

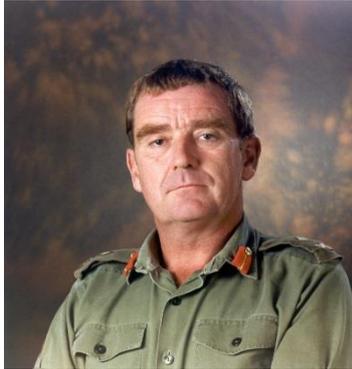
Over the last decade EU Member States have decreased defence spending by nearly 12% in real terms, but this has not been compensated by more European cooperation. The lack of cooperation between Member States in the field of defence and security is estimated to cost annually between €25 billion and €100 billion (see Annex).

At the Bratislava Summit in September 2016, the leaders of 27 Member States concluded: "We need the EU not only to guarantee peace and democracy but also the security of our people." In a challenging geopolitical environment, they agreed on the need to strengthen EU cooperation on external security and defence. Concretely, the December 2016 European Council should "decide on a concrete implementation plan on security and defence and on how to make better use of the options in the Treaties, especially as regards capabilities."

The European Defence Action Plan is closely linked with and complementary to the Global Strategy's Implementation Plan on Security and Defence, which sets out a new level of ambition for the Union and identifies actions to fulfil it, as well as with the implementation of the EU-NATO Joint Declaration signed by the President of the European Council, the President of the Commission and the Secretary-General of NATO. The actions proposed in this European Defence Action Plan will lead to a stronger European Union in defence, which ultimately means a stronger NATO.

The Action Plan is also linked to the April 2016 Joint Framework to counter hybrid threats and foster the resilience of the EU, its Member States and partner countries while increasing cooperation with NATO on countering these threats, which in turn builds on the European Agenda on Security adopted by the Commission in April 2015.

About the Authors and Contributors



Major General (Retired) Tim Cross CBE is a contributor to this report. Alongside various tours in the UK and Germany, he served with the UN in Cyprus in 1980/81 and had operational deployments to Kuwait/Iraq in 1990/91 and Bosnia in 1995/96 and '97. In 1999, as a Brigadier in command of 101 Logistic Brigade, he deployed to Macedonia, Albania and Kosovo and was appointed CBE in the subsequent operational awards for his work in leading the NATO response to the Humanitarian crisis; his brigade headquarters was also awarded the Wilkinson Sword of Peace.

In 2002 he became involved in the planning for operations in Iraq and subsequently deployed to Washington, Kuwait and Baghdad as the British Deputy to the US-led Coalition Provisional Authority. He returned to the UK in '03 and assumed command of one of the three Divisions of the UK Field Army from October '04. Retiring in Jan '07 he was the Army Adviser to the UK House of Commons Defence Committee for 7 years until 2014.



Dr Lee Rotherham (@DrBrexit) is the Executive Director of Veterans for Britain. He has been an adviser to John Major's whipless rebels, Eurosceptic MEPs, three Shadow Foreign Secretaries, the Conservative delegate to the Convention on the Future of Europe, a delegate to the Council of Europe, and government ministers. He was Head of Opposition Research for the No Campaign in the AV Referendum, and Director of Special Projects at Vote Leave, the designated pro-withdrawal campaign during the 2016 referendum. Outside of Westminster he has worked in publishing, teaching, heritage, and in

Defence. Lee is a reservist in the British army, and has served on three overseas deployments (pictured here by the Ziggurat of Ur).



David Banks is a research and communications officer at Veterans for Britain. He previously worked for the Shadow Treasury and Work and Pensions teams of the Conservative Party front bench, as a media relations officer.

He has also worked as a public relations adviser serving the financial services industry. Previous to that, he spent four years as a business journalist in the Middle East.

About Veterans for Britain



Veterans for Britain is led by ex-Armed Forces personnel but welcomes support from everyone who cares about the UK's autonomy, particularly in defence.

It campaigned during the referendum for a Leave vote and now seeks to make that a practical reality by ensuring that UK links with the EU are not constrictive or damaging the country's strategic interests.

The UK and its Armed Forces would be freer, more effective, under more democratic control, and more able to retain their distinctive capabilities and ethos if they were without the impositions being applied by the EU in defence command, defence structures, operations, procurement, intelligence and the development of new technology.

We believe it is essential to maintain and where necessary re-establish the United Kingdom's autonomy in defence in the context of its pre-existing alliances and to ensure it is directly and solely accountable to the UK Parliament.

You can sign up to the campaign at www.veteransforbritain.uk to keep in touch with us.

Or you can follow us on twitter @VeteransBritain.



HMS Ambush, an Astute Class submarine of the Royal Navy, pictured during sea trials in 2012. Image credit www.defenceimages.mod.uk and LA(Phot) Will Haigh. Image used under Creative Commons licence <https://creativecommons.org/licenses/by-sa/2.0/>

Image adapted with an artistic filter for colour enhancement.