



# The European Defence Fund and Norway

*Karsten Friis*

## RECOMMENDATIONS

The Norwegian government should live up to its official policy and join the EDF as soon as possible, as it will ultimately prove more expensive – both financially and politically – to stay out than to join. More generally, Norway should be proactive in and supportive of the various EU initiatives aimed at enhancing European security.

The establishment of the European Defence Fund (EDF) – along with the Permanent Structured Cooperation (PESCO), the Coordinated Annual Review on Defence (CARD), and the Capability Development Plan (CDP) – represents an important step towards a more coherent European security architecture. Through the EDF, taxpayer money is for the first time being spent on defence technology development in the European Union system. The objective of the EDF is to “foster the competitiveness, efficiency and innovation of the European defence industry” and thereby “contribute to the strategic autonomy of the Union”. In other words, it is economically and politically motivated; part of both industrial and security policy. However, it has also provoked uncertainty in terms of whether and on what terms non-EU countries can participate. This Policy Brief examines the position of “associated countries” – in particular, Norway – in relation to the EDF.

It is broadly recognised that Europe needs to get “more bang for its buck”, reducing duplication between, as well as the number of, weapons systems and platforms. This is regarded as the best way of strengthening Europe’s contribution to NATO, and so improving the burden sharing heavily emphasised by the United States. Thus, Europe needs a more coherent military posture, as well as increased interoperability and efficacy. The best way of achieving this is fostering greater industrial cooperation between EU countries, thereby strengthening the so-called European Defence Technological and Industrial Base (EDTIB). Utilising similar platforms would potentially allow European states to share costs, logistics and maintenance, without ceding political control of their armed forces to others. While decision-making regarding the use of military force remains a strong national prerogative, increased cooperation and streamlining would give governments immediate access to more potent armed forces, should they ever be needed.

Additionally, in the context of a more complex transatlantic relationship, Brexit, a resurgent Russia and the rise of China, there is a growing awareness that Europe needs to be able to act more independently. Regardless of whether one embraces the term “strategic autonomy”, European states want to be able to mobilise forces at short notice in order to act if and when needed.

There is also a shared interest in becoming “ITAR-free” – that is to be able to produce complete systems without US components, thereby avoiding associated export restrictions. For instance, in 2018 US authorities blocked France’s sale of Rafale fighters to Egypt because it included the Scalp cruise missile, which contained an American component. Moreover, ITAR regulations put restrictions not only on re-export, but also re-transfer. This implies that buyers of American products cannot use them in certain circumstances – for instance in international interventions – without prior US approval. The freedom to export and use systems without having to ask Washington for permission is an important element in the drive for strategic autonomy. This is particularly the case in France, but also in Germany and other countries. Strategic autonomy is, however, often overlooked in relevant debates, which tend to focus on political autonomy.

Furthermore, the global defence market is becoming increasingly competitive, with strong actors emerging in countries such as China, Israel and South Korea. If the European defence industry is to survive and thrive in this context, stronger industrial cooperation and integration is essential.

Following trial phases in 2017–2020, it is intended

that the EDF will be up and running from 2021. The proposed budget is reportedly around €8bn for the Multiannual Financial Framework (MFF) period of 2021–2027, about half of what was initially flagged. The reduction is largely a result of political bargaining, with many member states keen to see a smaller EU budget (the cuts were proposed in November 2019, and are therefore unrelated to the coronavirus crisis). Even so, the very fact that the EU has allocated money to defence represents a milestone. The call for applications will most likely be published in spring of 2021, with the main requirement – aimed at fostering intra-European cooperation – being that all projects must involve companies from at least three EU countries. To ensure European taxpayer money is not used to sponsor companies in non-EU countries, third-party countries are excluded from the EDF. While subsidiaries located within the EU may participate in EDF projects, intellectual property rights (IPR) cannot be transferred to a mother company outside the EU.

This latter point has created political controversy, with the US complaining that American companies are excluded. This criticism has been firmly rebutted by the EU, which argues, among other things, that restrictions on European access to the US market are far stricter. Furthermore, there are no restrictions on procurement – European states can buy American products just as before. Still, given the somewhat strained atmosphere between Washington and many European capitals, this is likely to remain a sensitive issue. From the European perspective, it is frustrating that the US is on the one hand calling on Europe to assume a larger defence burden, while on the other hand attempting to prevent Europe from developing the structures and technology it needs to do so.

Another complicating issue is Brexit. While this was not regarded as a particularly relevant factor when the EDF was initiated, uncertainty related to future relations between the United Kingdom and the EU is now impacting the fund. The UK is a very significant part of the European defence industry, accounting for about €10 bn of the estimated €40 bn aggregated annual European defence R&D budget. As such, the UK is an indispensable part of the European defence industry structure. Whatever is eventually negotiated between the EU and the UK, in terms of the EDF (and perhaps more generally in terms of Europe’s security and defence issues) it is likely that the UK will be granted special status. However, given the ongoing negotiations and uncertainties, the EU is being very cautious about sending out any signals in this regard.

This brings us to the question of associated countries. Associated countries are explicitly referred to in several places within the draft EDF regulation, and are defined as European Free Trade Association (EFTA)

members that are members of the European Economic Area (EEA) – that is, Norway, Iceland and Lichtenstein. Switzerland is in the EFTA but not the EEA. Of the three countries mentioned, only Norway has a defence industry. Hence, in practical terms, the associated countries referred to in the EDF regulation consists only of Norway.

Norway did participate in the first phase of the EDF – the so-called Preparatory Action on Defence Research (PADR) that ran from 2017 to 2019 – based on the country’s membership of the EEA. However, Norway was not invited to participate in the subsequent phase – the European Defence Industrial Development Programme (EDIDP) that ran from 2019 to 2020 – in all likelihood due to political uncertainties related to Brexit that were emerging at the time.

In June 2018, the European Commission adopted the proposed EDF regulation, Article 5 of which regulates the involvement of associated countries: “The Fund shall be open to the European Free Trade Association (EFTA) members which are members of the European Economic Area (EEA), in accordance with the conditions laid down in the EEA agreement.”

However, this paragraph was set aside – or “bracketed” – by the Council of the European Union in November 2018. The Council decided that, “Since the proposed Regulation is one of the package of proposals linked to the MFF, all provisions with budgetary implications or of horizontal nature have been set aside, and thus excluded from the partial general approach aimed for, pending further progress on the MFF”. Though the question of associated countries is not directly linked to the MFF, “provisions related to third countries to be considered associated countries under the Fund (Article 5)” were also set aside, pending agreement on the MFF. From a Norwegian perspective, this coupling of formal recognition of associated countries with the general debate over the MFF has been particularly unfortunate, hampering planning and preparation by both government and industry.

The Council’s decision to bracket Article 5 was, it seems, due to political concerns related to Brexit expressed by some member states, as at the time it was uncertain how the process would unfold and whether the UK would end up as part of the EEA. Indeed, amid the Brexit debate, there have been voices arguing in favour of the UK re-joining EFTA. Barely anyone, however, is championing the UK becoming part of the EEA, as this would involve the country being subject to European Court of Justice rulings, as well as other infringements on British sovereignty. Given the avoidance of such infringements was among the main arguments in favour of leaving the Union, the likelihood of the UK subjecting itself to the internal

market while being unable to wield any political or legal influence is miniscule. Hence, it is more probable that the UK would seek to return as a full member of the EU than to associate with it through the EFTA and EEA. Either scenario, however, seems very unlikely. Nonetheless, Norwegian officials interpreted Brexit-related uncertainties as having been responsible for the stalemate regarding Norway’s participation in the EDF. The blocking of Norway’s participation was thus regarded as “collateral damage” suffered by the country due to Brexit.

The Norwegian government has officially expressed its wish to join the EDF, stating in its EU strategy:

*The Government will work to ensure that Norwegian actors are able to participate in projects financed by the Fund, both in research projects and in projects under the Fund’s other strand aimed at promoting the joint development and acquisition of defence capabilities. This is important for Norwegian-owned companies, their subsidiaries and their industry partners in the EU.*

This position is driven by the fact that the Norwegian defence industry is significant, comprising around 150 companies and enterprises headquartered in the country, which in turn control companies employing about 5000 people across the EU. These companies have an annual turnover in the EU of approximately €1bn and specialise in high-end technology, including advanced missiles, air defence, subsea-systems and communication technology. Given the relatively small Norwegian market, 75% of the industry’s turnover is export based, with Europe accounting for a third of this. The Norwegian defence industry is also the fourth largest exporter to the US market. Thus, through subsidiaries and strategic alliances with the major European defence contractors, the Norwegian industry is heavily integrated into the broader European defence industry. Additionally, several European defence contractors – including Airbus, Thales, Indra, GKN and SAAB – have subsidiaries, as well as development and production facilities, in Norway.

In 2019, the Norwegian Ministry of Defence received a report prepared by the advisory and auditing firm BDO, assessing the pros and cons of Norwegian participation in the EDF. The report concludes that it would prove more expensive for Norway to remain outside the EDF than to participate in it. The latter option would enhance political dialogue and coordination with the EU, making possible the realisation of financial gains from previous research investments while strengthening the international competitiveness of Norway’s defence industry. Should Norway choose to stay out of the EDF, however, defence

exports to the EU may – according to the report – fall by around 60% over time. This would inevitably have negative implications for Norway both financially and in terms of national security.

Hence, following the Council's 2018 decision to bracket Article 5, the Norwegian Foreign Ministry lobbied hard in – among other places – Brussels, Paris and Berlin in order to convince the EU to lift the bracket and include Norwegian industry in the EDF. Finally, on 28 September 2020, the EU's Committee of Permanent Representatives (Coreper) did indeed lift the bracket. From the EU's perspective, Norway can now participate in the EDF as soon as the necessary formalities are in place.

However, given the uncertainties expressed by the EU and its drawn-out decision-making, the Norwegian government appears to have lost internal momentum. Participation will cost Norway about €28 million annually, based on the 2.5% agreed through the EEA for Norwegian contributions to EU programmes. However, the Norwegian government's draft fiscal budget for 2021, published on 7 October 2020, did not include any funds for the EDF. Thus, as it stands, Norway cannot participate in the EDF after all. Of course, with the bracket lifted barely a week prior to the budget being presented, this left little time for last-minute revisions. Even so, it is surprising that this scenario was not planned for given the intense lobbying the Norwegian government had recently engaged in. The draft fiscal budget will be debated in the Storting (parliament) in October/November. Whether the political will exists within the opposition to press for the inclusion of the EDF allocation is uncertain.

The more time passes without a national political decision on joining the EDF, the more challenging it will be for the Norwegian defence industry to engage. The process of building consortiums and partnerships is already underway among competitors in the EU – the fact that the Norwegian defence industry remains in the “waiting room” means its companies are less attractive as project partners. If Norway fails to join the EDF, its defence industry will no longer be considered part of the EDTIB. This would again reduce the partnership appeal of Norwegian companies within the European defence industry, potentially leading to a significant deterioration of Norway's defence industry market access in Europe. It may also make it more difficult for Norway to ensure that defence equipment developed in relevant European programmes is also suitable for Norwegian forces.

Given the Norwegian government's stated ambitions and long-term diplomatic engagement, it would be politically embarrassing if the country now declined to join the EDF. Furthermore, it would send out a message of unpredictability, as well as a lack of interest in European security. A possible long-term consequence may be that Norway would become a less appealing partner in terms of European security and defence in general, and European collaborative armament programmes in particular (regardless of whether such programmes are funded by the EDF). Given the deteriorating security environment and shifting geopolitical landscape, this would be a very unfortunate development indeed.

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