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## How the EU can support Ukrainian defence production

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Ukraine is increasingly on the defensive as Russia's war of aggression continues into its third year. Kyiv is struggling with a shortage of troops and equipment necessary to adequately defend the frontline and major cities from aerial attacks[1]. Meanwhile, Western support, which is crucial for Ukraine's defence, is vulnerable to shifting domestic politics.

To turn the tide, Ukraine needs above all a lot of guns and ammunition. For now, it remains heavily reliant on Western arms deliveries. Maintaining the flow of direct military aid remains essential – in particular, for advanced air defence systems, long-range missiles and NATO-standard artillery shells. In the medium term, the EU and Ukraine have a shared strategic interest in supporting the development of Ukraine's rapidly expanding defence industry.

## LOCALISING, INTEGRATING

Following the dissolution of the USSR in 1991, Ukraine inherited a major defence industry. At its peak, a workforce of one million contributed 30 % of Soviet

Summary

- The EU should expand its support to the development of Ukraine's defence industry to sustain the country's fighting power, reduce its dependencies on Western aid and boost its domestic economy.
- Two broad areas demand particular attention. As a matter of urgency Ukraine needs investment in local production capacities and repair and maintenance facilities closer to the battlefield. At the same time, Ukraine's defence industry should integrate into the European Defence Technological and Industrial Base (EDTIB). A share of the windfall profits generated from immobilised Russian assets should be used to facilitate both tasks.
- Several obstacles currently hinder progress in localising production and integrating Ukraine's defence industry. The EU and Ukraine should work together to assess and address these head-on. This includes providing sufficient air defence capabilities and financing.

armaments production with special strengths in shipbuilding, aircraft engines, armoured vehicles and missiles. However, during subsequent decades there was a steep decline in the industry's competitiveness due to underinvestment, widespread corruption and political interference [2].

Russia's aggression in 2014 marked a turning point for Ukraine's defence industry. It severely disrupted critical exports (with 50 % of total exports previously going to Russia) and left more than 20 of the subsidiaries of Ukroboronprom, the state-owned defence manufacturer, in occupied territories [3]. The full-scale invasion in 2022 spurred a significant production surge to cover domestic demand. By 2023, Ukraine had managed to triple its weapons production [4], including armoured vehicles, artillery and heavy munitions, missiles, drones, air defences and electronic warfare capabilities [5].

This increased pace of production goes hand-in-hand with the reform of the industrial base. Ukroboronprom was transformed in 2023 into the Ukraine Defence Industry (UDI), a joint stock company, with a new corporate structure and governance model. In 2024 the Ukrainian government significantly bolstered its commitment to defence by allocating €1.37 billion to develop the defence base – a sevenfold increase compared to the year before. It also convened the first international defence industry forum, established an international defence industry alliance, set up a dedicated defence fund to stimulate investment, and committed to providing special conditions for companies localising their production in Ukraine. In addition to UDI, the Ukrainian defence industry base consists of some 400 privately-owned companies, of which no fewer than 200 manufacture drones.

**In the medium term, the goal should be for the Ukrainian defence industry to be an integral part of the EDTIB.**

To further strengthen the defence industry in Ukraine, the EU and its Member States should prioritise two key areas of focus as integral elements of its long-term security commitments [6]. First, it should support the ramping up of localised production, and of repair and maintenance facilities, closer to the frontlines. Second, it should facilitate the gradual integration of Ukrainian industry into the European Defence Technological and Industrial Base (EDTIB).

Significant resources, both in time and money, are currently spent on transporting Western equipment from the frontlines to repair depots in Poland, Slovakia or the Czech Republic [7]. If more Western armoured vehicles and howitzers could be maintained and repaired in Ukraine, that equipment can be returned to the frontlines much faster and at lower cost. Some Western companies are already on the ground in Ukraine, employing local expertise. BAE systems opened an office in Kyiv in August 2023 and later that year teamed up with the maintenance company AMS to offer repair and support services in Ukraine for the BAE-manufactured artillery systems donated by the United Kingdom [8]. Similarly, in October 2023, another European defence giant, Rheinmetall, established a joint venture with UDI to maintain and repair armoured vehicles in Ukraine [9]. Meanwhile, German company Flensburger Fahrzeugbau is reportedly already building a repair hub in the country for donated Leopard 1 tanks [10].

Despite Ukraine's significant production efforts, there are several key domains where localised production should be further supported. A top priority is establishing the capacity for mass production of artillery ammunition, in particular NATO-standard 155 mm munitions, which Kyiv currently lacks. Additionally, air defence systems are critical and needed in large quantities. Without adequate air defence, it will be impossible to increase production but also to attract foreign investment.

Drones and electronic warfare systems that can defend against them are also two key capabilities where an intense competition in development and mass production is now underway. Ukraine is well-placed to become a world leader in these domains.

Sensing a high and sustained demand for defence equipment, many companies are already seeking a foothold in Ukraine's burgeoning defence market. One such company is German drone maker Quantum-Systems which opened a production site for drones in Ukraine in April 2024 [11]. In February 2024, Rheinmetall announced that it was setting up a joint venture for an ammunition plant to produce 155 mm artillery rounds together with propelling charges [12]. KNDS is creating a subsidiary in Ukraine for spare parts and ammunition production [13]. In September 2023, the Ukrainian Defence Ministry stated that Ukraine and Sweden were discussing joint production of CV90 IFVs in Ukraine [14]. Many others have signed memoranda or agreements on joint production, licensing and other means of cooperation with partners in Ukraine.

In the medium term, the goal should be for the Ukrainian defence industry to be an integral part of the EDTIB. Ukrainian defence technologies, production capacities and battlefield testing will significantly enhance the capabilities of the EDTIB. In recognition of the mutual benefit cooperation can bring, the Commission and the HR/VP Josep Borrell proposed in the recent European Defence Industry Strategy (EDIS) that Ukrainian industry be granted the opportunity to participate in the EU's defence industry support programmes. Accordingly, the proposed European Defence Industrial Programme (EDIP) includes the

### On the ground

Defence firms operating on Ukrainian soil as of April 2024

**Maintenance/repair/overhaul**

**BAE Systems** (United Kingdom)
**Arquus** (France)
**Flensburger Fahrzeugbau** (Germany/Ukraine)
**Rheinmetall Ukrainian Defense Industry LLC** (Germany/Ukraine)
**Polska Grupa Zbrojeniowa** (Poland)

**Drones**

**Quantum Systems** (Germany)
**Baykar** (Türkiye)

Data: EUISS research based on open-source media outlets, 2024

possibility for Ukraine to participate in common procurement and for Ukrainian companies to receive support for increasing defence production. To support these actions, EDIP proposes a specific budget line that could be funded by a share of the windfall profits derived by central securities depositories from immobilised Russian sovereign assets [15]. It is imperative that sufficient funding is found for these integration initiatives – whether using the windfall profits or otherwise. To foster further cooperation and facilitate matchmaking between defence start-ups and innovators in the Union and the Ukrainian industry and armed forces, the EU plans to set up an Innovation Office in Kyiv [16].

## REMOVING HURDLES

Localisation will boost Ukraine's fighting power while deeper Ukrainian integration in the EDTIB will also strengthen a sense of security community among participants [17] – an important consideration in view of Ukraine's future membership. The EU's support for localisation of production in Ukraine would also be an investment in the Member States' security and improve their industries' position in what is fast becoming a competitive local defence market. However, several obstacles to further localisation and integration exist. EU and Ukrainian officials need to assess and address these together.

Protecting the defence production infrastructure is paramount. Dispersion and concealment provide some protection but Ukraine's air defences struggle to intercept Russia's drones and missiles [18]. The EU must do more to help Ukraine build up its air defences as soon as possible. To offset some of the risks of investing in Ukraine, Member States can provide 'war risk insurance mechanisms', reportedly already envisaged by France and the UK, to provide cover for Western defence companies, as global corporate insurers generally exclude countries at war from their policies [19]. Joint ventures localised in the Member States close to Ukraine can also be supported [20]. Production supply chains of both raw materials and components need to be secured in parallel.

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Despite its recent surge in growth, Ukraine's defence industry continues to suffer from a shortage of qualified workers and managers, an inadequate regulatory environment, and from corruption and risks of industrial espionage impeding Western technology transfers. The EU should prioritise support for the reform of the Ukrainian defence industry sector. This entails efficient and transparent corporate governance, a regulatory environment with safeguards against graft or intellectual property violations, but also sound defence industrial policies and procurement processes. Some EU Member States like Sweden already provide support for the establishment and development of a modern defence procurement organisation in Ukraine [21] – an example worth emulating.

Such reforms will create the conditions for directing resources and investments by the EU and European companies to support the localisation of production in Ukraine and integration of the Ukrainian industry in the EDTIB. The EU should mobilise its risk finance provision instruments to this end. Efforts should focus on maximising the loan flexibility within the EIB's Strategic European Security Initiative (SESI) to enable financing of joint ventures that can support infrastructure development and protective measures critical to Ukraine's defence industrial base [22]. Member States' support through the Ukraine Assistance Fund, possibly boosted in the future by defence bonds, should have joint ventures as a focus. The Defence Equity Facility (DEF) to support innovative defence technologies with dual-use potential could also be opened for investments in joint ventures between EU and Ukrainian entities [23]. A new specifically designed blending operation could even be established for that purpose. All of this would be not just a form of assistance to Ukraine but a means of increasing the competitiveness of European industries.

Apart from the EU's own restrictions on financing, Member States also impose restrictions and bureaucratic hurdles regarding technology transfer. The EU and its Member States should prioritise a joint review of these restrictions and cut red tape wherever and whenever possible to make funding and transfers easier.

Finally, the EU needs to develop a clear long-term plan for, in the words of the HR/VP, 'anchor[ing] the Ukrainian defence industry in Europe' [24]. The European Defence Industrial Strategy (EDIS) is a good start but there is ample scope and need to do more in the coming months and years. For example, EU Member States could agree to design Permanent Structured Cooperation (PESCO) and European Defence Fund (EDF) projects with Ukraine and Ukrainian industry as partners. This might not give access to immediate funding but would underline the future status of Ukraine as a (member) state with a dynamic and innovative defence industry.

Russia has been striving hard to demilitarise Ukraine. It must not succeed. By supporting the reform and development of the Ukrainian defence industry, the EU will make an investment that is sustainable, responsible and right.

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