



The European Defence Fund and its impact on the EU defence industry

5 minute read - from V.E

May 2021

INTRODUCTION

In recent years, the European Union (EU) has substantially increased its funding for the research and development of new weapon systems and military technologies by European defence companies. In this regard, in April 2021 the European Parliament approved a European Defence Fund (EDF) worth EUR 7.9 billion over seven years (2021-2027).¹ The Fund will finance collaborative defence research and development projects involving at least three companies from three Member States.

This Sustainability Focus addresses the question of whether the EDF could be used to fund the development of so-called controversial weapons.² In addition, it presents V.E's data on military sales and capabilities of listed European companies to assess the potential implications of the EDF for Europe's defence industry.

THE EUROPEAN DEFENCE FUND

In April 2021, the European Parliament gave the final approval to the regulation establishing the European Defence Fund. Two precursors to the Fund are already in place. The EUR 90 million 2017-2019 Preparatory Action on Defence Research will provide funding for 18 collaborative defence research projects and benefit 202 entities.³ In addition, the EUR 500 million 2019-2020 European Defence Industrial Development Programme will co-finance 16 collaborative defence development projects affecting 223 entities.⁴ Participants in the projects include the EU's largest defence companies from France, Italy, Spain and Germany.⁵

Supporters argue that the EDF will strengthen the EU Common Defence and Security Policy by fostering competitiveness, efficiency and innovation of Europe's defence industry. In contrast, critical voices in politics and civil society argue that the EU should not contribute to arms proliferation and the potential development of controversial weapons.⁶

The issue of possible funding of controversial weapons under the EDF had already emerged during prior discussions of the regulation. The 2018 Commission's proposal referred to

¹ Parliament backs EU funding for cross-border defence R&D projects, European Parliament website, 29.04.2021

² Even though there is no official definition of the concept of "controversial weapons", investors and stakeholders typically use the term "controversial weapons" to refer to weapons of mass destruction (nuclear, chemical and biological weapons) and certain conventional weapons like cluster munitions, anti-personnel mines, incendiary weapons, and other weapons under stakeholder scrutiny because of their humanitarian impact, like white phosphorus weapons, depleted uranium weapons, and lethal autonomous weapons. These weapons are collectively referred to as "controversial weapons" because, in particular, they may be considered to be excessively injurious, to have indiscriminate effects or to damage the natural environment. For this reason, some of these weapons have been specifically banned or regulated under international treaties.

³ Preparatory Action on Defence Research, European Defence Agency website, accessed 05.02.2021

⁴ European Defence Industrial Development Programme, European Commission, 23.07.2020

⁵ European Industrial Development Programme (EDIDP) Results of the Calls, Foundation for Strategic Research, 06.2020

⁶ The European Defence Fund: Key Issues and Controversies, PRIO, 03.2019

international law, stating that funding for “actions for the development of products and technologies the use, development or production of which is prohibited by applicable international law shall not be eligible”.⁷ In December 2018, the European Parliament explicitly listed the types of weapons to be excluded from EDF funding, namely “incendiary weapons including white phosphorus, depleted uranium ammunitions, lethal autonomous weapons, including unmanned aerial vehicles” and “weapons of mass destruction and related warhead and missile technology”.⁸ However, any references to incendiary weapons, white phosphorus, depleted uranium, and weapons of mass destruction were removed subsequently in April 2019⁹ and from the final regulation approved in April 2021.¹⁰

Therefore, the possibility exists that the EDF may be used to fund weapons whose status under international law is ambiguous – at least in theory.

WEAPON PROGRAMMES UNDER DEVELOPMENT

A number of weapons programmes currently under development in EU countries may benefit from the EDF, with potential implications for two types of controversial weapons: nuclear weapons and cluster munitions (i.e. munitions designed to release explosive submunitions over a wide area).

COMBAT AIRCRAFT AND NUCLEAR WEAPONS

Following the UK’s withdrawal from the EU, France is the only member state possessing nuclear weapons.¹¹ The country aims to keep its nuclear arsenal operational beyond 2070 and to replace its submarines and aircraft carrying nuclear-armed missiles. MBDA produces France’s operational nuclear-armed air-launched missiles and the company is developing the next generation of nuclear missiles ASN4G (Air-Sol Nucléaire de 4eme Génération).¹² These missiles, which are expected to enter service in 2035, will be carried by FCAS (Future Combat Air System) fighter jets¹³. As the FCAS constitutes a joint weapon programme between France, Germany and Spain, it is well placed to receive funding under the EDF as a major EU collaborative defence project. The ASN4G could also theoretically be in line for funding since its development is classified as a

⁷ Regulation of the European Parliament and of the Council establishing the European Defence Fund, European Commission, 13.06.2018

⁸ Establishing the European Defence Fund - Amendments adopted by the European Parliament, 12.12.2018

⁹ European Defence Fund - European Parliament legislative resolution establishing the European Defence Fund, 18.04.2019

¹⁰ Regulation of the European Parliament and of the Council of 29 April 2021 establishing the European Defence Fund and repealing Regulation (EU) 2018/1092

¹¹ In addition, four EU countries (Belgium, Italy, Germany and the Netherlands) host US nuclear bombs and possess nuclear-capable fighters which can deliver them. However, the US nuclear bombs remain under the control of US personnel.

¹² MBDA is a joint venture between the main missile systems companies in France, Italy, the United Kingdom, Germany and Spain: Airbus (37.5%), BAE Systems (37.5%) and Leonardo (25%).

¹³ Commission de la défense nationale et des forces armées, Assemblée Nationale, 12.06.2019; Sénat, 2040 l'odyssée du SCAF - Le système de combat aérien du futur, 15.07.2020

hypersonic missile,¹⁴ and the EDF promotes the development of “disruptive technologies for defence”. However, given that France would be the only EU country operating the ASN4G, it is highly unlikely that it would receive EDF funding.

ARTILLERY SYSTEMS AND SUBMUNITIONS

The possibility of the EDF funding cluster munitions is very low, but new artillery systems and related ammunition, including projectiles containing submunitions, may be in scope. The funding of cluster munitions will likely be excluded given the reference to international law in the regulation, even though not all EU countries have ratified the Convention banning Cluster Munitions (CCM). In EU countries which are parties to the CCM, major arms companies are producing “smart” artillery projectiles containing submunitions (BONUS, Smart155), with features compliant with the Cluster Munition Convention.¹⁵ EU countries have shown an increasing interest in developing and acquiring new artillery systems.¹⁶ Permanent Structured Cooperation (PESCO) projects, which are well placed to receive EDF funding,¹⁷ include the development of a new mobile precision artillery platform and related ammunition by Slovakia, Hungary and Italy.¹⁸

THE EUROPEAN DEFENCE INDUSTRY

As of March 2021, V.E’s Military screening identified 268 listed or bond-issuing European companies¹⁹ involved in military sales.²⁰ The extent to which these companies are involved in military sales varies, both in terms of derived revenues (from less than 5% to over 80% of total revenue) and types of military products and services provided.

Our data shows that 23 companies (9% of total) produce full weapon systems – including military aircraft, vessels, vehicles and munitions – and 59 (22%) supply key parts or services for weapons, such as major weapon subsystems. An additional 182 (68%) supply minor parts or services for weapons or other key military products or services.

In total, we find that 32 companies (12% of total) are directly or indirectly involved in controversial weapons, including nuclear weapons, white phosphorus weapons or cluster weapons.²¹ Most of

¹⁴ I.e. a missile travelling at over five times the speed of sound.

¹⁵ As they meet all the criteria dictated by the Convention in order to avoid indiscriminate area effects and the risks posed by unexploded submunitions.

¹⁶ Long Live the King (of battle): The Return to Centrality of Artillery in Warfare and its Consequences on the Military Balance in Europe, Finabel, 29.10.2019; The Future of Fires, RUSI, 27.11.2019

¹⁷ Keeping the momentum in European defence collaboration: An early assessment of PESCO implementation, International Institute for Strategic Studies, 14.05.2019

¹⁸ Indirect Fire Support, PESCO website, accessed 05.02.2021

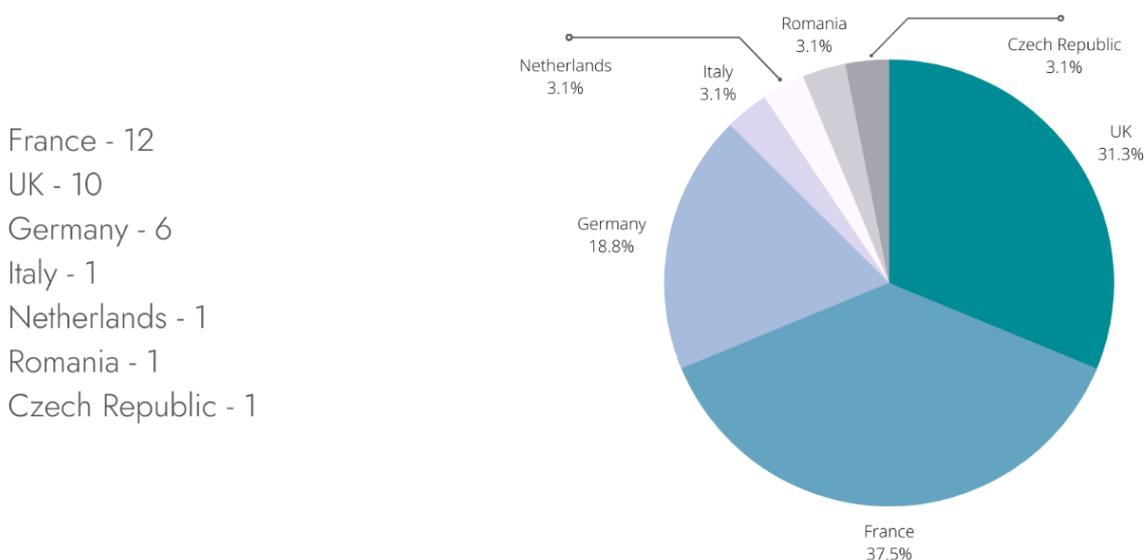
¹⁹ This analysis takes into consideration listed or bond-issuing companies which are headquartered in the EU-27, plus the UK, Norway and Switzerland. V.E’s universe includes 2,356 companies headquartered in these countries. Companies involved in military sales are headquartered in 21 of these 30 countries.

²⁰ Military sales are defined as sales of weapons, key parts or services for weapons, or other military parts or services to the armed forces of a Country or to other defence companies.

²¹ V.E applies the label of “controversial weapons”, as typically used by investors and stakeholders, to ten types of weapons including nuclear weapons, cluster munitions and white phosphorus weapons.

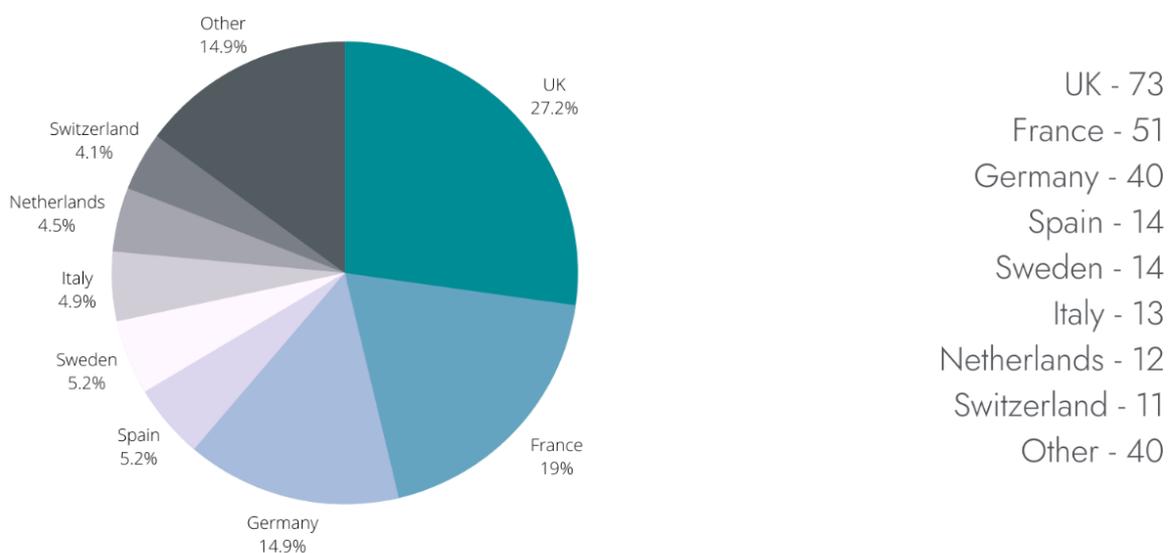
these companies are based in France (12) and the UK (10), and are involved in those countries' nuclear weapon programmes. Five companies, meanwhile, are involved in the production of white phosphorus munitions. Most EU countries are parties to the CCM and, as such, no listed companies are directly involved in the production of cluster munitions. Nevertheless, some companies supply full delivery platforms (or related components) that are specifically designed or adapted to launch cluster munitions. Such platforms are in operation in countries which still stockpile cluster munitions, such as Romania, the US, Turkey and India.

Listed European Companies Involved in Controversial Weapons, by Country



- France - 12
- UK - 10
- Germany - 6
- Italy - 1
- Netherlands - 1
- Romania - 1
- Czech Republic - 1

Listed European Companies Involved in Military Sales, by Country



- UK - 73
- France - 51
- Germany - 40
- Spain - 14
- Sweden - 14
- Italy - 13
- Netherlands - 12
- Switzerland - 11
- Other - 40

CONCLUSION

The EDF will fund collaborative defence projects for the research and development of new weapon systems and military technologies, thereby benefitting Europe's defence industry. However, the EU remains divided over controversial weapons such as nuclear weapons and cluster munitions, which will likely influence the allocation of EDF funding over the coming years. V.E research screens over 9,000 companies for involvement in military sales (including all conventional weapons and key military products or services) and over 50,000 companies for involvement in ten types of controversial weapons, including nuclear weapons and cluster munitions. Investors can use this information for compliance or management of reputational and financial risks, to implement their exclusion policies or engagement initiatives regarding companies operating in the defence sector.

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V.E is a global leader in ESG assessments, data, research, benchmarks and analytics. Leveraging our extensive proprietary database, we equip market players with the ESG insight they need to manage risks and better understand and address their social and environmental impact. With a team of nearly 300 experts of 30 different nationalities, V.E is present in Paris, London, Brussels, Casablanca, Hong Kong, Milan, New York, Rabat and Santiago. Since 2019, V.E has been an Affiliate of Moody's Corporation.

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