

# Proposals unveiled to develop EU defence equipment market



**D**efence markets in the EU are currently organised on a predominantly national basis which, the European Commission believes, hampers innovation, competitiveness and efficiency. Divergent national policies create excessive red tape and ultimately lead to excessive expenditure on defence, whilst weakening the European Security and Defence Policy (ESDP).

To overcome existing fragmentation and make progress towards the establishment of a common European Defence Equipment Market (EDEM), the Commission proposed a package of measures in December 2007 which include:

- a Communication with recommendations for fostering the competitiveness of the sector;
- a Directive on defence procurement to enhance openness and intra-European competition in Member States' defence markets;
- a Directive on intra-EU transfers of defence products designed to alleviate the obstacles to intra-Community trade.

The proposed new legislation sets out to create a genuine European market in this sector without sacrificing Member State control over their security interests.

## Exclusion from the Single Market

For more than 40 years, defence and security matters have been excluded from European integration. As a consequence, defence markets have remained de facto outside the Single Market and have become fragmented along national lines.

Since the end of the Cold War, this fragmentation has become increasingly problematic. With severe budget constraints, on the one hand, and rising costs for military equipment, on the other, national defence markets in Europe are in many cases too small to manufacture and procure high-quality equipment at affordable prices. Far-reaching reforms have become indispensable if Europe is to maintain a viable defence industry and equip its armed forces adequately.

## Defence equipment market

This is particularly important in the context of the establishment of a European Defence Equipment Market (EDEM). Given the sensitivity of the sector, Member States clearly have the lead role in this area, but the Commission can play a useful role in supporting Member States in their efforts. In particular, Community instruments can help establish a more homogenous regulatory framework, which is crucial for improving the efficiency of Europe's defence markets and boosting the competitiveness of its industries.

The Commission has consequently tabled two legislative proposals:

- a Directive on defence procurement, which will coordinate national award procedures for military and sensitive security equipment;
- a Directive on intra-EU transfers of defence products



which aims to significantly simplifying national licensing procedures.

#### Defence procurement

Up until now, the vast majority of defence procurement contracts have been exempted from the rules of the Single Market. This practice stands in contrast to the case law of the European Court of Justice (ECJ) and is an impediment to establishing an open defence market between Member States.



The same problem affects the procurement of sensitive non-military security equipment, albeit to a lesser extent. One reason for this is that current EU procurement rules are ill-suited to the purchasing of most defence and security equipment.

To improve this situation, the Commission has proposed a new Directive which is tailor-made for defence and security. When implemented, Member States will have rules at their disposal which they can apply to complex and sensitive procurements without putting at risk their legitimate security interests. The end result will be a regulatory framework for defence which is more efficient and improves the openness of defence and security markets between Member States.

#### Security interests

Today's Community procurement rules do indeed apply to defence and security procurement but Member States can exempt contracts in these fields on the grounds that they need to protect their essential security interests. The legal basis for this exemption is Article 296 of the Treaty (for defence) and Article 14 of the current procurement Directive (for security).

According to the ECJ, the use of these exemptions must be limited to exceptional cases. In practice, however, many Member States have used them extensively to exempt almost all defence and sensitive security procurement from Single Market rules.

One of the reasons for this practice is the lack of Community rules suited to the specificities of defence and sensitive security contracts, namely complexity (which calls for flexibility) and special requirements for security of supply and security of information.

Since the rules of the current Directive have been de-



veloped for non-military and non-sensitive procurement, they do not sufficiently take these features into account.

As a consequence, most defence and sensitive security equipment is procured on the basis of uncoordinated national rules, which differ greatly in terms of publication, tendering procedures, selection/award criteria, etc. This

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regulatory patchwork is a major obstacle in the road towards a common European Defence Equipment Market and opens the door to non-compliance with EU Treaty principles. The lack of transparency and discrimination against suppliers from other Member States diminishes the openness of defence markets, with negative effects for all stakeholders.

#### Tailor-made provisions

The new Directive will apply to the procurement of arms, munitions and war material, as well as related works and services. At the same time, Member States can also use it for certain particularly sensitive non-military procurements in areas such as protection against terrorism, where contracts often have similar features as for defence.

It will contain a number of innovations tailored to the specificities of such procurement cases. Awarding authorities may in particular use the negotiated procedure with prior publication as a standard procedure, which gives them flexibility to negotiate all details of the contract. They may also require from candidates, specific clauses for security of information (in order to ensure the confidentiality of sensitive information) and for security of supply (in order to ensure to be always delivered in time).

Member States will still have the possibility to use Article 296 to exempt defence and security procurement contracts which are so sensitive that even the new rules do not satisfy their security needs. In most cases, however, Member States should be able to use the new Directive without any risk to their security. This has several advantages:

- The use of Article 296 can be limited to truly exceptional cases, as it is stipulated by the Treaty and the ECJ. This will enhance legal certainty for the awarding authorities;
- National procurement rules will be coordinated,

which streamlines the regulatory patchwork in these areas and reduces industries' administrative costs;

- The principles of the Treaty, in particular transparency, non-discrimination and openness, will be implemented in defence and security markets. This will improve the efficiency of defence spending and provide better value for money.

### Defence Transfers

Up until now, trade in defence-related products within the Single Market has been constrained by a web of heterogeneous and disproportionate national licensing procedures. By streamlining those procedures, the Commission's proposal will help make European defence industries more competitive. It will also encourage greater involvement of smaller firms - SME's - in armament development and production. In addition, it should enable Member States to meet military needs at lower cost and enhance security of supply for public procurement and industrial cooperation.

To preserve the overall prevailing level of protection if security interests, these measures to boost intra-EU transfers will be complemented by mutual confidence-building



measures, notably guarantees for the protection of national security in case of re-exportation to third countries.

### Removing administrative burdens

Licensing rules, which have to be complied with by defence companies wishing to exchange even components between subsidiaries within the EU, differ significantly from one Member State to another in terms of scope, competent authorities, procedures and timing. Furthermore, they typically do not establish any distinction between transfers to another Member State and exports to third

countries (i.e. an intra-Community transfer of a defence-related product commonly follows the same procedural requirements as the same export to any third country).

This patchwork of licensing schemes not only imposes a significant administrative burden on companies, but also induces long lead times – up to several months. The corresponding administrative burden on companies and public administrations and the indirect impact have been estimated to cost respectively at 433 million euro/year and 2.73 billion euro/year.

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This burden is clearly out of proportion to actual need for control. Indeed, license applications for intra-Community transfers are hardly ever rejected: whilst around 11,500 licences for such transfers are annually issued, not a single request has been formally denied since 2003.

By improving conditions for commercial exchanges between European defence industries, the proposal will pave the way for increasing industrial cooperation and optimising supply chains, with the prime beneficiaries being large industrial groups with subsidiaries in several Member States. It will finally make a crucial contribution to a more competitive European industrial and technological defence industrial base.

### Proposed measures

In concrete terms, the EU framework will induce Member States to replace as far as possible their existing individual licences by general licences for those intra-Community transfers where the risks of undesired re-exportation to third countries is under control, namely:

- purchases by armed forces of others EU Member States;
- transfers to certified companies of components in the context of industrial cooperation;
- transfers of products necessary for cooperative programmes between participating Member States.

Global licences, regrouping several transfers to several recipients by one supplier, should in principle cover most





of the remaining intra-Community transfers, individual licensing thus becoming the exception.

Member States will remain free to determine which products are eligible for the different types of licences, to set terms and conditions of such licences and to continue their cooperation in intergovernmental frameworks.

The shift from ex-ante to ex-post control will require additional guarantees designed to increase

confidence between Member States in their mutual ability to deal with exports to third countries following the initial intra-Community transfer. Member States will have to establish procedures on the basis of common criteria to certify the capacity of the recipient companies to properly handle the risks associated with the trade in defence-related products. Hence, any SME, wherever located in Europe, will be able to benefit from the simplified framework when transferring its products under a general licence to a certified system integrator located in another Member State.

In addition, there will be a 'safeguard clause' whereby, in exceptional circumstances concerning risks to national security, Member States can suspend or revoke general licences to certified companies.

The proposed Directive takes full account of Member States' need to protect their essential security interests as well as to respect their commitments under international armaments control regimes. Indeed, companies will be responsible for managing export limitations attached to transfer licences for defence-related products sourced from another Member State and will be prohibited from requesting export authorisations that infringe such restrictions. By reinforcing controls at the common external frontiers of the Community, the proposed Directive will also contribute to strengthening the fight against illicit trafficking of defence related products.

## Strengthening Security and Defence Policy

The Directives on defence procurement and intra-Community defence transfers are crucial elements of the future common European Defence Equipment Market.

As such, they are not simply new pieces of legislation, but important contributions to strengthening the Union's Security and Defence Policy.

The two proposals allow Member States to safeguard their legitimate security interests and, at the same time, introduce the principles of the Single Market – transparency, openness and non-discrimination – into European defence markets. This will be to the benefit of all – taxpayers, armed forces and industries.

At the same time, the two proposals are in line with ongoing intergovernmental initiatives. The Defence Procurement Directive is complementary to the Code of Conduct of the European Defence Agency, which aims at enhancing cross-border competition for those defence contracts which are exempted from Community rules under Article 296.

The Directive on Transfers is fully compatible with the so-called Lol-Initiative, which aims at facilitating export and transfer procedures between the six major arms producing Member States (DE, ES, FR, IT, SW, UK).

This illustrates that the establishment of a European Defence Equipment Market is clearly a 'cross-pillar' endeavour. To accomplish this, however, much more remains to be done both in the intergovernmental and the Community arena.

The Communication accompanying the two legislative proposals has already identified a number of further actions to strengthen the sector's competitiveness: the use of common standards, a common system for security of information, improved coordination in the field of research. And this list is certainly not exhaustive.

All this clearly shows that the defence package adopted on 5 December, 2007, is only one step towards a European Defence Market – but an important one.

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[http://ec.europa.eu/internal\\_market/publicprocurement/dpp\\_en.htm](http://ec.europa.eu/internal_market/publicprocurement/dpp_en.htm)

