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Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on simplifying terms and conditions of transfers of defence-related products within the Community

IMPACT ASSESSMENT

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TABLE OF CONTENTS

1. Executive summary ........................................................................................................... 4
2. Introduction .................................................................................................................. 8
   2.1. Legal and political context ......................................................................................... 8
2.2. Procedural issues ........................................................................................................... 9
2.3. Stakeholder consultations ........................................................................................... 10
3. Problem definition ......................................................................................................... 11
   3.1. Scope ...................................................................................................................... 11
   3.2. Obstacles to intra-community transfers of defence-related products ....................... 11
       3.2.1. Different kinds of transfers of defence-related products ...................................... 11
       3.2.2. Exports of defence-related products under strict controls ................................... 12
       3.2.3. Licences at the heart of all national export control schemes ............................... 12
       3.2.4. Intra-community transfers of defence-related goods hindered by cumbersome and disproportionate procedures ................................. 13
       3.2.5. Obstacles to intra-community transfers imped the creation of a European Defence Industrial and Technological Base (EDITB) and undermine security of supply for EU procuring governments ............................................................ 15
       3.2.6. Additional obstacles arising from third country restrictions ............................... 17
   3.3. Existing intergovernmental arrangements do not appropriately reduce the current obstacles to intra-community transfers ............................................................ 17
       3.3.1. The LoI and the Farnborough Framework Agreement ........................................ 17
       3.3.2. The European Defence Agency .......................................................................... 18
   3.4. Legal scope for action at Community level ............................................................... 19
   3.5. Problem summary ..................................................................................................... 20
   3.6. Is the EU best suited to act? ....................................................................................... 20
4. Objectives .................................................................................................................. 20
   4.1. General objective ....................................................................................................... 20
   4.2. Specific objective ....................................................................................................... 21
5. Policy Options ........................................................................................................... 22
   5.1. Introduction .............................................................................................................. 22
   5.2. No EU initiative (option 1) ....................................................................................... 22
   5.3. Non legislative measures (option 2) .......................................................................... 23
   5.4. Legislative measures ................................................................................................ 24
       5.4.1. Creating a EU licence-free zone (option 3) ............................................................ 24
       5.4.2. Managing the issuing of intra-community transfer licences at EU level (option 4) ... 25
       5.4.3. Simplifying and approximating national licensing schemes (option 5) ............... 25
       5.4.3.1. Type of licence issued (option 5 Ax) ................................................................. 26
       5.4.3.2. Guarantees concerning the reliability of the recipients (option 5 By) .............. 26
5.4.3.3. Guarantees concerning the management of re-exportation to third countries (option 5 Cz)............................................................................................................... 27

5.5. Summary of options ................................................................................................... 28

6. Analysis of impact ....................................................................................................... 29

6.1. No EU initiative ....................................................................................................... 29

6.1.1. Direct and indirect costs associated to the existing obstacles to intra-community transfers...................................................................................................................... 29

6.1.2. Likely industrial developments ................................................................................ 29

6.1.3. Social impact........................................................................................................... 31

6.1.4. Impact on the environment..................................................................................... 31

6.2. EU legislative initiative to facilitate intra-community transfers............................... 31

6.2.1. Social and environmental impacts ......................................................................... 32

6.2.2. Easier outsourcing for the main benefit of SME...................................................... 33

6.2.3. Foreign trade impact ............................................................................................. 33

6.2.3.1. A comparative advantage to EU defence products in terms of security of supply..... 33

6.2.3.2. The ITAR burden mostly lies in complete systems ............................................ 34

6.2.4. Type of licence ....................................................................................................... 34

6.2.4.1. Option A1: general licence only......................................................................... 34

6.2.4.2. Option A2: global licence only......................................................................... 35

6.2.4.3. Option A3: combination of A1 and A2 ......................................................... 36

6.2.5. Certification............................................................................................................ 36

6.2.5.1. Option B1: No EU certification scheme............................................................... 38

6.2.5.2. Option B2: Mandatory certification.................................................................... 38

6.2.5.3. Option B3: Optional certification ....................................................................... 40

6.2.6. Re-exportation ....................................................................................................... 41

6.2.6.1. Option C1: regulatory information requirements ............................................... 41

6.2.6.2. Option C2: IT traceability system .................................................................... 42

7. Comparing the Options ............................................................................................. 43

7.1. Summary table .......................................................................................................... 43

7.2. Preferred option........................................................................................................ 47

8. Monitoring and evaluation ........................................................................................ 48

ANNEX I - The EU defence industry .............................................................................. 49

ANNEX II - Assessment of the costs of intra-community transfers barriers.................... 53

ANNEX III - Summary of national licensing requirements ............................................. 65

ANNEX IV - Example of implementation of a traceability system .................................. 73

ANNEX V - Summary of the consultation process ......................................................... 74
1. **Executive Summary**

All Member States implement their own legislation to regulate the import, export and transit of defence-related products. *Ex ante* licensing schemes are at the heart of these control regimes. All Member States basically implement one, or several of the following three main types of licences:

- an individual licence corresponds to an authorisation granted by a national authority on the request of an individual supplier for one transfer to one recipient,

- a global licence corresponds to an authorisation granted by a national authority on the request of an individual supplier for one or several transfers to one or several recipients within the European Community,

- a general licence is an authorisation enacted in a general administrative or legislative act and allowing the transfer by any exporter of controlled goods to certain destinations both specified in the licence itself.

Despite similarities in the means employed, national rules significantly differ 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.

National licensing schemes impose a significant administrative burden on companies, and require long lead times – up to several months. The corresponding administrative burden and indirect impact have been estimated respectively at € 433 million/year and € 2.73 billion/year.

This patchwork of licensing requirements - and the corresponding administrative burden – clearly appear to be out of proportion with actual control needs, given that license applications for intra-Community transfers are almost never rejected (whilst around 11500 licences for such transfers are issued annually, not a single request has been formally denied since 2003).

Furthermore, there is growing consensus amongst both industry and governmental stakeholders that these obstacles to intra-Community transfers impede the creation of a European Defence Industrial and Technological Base (EDTIB) and undermine security of supply between Member States:

- at industrial level, the need to conform to disparate national licensing regimes will continue hampering the optimization of supply chains. To avoid time-consuming, uncertain and costly procedures, companies indeed tend to prefer national suppliers. This impedes the specialisation of European defence industries and hinders the creation of economies of scale. Furthermore, pan-European companies cannot enjoy the full benefits of cross-border integration, as long as data transfers between a company based in one Member State with its subsidiary in another remain subject to complex and lengthy prior approval schemes,

- a EU tendering governmental authority cannot take it for granted that export licences will be issued if it wants to procure defence equipment from a supplier established in another Member State. Although licences are hardly ever refused, the "theoretical" possibility that this may happen is an incentive for Member States to prefer sourcing sensitive military
equipment to a national producer rather than to its (possibly more advantageous) European competitors.

To address these obstacles, a number of bilateral or multilateral agreements and initiatives aimed at structuring and regulating the international trade in defence-related products have been developed on an inter-governmental basis. Even the most prominent of these, namely the Letter of Intent and the subsequent Farnborough Framework Agreement signed by the six main arms producing Member States, have achieved rather limited results to date. As far as the European Defence Agency is concerned, it has no mandate for dealing with transfers.

As regards a possible initiative, the Commission’s general objective is to contribute the establishment of European Defence Equipment Market, whilst its specific objective is to facilitate intra-Community transfers of defence-related products (ICTDP). Facilitating intra-community transfers of defence-related goods is presumed to improve security of supply for EU procuring governments and positively contribute to the EDITB competitiveness by allowing better conditions for industrial specialisation, secured and smooth-operating supply chains and economies of scale.

An extensive consultation process has paved the way for this initiative. Besides an on-line consultation and the commissioning of two preparatory studies involving a series of interviews with relevant stakeholders, several workshops with industry stakeholders and Member States representatives have been organised since July 2005. These consultations have revealed some areas of possible agreement on which a future Community initiative could be based, whilst at the same time also enabled the Commission to clearly identify the relevant constraints and limitations pertaining to this sensitive domain.

Different policy approaches were considered and discussed with interested parties during the preparatory phase. Five main options have been considered:

<table>
<thead>
<tr>
<th>Option 1</th>
<th>No action (business-as-usual scenario)</th>
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</thead>
<tbody>
<tr>
<td>Option 2</td>
<td>Non-legislative measures, taking the form of an interpretative Communication on Article 296 or confidence building measures</td>
</tr>
<tr>
<td>Option 3</td>
<td>Complete liberalisation of all defence-related products transfers</td>
</tr>
<tr>
<td>Option 4</td>
<td>Management of intra-community transfers at EU level via an Agency</td>
</tr>
<tr>
<td>Option 5</td>
<td>Simplification and approximation of national licensing schemes. These simplification elements pertain to:</td>
</tr>
<tr>
<td></td>
<td>– the type of licence issued (3 sub-options: A1 = general licences only, A2 = global licences only, A3 = combinations of general and global licences),</td>
</tr>
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<td></td>
<td>– the guarantees provided concerning the reliability of the recipients (3 sub-options: B1 = no EU certification for companies, B2= mandatory certification, B3 = certification for transfers under a general licence),</td>
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<tr>
<td></td>
<td>– the guarantees provided concerning the management of re-exportation to third countries (2 sub-options: C1 = regulatory information requirements, C2 = traceability system based on a centralized database).</td>
</tr>
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</table>

In line with the principle of proportionate analysis, options 2, 3 and 4 have not been retained for further detailed analysis, given either their unlikelihood to effectively meet the identified
objectives, or their unrealistic nature from a political acceptability perspective. A thorough impact analysis has been performed for the business-as-usual scenario, as well as each sub-option of the simplification scenario. For all scenarios, this analysis concluded that no noticeable environmental impact is to be expected.

**Option 1: no EU action**

The absence of action at Community level to address intra-Community transfers of defence-related products does not necessarily imply a frozen status quo. A certain number of Member States are likely to continue reviewing their national licensing regimes with a view to simplifying them, and (ongoing or future) initiatives developed in an intergovernmental context will continue to endeavour achieving a genuine facilitation of transfers between participating countries. Given the observed difficulty in extending such arrangements to additional participating members, the potential discrimination between participating and non-participating Member States would at best be maintained, or be even amplified.

Such situation would hinder the exploitation of all European competencies and niche expertise (in particular those located in new Member States). Excluded Member States will continue to see little complementary incentive to buy European defence products given that (a) their defence industry companies (mostly SME) will be less integrated in major defence programmes, and (b) the absence of any greater security of supply compared to alternative third country suppliers. In the medium to long run, if deprived from the benefits of deeper cooperation and integration, European industry will lose competitiveness and its role could be reduced to that of niche players and suppliers to mostly non-European prime contractors, thereby jeopardising its capacity to autonomously develop the capabilities needed for the European security and defence policy. Any such exclusion from the highest value-added market segments would also have a negative impact on returns available from European defence companies, creating difficulties in attracting investment as opposed to other, more profitable economic sectors. If not halted, the progressive erosion of EU industry’s competitive edge will ineluctably negatively influence both the level and the quality of employment in the sector.

**Option 5: Simplification and approximation of national licensing schemes**

It clearly emerged during the consultation phase that the overall prevailing level of security interests protection should be maintained. Concretely, this implies that any simplification / facilitation of intraEU transfers needs to be complemented by measures fostering a climate of mutual confidence, notably as regards re-exportations to third countries. The cost efficiency of the various above-mentioned sub-options as regards the facilitation means (type of licence) and the guarantees (certification and re-exportation control) have been screened in detail.

The analysis concludes that an EU scheme based on both global and general licences would constitute the most adequate compromise between the efficiency objectives of the measure (i.e. meeting the objective of genuinely facilitating ICTDP) and the required flexibility for Member States to fine-tune possible re-exportation or end-use restrictions on the most sensitive products.

EU certification of recipient companies appears to constitute a powerful means of raising mutual confidence at minimum marginal cost. Given however the potential disproportionate impact of making certification mandatory (notably for SMEs), the sub-option linking the use
of a general licence and certification appeared to represent an efficient confidence-building incentive for Member States to make the widest possible use of the least burdensome licences.

Finally, as regards re-exportation control, a double control IT traceability system would manifestly generate significant burdensome new obligations for both companies and administrations. The more conventional regulatory technique based on information requirements and effective enforcement policies are therefore deemed as more cost-efficient.

Combining the estimates of the corresponding sub-scenarios leads to an estimated net benefit in administrative burden comprised in a range stretching from € 190 mio and € 405 mio /year. But even more significantly, the expected indirect benefits of simplified transfers as a contribution to a well functioning European Defence Equipment Market and a strong European Defence Technological and Industrial Base are deemed to considerably exceed these direct net benefits.

Direct social impacts are expected to be minimal, whilst by contrast, indirect impacts are likely to be much more significant. The strengthening of a pan-European Defence and Technological Industrial Base could in the short term lead to rationalisation of structures, and hence, job cuts in redundant programmes and in poorly-competitive companies. Such restructuring is however a prerequisite for keeping the EU defence industry abreast of technological developments, a necessary condition both for being able to face the competition of new entrants and to avoid any further widening of the technological gap with its most advanced competitors. This scenario thereby offers the best guarantee to maintain or develop both in qualitative and quantitative terms, employment in the medium to long run.

As part of the Commission’s commitment to improving the quality of Impact Assessments, an independent internal Impact Assessment Board (IAB) has been set up. The current Impact Assessment has been reviewed by the IAB during a meeting on 18 July 2007.

The recommendations for improvements are detailed below, with a short commentary indicating how and where these recommendations have been accommodated within the current version of the report:

(1) The problem definition should better articulate and analyse the obstacles to effective intra-community transfers of defence-related products: Problems caused by the current patchwork of national licensing procedures and the resulting implications on administrative burden and product lead times have been explained in depth under 3.2.4.

(2) The continued need for intra-community transfer licences needs to be better explained: the revised IA provides further information in 3.2.4. and 5.4.1. on the need for keeping intra-EU licences to form the “vehicle” for carrying possible limitations on the end-use and/or the end-user and to allow for the mandatory reporting and transparency obligations imposed on national governments.

(3) The international dimension of the proposed measures requires further analysis, in particular the detrimental effects of US ITAR rules: additional information on the way European defence companies deal with ITAR-flagged material has been provided in 6.2.3. The summary table in chapter 7 also reports on the expected benefits associated to the preferred option concerning ITAR rules and the impact on third country producers.

(4) Employment, social, regional and sectoral impacts need to be assessed more thoroughly: the section discussing the impacts on employment (6.2.1.) has been
complemented with additional elements (drawing on general theory as well as practical observation) and a new dedicated section on SMEs (6.2.2.) with a focus on geographical impacts in the EU has been added. The summary table in chapter 7 has been revised accordingly. A more detailed overview of EU defence industries has been added in annex I.

(5) The IA report should review the robustness of certain cost/benefit parameters when calculating administrative costs: Assumptions about cost/benefit calculations have been reassessed and a more thorough explanation, where relevant and appropriate, is provided in annex II.

2. **INTRODUCTION**

2.1. **Legal and political context**

This Impact Assessment (IA) accompanies the initiative on intra-community transfers of defence-related products, as included in the 2007 Commission Legislative and Work Programme (subheading “strategic initiative”) under item 2007/ENTR/010. It belongs to a package of two complementary instruments aiming at completing the internal market for defence-related products and at reinforcing the EU defence industry’s competitiveness. The second component of this “defence package” is constituted by the proposed instrument on defence and security public procurement.¹ Both initiatives will be accompanied by an umbrella Communication on "A Strategy for a stronger and more competitive European Defence Industry".

This initiative builds upon earlier steps taken by the Commission to encourage restructuring and setting up a genuine EU defence equipment market:

- the 1996 Commission Communication addressing “The challenges facing the European defence-related industry – a contribution for action at European level"²,

- the 1997 Commission Communication on “Implementing European Union strategy on defence-related industries”³,

- the 2003 Commission Communication entitled “Towards a European Defence Equipment Policy”⁴, which sets out guidelines to strengthen and reinforce the competitiveness of the EU defence industry. One of these guidelines specifically addressed the need for simplifying intra-community transfers of defence-related products, whilst respecting Member States prerogatives in this highly sensitive sector.

The Council welcomed the latter Communication “as a valuable contribution towards creating the necessary conditions for strengthening the industrial and market situation of European businesses, which are directly or indirectly connected with the defence equipment

¹ Proposal for a Directive of the European Parliament and of the Council on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts in the field of defence and sensitive non-military security.
market, enhancing defence related research and improving international competitiveness of the industries concerned”.

Reacting for its part on the same Communication, the European Parliament advocated “a reduction in controls on intra-Community transfers of defence equipment, the simplification of administrative procedures, and the approximation of national licence systems” whilst recognising “the complexity and political sensitivity of this sector”6. Furthermore, in its 2006 resolution on the implementation of the European Security Strategy7, the European Parliament indicated that it was inter alia looking forward to the “creation of a binding legal instrument on the facilitation of intra-Community transfers of defence-related products that will substitute a simplified common system in place of the existing national export licences”.

At intergovernmental level, some limited initiatives have already been taken. The main developments relate to the Letter of Intent (LoI) signed by six Member States and the subsequent Framework Agreement adopted in Farnborough in 20008. Restricted to its participating Member States and impeded by the rule of unanimity and the weakness of its coordination mechanisms, the LoI has brought limited results.

The examination of the likely impacts of any proposal concerning such a sensitive area as trade in defence-related products (i.e. war material) cannot be confined to the traditional compartments of sustainable development (i.e. economic, social and environmental impacts). Indeed, these elements must necessarily be balanced with a broader global and geo-strategic perspective, taking due account of security requirements and notably the need to control the final use of defence-related products.

2.2. Procedural issues

The production of this impact assessment has been supported by:

– a first fact-finding study led on behalf of DG-Enterprise (DG ENTR) by consultants UNISYS entitled “Intra-Community Transfers of Defence Products”9 (hereafter referred to as the “February 2005 study”). Its terms of reference included the assessment of all national obstacles to such intra-community transfers (be they of administrative, legal, technical or economic nature), the evaluation of existing intergovernmental initiatives aiming at facilitating intra-community and international trade in defence products, and the identification of possible additional measures at Community level. The February 2005

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5 Council Conclusions of 13 May 2003 – doc. ref. 9341/03.
6 European Parliament resolution on the communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - European Defence - Industrial and market issues - Towards an EU Defence Equipment Policy (2003/2096(INI))
8 The six main arms manufacturing Member States (UK, FR, DE, ES, SE, IT) have committed in an international treaty the “Letter of Intent” (LoI) and its resulting Framework Agreement to facilitating defence industrial cooperation and restructuring. The LoI follow-up is carried out by six subcommittees respectively in charge of the six main tasks identified in the treaty: security of supply, export controls, security of information, research and technology, management of technical information and harmonisation of military requirements
9 http://ec.europa.eu/enterprise/regulation/inst_sp/defense_en.htm
study was presented on 12 July 2005 at a workshop co-chaired by EU HR J. Solana and Commissioner G. Verheugen.

– a second study, led by the same consultants, entitled “Intra-Community Transfers of Defence Products- impact assessment”\textsuperscript{10} (hereby referred to as the “February 2007 study”) which provided further elements for the assessment of the desirability and likely impacts of a series of options to reduce the burden associated with intra-community transfers of defence-related products.

Both studies have been monitored by a steering Committee, chaired by DG ENTR and consisting of representatives of key interested Commission departments: DG MARKT (responsible for the Internal Market), DG TRADE (responsible for external trade), DG RELEX (responsible for external relations), DG RDT (responsible for research), DG COMP (responsible for competition policy), DG TAXUD (notably responsible for the Customs Union), DG INFSO (notably responsible for ICT), the Legal Service and the Secretariat General.

2.3. Stakeholder consultations

The consultation process has been launched in the framework of the July 2005 conference “Europe Defence Industries and marketplace” organised by the European Commission in cooperation with the European Defence Agency\textsuperscript{11}, during which the findings of UNISYS’ “February 2005 study” were first presented.

An on-line consultation, published on the Commission single access point “Your voice in Europe”\textsuperscript{12}, was carried out between March 2006 and September 2006 on the basis of a Commission consultation paper. Seven Member States, ten industry associations and companies, five NGOs and three other organisations seized the opportunity to present their views. A summary can be found on the Commission website\textsuperscript{13}.

In the run-up to the “February 2007 study”, the consultant carried out a series of interviews with experts, public bodies, enterprises, stakeholders and EU institutions representatives covering the period between August and December 2006.

Finally, throughout the consultation phase between July 2005 and April 2007, a total of 7 workshops (4 with Member States and 3 with industry representatives) have been organised in Brussels by the Commission. These enabled the Commission services to widen and refine their knowledge basis, collect the views of those stakeholders and Member States which had abstained from contributing to the on-line consultation, and test options, from a technical, economic and political feasibility perspective, for the envisaged features of a possible initiative.

To sum up, the consultations undertaken with the Member States and industry have revealed four areas of possible agreement on which a future Community initiative could be based:

– the instrument should cover intra-community transfers from industry to governments as well as transfers from industry to industry;

\textsuperscript{10} ibidem
\textsuperscript{11} See http://ec.europa.eu/enterprise/defence/conference.htm
\textsuperscript{12} See http://ec.europa.eu/yourvoice/index_en.htm
\textsuperscript{13} See http://ec.europa.eu/enterprise/regulation/inst_sp/docs/consult_transfer/analyse_cons_en.pdf
– the scope of the instrument should primarily rely on the common military list (CML) contained in the EU Code of Conduct on arms exports;

– the introduction of a general / global licence scheme would provide for a significant simplification of intra-community transfers;

– mutual trust could be forged on guarantees by the recipient Member State as to security concerns (certification of companies, control customs in view of re-exports, reporting, mutual information, etc.). This seems particularly important for transfers from industry to industry.

The outcome of this extensive consultation process is elaborated in more details in Annex V.

3. PROBLEM DEFINITION

3.1. Scope
Defence-related cover a broad spectrum of military goods and services, ranging from lowly sensitive components and light arms to complex weapon systems, such as combat aircraft or war vessels, as well as highly sensitive material, such as nuclear, biological and chemical gear. Those products are subject to national ex ante licensing before they can be transferred due to their registration on national or common ammunition lists.

Defence-related products are characterised by their *exclusive military nature and purpose*, in contrast to the so-called “dual-use” products which are, in principle, civil in nature but can (also) be used for military purposes (for example toxic chemicals, electronic and telecom components). Given this exclusive military nature and purpose, defence-related products also differ from security products (e.g. biometrics identification devices) mostly used in civil cases (police, customs, local authorities…) and void of prior licensing requirements.

Annex I provides an overview of the European defence industry and the defence market.

3.2. Obstacles to intra-community transfers of defence-related products

3.2.1. Different kinds of transfers of defence-related products
Transferring defence-related products from one Member State to another Member State can be manifold:

– Transfers from industry to industry: such transfers encompass components transferred from a supplier to an integrator that incorporates the received component in a larger sub-system (ex: a sonar) or in a larger system (ex: a submarine). Possible related-services (like repair) and complementary transfers (like a software update) can be then implied.

– Transfers from industry to government: such transfers mostly encompass complete material but also services and goods related to these complete materials (related services like repair and overhaul and related goods like spare parts and maintenance equipment).

– Transfers from government to government: such transfers typically relate to the sale of decommissioned equipment (e.g. old aircrafts) to another government. However, such
transfers are rather infrequent, and do not raise any problem in terms of licensing procedures, in so far as the government seller is at the same time the licensing authority.

![Image of a diagram showing 2005 TICPD transfers](image)

*Source: EU Code of Conduct on Arms Exports 2005. (For a LoI description, see footnote n°8 and 3.3.1)*

### 3.2.2. Exports of defence-related products under strict controls

All Member States restrict the circulation of defence-related products within the Internal Market. Controlling the dissemination of defence equipments to ensure that such material does not end up in hostile hands or “rogue governments” is a key concern - and a matter of political and/or legal responsibility- shared by all democratic governments. The rational of such dissemination controls remains acutely valid today with the threat of terrorism and the risks of proliferation of weapons of mass destruction. Moreover, civil society’s analysis of the human rights and democratic credentials of the country of destination increasingly reinforces the need for a strict and effective export discipline. All Member States are thus implementing a series of control tools to balance non-dissemination imperatives with the necessities of production and circulation of defence material with trusted partners.

Annex III provides a summary table of the various national export regimes.

### 3.2.3. Licences at the heart of all national export control schemes

All Member States have their own legislation to regulate the import, export and transit of military goods. Although the means prescribed in these national rules are generally similar, they do present a significant number of important differences in terms of scope, competent

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14 The EU Code of Conduct on arms exports adopted in 1998 builds on eight common criteria for arms exports and also includes a denial notification and consultation mechanism, the first such mechanism ever applied to conventional arms exports. The adoption of the Code marked a qualitatively new stage in the EU's development of a common approach to arms exports as an important element of the Common Foreign and Security Policy. The Council assesses implementation of the Code on an annual basis. See [http://www.consilium.europa.eu/cms3_fo/showPage.asp?id=408&mode=g&lang=en](http://www.consilium.europa.eu/cms3_fo/showPage.asp?id=408&mode=g&lang=en)
authorities, procedures and timing. A common feature shared by all Member States is the reliance on prior licence schemes to manage such transfers. Practically, this means that exporters have to obtain a national ex ante export licence for shipping defence-related goods outside the national borders of each Member State. No distinction is being made whether the destination is another Member State or a third country.

There are basically three main different types of licenses that can be issued for the export of defence-related goods:

- **Individual license**: An individual license covers one or several consignments from a specific exporter of specific goods to a specific consignee / end-user. Thus, granted on the request of the manufacturer, an individual license must be applied for each transaction, implying that a case-by-case evaluation will take place. Such licenses are either valid for a pre-defined period or when a quantified limit has been reached. If a license expires without having yet been entirely fulfilled, it is usually possible, to apply for a time extension. In some countries however, it is easier to submit a new application for the remaining quantity.

- **Global license**: The global license can be granted on request to a specific exporter for specific goods to one or several recipients. The global licence is granted for a defined period but is not limited in quantity, hence covering shipments that were unexpected when the exporter applied for the licence. This type of license is typically issued in cases where a prohibitive number of licenses would otherwise be required, in order to prevent the creation of an undue administrative burden for the exporter. The license can require the exporter to submit the details of the consignees to whom the items listed have been exported on a regular basis (e.g. every three months).

- **General license**: General licenses, or national general authorisations, are laid down by a general administrative or legislative act. They offer a simplified procedure for the export by any exporter of controlled goods to certain destinations. The conditions for the use of this type of license, the covered goods and the authorized destinations are specified within the license itself. This type of license does not exist in most Member States.

3.2.4. Intra-community transfers of defence-related goods hindered by cumbersome and disproportionate procedures

Each individual or global licence application is normally dealt on a case-by-case basis, taking of course into account the relevant UN and EU arms embargoes as well as relevant multilaterally binding restrictions. Both for economic operators and authorities, the licence granting procedure is time-consuming and resource-intensive. The underlying factors are detailed in the following box:

- **Overlapping competencies**: there is a wide diversity of administrative national arrangements for issuing export licences. Their complexity is often the reason for delays and bottlenecks in some countries. The relevant authority for approving licence applications may also depend on the type of good or technology involved.

- **Inter-agency process**: the competent authority issuing the licences is typically required to consult other governmental departments to reach its final decision. This final decision can also be taken at the level of an intergovernmental board.
• *Lack of transparency in licensing criteria:* in some countries, the criteria that need to be fulfilled to obtain a license are not defined by law and are entirely left to the discretionary assessment of the competent authority. For the supplier and the receiver, this lack of transparency jeopardises the predictability of transfers and can imply additional delays in finalising incomplete applications.

• *Administrative licensing fees:* some countries impose a fee for covering the cost of the administrative procedure.

• *Additional licensing and pre-licensing requirements:* in some countries additional licenses/permits need to be secured before being able to apply for an export/import/transit license.

• *Diversity in control lists:* for defining which products are considered as military material, most Member States have their own national list. Whilst usually based on the Wassenaar Arrangement, most of these national lists contain a series of added items. These differences can lead to complex situations (e.g.: a specific item can be freely traded in one country but is subject to controls in another country). A pan-European company transferring defence components between its subsidiaries located in three countries must deal with three different control lists.

The duration of the administrative licensing process may vary from one week to several months, depending on countries and circumstances. These delays have clearly a negative impact on the defence industry, as efficient time management is nowadays a cornerstone of any industrial project. According to the assessment made in the 2005 UNYSIS report, obtaining an *ex ante* export licence represents for a company on average an investment above 20,000 € in terms of administrative burden.

Overall, the licensing requirements impose significant administrative burdens on companies, and imply long lead times – up to several months.

As a general rule, *all “exports” of military goods are submitted to the same rules, without making a difference between intra-community transfers and extra-community exports.* Although in practice the scrutiny level for export applications within the European Community (or destined to NATO countries) are no doubt lower than for exports to third countries, the requirements for submitting an application are formally the same regardless of the country of destination.

The licensing requirements for intra-community transfers appear to be disproportionate to the actual control needs. The EU Code of Conduct on Arms Exports statistics provide a clear idea of the ratio of rejected intra-community “export licences” in recent years:

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of licences</td>
<td>31,038</td>
<td>28,716</td>
<td>31,550</td>
</tr>
<tr>
<td>Intra-community transfer</td>
<td>12,627</td>
<td>11,360</td>
<td>11,409</td>
</tr>
</tbody>
</table>

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15 Examples: In Hungary, exporters must own both an activity licence and negotiation license (both documents being valid 2 years). Poland requires an ISO 9001 certificate. In France, exporters have to apply for a permit allowing them to start negotiating and for a sales permit for signing the contract.

16 See detailed quantification in Chapter 6 and Annex II.
It should be noted that all the 15 denials registered in 2003 concerned exports to the three Baltic States (not yet EU Members at that time). The categories where refusals occurred (small, light arms) concerned equipment with potentially higher risks of uncontrolled dissemination (re-export). There are indications that these refusals were primarily linked to the lack of awareness on the legislation in “new” Member States and the lack of established trust concerning the actual enforcement of re-exportation controls by these new occasional buyers. **No intra-community transfer of defence equipment has been denied since.**

Some Member States however justify the maintenance of their licensing systems arguing that these statistics underestimate the real denial rate, given that certain applications are never officially filed following a negative signal registered from prior informal contacts with the competent authorities. They also point out that the negligible refusal rate also ignores the possible specific conditions or restrictions attached to some transfers. For instance, for some complex defence-related products (weapons systems), licences can curtail technical functions of the product to be transferred or can include conditions (e.g. the product can be transferred on the condition that some of its features are downgraded or provided that its technology is not transferred).

Furthermore, certain Member States argue that a licensing scheme is needed to provide them with the necessary data for respecting their transparency and information obligations or commitments towards various stakeholders (national Parliaments, NGOs, international or EU agreements…). However, those Member States already implementing global and general licensing bring evidence that all necessary reporting data can also be gathered via *a posteriori* reporting requirements from suppliers located on their territories.

<table>
<thead>
<tr>
<th>licences</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Declared Value (<em>billion Euro</em>)</td>
<td>8.9</td>
<td>10.4</td>
</tr>
<tr>
<td>Rejected intra-community transfer licences</td>
<td>15</td>
<td>0</td>
</tr>
<tr>
<td>Rejection rate</td>
<td>0,12 %</td>
<td>0 %</td>
</tr>
</tbody>
</table>

As far as controls are concerned, no distinction is being made between intra-community ‘transfers’ and ‘exports’ to third countries. Given the negligible level of denials, the level of intra-community transfers’ control, mostly enforced through individual licensing, is disproportionate.

3.2.5. **Obstacles to intra-community transfers impede the creation of a European Defence Industrial and Technological Base (EDITB) and undermine security of supply for EU procuring governments**

There is a growing consensus amongst both industry and governmental stakeholders that reforms have become indispensable for Europe to maintain a viable European Defence Industrial and Technological Base (EDITB) and equip its armed forces adequately.\(^{17}\)

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\(^{17}\) See European Defence Agency requirements in “Characteristics of a strong future European Defence Technological and Industrial Base” adopted in September 2006: “*In order to develop and sustain a capability driven, competent and competitive European Defence Technological Industrial Base, Europe needs to work towards more consolidation, work-sharing and interdependencies on a European-wide basis, based on Security of Supply and drastically simplified procedures for Intra-Community Transfer*”. This has been thoroughly recalled in the “EDITIB Strategy” adopted in May 2007.
In this regard, the very existence of obstacles to intra-community transfer of defence-related products is incompatible with any genuine integration of the EU defence industrial and technological base. **The widely acknowledged need for closer cooperation between European defence industries and rationalisation of their supply chains is impeded by current obstacles on transfers.**

Indeed, a prerequisite for such a deeper industrial integration is the reasonable guarantee to benefit from an efficient, seamless and reliable supply chain whenever acquiring equipment in another Member State.

Furthermore, security of supply is of paramount strategic importance not only for industrial supply chains, but also for procuring governments. Indeed, the adequate and timely supply of defence equipment is essential to the success of military operations. This implies that suppliers must have the capacity to deliver defence equipment (including spare parts, maintenance and upgrades) over a long period of time (because of the long life cycles of many defence systems). In addition, in times of crisis or war, suppliers must be able to meet urgent additional demands for incremental or accelerated deliveries.

As long as intra-community transfers are hindered by such barriers:

- At industrial level, the need to conform to disparate national licensing regimes will continue hampering the optimization of supply chains. To avoid time-consuming, uncertain and costly procedures, companies indeed tend to prefer national suppliers. This impedes the specialisation of European defence industries and hinders the creation of economies of scale. Furthermore, pan-European companies cannot enjoy the full benefits of cross-border integration, as long as data transfers between a company based in one Member State with its subsidiary in another remain subject to complex and lengthy prior approval schemes.

- A EU tendering governmental authority can not take it for granted that export licences will be issued if it wants to procure defence equipment from a supplier established in another Member State. Although licences are hardly ever refused, the "theoretical" possibility that this may happen is an incentive for Member States to prefer sourcing sensitive military equipment to a national producer rather than to its (possibly more advantageous) European competitors.

Therefore, besides the direct cost linked to the preparation and management of licences themselves, which is estimated in UNISYS’ 2005 report to represent about € 430 million in 2004\(^{18}\), the bulk of the "costs of non-Europe" in the defence-industry are of an indirect nature. The same report actually concluded at an indirect yearly impact of € 2.73 Billion, although some authors have suggested even much larger figures\(^{19}\).

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\(^{18}\) This yearly direct cost of €433 million is shared between governments (42%) and enterprises (58%), making the average cost of every single licence €16.142 for governments and € 21.885 for enterprises. This figure is consistent the estimation provided in 1998 by the European Defence Industry Group (EDIG), which calculated the direct costs of export control measures for companies at € 107.1 million, or 0.22% of the annual turnover for defence related activities. See Annexe II for details on quantification.

\(^{19}\) In his study “A single European market for defence equipment: organisation and collaboration” professor Keith Hartley ranges four “liberalisation scenarios” ensuring much more important annual savings, from 3.8 to 7.8 €billion (according however to wider liberalisation options including notably a
3.2.6. Additional obstacles arising from third country restrictions

Restrictions on trade of defense equipment imposed by third countries indirectly impact intra-community transfers. The most prominent of such restrictions is undoubtedly US rules. International Traffic in Arms Regulations (ITAR)\(^{20}\) is a set of US government regulations that control the export and import of defense-related articles and services under the Arms Export Control Act. Its goal is to advance national strategic objectives and U.S. foreign policy via the trade controls. This export control regime, which covers both transactions with the countries receiving the articles or services and any further re-export of those articles or services to third countries, is administered by the Department of State.

In practice, ITAR impose on European industries relying on US components to request prior US government approval when US components are moved onto other countries. EU companies have to fill end-user statements when they sell products containing US ITAR-flagged components. This end-user statement is then sent to the US supplier that, in turn, submits it to the US administration for approval. With ITAR, orders cannot be made until the final customer identity is known to the US authorities\(^{21}\).

The ITAR approval procedure can be very lengthy and burdensome. Furthermore, its intrinsic extraterritorial nature has an obvious restrictive impact for EU integrators both on market access to third countries (for example, the US has blocked in 2006 the planned sale of EADS CASA's military aircraft to Venezuela\(^{22}\)) and on intra-community transfers (in so far as prior US agreement has to be sought for intra-Community transfers containing ITAR-components).

3.3. Existing intergovernmental arrangements do not appropriately reduce the current obstacles to intra-community transfers

3.3.1. The LoI and the Farnborough Framework Agreement

To address these obstacles, a number of bilateral or multilateral agreements and initiatives aimed at structuring and regulating the international trade in defence-related products have been developed on an inter-governmental basis. The most prominent of these is no doubt the Letter of Intent (LoI) and the subsequent Farnborough Framework Agreement\(^{23}\), which aims at facilitating cross-border restructuring and cooperation of defence industries between the six participating countries: United Kingdom, France, Germany, Spain, Italy and Sweden.

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\(^{20}\) http://www.pmddtc.state.gov/itar_index.htm

\(^{21}\) See Title 22 Chapter I, Subchapter M of the US Code of federal regulations[Sec. 123.9 Country of ultimate destination]: (a) The country designated as the country of ultimate destination on an application for an export license, or on a Shipper's Export Declaration where an exemption is claimed under this subchapter, must be the country of ultimate end-use. The written approval of the Directorate of Defence Trade Controls must be obtained before reselling, transferring, transhipping, or disposing of a defence article to any end user, end use or destination other than as stated on the export license, or on the Shipper's Export Declaration in cases where an exemption is claimed under this subchapter. Exporters must ascertain the specific end-user and end-use prior to submitting an application to the Directorate of Defence Trade Controls or claiming an exemption under this subchapter.


\(^{23}\) See footnote no.8
One of the areas the Framework Agreement is covering is transfers and exports in the framework of cooperative projects and Trans-national defence Companies (TDCs).

The genesis of the LoI has been quite difficult: indeed, the actual ratification of the Framework Agreement and the preparation of its subsequent Implementation Arrangements have proved extremely slow to set up (given that it is a purely intergovernmental agreement, unanimity is required for any decision). Moreover, LoI solutions are often considered as too complex, vague and insufficiently binding. It has therefore yielded little concrete results yet. In particular, it is not aiming at establishing a unique set of export procedures and regulations but only tries to make persisting national procedures compatible and agree on common principles for cooperative projects and TDCs.

Moreover, the LoI intrinsically creates a potential distortion within the internal market. It potentially confers an advantage to sub-contractors located within the boundaries of the agreement and thereby penalises competitors located in “excluded” EU Member States, thus bearing a significant risk of excluding in particular SMEs from non-LoI Member States from the process of industrial integration.

The LoI agreement is limited in its membership and scope. Consequently, it implies the risk of excluding companies of non-LoI countries to get access to the supply chains of the big prime contractors and hardly ensures security of supply at the EU level.

3.3.2. The European Defence Agency

Created under second pillar joint action 2004/551 of 12 July 2004, the European Defence Agency (EDA) is designed "to support the Council and the Member States in their effort to improve European defence capabilities and to foster the European defence industrial base". More specifically, the Agency is ascribed four functions, relating to (a) defence capabilities development, (b) armaments cooperation (c) the European defence technological and industrial base and defence equipment market and (d) research and technology. The EDA has however no mandate for dealing with transfers.

Furthermore, when asked which possible role EDA could play in the implementation of a simplified transfers regime, most stakeholders objected that EDA stems from Ministries of Defence whilst export control schemes are under the responsibility of other departments in most Member States. Some stakeholders also pointed that it would take a lot of time and resources for the EDA to develop a competence in export controls.

While investigating ways to foster the European defence industrial base, the EDA has highlighted the issue of transfers as very relevant, though abstaining from further involvement. Considering the characteristics of a strong future European Defence Technological and Industrial Base, the EDA Steering Board in September 2006 settled that “In order to develop and sustain a capability driven, competent and competitive European Defence Technological Industrial Base, Europe needs to work towards more consolidation, work-sharing and interdependencies on a European-wide basis, based on Security of Supply and drastically simplified procedures for Intra-Community Transfer”. This has been thoroughly recalled in the recent “EDTIB Strategy” adopted by the EDA steering Board in May 2007.

In September 2006, EDA members also agreed on the “Framework Arrangement for security of supply between subscribing Member States in circumstances of operational urgency”. This
Framework Arrangement states that “the subscribing Member states will support efforts to simplify amongst them intra-community transfers and transits of defence goods and technologies”.

3.4. Legal scope for action at Community level

Besides the legitimate concern to control defence equipment dissemination, armaments policy and the trade related to such equipment are linked to considerations of national sovereignty and foreign policy.

Member States typically invoke Article 296 of the EC Treaty\(^24\) (national essential security interests) as a justification for their licensing and control requirements on the movements of military equipment.

According to the case-law of the Court of Justice of the European Communities, Community law applies to defence-related products, as it does to all other products. In particular, the principle of free movement of goods and services and commercial policy (Articles 28, 49, 133 TEC) are applicable. By their very nature, export authorisations are one of the measures which create quantitative restrictions or measures having equivalent effect which Community law aims to eliminate with regard to intra-Community trade.

Article 296 TEC allows Member States to take restrictive measures on the condition that they demonstrate on a case-by-case basis that these measures are necessary and proportional to protect essential national security interests. However, it is not possible to infer from this article that there is inherent in the Treaty a general proviso covering all measures taken by Member States\(^25\). Thus Article 296 has no effect on the Community’s legislative power to lay down measures concerning the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market (Article 95(1)).

This jurisprudence evidently contradicts the current Member States practice of claiming generic, unsubstantiated ‘national security’ interests to justify restrictions on the movement of defence-related products.

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\(^{24}\) Article 296 reads as follows:

1. The provisions of this Treaty shall not preclude the application of the following rules:

   (a) no Member State shall be obliged to supply information the disclosure of which it considers contrary to the essential interests of its security;

   (b) any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.

2. The Council may, acting unanimously on a proposal from the Commission, make changes to the list, which it drew up on 15 April 1958, of the products to which the provisions of paragraph 1(b) apply.

\(^{25}\) Opinion of Mr Advocate General La Pergola, Case C- 273/97, Angela Maria Sirdar v The Army Board and Secretary of State for Defence, point 11.
action in Member States which have as their object the establishment and functioning of the internal market (Article 95(1)).

3.5. Problem summary

Overall the licensing requirements for transferring defence material challenge security of supply for procuring governments, which is hardly compatible with the inherent solidarity of the EU, and curtail industrial cooperation. They impose a significant administrative burden on companies, and require long lead times – up to several months – in order to obtain transfer licenses. The licensing requirements - and the corresponding administrative burden – clearly appear to be out of proportion with actual control needs, given that license applications for intra-community transfers are almost never rejected.

The current intergovernmental arrangements do not provide a satisfactory basis for the simplification of intra-community transfers. Their intergovernmental nature (i.e. unanimity rule, absence of a body to check their implementation) limits their effectiveness and their potential for significant progress seems questionable. Moreover, they are intrinsically ‘exclusive clubs’, which potentially implies prejudicial consequences for any operator located outside their geographical boundaries.

3.6. Is the EU best suited to act?

A reinforced security of supply constitutes a prerequisite for the correct functioning of the Internal Market in the area of public procurement. Moreover, a genuine European Defence Technological and Industrial Base (EDTIB) requires exploiting the full range of Europe's competencies and niche capabilities, in particular SMEs’ competencies.

The current intergovernmental arrangements imply a serious risk of excluding companies of non participating countries to get access to the supply chains of the big prime contractors, and do not contribute to improve security of supply at EU level.

Furthermore, the EDA has no mandate to deal with transfers issues, and stakeholders unanimously discarded its possible involvement in the matter.

The general use of the essential security interest exemption in the field of intra-community transfers of defence material is incompatible with the Treaty, as consistently confirmed by the related Court of Justice jurisprudence. In this regard, the Community is not only the best suited, but the only possible player to address this problem.

Proportionate action at Community level is therefore necessary to facilitate intra-community transfers of defence equipments, hence contributing to the emergence of a European defence equipment market which can support a truly European Defence Technological and Industrial Base.

4. Objectives

4.1. General objective

In line with Member States commitments, the Commission's overarching objective in this field is to establish an open and competitive European Defence Equipment Market (EDEM) in the EU. A well functioning EDEM requires a coherent regulatory framework in the various
policy areas, such as procurement and transfers. In order to protect Member States’ security interests, this framework needs to take into account the specific nature of defence equipment (strategic importance, complexity, security of supply and security of information requirements).

The expected benefits of a properly working EDEM would be the following:

– from a supply side perspective: substantial economies can be expected to arise from access to a much larger ‘home’ market and longer production runs. More competition and market disciplines would encourage the sector to optimise production capacity and thus help lower production costs. Lifting existing disincentives to restructure and cooperate across national boundaries will contribute to the emergence of a Europe-wide Defence Industrial and Technological Base (EDITB), hence reducing the costly duplication and fragmentation of production capacities. Less fragmentation or more rational resource allocation would also provide the sector with the necessary critical mass in terms of business and research investments, thus leading to the creation of centres of excellence. This in turn would mean a more economically and technologically competitive EU defence industry on both domestic and third markets.

– from a demand side perspective: better guarantees of supply provided by the easier circulation of defence-related products would reinforce the attractiveness of defence manufacturers located in another Member State, facilitate the adoption of best practices regarding trans-European military procurement (including the purchase of similar / compatible material), and ultimately improve the efficiency of defence spending (less duplication of defence stocks, more material pooling). A greater security of supply on EU defence-related products would favour European goods compared to goods sourced from third countries.

– This proposal’s general objective also fits into the broader pictures of the Lisbon agenda given its contribution to the development of a competent and competitive European Defence Technological and Industrial Base (EDTIB). A competent and competitive European defence industry may in its turn foster the Common Foreign Security Policy (CFSP).

4.2. Specific objective

The specific objective pursued by the Commission in the framework of this initiative is the facilitation of intra-community transfers of defence-related products to reduce the complexity - and the related administrative burden - associated with the existing web of diverging national licensing schemes. To that extent, reaching this specific objective will complement the forthcoming directive on defence procurement. Because most transfers of defence-related products destined for Member States’ armed forces will be facilitated, procuring governments will enjoy more predictability and consequently much greater security of supply, which will reduce current reluctance to cross-border purchases. It will make it easier for cross-border suppliers to “demonstrate” their ability to timely deliver defence-related products.
5. **POLICY OPTIONS**

5.1. **Introduction**

This chapter identifies and examines different ways to tackle the problems outlined in chapter 3 and achieve the objectives defined in chapter 4. Different policy approaches were considered and discussed with interested parties during the consultation process. Some of these will be considered here but however not retained for further analysis, given either their unlikelihood to effectively meet the identified objectives, or their unrealistic nature from a political acceptability perspective. The potential impacts associated with the key measures of the remaining options are analysed in detail in the following chapter.

Achieving concrete steps in trade facilitation of intra-community transfers of defence materials fundamentally presupposes the establishment of a climate of trust and mutual confidence in the capacity of the recipient’s authorities to safeguard the crucial security dimension associated with the transferred good and notably guarantees in the case of re-exportation to third countries. It is also a necessary condition for featuring a credible common defence market as a secure space, notably towards extra-territorial regulations imposed by third countries (mainly the US) and thus avoiding discriminating Member States based on the assumption that some of them could be “less trust-worthy” than others.

5.2. **No EU initiative (option 1)**

The absence of action at Community level to address intra-Community transfers of defence-related products does not necessarily imply a frozen status quo:

- A certain number of Member States are likely to review their national licensing regimes with a view to simplifying them (probably making a more widespread use of global or general licences, and by opening the possibility for derogations to licensing in certain specific cases). Such national simplifications will however not substantially improve the current fragmentation and patchy implementation.

- Ongoing intergovernmental initiatives – in particular the LoI - have been mandated to simplify transfers between the participating Member States. However, these initiatives have not been very successful up to now. Given the observed difficulty in extending such arrangements to additional participating members, the potential discrimination between participating and non-participating Member States would at best be maintained, or be even amplified.

- Smaller initiatives on a bilateral or tripartite basis could continue to develop for certain specific cooperation programmes. Past experience shows that bilateral agreements have sometimes been concluded with third countries (very often the US), hence making the consolidation of the EDITB potentially even more difficult. Again, whilst facilitating cross-border transfers between mutually trusted countries sharing common interests, such developments do not fundamentally rationalise the patchwork of licensing schemes and bear the risks of discrimination against operators located in non-participating countries.

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26 The issue is particularly burdensome when considering the integration of US ITAR-flagged components in European supply chains. Because of ITAR rules, transferring a system containing US components from one MS to another MS is subject to prior approval from the US administration. European industrial partnerships are thus made more difficult. See also 3.2.6
This option will constitute the ‘baseline scenario’ to which the alternative options will be compared to.

5.3. **Non legislative measures (option 2)**

Given that mutual confidence appears as a prerequisite for Member States to simplify transfers, the Commission could promote a better understanding of the intra-Community transfer issue through non legislative measures, such as:

1. **Building confidence through information sharing and exchanging of best practices**

   The Commission could consider playing a leading role in fostering information sharing and exchanges of best practices via meetings, workshops, data-bases… Whilst no doubt acceptable to Member States, such a soft information exchange option is however highly unlikely to lead to concrete tangible effects on national “hard law” licensing practices, and therefore, would in effect not substantially differ from the “business as usual scenario”.

2. **Framing the interpretation of Art. 296 of the Treaty**

   Member States have traditionally invoked Article 296 for justifying their *de facto* blanket exclusion of defence-related products from the internal market rules. The Commission could undertake to frame more tightly the currently wide use of this derogation. This could take the form of an interpretative communication on the use of Article 296 in the field of intra-community transfers of defence-related products. While acknowledging the legitimacy under Article 296 of transfer control procedures for defence-related products, such a document could *inter alia* stress the need for any derogation to the Treaty to respect the principle of proportionality, be it in relation to the licensing procedure itself, or in relation to the corresponding costs and delays entailed by individual administrative procedures.

   In the absence of jurisprudence on the Court’s reading of Article 296 in the context of intra-Community transfers of defence-related products, it is however doubtful that such an interpretative Communication would go as far as setting out criteria that may allow national licensing authorities to duly resort to the “essential security interests” derogation. Practically, Member States would have to conduct a case-by-case assessment to ascertain whether Article 296 is applicable. Such a case-by-case procedural approach would definitely not streamline current practices.

   As there is no Community framework dealing with the core security issues pertaining to transfers of defence-related products, the most likely outcome is continued recourse by Member States to Article 296, thus leaving the Commission with the task of demonstrating possible misuses. At the end of the day, enforcement would therefore continue relying on infringement procedures, a route that may prove to be rather arduous for the Commission services due to the considerable number of licences to monitor. Besides its practical dimension, such a legalistic case-by-case approach would fail to efficiently meet businesses industrial needs, given the intrinsic procedural delays involved.

   Furthermore, such an interpretative approach would not address obstacles resulting from divergences of national systems and procedures, and therefore would not lead
to a lean regulatory framework nor would it lead to a general enhancement of mutual trust.

Taking into account that they would not in the short to medium term substantially differ from the current situation, non-legislative measures are therefore discarded and will not be subject to further impact analysis.

5.4. **Legislative measures**

Whatever their nature and the associated procedural requirements, licences constitute a common feature of the diverse national schemes both for managing intra-community transfers and exports of defence-related products. Exporting and transferring defence materials implies States’ responsibility that is materialized by the issuance of licences. All Member States have retained this licensing option to secure reassurances on the likely use and final destination of defence-related products leaving their territory. These licences also promote transparency and allow for reporting requirements, for instance towards national Parliaments and NGOs. Any scheme implemented at Community level should at minimum preserve the prevailing degree of security and transparency.

The Commission could propose a legislative initiative to facilitate such intra-community transfers. It should be noted that, according to the afore-mentioned objectives (i.e. contribute to the establishment of an EDEM inspired by the internal market rules), national regimes regulating exports to third countries would not be affected by this instrument. National licensing schemes for such exports would remain in place, although Member States could eventually implement certain features of the simplified intra-community scheme to maximise synergies and cut costs.

5.4.1. **Creating a EU licence-free zone (option 3)**

Such an option would basically consist of a Community instrument prohibiting all national licensing schemes for the transfers of defence-related products. Such a tool should however provide for a kind of ‘safeguard clause’ reflecting the terms of the Treaty, notably Article 296.

In essence, such full liberalisation scenario would imply that defence goods should be treated in exactly the same way as any other manufactured good or service in accordance to the ‘normal’ internal market rules, and should thus be entitled to circulate within the Community almost without restriction.

By and large, the economic benefits of this option would mirror the corresponding costs of the ‘business as usual’ scenario.

Promoting a licence-free zone in the EU would however clearly go beyond what is politically achievable in the present context, with a common foreign policy still at an infant stage and uneven levels of trust concerning the watertightness of certain external borders. The issue of reexportation outside the EU would undermine such an approach insofar as Member States do not always share identical views on third countries, despite coordination efforts in the framework of the EU code of conduct on arms exports. Besides, full liberalisation even limited to intra-community transfers, would contradict current national and Community commitments taken in international control regimes (e.g Wassenaar, MTCR). Licensing is

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27 Missile Technology Control Regime. See http://www.mtcr.info
therefore still needed as the “vehicle” to carry possible reexportation limitations enacted by the Member States originating the transfer.

This option is therefore politically too unrealistic to deserve further detailed analysis. It is thus discarded.

5.4.2. Managing the issuing of intra-community transfer licences at EU level (option 4)

Under this scenario, the principle of licences for authorizing intra-community movements of defence goods would be kept (thus preserving the ‘guarantees’ associated to this tool), but the responsibility for issuing and managing such licences would be transferred to a centralized body, such as a dedicated Agency (possibly via the extension of the mandate of the European Defence Agency – such a move could however raise delicate institutional issues).

The advantages of such a scenario would be *inter alia* the setting up of a truly non-discriminatory and homogeneous regulatory framework, probable economies of scale resulting from the pooling of scattered authorities (although the budgetary authorities would obviously be different, the costs for implementing and running a Community Agency would clearly be lower than those related to the set of existing national/sub national licensing authorities).

During the consultation phase however, Member States unanimously and firmly rejected any such delegation of power to the Community sphere. Again, given that this scenario is clearly unacceptable for all Member States, the principle of proportionate analysis suggests not furthering this option, which is therefore also discarded.

5.4.3. Simplifying and approximating national licensing schemes (option 5)

On the basis of the above discussion, it appears that there is hardly any room for a Community instrument that would not maintain the principle where licences are issued on a national level basis. Similarly, it emerged during the consultation phase that the overall prevailing level of security interests protection should be maintained. Concretely, this implies that any facilitation of EU transfers should be complemented by measures fostering a climate of mutual confidence in the capacity of the recipient companies to respect possible export restrictions and, where appropriate, to provide evidence of such respect to their competent authorities.

Taking into account these prerequisites and constraints, there remains however substantial scope for rationalising and simplifying the currently complex and heterogeneous regulatory framework, whilst preserving the pursued legitimate security objectives. These simplification elements pertain to:

- the type of licence issued (A),
- the guarantees provided concerning the reliability of the recipients (B),
- the guarantees provided concerning the management of re-exportation to third countries (C).
5.4.3.1. Type of licence issued (option 5 Ax)

Currently most national licensing schemes primarily rely on individual licences, which are granted on request to authorise specific shipments in specific quantities concerning specified products to a precisely-identified recipient. Given their more restrictive nature, such individual licences are by far the most burdensome (and hence costly) type of licence. Moving towards a more systematic use of global or general licences would prompt substantial reductions in administrative costs associated to such controls.

A Community instrument could therefore stipulate that Member States use:

– general licences (A1) or
– global licences (A2) or
– a combination of general and global licences (A3).

5.4.3.2. Guarantees concerning the reliability of the recipients (option 5 By)

For national control authorities, the reliability of a recipient is first and foremost gauged at the light of its capacity to prevent undesired re-exportation to third parties or to demonstrate that it is the end-user of the transferred product.

Recipients of defence-related products belong to two different categories:

- Member States’ defence ministries buying arms, munitions, war material, plus related services (such as maintenance, repair including relevant spare parts and overhaul). As end-users, public contracting authorities in the EU are by definition reliable.

- Integrating companies: these usually produce large weapon systems incorporating components sourced from a supplier possibly located in another Member State (e.g. connectors to be incorporated in an aircraft). The final destination of the resulting equipment may not be in the EU. The reliability of the company thus becomes a crucial issue.

Moving away from the concept of individual licences necessarily implies a lower level of monitoring on individual consignments and, in the case of general licences, no prior identification of the recipients. Indeed, when it comes to transferring components under a general licence, the national authority, at the time it issues it, ignores which company will finally receive components covered by the licence nor does it know the final destination of the system incorporating the component. In order to preserve the degree of security under a simplified framework, the authority of the country of origin needs “guarantees” as regards the “reliability” of the recipient companies (e.g.: provide information on the end-user, comply with possible restrictions on the transferred component etc…).

This ‘quality insurance’ could be formalised in the form of the certification of the recipient companies, which would address issues such as:

– proven experience and reputation as producer or integrator of defence material,

28 See chapter 3.2.3 for the definitions of global and general licences.
– proven record of compliance to Community and national export rules, as well as all specific conditions related to end-use and re-exportation of received component or product,

– implementation and documentation of appropriate internal control programmes and structures (for example the appointment of a dedicated high-level executive officer, covering in particular export management controls),

– implementation and documentation of appropriate risk prevention measures to protect goods and technology (including intangible goods).

Whilst no certification at EU level represents the status quo (B1), certification of recipient companies of defence material could be made uniformly mandatory at EU level (B2). During the consultation phase, it however emerged that certain stakeholders were reluctant to impose mandatory certification to all defence companies, fearing that such a scheme would generate disproportionate administrative burden.

An alternative option would be to leave certification voluntary, but with some kind of associated ‘reward’. Conceptually, a defence certification is a means for a company to provide credentials as a trustworthy defence operator. Hence the logical idea of linking certification with the general licensing scheme, where the recipient company is unknown a priori to the authorities issuing the said licence (B3). Indeed, such reinforced guarantees associated to certification will provide an additional incentive to Member States to make the widest possible use of general licence, which is by far the least burdensome licensing scheme. As end-users, EU public contracting authorities provide satisfactory security guarantees, thus justifying the opening of general licensing for transfers to EU procuring governments.

5.4.3.3. Guarantees concerning the management of re-exportation to third countries (option 5 Cz)

The fundamental issue here is to give satisfactory assurance to the country of origin of a transferred product that the conditions that it might have attached to the transfer (e.g. “do not re-export the transferred product to countries X, Y and W without my prior consent”, “do not re-export to any third country the transferred component unless integrated into another product in such a way that it is not detachable”) will be respected by the recipient companies, should the product (or the component integrated into a more complex product) be re-exported. It is also important to keep in mind that most components lose their identity and/or sensitivity when integrated in larger systems, thus “deleting” the responsibility of the country originating the components.

Current controls on transferred components widely vary among Member States. As to the re-exportation of the final product, certain Member States largely delegate their responsibility to the country where the exporter is located. This is all the more acceptable that all EU Member States are coordinating their export policies in the framework of the EU Code of conduct on arms exports and have committed themselves to make this Code legally-binding as soon as some interpretative issues are clarified. By contrast, some other Member States explicitly require to be consulted, especially when the transferred component makes a substantial part of the final product. Different national practices can be explained by different transparency obligations and a different level of confidence towards receiving countries and companies.

There are basically two policy options to address this issue:
• **reporting and ex-post enquiries (C1):** the recipient of a transferred good would be required by Community law to inform its authorities on the respect of any export limitation attached to the product it intends to export outside the EU. Member States should implement effective enforcement measures to ensure that recipient companies are respecting any possible export limitation enacted by the Member State of origin before applying for an export licence.

• **double control with the implementation of an IT traceability system (C2):** A central database, accessible by the Member States authorities (including the customs authorities) would keep track of all licences and their eventual restrictions²⁹.

5.5. **Summary of options**

<table>
<thead>
<tr>
<th>Option 1</th>
<th>No action (business-as-usual scenario)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option 2</td>
<td>Non-legislative measures, taking the form of an interpretative Communication on Article 296 or actions aiming at exchanging best practices</td>
</tr>
<tr>
<td>Legislative instrument</td>
<td>DISCARDED</td>
</tr>
<tr>
<td>Option 3</td>
<td>Complete liberalisation of all defence-related products transfers</td>
</tr>
<tr>
<td>DISCARDED</td>
<td></td>
</tr>
<tr>
<td>Option 4</td>
<td>Management of intra-community transfers at EU level via an Agency</td>
</tr>
<tr>
<td>DISCARDED</td>
<td></td>
</tr>
<tr>
<td>Option 5</td>
<td>Simplification and approximation of national licensing schemes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Licence</th>
<th>Certification</th>
<th>Re-exportation</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1: General licence only</td>
<td>B1: No certification scheme at EU level</td>
<td>C1: Regulatory information requirements</td>
</tr>
<tr>
<td>A2: Global licence only</td>
<td>B2: Mandatory for all recipients of a transfer</td>
<td>C2: Traceability system based on a centralized database</td>
</tr>
<tr>
<td>A3: Global or general licence</td>
<td>B3: Optional certification: only certified companies (and EU governments) can source material transferred under a general licence</td>
<td></td>
</tr>
</tbody>
</table>

*Note*: Option 5 is made up of one of the sub-options for each column (Aᵢ+Bⱼ+Cᵢ). Sub-option B3 however conceptually only makes sense when combined with sub-option A3 – All other combinations are possible.

²⁹ See annex IV for an example of implementation for such a IT traceability system.
6. **ANALYSIS OF IMPACT**

Despite the theoretically wide set of possible options, it emerged from the analysis made in the previous chapter that, when bringing into the picture the constraints pertaining to the related overarching security dimension of the issue, the range of ‘politically acceptable’ options is significantly narrower. This chapter will evaluate the main direct and indirect incidences, from the social, environmental and economic perspectives, of the various sub-options that could frame a possible EU initiative for facilitating intra-Community transfers of defence-related products, compared with the business-as-usual scenario of ‘doing nothing’.

It should be stressed at the outset that, when it comes to defence and security matters or protection of human rights issues, “informed political judgement” will always continue taking precedence over purely economic quantification and optimization.

6.1. **No EU initiative**

6.1.1. **Direct and indirect costs associated to the existing obstacles to intra-community transfers**

The cost for preparing, submitting, and managing the 11,400 annual licence requests for intra-Community transfers represents a good proxy of the administrative burden associated to the current patchy regulatory landscape. Annex 2 (section E §1) provides the methodology, assumptions and detailed calculations for assessing the corresponding burden, which has been assessed at the level of **€ 433 million / year** (respectively € 251 mio for industry and € 182 mio for the public authorities).

However, indirect costs by far surpass such direct costs. Various studies have tried to assess this “cost of non-Europe”. The study carried out by Unisys for the European Commission in 2005 has estimated this indirect impact to be close to **€ 2.73 billion / year** (see annex 2 for details and comparison with other publicly available material).

6.1.2. **Likely industrial developments**

As noted earlier, refraining from tackling intra-Community transfers of defence-related products at Community level does not necessarily imply the persistence of the *status quo*:

- individual Member States, in particular those pursuing a pro-active Better Regulation agenda, keep all latitude to simplify their own licensing schemes. Such national simplifications however will not fundamentally improve the current fragmented and patchy EU regulatory pattern, hence making no contribution to the EDEM development;

- one can not fully exclude that (ongoing or future) initiatives developed in an intergovernmental context could achieve a genuine facilitation of transfers between a
limited number of participating countries (potentially embracing third countries). Experience with such intergovernmental arrangements however shows that:

- progress is extremely slow: albeit the most ambitious attempt to simplify transfers, the six-country LoI process has yet shown no tangible results despite its signature in 2000 and its full implementation since 2003.

- the potential of extending them to other EU Member States (especially the new ones) is very weak, since they have been designed for the specific needs of big producing countries and have high political barriers for newcomers. The LoI is indeed a comprehensive arrangement covering six different areas which are normally only of interest to producer countries. For potential candidate Member States, the political trade-off for joining the LoI solely to benefit from lighter transfer procedures is therefore high. It is therefore not astonishing that no other Member State has to date officially applied for joining the LoI club.

Consequently, whilst no breakthrough is to be expected in the short term, the most likely path of development in the medium to long term is a scenario where one of several clusters of trusted countries (e.g. the LoI) deal with the issue of transfers. As a result, deprived of the benefits of facilitated trade, industries located outside those “restricted clubs” will de facto be further marginalised, for example when it comes to bidding for participation in cooperative programmes. Such situation would hinder the exploitation of all European competencies and niche expertise (in particular those located in new Member States).

Excluded Member States will continue to see little complementary incentive to buy European defence-related products given that (a) their defence industry companies (mostly SME) will be less integrated in major defence programmes, and (b) the absence of any greater security of supply compared to alternative third country suppliers. This would go against reinforcing European solidarity as advocated, for instance, by the EDA\(^{30}\). On the contrary, the uncertainty for procuring authorities as to whether export licences are granted would continue to be a major obstacle for suppliers to access other defence markets in the EU: this uncertainty could still be used to discriminate non-national suppliers and thus have a negative impact on the effectiveness of the proposed defence procurement Directive.

The umbrella communication entitled “A Strategy for a stronger and more competitive European Defence Industry” provides an in-depth analysis of the rather bleak prognosis for the EU defence sector in the absence of appropriate policy measures to curb the “business-as-usual” scenario. It inter alia concludes that European industry will lose competitiveness and its role could be reduced to that of niche players and suppliers to mostly non-European prime contractors thereby jeopardising the industrial capacities to autonomously develop the capabilities needed for the European security and defence policy. Any such exclusion from the highest value-added market segments would also hit the returns available from European defence companies creating difficulties in attracting investment in competition with other, more profitable economic sectors.

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\(^{30}\) “Our ultimate aim is the achievement of equal confidence in security of supply from any part of Europe” (European Defence Agency’s EDTIB Charter, May 2007 – section “ensuring security of supply”).
6.1.3. Social impact

The cumulated effect of (i) increasing productivity and (ii) stagnating (or decreasing) government defence budgets (and thus purchases of equipment) experienced over the last 15 years is definitively not favourable to long-term employment in the sector.

The medium to long term trajectory for EU jobs derives by and large from the industrial policy scenario described above. If not halted, the progressive erosion of EU industry’s competitive edge will ineluctably negatively influence both the level and the quality of employment in the sector. In this regard, the current fragmentation of the Internal Market (and the protection that national firms and contractors continue enjoying) rather contributes to delay and damp the structural adjustments that would otherwise take place, should the sector be subject to more conventional internal market rules.

Given the level of uncertainty linked to the influence of external parameters (e.g. deterioration of the international climate, break up of crisis), quantification of social impacts would however constitute a highly speculative exercise.

6.1.4. Impact on the environment

There is anecdotic evidence of possible environmental impacts that can be directly attributed to intra-community barriers. Preventive oversized stocks built up to anticipate possible breaks in the supply chain when a specific material (the equipment itself, its spare parts and its ammunitions) is purchased in another Member State no doubt also tend to duplication of material indirectly implying a sub-optimal use of environmental resources. However, such impacts are deemed to be extremely marginal when compared to the overall “environmental footprint” of the defence sector (production of the defence product, training of the troops operating it, maintenance of the equipment, not to mention its possible use in operational conditions). It is therefore reasonable to assume the overall environmental impact of defence activities is primarily linked to the ‘consumption’ of military material (and hence to the global evolution of military budgets) and, as a second order parameter, to the evolution of the turnover of the corresponding EU industry (European companies’ market share is expected to grow both domestically and on third markets if its products are technologically up-to-date and competitive). Given the rather thin indirect relationship with intra-community transfers, the matter is not further investigated, and it can be safely concluded that no significant environmental net impact is to be expected from any Community action - or lack of action - as regards the facilitation of intra-community transfers.

6.2. EU legislative initiative to facilitate intra-community transfers

Facilitating intra-community transfers of defence-related goods is presumed to improve security of supply for procuring EU Member States and positively contribute to the EDTIB

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31 Under the Eurofighter cooperation programme, enterprises located in Northern Italy supply parts to partners located in Germany. As the destination is just a few hundred kilometres away, the most advantageous way of sending these parts would be by road using trucks. The problem is that the motorway crosses over Austria. If requested, Austria would most probably authorise the transit, but this would also imply further administrative burden and uncertain delays due to the involvement of a third country authority. To overcome this administrative obstacle, the parts are sent by special flight, which avoid flying over Austrian territory at a cost 6 times higher than road.
competitiveness by allowing better conditions for industrial specialisation, secured and smooth-operating supply chains and economies of scale.

Under this section, the cost efficiency of the various sub-options identified in Chapter 5 as regards the facilitation means (type of licence) and the guarantees (certification and re-exportation control) will be screened in detail. As for their social and environmental impacts, the analysis nevertheless remains at a more aggregated level, without distinguishing between these sub-options.

6.2.1. **Social and environmental impacts**

By itself, the removal of barriers to intra-community barriers is unlikely to lead to any significant direct impact of the level of employment:

- for national administrations: the shift from individual to global / general licences will undoubtedly lighten the administration’s routine management of intra-community transfers. However, as requests for intra-community transfer overall only represent about 1/3 of all licence requests (exports to third countries should in principle remain unaffected by the new Community instrument), reallocation of staff in the corresponding departments is expected to remain limited. It is more likely that resources freed from routine handling of intra-community transfers will be fruitfully re-affected to the handling of the most sensible exports.

- for defence companies: a simplification of intra-community transfers will mechanically reduce the need to prepare submissions for obtaining individual licences. Whilst some reduction in the corresponding clerical needs might be observed, the most significant impact is expected to be the reduction in executive time diversion (paperwork, contacts and negotiations with competent authorities). Consequently, the net impact on employment is deemed to be very low.

By contrast, indirect impacts are expected to be more significant, notably in the medium and long term. The macroeconomic reasoning underpinning the internal market for goods is by and large transposable *mutatis mutandis* to defence-related goods. The creation of a pan-European Defence and Technological Industrial Base could in the short term lead to rationalisation of structures, and hence, job cuts in redundant programmes and in poorly-competitive companies that mainly owe their survival to the fragmentation of markets along national line. Certain uncompetitive locations might have to close, causing unemployment and other economic and social costs in the country/location concerned. Steps would need to be taken at national level in order to mitigate the social costs for the loosing companies and regions and their workers, for example through industrial policy and labour market measures. Such restructuring is however a prerequisite for keeping the EU defence industry abreast of technological developments, a necessary condition both for being able to face the competition of new entrants (Brazil, India…) and to avoid any further widening of the technological gap with its most advanced competitors (notably the US). The reinforcement of its competitiveness would in turn better profile it both on the domestic market and on third markets.

An outlook can be inferred from the civil aeronautic sector where employment grew following successful consolidation (Airbus for large aircrafts, ATR for turbo propellers, Eurocopter for helicopters…). Such comparison must however be viewed with some caution as the European civil aeronautic sector benefited at the same time from a steady global
demand. Restructuring nevertheless enabled the sector to efficiently meet such demand in a context of fierce competition.

Quantification of the net impact is extremely difficult in military matters because the overall social impact depends on many more decisive factors, the combination of which is hardly predictable (procurement, state aids, ongoing redundancy of weapons programs or rationalisation, evolution of military budgets...). A major international crisis, for example, could boost defence budgets. In other words, defence markets are driven by a great variety of factors, which makes it by definition almost impossible to measure the economic impact of one specific legislative measure in one isolated area.

As already explained above, no significant environmental net impact is to be expected from any action - or lack of action - of the Community as regards the facilitation of intra-community transfers.

6.2.2. Easier outsourcing for the main benefit of SMEs

It is widely acknowledged that EU SME’s current industrial defence capabilities are not fully exploited. Among the factors explaining such under-exploitation are the long delays needed for reorganizing supply chains and the lack of mutual awareness of both suppliers and system integrators (whose working methods and legal obligations have long compelled to domestic-oriented outlooks). But burdens on transfers however also play a role. Smoother and more predictable transfers will incite defence system integrators to outsource the production of certain sub-components to specialised SMEs with niche capabilities rather than to resort to in-house developments. In terms of regional distribution, such outsourcing by system integrators to subcontractors could not only benefit to EU-15 small defence-industry Member States but also represent genuine opportunities for SMEs located in the new Member States. For instance, niche capabilities in these new Member States have now emerged as subcontractor in the civil aeronautics sector.

Furthermore, SMEs are expected to greatly benefit from facilitated intra-EU transfers: SMEs are indeed typically disproportionately affected by licensing burdens, given, that they have more limited resources and expertise to tackle with complex rules.

6.2.3. Foreign trade impact

6.2.3.1. A comparative advantage to EU defence-related products in terms of security of supply

Facilitating intra-community transfers could provide European system integrators with a further incentive to work with EU rather than third-country suppliers because of the improved guarantee on security of supply when they source components in the EU. This would be consistent with current efforts of some EU defence companies to promote “ITAR-free” defence items in order to elude the complexity and restrictive impacts of US ITAR rules, and thereby enlarge their access potential on third markets (see also 3.2.6). This is also mirrored in the EU governments’ new momentum looking for greater autonomy\(^{32}\).

\(^{32}\) See the European Defence Agency EDTIB Strategy adopted in May 2007 by the EU ministers of defence: “This EDTIB must also be more closely integrated with the wider, non-defence European technological and industrial base, with less European dependence on non-European sources for key defence technologies ».
6.2.3.2. The ITAR burden mostly lies in complete systems

It has been objected that facilitated intra-EU transfers could bump against ITAR restrictions, thereby damping the facilitation potential. However, ITAR rules essentially concern final weapons systems that account for a slight minority of intra-EU transfers (the probability that a transferred good includes a US ITAR-flagged component grows with the number of components and technologies that it integrates, and is thus higher for complete weapon systems). Conversely, transfers of components are little affected by ITAR rules (unless the component itself stems from an US supplier).

6.2.4. Type of licence

In spite of isolated simplification initiatives undertaken at national level, the bulk of intra-community transfer licences remains largely based on individual licences. Imposing lighter authorisation schemes would substantially reduce the corresponding administrative burden, whilst meeting the legitimate security objectives.

6.2.4.1. Option A1: general licence only

General licenses, or national general authorisations, provide for a simplified procedure for the export of controlled goods to certain destinations. Such licences are promulgated in a legal or administrative general act. The scope, the possible use conditions and any potential destination restriction are specified within the license itself. Any exporter fulfilling the prescribed conditions can avail itself of the authorisation to perform the corresponding transfer without further prior administrative demarche.

Interviews with the Member States have shown that most countries do not provide for this type of license and that some of those which have foreseen this type of licence do not use it in practice. The United Kingdom, however, is widely implementing general licensing for military goods under Open General Export Licences (OGELs). These OGEL allow the export of specified controlled items by any exporter, removing the need for them to apply for an individual licence, provided the shipment and destinations are eligible and the conditions\(^{33}\) are met. All OGELs remain in force until they are revoked.

Under this scenario, general licences would de facto substitute the more than 11,000 annual licences associated to intra-community transfers (if we ignore the occurrences of clearly identified transfers where Member States would still invoke - and duly justify - an exemption under Article 296 of the Treaty).

\(^{33}\) Typical conditions include:
1) Exporters cannot use the licence if they have been informed by a competent authority that the goods are or may be intended or used in connection with the development of chemical, biological or nuclear weapons or the development of missiles capable of delivering such weapons;
2) Exporters cannot use the licence if they know or have grounds for suspecting that the goods may be intended for the uses aforementioned;
3) Exporters must register with the national control authorities;
4) Exporters have recordkeeping obligations (date and destination of exports, name and address of recipients, descriptions of the exported goods…) usually for a six-year duration;
5) Exporters must indicate on their official and commercial export documentation accompanying the goods a note stating that “the goods are being exported under the (relevant) OGEL”, this documentation shall be presented to Customs if so requested.
On the other hand, the preparation, adoption and enforcement of general licenses also involve some legislative and enforcement costs both for national authorities as well as certain compliance costs for companies. Given on the one hand the variety of legal and administrative traditions in Member States and, on the other hand, the impossibility to foresee at this stage the degree of details and the number of such general licences, quantification of this legal and administrative work is hardly possible. The corresponding costs are however deemed to be negligible in comparison with the current bulk of individual licences’ applications and processes.

Consequently, the direct gain for industry can broadly be assimilated to the administrative burden associated to the corresponding individual licences (see option 1), i.e. an annual benefit capped at € 251 mio. minus the cost of implementing possible additional control provisions linked to general licensing (e.g. notification to the authorities at the first time a company makes use of a general licence, requirement to affix to the transport document a reference to the specific general licence used for that shipment for the customs authorities, recordkeeping obligations, etc).

As far as public authorities as concerned, the potential annual gain would be in the area of € 182 mio minus the regulatory / legislative work associated to drafting and publication of those general licences. The shift from individual prior authorisations to a general “prior consent regime” might also entail some slightly higher control and enforcement costs (for example at the customs point).

This option of general licensing only might raise proportionality issues for those Member States having a limited defence industry sector, as the obligation to issue a set of general licences might indeed exceed the cost of issuing individual licences.

Another question mark relates to the ability of such general scheme to satisfactory cover any transfer of defence-related products, notably the most sensitive ones. As a matter of fact, at the time it issues a general licence, the national authority ignores a priori the identity of the recipients of the products covered by the licence. A framework relying exclusively on general licences does not seem to provide Member States with the necessary flexibility when it comes to discriminating recipient companies according to the guarantee they offer against possible misuses or re-exportation of the transferred products. As a consequence, such a scenario could lead to a non-negligible rate of cases where Member States would invoke the exceptions provided under Article 296.

6.2.4.2. Option A2: global licence only

Global licences are company-specific prior authorisations for shipping specific products (typically the products listed in the company’s catalogue) to one or several specified recipients. Their main simplification potential resides in the fact that they are not specific to a precise shipment and thus can be used several times to covers similar transfers. Global licences are typically not associated to quantitative limits and are valid over a relatively long period (typically 2 or 3 years). They are particularly helpful in the case of routine shipments of equipments to habitual customers or for SMEs with a limited catalogue.

Experience in certain Member States has shown the substantial simplification potential of global licences schemes. France has for example introduced in 2002 the option of global licences based on the catalogue of the participating companies (targeting more specifically SMEs). The first 35 licences delivered replaced not less than 1.250 individual licences, thus
representing a red-tape cut by a ratio of 36. Similarly, during the preparatory phase, Romania quoted its national experience where 7 global licences have replaced over 700 individual licences.

The level of aggregation of publicly available data (notably via the annual report of EU Code of Conduct of Arms Exports) does not however provide the necessary elements to assess with reasonable accuracy the ‘compression rate’ achievable with the substitution of all individual licences by global licences. Such calculations would indeed require access to detailed confidential information about individual transfers. What can be reasonably assumed is that the red-tape gains will substantially differ according to each Member State. Logically, these gains will be minimal in those Member States that have already introduced - and are making a standard use of - such simplified global licence schemes, whilst a reduction of the number of licence by at least a factor 10 could reasonably be expected in those Member States starting from scratch. In this context, the assumption of a 50% reduction of the overall associated administrative burden appears to be a very conservative minimum figure.

The main drawbacks of this ‘global licences only’ scenario lie:

– in the risk that certain Member States define in such restrictive terms their global licences that these remain in essence very close to individual licences. There is nevertheless little reason to fear such abuses, as a Member State acting so would necessary place its own industry into a difficult competitive position for no reason;

– in the risk of obliging those Member States which are already making a wide use of general licence to backtracking.

Compared to option A1, a much more limited number of Article 296 case should arise given the higher potential of control available to Member States authorities under this scenario.

6.2.4.3. Option A3: combination of A1 and A2

This intermediary scenario presents the dual advantage of delivering the full benefits of the general licence option for routine non-sensitive intra-community transfers, whilst providing at the same time the necessary flexibility for Member States to handle more sensitive transfers. It also addresses the main drawbacks related to the mandatory ‘one size fits all’ models described in scenarios A1 and A2.

The exact ratio between global and general licences seems difficult to anticipate at this stage. The figures provided for in scenarios A1 and A2 can nevertheless be considered as providing the range of potential direct gain under scenario A3.

6.2.5. Certification

Certification of recipients companies can contribute to the facilitation of intra-community transfers, in so far as this tool provides Member States with ‘guarantees’ concerning the recipient company experience in defence activities, its record of compliance to relevant legal requirements (notably in the field of re-exportation), the reliability and quality of its internal control programmes and structure. In particular, certification acknowledges that appropriate risk prevention measures are implemented to protect goods, including intangibles (technologies, know-how, software, ...).
The specificity of a Community legal instrument is to make possible the adoption of common certification conditions across the whole territory of the Union. In other terms, a certified enterprise could be located in any EU country without being considered as less safe because of its location. For such enterprises, a certification would be extremely precious as one would expect them to deploy best efforts to maintain their reputation and business.

Certification could also contribute providing the US with greater assurance against the risk of illicit technology transfer, thus enhancing better mutual trust. Indeed, certification would inter alia cover traceability and reporting on re-exportation to the Member State of origin, issues considered by the US authorities as prerequisites for any softening of ITAR rules (a limited set of countries currently benefit from a ITAR relaxation and the US industry is in favour of introducing more flexibility in the US export regime34). A credible European regulatory framework could therefore indirectly help convince the US authorities that EU certified companies are reliable partners offering satisfactory guarantees on the proper end-use of US products.

The concept of certification is widespread in industry35, whether for attesting the generic quality of management system (ISO 9001, ISO 14001) or more specific aspects (such as information security, food safety, airplanes…). However, there is currently no ISO certification specifically dedicated to defence industries or addressing the specific aspect of transfers of defence goods. More widely, the principle of certification has been applied by European authorities to custom control in general with the current implementation of “Authorised Economic Operator” (AEO) granted by Member States customs authorities based on common criteria (compliance with customs requirements, a satisfactory internal management system, solvency and security standard where appropriate)36. Certification generally results from a voluntary demarche, as benefits (linked to efficiency, quality and reputation improvements) are deemed to widely outweigh the costs of implementing a quality management system and the cost of the certification process itself. Certification can also be granted by independent certification bodies, themselves accredited by a national accreditation body.

Furthermore, in most Member States, defence companies are already de facto or de jure undergoing - in one form or another - certification procedures in order to be allowed to perform their activities. For example, French companies must obtain a “licence for manufacturing and trading – autorisation de fabrication et de commerce” whilst UK companies are invited to implement a “compliance program for exporters”. As a consequence, any new EU certification scheme would most probably either fit within, or supersede existing national requirements (so as to avoid a double layer of certification), thereby reducing the net cost of the new scheme. A dedicated certification process could either be directly performed by the national competent authorities, or delegated to accredited parties.

34 US defence companies are advocating for a certified (domestic and foreign) company licensing program in which the US administration should, on the one hand, consider developing the certification of defence companies implementing an internal compliance program and, on the other hand, grant corresponding benefit in terms of simplified licensing procedures. See http://www.securityandcompetitiveness.org/
35 According to industry (ASD), 87% of defence industry companies are certified under ISO9001.
Given that the size of an enterprise is not a relevant indicator of the sensitivity of a transferred good (especially in the fields of new technologies, cryptography …), it seems inappropriate to set up different certification levels, thereby also giving the impression that there are different levels of trust.

6.2.5.1. Option B1: No EU certification scheme

The sub-option in essence corresponds to the status quo: the matter remains a national policy issue (national mandatory requirements, such as licences for manufacturing) or a business choice (quality management systems). No harmonised criterion is defined at EU level regarding the “reliability guarantees” applicable to defence companies. Mutual trust is of course not enhanced with this sub-option, given that no mutual recognition exists between the various national schemes.

6.2.5.2. Option B2: Mandatory certification

Under this sub-option, all recipient companies participating in simplified intra-community transfers would be required to be certified on the basis of harmonised criteria.

As the purpose of certification is to provide assurances about the recipient’s reliability, there is conceptually no need to extend the obligation to the “originator” (this should remain a national policy matter). This should make life easier for SMEs and occasional suppliers.

Whilst, in one form or another, certification of defence companies is already a reality in several Member States, quantification is not an easy task, given the obvious lack of publicly available data on such rather confidential matters. Company size is an obvious parameter influencing certification costs.

As such certification procedures share many common characteristics with existing quality system management, the cost estimation will be based on available data associated with ISO 9001 certification. Whilst the latter clearly does not satisfactorily cover all defence related concerns, given that about 87% of the 2000 ASD members are already ISO 9001 certified, the specific compliance conditions related to ICTDP could be seen as a complement rather than a new set of completely brand new requirements.

The average certification cost for ISO 9001 is in the area of 7,500 Euro per certificate. The total cost of certification is however significantly higher as the process also often involves certain organisational and processes modifications, training of employees, the setting up of documentation systems, etc.

On the basis of information gathered during the consultation phase and contacts with relevant industry stakeholders, and taking into account that there is a large diversity in terms of complexity of the processes to certify (depending on the company size, the supply chain structure,…), the average net certification cost is estimated in the area of € 30,000 per company in charge of export/transfer licensing (for a company already certified under ISO 9001). Assuming a validity of 3 years for a certification, this represents an annual cost of

37 www.iso.org/
38 According to a 1996 Quality Systems Update survey, the average cost of ISO certification for small firms (those registering less than $11 million in annual sales) was above 50,000 Euro ($71, 000) http://www.answers.com/topic/iso-9000.
about €10,000 EUR. This estimate should however be taken with some caution, given industry stakeholders’ difficulties to provide a clear picture on cost implications of certification schemes.

ASD represents over 2000 aeronautics, space and defence companies in Europe. This figure should be seen as an upper limit, given that all these companies are not active in the military sector (some only produce dual use equipments) and that all are not necessarily involved as recipients companies in ICTDP. This figure of 2000 companies will be used for the calculations.
The maximum net total cost for mandatory certification is therefore estimated at €25 mio\textsuperscript{39}.

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<th>All companies are certified (max 2000 enterprises)</th>
<th>Yearly cost</th>
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<td>€ 25 million</td>
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Based on common criteria, certification would increase mutual trust between authorities and stakeholders at a moderate net administrative cost.

6.2.5.3. Option B3: Optional certification

Under this option, certification is linked with the general licensing scheme. The additional guarantees pertaining to certification will provide an additional incentive to Member States to make the widest possible use of such licences, which is by far the least burdensome one.

It is impossible to forecast at this stage the proportion of companies that would undergo optional certification to benefit from the general licence scheme advantages. For companies, the decision of whether to opt for certification or not will depend on economic trade-offs. The main parameter influencing this choice is no doubt the prevailing industrial position. An integrator assembling a large number of components will have an incentive to organize its supply chain according to simplified licences. Conversely, a SME mainly involved in the civil market and delivering few military components on a case-by-case basis, will see no incentive to certification. Furthermore, it is not excluded that certain Member States with align their national requirements to fit the harmonised ones, and make these mandatory for all defence companies on their territory.

Accordingly, the cost figure for this scenario is within the range between no additional cost (i.e. no additional company is interested in undergoing certification) and the cost figure identified under scenario B2.

\textsuperscript{39} Detail of calculation : 2000*\((87\%*€30000)+13\%*(€30000+€50000))\div 3 = € 24,3 mio
6.2.6. Re-exportation

The core issue is to ensure that any re-exportation restriction emitted by the authority of the country of origin of an ICTDP “follows” the transferred good, so as to ensure that when possibly re-exported to a third country (as such or integrated as part of a more complex good), these re-exportation restrictions are known (and enforced) by the receiving company.

6.2.6.1. Option C1: regulatory information requirements

This option implies that goods flagged with re-exportation restrictions are handled accordingly by the receiving company. This means in particular that, when applying for a re-exportation licence, the receiving company informs its authorities on the respect of any re-exportation restriction enacted by the Member State of origin (e.g.: “consultation requirement if re-exportation to non NATO countries”).

Compliance by itself to the terms of a re-exportation restriction does not generate additional costs, as compared to the current situation: if for example re-exportation is conditioned to prior consent of the country of origin authorities, the corresponding costs associated with securing such consent already exist in the absence of any community scheme.

The only additional requirement provided for by the Community instrument would be the obligation for companies to provide evidence to the authorities that any possible re-exportation restriction linked to the good intended for re-exportation has been lifted. Despite the fact that components progressively lose their sensitive character when integrated in more
complex systems, it is reasonable to assume that information about the composition of an assembled product is readily available without any additional cost to companies.

In the absence of precise data, a series of assumptions are needed to estimate the maximum administrative burden associated to the corresponding requirement. If we take the extreme hypotheses that:
- gathering and including the necessary information for a re-exportation dossier requires 30 additional minutes,
- a re-exportation provision is associated to every relevant ICTDP (ICTDP to companies\(^{40}\)),
- every relevant ICTDP subsequently generates on average 5 requests for re-exportation of the transferred good,

and using the same hourly cost parameter as previously, then the maximum administrative burden is \(€ 2,5\) mio\(^{41}\).

Member States will have to determine effective measures to ensure that companies respect the possible export limitations attached to a defence related product after its transfer. Given that all Member States already have in place legislation concerning illegal exports of defence-related products, such a provision of the Community act is deemed not to entail new enforcement costs.

6.2.6.2. Option C2: IT traceability system

Under this scenario, a central database, interlinking defence operators and Member States authorities, would keep track of all licences and their possible restrictions.

A computerised traceability of transfers would in essence imply the following\(^{42}\) (the corresponding estimated costs derive from expert judgement as well as experience gathered in the area of e-Customs developments):

- the development of a central application (at least € 3 million of investment);
- the connection to the system with the necessary security and data protection modules of all participants (suppliers and integrators = least 2000 enterprises): on the basis of € 50,000 per enterprise, this amounts to € 100 million;
- the interlinking between national interfaces of EU-27 authorities: using the figure of € 200,000 / Member State, this represents € 5.4 million Euro;
- the human investment (training, …) which is important for both 2000 enterprises and 27 governments: €120 million;

\(^{40}\) Whilst EU governments are the destination (and therefore the end users) of about 70% of ICTDP transfers (in value), their share as destination in terms of percentage of licences is unfortunately not available. In principle, only transfers to non-government recipients should be taken into account for the calculation of possible re-exportations.

\(^{41}\) Detail of calculation: 85,5 (€/h) * ½ (h) * 11500 (ICTDP) * 5 (re-exportation/IC licence)

\(^{42}\) See annex IV for an example of implementation for such a IT traceability system.
Assuming a 5 years amortisation period for these investments, then the yearly cost is in the area of € 45 million.

Operational annual costs must be added (declaration of transfers, declaration of reception, control of quantities, follow-up of component integration, maintaining trained staff). Assuming a figure of € 20.000 per year and per participant, this adds another € 40 million.

Implementing a common traceability system therefore roughly represents a yearly cost of € 85 million.

7. **COMPARING THE OPTIONS**

7.1. **Summary table**

The table below summarizes the impacts of the various scenarios:
### TABLE OF COMPARISON OF OPTIONS

<table>
<thead>
<tr>
<th>Impact on obstacles</th>
<th>Impact on security</th>
<th>Net costs and benefits (compared to reference scenario)</th>
<th>Social and Environmental Impacts</th>
<th>Industry competitiveness</th>
</tr>
</thead>
<tbody>
<tr>
<td>No action undertaken at EU level (Status quo)</td>
<td>0</td>
<td>0 (Reference scenario)</td>
<td>o Increasing labour productivity combined with stagnating defence budgets and limited new opportunities on third market define a rather unfavourable long-term path for employment (job losses unavoidable, but damped by fragmentation shelter)</td>
<td>o Fragmented structure along national lines remains – Necessary consolidation delayed o Risks increasing discrimination between operators covered by an intergovernmental arrangement and other EU operators. o Makes integration of SMEs from new MS in prime contractors’ supply chains more difficult. o Gradual technological decline (critical mass insufficient) – Progressive exclusion from the highest value-added market segments. o Resulting progressive erosion of competitiveness, sanctioned by loss of market share in both EU and third countries.</td>
</tr>
<tr>
<td>Legislative initiative Licence</td>
<td>Impact on obstacles</td>
<td>Impact on security</td>
<td>Net costs and benefits (compared to reference scenario)</td>
<td>Social and Environmental Impacts</td>
</tr>
<tr>
<td>--------------------------------</td>
<td>---------------------</td>
<td>--------------------</td>
<td>--------------------------------------------------------</td>
<td>--------------------------------</td>
</tr>
<tr>
<td>A1: General licence only</td>
<td>+++</td>
<td>--</td>
<td>Direct benefits:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>€ 433 million / y</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>(a high rate of Article 296 exemptions might reduce benefits)</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Indirect benefits:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>up to € 2,73 billion / y</td>
<td></td>
</tr>
<tr>
<td>A2: Global Licence only</td>
<td>+</td>
<td>+</td>
<td>Direct benefits:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Higher than €217 million / y</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>(a lower Article 296 exemption is expected)</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Indirect benefits:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Lower than for A1 scenario</td>
<td></td>
</tr>
<tr>
<td>A3: Mix A1 / A2</td>
<td>++</td>
<td>+</td>
<td>Direct benefits:</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Within the range of scenarios A1 and A2</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><em>(i.e. between € 217 mio / y and 433 mio / y)</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Social impact</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Direct impact</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Limited direct impact from the removal of intra-community barriers <em>(some job losses to reduction of clerical work + reduction of executive time diversion)</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Limited reallocation of staff in national administrations <em>(thereby allowing for a better focus on most sensitive exports)</em></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Indirect impact</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o In the short term: industrial rationalisation lead to job cuts in redundant programmes and poorly competitive companies currently sheltered by EU fragmentation</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o In the long run: improved competitiveness should have a positive impact on employment</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Possible high-tech innovation in defence industries transferable to civil industries.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Environmental impact</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o No significant environmental impact expected from any facilitation of intra-community trade</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Direct impact</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Reduced administrative burden</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Improved security of supply will facilitate sourcing from another Member State, hence giving an advantage to EU defence-related products vis-à-vis third-country products.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Optimization of supply chains for system integrators</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Greater incentive to outsource to specialised SME with niche capabilities.</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>o Progressive restructuring of EU defence industry across national borders, with a view to creating a consistent European Defence Industrial Base</td>
<td></td>
</tr>
<tr>
<td>Certification</td>
<td>Impact on obstacles</td>
<td>Impact on security</td>
<td>Net costs and benefits (compared to reference scenario)</td>
<td>Social and Environmental Impacts</td>
</tr>
<tr>
<td>---------------</td>
<td>---------------------</td>
<td>--------------------</td>
<td>--------------------------------------------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>B1: No EU certif.</td>
<td>0</td>
<td>0</td>
<td>No cost impact</td>
<td></td>
</tr>
<tr>
<td>B2: Mandatory certification.</td>
<td>+</td>
<td>++</td>
<td>Estimated cost = € 25 million About 2000 companies concerned. Possibly disproportionately costly for SMEs involved in occasional / lowly sensitive transfers</td>
<td></td>
</tr>
<tr>
<td>B3: Optional certification</td>
<td>+</td>
<td>+</td>
<td>In the range between € 0 to € 25 million</td>
<td></td>
</tr>
<tr>
<td>C1: Info. requirements</td>
<td>0</td>
<td>+</td>
<td>max € 2,5 million</td>
<td></td>
</tr>
<tr>
<td>C2: IT traceability system</td>
<td>0</td>
<td>++</td>
<td>Initial one-shot investment of about € 225 million Annual cost in the areas € 40 million</td>
<td></td>
</tr>
</tbody>
</table>
7.2. Preferred option

There is growing understanding amongst stakeholders and public authorities that the energy spent in controlling ICTDP is becoming disproportionate to the actual control needs, and that these obstacles hinder the establishment of an EDEM.

Relying on individual national initiatives or on the inter-governmental route for tackling ICTDP outside the Community first pillar context entails considerable discrimination risks not only contrary to the letter and spirit of the Treaty, but also counterproductive for the defence sector and tax-payers long term interests.

Given the particular sensitivity of the products at hand and the still infant nature of EU external policy, it emerged at the outset from the analysis that:

– licences should remain the backbone of any Community scheme, and
– guarantees (in particular in relation to the issue of re-exportation) need to be provided to Member States to balance the facilitation of intra-community movements.

Basing the EU scheme on both global and general licences (option 5 A3) seems to constitute the most adequate compromise between the efficiency objectives of the measure (i.e. meeting the objective of genuinely facilitating ICTDP) and the required flexibility for Member States to fine-tune possible re-exportation restrictions on the most sensitive products.

EU certification of recipient companies appears to constitute a powerful means of raising mutual confidence at minimum marginal cost. Should mandatory certification (option 5 B2) be considered as disproportionate (notably for SMEs), option 5 B3 (linking general licence and certification) could then represent an efficient confidence-building incentive for Member States to make the widest possible use of the least burdensome licences.

Finally, as regards re-exportation control, a double control IT traceability system (option 5 C2) would manifestly generate significant burdensome new obligations for both companies and administrations. In the absence of decisive demonstrated advantages over option C1 (information requirements and effective enforcement policy), the latter should be deemed as more cost-efficient.

To sum up, the preferred scenario would consist in a scheme based on a combination of both global and general licences, the latter being specifically intended for products sourced by certified receiving companies and by EU procuring governments. The EU legal framework would provide the necessary safeguard against undesired re-exportation.

<table>
<thead>
<tr>
<th>Option 5</th>
<th>Simplification and approximation of national licensing schemes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Licence</strong></td>
<td><strong>Certification</strong></td>
</tr>
<tr>
<td>A3: Global or general licence</td>
<td>B3: Optional certification: only certified companies (and EU governments) can source material transferred under a general licence</td>
</tr>
</tbody>
</table>
Combining the estimates of the corresponding sub-scenarios leads to an estimated net benefit in administrative burden comprised in a range stretching from €190 mio and €405 mio/year. Furthermore, the expected indirect benefits of simplified transfers as a contribution to a well functioning European Defence Equipment Market and a strong European Defence Technological and Industrial Base are deemed to considerably exceed these direct net benefits.

Similarly, direct social impacts are expected to be minimal, whilst by contrast, indirect impacts are likely to be much more significant. The strengthening of a pan-European Defence Technological and Industrial Base could in the short term lead to rationalisation of structures, and hence, job cuts in redundant programmes and in poorly-competitive companies. Such restructuring is however a prerequisite for keeping the EU defence industry abreast of technological developments, a necessary condition both for being able to face the competition of new entrants and to avoid any further widening of the technological gap with its most advanced competitors. This strategic option of better integration and specialization offers the best guarantee to maintain or develop, both in qualitative and quantitative terms, employment in the medium to long run.

Finally, this framework should entail no perceptible environmental impact.

8. Monitoring and Evaluation

Any Community instrument established to facilitate ICTDP will require implementing measures. Member States will have to adapt their legislation accordingly, for instance in order to provide for appropriate provisions on certification and global / general licences. These national implementing measures will need proper monitoring by Commission services, first to check compliance with Community rules, and secondly to organise transparent information exchanges amongst Member States.

In the mid term, the Commission should assess the functioning of the new EU simplified regime, with special attention on administrative costs. One robust indicator for monitoring progress towards intra-community trade facilitation could be the number of intra-EU licences yearly issued by Member States. Such data is published in the yearly report of the EU Code of conduct on arms exports.

Given the rather long life cycle of defence equipments, changes of government procurement practices and reorganisation of industrial supply chains should not be expected to take place overnight. The yield of greater security supply remains a rather subjective feeling, and time is therefore an essential parameter for forging mutual confidence. The indirect benefits pursued by the facilitation of ICTDP can therefore only be harvested over the long run.

Evaluation of these broader macroeconomic impacts should thus be conducted over the same time horizon, probably not sooner than 6 years after entry into application of the Community instrument. Such an evaluation should inter alia assess the impact on the EDEM reinforcement and assess the instrument’s contribution to a well-performing EDTIB.

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43 Benefits (scenario A3) – cost (certification B3 & re-exportation information requirements C1)
ANNEX I The EU defence industry

The EU defence industry is composed of a diverse range of industries and businesses providing products and services to the EU and Member States, both for national security purposes and to provide the necessary support to international organisations such as the UN and NATO. Member States have recently been involved in the stabilisation process in Bosnia Herzegovina conducted by EUFOR and individually within international peacekeeping contingencies established in Afghanistan and Lebanon.

The demands of modern military units often push current technological boundaries, with the defence industry increasingly regarded as one of the principle high-tech industries in the EU, providing advanced technologies, which can spill over into civil applications. Dual-use goods have evolved, exhibiting both civil and military properties, although originally developed for the defence sector. Over time, the take-up of such technologies by the civil market often becomes dominant, providing important knock-on employment and value added affects throughout the EU economy. Examples include satellite communications and the internet, both of which have been critical in the economic development of the EU in recent decades. For these reasons, it is important to evaluate the defence industry not just in terms of strategic military and defence objectives, but also in terms of its wider economic and social impacts accruing from innovation, employment and the associated high skills base.

With so many different product and market segments across the traditional defence industry and supplied via commercial companies, it is difficult to accurately define the defence equipment and services market. The sectors of the EU defence industry can be most simply categorised into four sectors: aeronautics; space; land; and naval defence.

In addition to these main sectors, there are other components necessary for the complete manufacture of a defence platform which are referred to as ‘sub-systems’. Sub-systems include the defence electronics, electronic warfare, radar/sonar and propulsion systems used in aeronautics, space, land and naval defence systems.

As with most industries, products designed and produced for a specific purpose can often be procured and applied to similar markets. Military defence equipment is no different, as protective clothing, bomb detection devices and armoured equipment are also used by security organisations in the civil sector, including police forces and private security companies. With the advent of more protective and anti terrorism equipment common to both the military and civil sectors, market definitions and associated statistics have become increasingly blurred.

a) Global Military Expenditure

Globally, military expenditure totals €800 billion per year. Of this, the USA accounts for nearly half (48%) with the EU-25 accounting for 20% (€180 billion). Further detail on those countries with the greatest expenditure is provided in Table 1.
Table 1: World Defence Expenditure by Country 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Spending ($ billion)</th>
<th>Spending per Capita ($)</th>
<th>World Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Spending</td>
</tr>
<tr>
<td>1</td>
<td>USA</td>
<td>478.2</td>
<td>1,604</td>
<td>48</td>
</tr>
<tr>
<td>2</td>
<td>UK</td>
<td>48.3</td>
<td>809</td>
<td>5</td>
</tr>
<tr>
<td>3</td>
<td>France</td>
<td>46.2</td>
<td>763</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>Japan</td>
<td>42.1</td>
<td>329</td>
<td>4</td>
</tr>
<tr>
<td>5</td>
<td>China*</td>
<td>41.0</td>
<td>31</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>Germany</td>
<td>33.2</td>
<td>401</td>
<td>3</td>
</tr>
<tr>
<td>7</td>
<td>Italy</td>
<td>27.2</td>
<td>468</td>
<td>3</td>
</tr>
<tr>
<td>8</td>
<td>Saudi Arabia</td>
<td>25.2</td>
<td>1,025</td>
<td>3</td>
</tr>
<tr>
<td>9</td>
<td>Russia*</td>
<td>21.0</td>
<td>147</td>
<td>2</td>
</tr>
<tr>
<td>10</td>
<td>India</td>
<td>20.4</td>
<td>18</td>
<td>2</td>
</tr>
<tr>
<td>11</td>
<td>South Korea</td>
<td>16.4</td>
<td>344</td>
<td>2</td>
</tr>
<tr>
<td>12</td>
<td>Canada</td>
<td>10.6</td>
<td>327</td>
<td>1</td>
</tr>
<tr>
<td>13</td>
<td>Austria</td>
<td>10.5</td>
<td>522</td>
<td>1</td>
</tr>
<tr>
<td>14</td>
<td>Spain</td>
<td>9.9</td>
<td>230</td>
<td>1</td>
</tr>
<tr>
<td>15</td>
<td>Israel</td>
<td>9.6</td>
<td>1,430</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Other Countries</td>
<td>161.2</td>
<td>-</td>
<td>16</td>
</tr>
<tr>
<td></td>
<td>World Total</td>
<td>1,001</td>
<td>155</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: SIPRI Yearbook 2006, www.sipri.org - note figures for China and Russia are estimates

b) EU Military Expenditure

For the EU-25 as a whole, military expenditure has remained relatively constant over the past decade at around €180 billion per year. With reference to the data presented in Table 2, it can be seen that 80% is accounted for by the expenditure of the larger countries (UK, France, Germany, Italy and Spain). Across the EU-25, most countries now spend between 1.2 and 2.2% of GDP on military expenditure. Austria, Ireland, Malta and the Netherlands spend less (i.e. less than 1.2% of GDP), whilst France, Greece and the UK spend more (i.e. more than 2.2% of GDP).

Table 2: Defence Budgets of EDA Member States (2005)

<table>
<thead>
<tr>
<th>Member State</th>
<th>Defence Spending in 2005 (in m€)</th>
<th>% of total EDA Member States spending</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>44,20</td>
<td>22.90</td>
</tr>
<tr>
<td>France</td>
<td>42,53</td>
<td>22.03</td>
</tr>
<tr>
<td>Germany</td>
<td>30,60</td>
<td>15.85</td>
</tr>
<tr>
<td>Italy</td>
<td>26,96</td>
<td>13.96</td>
</tr>
<tr>
<td>Spain</td>
<td>10,50</td>
<td>5.44</td>
</tr>
<tr>
<td>Netherlands</td>
<td>7,69</td>
<td>3.98</td>
</tr>
<tr>
<td>Poland</td>
<td>4,64</td>
<td>2.40</td>
</tr>
<tr>
<td>Sweden</td>
<td>4,43</td>
<td>2.29</td>
</tr>
<tr>
<td>Greece</td>
<td>4,96</td>
<td>2.56</td>
</tr>
<tr>
<td>Belgium</td>
<td>3,34</td>
<td>1.73</td>
</tr>
<tr>
<td>Portugal</td>
<td>2,53</td>
<td>1.31</td>
</tr>
<tr>
<td>Finland</td>
<td>2,15</td>
<td>1.11</td>
</tr>
<tr>
<td>Austria</td>
<td>2,16</td>
<td>1.11</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>1,84</td>
<td>0.95</td>
</tr>
<tr>
<td>Hungary</td>
<td>1,26</td>
<td>0.65</td>
</tr>
<tr>
<td>Ireland</td>
<td>0,92</td>
<td>0.47</td>
</tr>
<tr>
<td>Slovakia</td>
<td>0,67</td>
<td>0.34</td>
</tr>
</tbody>
</table>
Slovenia 0,41 0.21
Cyprus 0,30 0.15
Lithuania 0,24 0.12
Luxembourg 0,21 0.10
Latvia 0,16 0.08
Estonia 0,16 0.08
Malta 0,04 0.02
Total 193,0 100

Source: EDA: National Breakdowns of European Defence Expenditure

The next table indicates the size of major European defence companies on a global level.

Table 3: Top 10 European Union Defence Companies

<table>
<thead>
<tr>
<th>EU RANK</th>
<th>WORLD RANK</th>
<th>COMPANY</th>
<th>COUNTRY</th>
<th>2004 DEFENCE REVENUE (million $)</th>
<th>2003 DEFENCE REVENUE (million $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>4</td>
<td>BAE Systems</td>
<td>UK</td>
<td>$20,345</td>
<td>$17,159</td>
</tr>
<tr>
<td>2</td>
<td>7</td>
<td>EADS</td>
<td>Multiple</td>
<td>$10,506</td>
<td>$8,037</td>
</tr>
<tr>
<td>3</td>
<td>9</td>
<td>Thales</td>
<td>France</td>
<td>$8,868</td>
<td>$8,476</td>
</tr>
<tr>
<td>4</td>
<td>11</td>
<td>Finmeccanica</td>
<td>Italy</td>
<td>$7,670</td>
<td>$5,896</td>
</tr>
<tr>
<td>5</td>
<td>16</td>
<td>DCN</td>
<td>France</td>
<td>$3,547</td>
<td>$2,085</td>
</tr>
<tr>
<td>6</td>
<td>18</td>
<td>Rolls Royce</td>
<td>UK</td>
<td>$3,069</td>
<td>$2,490</td>
</tr>
<tr>
<td>7</td>
<td>23</td>
<td>Sncema</td>
<td>France</td>
<td>$2,183</td>
<td>$1,846</td>
</tr>
<tr>
<td>8</td>
<td>26</td>
<td>Rheinmetall</td>
<td>Germany</td>
<td>$1,883</td>
<td>$2,014</td>
</tr>
<tr>
<td>9</td>
<td>27</td>
<td>Dassault Aviation</td>
<td>France</td>
<td>$1,828</td>
<td>$2,009</td>
</tr>
<tr>
<td>10</td>
<td>25</td>
<td>Saab</td>
<td>Sweden</td>
<td>$1,900</td>
<td>$1,380</td>
</tr>
</tbody>
</table>

Source: http://www.defensenews.com/content/features/2005chart1.html

c) Defence employment

Although definitive data on employment within the defence industry are lacking, there is a general consensus that following the end of the Cold War in the late 1980s, there was a substantial reduction in employment numbers in line with declining defence budgets. This, in turn, led some companies to consolidate or exit from the market. In addition, the skill base has changed from those skilled in traditional engineering of trucks, aircraft and ships, to the more highly skilled workforce, based on R&D, aerodynamics, computer programming, chemistry, physics, etc. required to develop and apply new techniques, materials, designs and systems. The current level of employment within the EU-25 defence sector is estimated to be more than 300,000 employees.

d) Defence turnover of the European defence industry

The following table gives an indication on defence turnover in some sub-sectors (excl. defence systems) of members reporting their numbers to ASD.
In terms of trade, military exports account for around 47% of turnover demonstrating the international significance of the EU defence industry as a world player.

e) Defence R & D / R & T

<table>
<thead>
<tr>
<th>Sector</th>
<th>Expenditure € billion</th>
<th>Expenditure %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aeronautics (Military &amp; Civil)</td>
<td>10.4</td>
<td>79%</td>
</tr>
<tr>
<td>Space (Military &amp; Civil)</td>
<td>0.5</td>
<td>4%</td>
</tr>
<tr>
<td>Land &amp; Naval (Military)</td>
<td>2.2</td>
<td>17%</td>
</tr>
<tr>
<td>Total</td>
<td>13.2</td>
<td>100%</td>
</tr>
</tbody>
</table>

ANNEX II
Assessment of the costs of intra-community transfers barriers

Introduction

Annex II summarizes the analysis carried out in 2005 by UNISYS on behalf of the European Commission on intraCommunity transfers of defence products. One section of this study was dedicated to the assessment of the cost impact of intra-community barriers on transfers.

Calculating the cost of intra-community transfer barriers with precision is not an easy task.

Indeed,

– companies and government hardly ever evaluate such costs, and these are anyway never published, given the confidential nature of the matter at hand,

– most of these are opportunity costs (cost of “not doing things” like, for instance, refraining from subcontracting with an SME located in another Member State or, for a government, refraining from procuring cross-border).

– The assessment of the indirect costs largely relies on a comparison with the US situation insofar as the US constitute a genuine single market in which defence-related products circulate without licensing requirements. The preferred option however does not suggest the free circulation for defence-related, as it notably keeps in place national licensing schemes. Accordingly, the indirect potential benefits of the simplified scheme are expected to be lower than the indirect costs identified with the existing situation.

The main sources for estimates are

– the Stockholm International Peace Research Institute (SIPRI),

– the International Institute for Strategic Studies (IISS),

– the European Institute for Security Studies (ISS),

– the 6th annual report according to operative provision 8 of the European Union Code of Conduct on arms export.

Several previous studies have attempted to determine the “Cost of non- Europe”.

A. Weight of Intra-community transfers

The information system implemented by the Code of Conduct provides data allowing analysts to evaluate the weight of intra-community transfers with a reasonable precision. Indeed,

http://ec.europa.eu/enterprise/regulation/inst_sp/defense_en.htm

In 1992, Keith Hartley and A. Cox (“The Cost of Non-Europe in Defence Procurement”) came to the conclusion that the introduction of transnational competition in tendering for armament orders could lead to savings between 6.5 and 9.3 billion ECU. This non-published study went public in 1997 with the Bangemann Report: “Implementing European Union Strategy on Defence Related Industries” COM(1997) 583.
provision 8 of the Code of Conduct states that each EU Member State will communicate to other EU Partners in confidence an annual report on its defence exports and on its implementation of the Code. These reports are discussed at an annual meeting held within the framework of the CFSP, and this produces a consolidated report, based on contributions from Member States. Analysis of the 2003 annual report\(^{48}\) includes for the first time the 10 new Member States.

The report details the 22 EU common categories of military products, without however making a distinction between arm systems and their components (each category includes components, e.g. “Ground vehicles and components”).

The total value of all delivered licenses is relatively stable over the last years, fluctuating between €8,9 billion in 2003 and €10,4 billion in 2004\(^{49}\).

These refusals occurred in categories (small, light arms) with higher potential risks of uncontrolled dissemination. Furthermore, as several interview have demonstrated, most of the “old” Member States were not fully aware of the level of development of the “new” Member States legislation, and ignored that these Member States had and did effectively apply legislation conform to EU standards.

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Country of destination</td>
</tr>
<tr>
<td>Estonia</td>
</tr>
<tr>
<td>Latvia</td>
</tr>
<tr>
<td>Lithuania</td>
</tr>
<tr>
<td><strong>Total</strong></td>
</tr>
</tbody>
</table>

In the subsequent years, no intra-community licence request has been denied:

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total number of licences</td>
<td>31,038</td>
<td>28,716</td>
<td>31,550</td>
</tr>
<tr>
<td>Intra-community transfer licences</td>
<td>12,627</td>
<td>11,360</td>
<td>11,409</td>
</tr>
<tr>
<td>Declared Value (billion Euro)</td>
<td>8.9</td>
<td>10.4</td>
<td>9.4</td>
</tr>
<tr>
<td>Rejected intra-community transfer licences</td>
<td>15</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Rejection rate</td>
<td>0,12 %</td>
<td>0 %</td>
<td>0 %</td>
</tr>
</tbody>
</table>

**B. Comparison with extra-community exports**

The same 2003 Code of Conduct report provides the global value of all delivered licenses by destination. We can draw from it that intra-community transfers represent therefore about 31,4 % of all transfers. This percentage is in line with the turnover reported by large European

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\(^{48}\) Sixth annual report according to operative provision 8 of the European Union Code of Conduct on arms exports, OJ 2004/ C 316 / 01.

\(^{49}\) This figure must be taken with some caution given that (a) -the real value of transferred arms is sometimes missing in the report and (b) some are related to licenses awarded during previous years: e.g. in 2003 Spain licensed for 39.2 million in direction of UK, but transferred 121 million.
enterprises (e.g. Thales reports a military turnover of 30% inside the Union and 70% outside the Union (Interview D. L. August 2004)).

<table>
<thead>
<tr>
<th>Destinations</th>
<th>Number of licences requested</th>
<th>Amounts covered by licences, in million</th>
<th>Number of refusals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra Community Transfers</td>
<td>12627</td>
<td>8913,9</td>
<td>15</td>
</tr>
<tr>
<td>Extra Community Transfers</td>
<td>18411</td>
<td>19405,4</td>
<td>345</td>
</tr>
<tr>
<td>EU Exports World Wide</td>
<td>31038</td>
<td>28319,3</td>
<td>360</td>
</tr>
</tbody>
</table>

A significant difference concerns the figures of refusals concerning exports to third countries: with 345 denials (i.e. nearly 2% of the corresponding requests), ex-ante authorisation schemes evidently serve a clear purpose for such exports.

C. **EU and US defence budgets**

The EDA has compared its data on European defence expenditure – released on 20 November 2006 – with United States defence spending in 2005. The data show that the US spent €406 billion on defence in 2005, more than double the €193 billion spent in Europe50.

European defence expenditure data represent spending by the 24 EDA participating Member States. US data are based on public sources, mainly US Government publications. The €/$ exchange rate is based on average for 2005: rate of 1.2441.

<table>
<thead>
<tr>
<th></th>
<th>Europe</th>
<th>US</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total defence expenditure (€ billion)</td>
<td>193</td>
<td>406</td>
</tr>
<tr>
<td>Defence expenditure as a % of GDO</td>
<td>1,81%</td>
<td>4,06%</td>
</tr>
<tr>
<td>Defence expenditure per capita (€)</td>
<td>425</td>
<td>1.363</td>
</tr>
</tbody>
</table>

D. **The cost of inefficiency**

Irrespective of how budgets are finally calculated, there is a wide consensus amongst experts on the fact that Europe’s defence spending is in the order of magnitude of half of the corresponding US figure. As such, this would not be a problem if the resulting capacities, in line with the EU needs, where also about 50% of the US ones.

It is obviously not the case: the military experts estimate the resulting European capacities in the range of 10% to 15% of the US capacities51.

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51 DE DECKER, Armand – President of the Belgian Senate (since then also WEO Chairman) - Vers une agence européenne de l’armement ? - Tribune de l’Institut Royal Supérieur de Défense, 23 janvier
This means that, to obtain 12.5% capacity (i.e. the middle of the range), the European States, if operating under the same conditions and environment as the United States, should have spent in 2005 only €50 billion (instead of €193 billion). Therefore the difference of €142 billion can be assumed to represent a proxy of the yearly cost of relative EU/US efficiency gap.

**E. The causes of inefficiency and their link with obstacles to intra-community transfers**

The burden of intra-community transfers represents only a fraction of the above “cost of non-Europe” (= direct cost). A series of other factors contribute to the inefficiency of EU defence expenditures. Some of these factors are unrelated to intra-community barriers, whilst others are indirectly linked to these, as they might justify the continuation of existing duplications or fragmentation (= indirect costs).

<table>
<thead>
<tr>
<th>Direct costs</th>
<th>Structural and procedural costs related to the execution of the licensing processes itself</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect costs</td>
<td>Opportunity cost (other than direct costs) linked to the maintenance of barriers to intra-community transfers.</td>
</tr>
</tbody>
</table>

### i. Direct costs

Direct administrative costs\(^{52}\) flow from:

![Diagram of direct costs]

The “Code of Conduct” statistics provide a clear idea on the number of intra-community transfer “export licences”, which is as follows from 2003 to 2005.

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\(^{52}\) Administrative costs are defined as the costs incurred by enterprises, the voluntary sector, public authorities and citizens in meeting legal obligations to provide information on their action or production, either to public authorities or to private parties (Chapter 10 of the Annexes to the Impact Assessment guidelines, as updated on 15 March 2006).-
<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intra-community transfer licences</td>
<td>12,627</td>
<td>11,360</td>
<td>11,409</td>
</tr>
<tr>
<td>Declared Value (billion Euro)</td>
<td>8,9</td>
<td>10,4</td>
<td>9,4</td>
</tr>
</tbody>
</table>

The duration of the administrative licensing process may vary from one week to several months, depending on countries and circumstances.\(^{53}\)

**Calculation of administrative costs**

The administrative costs is calculated on the basis of the average cost of an action (Price) multiplied by the total number of actions performed per year (Quantity). The Price is estimated by multiplying a tariff (based on average labour cost per hour including prorated overheads) and the effective working time required per action.

Formula:

\[
\sum P \times Q
\]

\[
P = \text{Price} = \text{Tariff} \times \text{Time};
\]

\[
Q = \text{Quantity} = \text{Number of business} \times \text{Frequency})
\]

The **Frequency** is 11,409 delivered licences (2005), a figure relatively stable over time.

Concerning the variable **time**, the average cost / request has been estimated as follows (in hours):

<table>
<thead>
<tr>
<th></th>
<th>Gathering general information</th>
<th>Preparation of single application</th>
<th>Submission</th>
<th>Analysis, questions, answers</th>
<th>Decision - communication</th>
<th>Management, including import + export + transit procedures</th>
<th>Reporting, ex post contacts - recordkeeping</th>
<th>Varia</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public authorities</td>
<td>25</td>
<td>6</td>
<td>4</td>
<td>55</td>
<td>30</td>
<td>23</td>
<td>25</td>
<td>20</td>
<td>188</td>
</tr>
<tr>
<td>Enterprises</td>
<td>25</td>
<td>55</td>
<td>15</td>
<td>13</td>
<td>7</td>
<td>65</td>
<td>25</td>
<td>20</td>
<td>225</td>
</tr>
</tbody>
</table>

\(^{53}\) Member States strive to optimize processes and to reduce their theoretical number of days. In Germany for example, the administration reported the average duration to 19 working day per licence. However, the number of days reported by each administration always starts from the reception of the request (enterprise work starts long before) and do never consider the management of the licence after its attribution.
These figures are based on an analysis of each national licensing process, subsequently consolidated into an average typical licensing scenario. The time estimates have been obtained from stakeholder interviews.

For national administrations, the rather high figure under the column “analysis, questions and answers” inter alia mirrors the inter-agency process that is taking place in most Member States. Licences’ applications are indeed lodged in one ministerial department but the application is then often scrutinized by other departments (foreign affairs, defence, economic affairs). The final examination also sometimes takes place in the framework of an ad hoc inter-ministerial body that makes the final decision after reception of the opinions from the various departments involved.

As far as companies are concerned, the preparatory phase can be particularly resource-consuming. A licence application must indeed generally fulfil very strict and detailed requirements. For instance, licences applications often require information about the final end-user(s). Extensive investigation must be performed by the applicant in the case of a transfer of components: transferred components will indeed be incorporated in final products whose final destination is not always a priori known by the components supplier. Any change in the expected final end-user must be reported to the licensing national authorities. Certain licences applications must be accompanied by an “end-user certificate” that must be transmitted by the supplier once the end-user has filled it. Some Member States require a prior sale agreement, which implies additional tasks such as a description of the prospected market. Furthermore, for some complex defence equipment, national licensing authorities may require the supplier to show and explain the technical record of the equipment to be exported.

The column “gathering general information” also includes the workload associated to the need for companies to remain updated with the fast-evolving export legislation and to maintain their corresponding technical/legal competences. For instance, certain specific rules, such as those relating to the embargoed destinations, are subject to frequent changes. Dealing with export regulations amounts to high “learning costs” and requires frequent training and awareness-raising sessions for the dedicated staff.

The highest workload however occurs during the “management (including import and transit procedures)” phase, notably to comply with the strict and time-consuming obligations laid down in the licence (e.g. technical and/or security restrictions -see 3.2.4). For example, evidence has to be provided that all restrictions have been enforced, which may necessitate the provision of thorough documentation. Any change in the exported product’s features or concerning the consignee must be reported to the control authorities (e.g. change in the address of deliver…). Any possible addendum to the original sales contract must be fully reported and documented. In case of transit, a brand new licensing procedure with new national authorities must be conducted.

The hourly Tariff is estimated at €85,5 (based on an assessed daily cost for the employer of 650 € to hire managers / high level employees). This tariff includes overhead costs, taking into account that security/secrecy classification of the data at stake represents an additional overhead cost for administrations and companies. The figure is also consistent with what has been used in other administrative burden calculation based on the SCM:

- “Measurement and reduction of administrative costs in France 2007 measurement exercise” – Ministère de l’économie, des finances et de l’industrie : a daily cost including (including overheads) of €530 has been used (see http://regplus.free.fr/abmfrance.ppt);

- In the REACH impact assessment, the labour costs associated with the different activities involved in preparing a registration dossier have been estimated at € 875 a day. See SEC (2003)1171/3 (available at http://ec.europa.eu/enterprise/reach/docs/reach/eia-sec-2003_1171.pdf).

On this basis, the yearly cost is estimated to be € 432.9 million\(^{54}\).

\[^{54}\] (188 + 225) hours * 11409 licences/year * 85,5 €/hour + 2000 companies * 175hours * 85,5 €/hour = 432,9 € million.

Note: 1 man.month (yearly average corresponding to 175 hours/month) has been added for each participating enterprise (2000 enterprises) to cover the cost incurred by companies for the preparation of
This yearly direct cost is shared between governments (42%) and enterprises (58%), making the average cost of every single licence € 16.079 for governments and € 21.867 for enterprises.

**ii. Indirect costs**

- **Duplication of operational structures** (i.e national defence administration and management both political and military; military schools and academies; international structures and representations)

With € 91,44 billion euro on a total of 153,3 billion in 2003, operational structures constitute the highest portion of the EU-25 defence budget. With the exception of the cost of administrations delivering the licences, these are unrelated, directly or indirectly, to the intra-community transfers.

- **Duplication of stocks** (material, ammunitions, consumables and spare parts)

Whether simple or complex, any military system cannot be deployed without a whole range of furniture, ammunitions and spare parts. The global cost of these “accessories” may be higher of the cost of the system itself, across its complete lifetime. Where global numbers are available for a well managed defence, the simple cost of maintaining spare parts depots represents about 6% of the global defence budget. It grows up to more than 10% when defence materials are fragmented in small heterogeneous series, a hypothesis valid in the case of Europe.

Crisis time demand for military supplies is difficult to predict and can change dramatically, depending on the particular scenario envisaged. Military operations are by nature urgent and unpredictable, and may require completing or renewing under tight time constraints a stock of ammunitions. And what is true for ammunitions is of course even more relevant for any part of complex armament systems. Should such urgent demands not be met, the operational viability of such systems would not been guaranteed.

In such circumstances, a Member State relying on another Member State for supplying its spare parts or ammunitions runs a serious – and hardly acceptable - risk of weakening its defence capacities. Indeed, under the current European framework, there is no guarantee that the transfers will not be delayed by administrative burden, or even worse, denied by the authority of the Member State of origin.

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55 Calculation of Depot costs by the US General Accounting Office – Report to the Congressional Committees on Defence Depot maintenance GAO/NSIAD-96-166.

56 The Iraq war provides several examples of these urgent requirements, as the special sand filters to fit on the British Challenger-II battle tanks in order to reduce the penetration of sand dust that was damaging the engines, compromising the whole system operation: during the 2003 campaign, no less than 190 so called “Urgent Operational Requirements” were issued for a total of 510 million £, demonstrating the strong dependence of military operations on instant response from industry. Source: UK Ministry of Defence “Operation in Iraq – Lessons for the Future” London 2003 P. 6.

57 Corresponding situations are not just theoretical: in 1991 (1st Gulf war) the Belgian Government refused to transfer artillery ammunitions to Great Britain. Taking lessons of the Belgian 1991 transfer refusal, the British undertook negotiations for an ammunition joint venture between Royal Ordnance and Giat of France which would have involved a significant degree of interdependence. As the 1998
To overcome such risks, Member States either tend to favour national suppliers, or, when material is sourced abroad, to constitute oversized and costly stocks. The relation between the absence of free intra-community transfers and the cost of duplicating and maintaining national stocks is therefore evident.

- **Duplication of research activities and programmes**

De Vestel\(^{58}\) and other authors illustrated in 1995 already the impact of duplicating defence programmes and the related research activities when comparing Europe and US ambitions regarding the three main domains land, air and sea.

<table>
<thead>
<tr>
<th>Type of developed system</th>
<th>Europe</th>
<th>USA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Land Systems</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Main battle tank</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Armoured Infantry Fighting Vehicle</td>
<td>16</td>
<td>3</td>
</tr>
<tr>
<td>155 mm howitzer</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td><strong>Air Systems</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fighter-strike</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Ground-attack trainer</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Attack helicopter</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Anti-ship missile</td>
<td>9</td>
<td>3</td>
</tr>
<tr>
<td>Air-air missile</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td><strong>Sea Systems</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Frigate</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>Anti-submarine torpedo</td>
<td>9</td>
<td>2</td>
</tr>
<tr>
<td>Diesel submarine</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Nuclear-powered submarine</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>89</strong></td>
<td><strong>27</strong></td>
</tr>
</tbody>
</table>

*Types of systems developed in Europe and in the US*

With 89 programmes in Europe compared to only 27 in the US, the cost impact of such duplication is at least threefold: R&T spending, operating the multiple decision levels and production chains (over production capacities) and poor scaling effect due to amortisation of investments on lower quantities produced.

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For example, the total R&T investment in the three fighter-strike or combat aircraft system that are in competition inside Europe has been 10.5 billion higher (54.7%) for 66% less produced output and at the same time – which is worse – less technology output, since the Eurofighter, the Rafale and the Gripen are all effective aircraft but their technologies are aging compared to the latest developments in the US.

<table>
<thead>
<tr>
<th>Aircraft</th>
<th>Research cost (billion euro)</th>
<th>Expected output</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eurofighter</td>
<td>19.48</td>
<td>620</td>
</tr>
<tr>
<td>Gripen</td>
<td>1.84</td>
<td>204</td>
</tr>
<tr>
<td>Rafale</td>
<td>8.61</td>
<td>294</td>
</tr>
<tr>
<td>JSF (US)</td>
<td>19.34</td>
<td>3003</td>
</tr>
</tbody>
</table>

Combat aircraft research costs

Source: HARTLEY, K. and SANDLER, T, Eds (2001). The Economics of Defence, International Library of Critical Writings in Economics 128, Elgar, Cheltenham, volumes I-III (estimates of the authors – in GB pounds – have been converted in euro)

The relation between the duplication of research programmes and barriers due to the intra-community transfers is indirect but real. A standalone production was considered as the best guarantee for autonomous capacities and even – in the case of Sweden – of political neutrality.

- **Poor scaling effects due to fragmentation**

Reflecting the diverging policies and military ambitions, the EU internal market does not benefit from the same scaling effect than the US internal market. If we ignore exports to third countries, the EU internal market represents in general 35 to 40 % of the US internal market in term of potentialities.

The impact of relatively small production series is reinforced by the differences in military requirements and regulations. If we consider for example the combat aircraft market, the combined output of the 3 leading European programmes (Eurofighter, Rafale and Gripen) will not exceed 1100 units, while 3003 units of the equivalent US Joint Strike Fighter (JSF) will be produced (including 150 aircraft for UK). This less favourable scaling effect, multiplied by the number of European programmes, has an additional impact on production costs, after the duplication of the initial research costs. For the same reasons as research activities, the above costs are related indirectly to the intra-community transfer barriers, because small series result from the multiplication of programmes, which reflects the lack of mutual trust in obtaining the needed material in time when required.

- **Inefficiencies and extra-costs in cooperation programmes**

The cooperation programmes have so far not caused any reduction of administrative overhead, on the contrary: each programme has its own *ad hoc* structure, with a number of partners changing from project to project, and the management and decision making processes are time-consuming and complex.

Neither have cooperation programmes so far much reduced industry fragmentation: they were used to maintain national technology and industry policies, and for further fragmentation in even smaller series, as the production is usually divided in all participating countries and the
project work packages are designed in such a way that all participants will contribute to all key technological components.

To take the case of Eurofighter (the largest co-operation programme), according to the UK National Audit Office (NAO), decisions are made in a four-stage hierarchy with about 50 committees by way of trying to reach a consensus between all participating nations. The NAO analysed the factors causing delays in cooperative acquisition programmes and found that “Industrial arrangements and delayed approvals by partner nations are the main causes of slippage on cooperative acquisition programmes”.

- **Non-synchronisation of procurement / acquisition policies**

Another cause of loss is the duplication of procurement, even when purchasing “almost” the same system. Although duplicated procurement of these small, non-fully interoperable series are the major cause of loss regarding equipment, this problem is uncorrelated to intra-community barriers.

- **“Juste retour” policies**

According to the juste retour (or fair return) principle, the industry of each participating nation should get a work share that corresponds to the financial contribution of its government. In its traditional and worst form, industrial “juste retour” is calculated each year, programme by programme. In practice, this method has greatly reduced the flexibility of programme management and has often contributed to an inefficient distribution of work: it leads to the creation of several production lines in the participating states, with the consequence that the expected scaling effect cannot be achieved in practice and that the co-operative programme provides no economy comparing with isolated works, but adds the burden of co-operation.

To illustrate again with the EuroFighter example, production work was divided among the countries proportionally to initial procurement plans (UK 250, Germany 250, Italy 165, and Spain 100): British Aerospace (33%), Daimler-Benz (33%), Aeritalia (21%), and Spain's CASA (13%). Over time, procurement changed and a new partner joined (Austria in 2003). When the final output was fixed to UK 232, Germany 180, Italy 121, and Spain 87, production was again allotted according to procurement: British Aerospace (37%), DASA (29%), Aeritalia (19.5%) and CASA (14%).

Due to mergers and acquisitions, development is now the responsibility of Eurofighter Jagdflugzeug GmbH, based in Munich and wholly owned by BAE Systems (formerly British Aerospace) in the UK, Alenia Aerospazio in Italy, and the EADS Deutschland Aerospace Group (formerly DaimlerChrysler, in conjunction with Deutsche Aerospace AG) and EADS Spain (formerly CASA).

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60 QUILES, Paul (former French Minister of Defence), in «Libération» of 9 January 2003: «…la faiblesse militaire des Européens résulte plus encore de la dispersion de leurs efforts. Il n’existe pas de véritable coordination des programmes d’armement. L’équipement des armées européennes se distingue par une diversité excessive des matériels, dont une part substantielle est d’ailleurs d’origine américaine». 
As a result, the aircraft has four separate assembly lines. Each partner company assembles its own national aircraft.

On one hand, the application of the *juste retour* principle has generated (sometimes artificially and against economic logic) an intense traffic of components between participating States. Therefore we can say that the burden of intra-community transfers has been highlighted by this practice. On the other hand, one of the “juste retour” secondary justification is the lack of confidence resulting from the same intra-community barriers: each national authority wants to control a local production of sensitive components, because it has no absolute trust that it can be obtained from its partners, in all circumstances.

- Summary of indirect costs

Starting from the global EU-25 defence budget and summing up the analysis above, by affecting to each cost post a percentage of possible savings, should obstacles to intra-community transfers be removed. The indirect costs related to the obstacles to intra-community transfers can be estimated at €2.73 billion.

<table>
<thead>
<tr>
<th>Area</th>
<th>Global Budget</th>
<th>Possible savings / reallocation</th>
<th>Calculation of potential savings</th>
<th>Savings from removing all intra-Community transfer barriers</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Maintaining infrastructures, staff, operations</td>
<td>91,44</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>2. Stocks, ammunitions, spare parts and other consumables</td>
<td>15,33</td>
<td>7,66</td>
<td>5% global defence budget</td>
<td>1,53</td>
</tr>
<tr>
<td>3. Research activities for defence programmes</td>
<td>10,44</td>
<td>7,27</td>
<td>70% of research budget</td>
<td>0,36</td>
</tr>
<tr>
<td>4. Equipment procurement</td>
<td>36,07</td>
<td>11,54</td>
<td>32% of procurement budget</td>
<td>0,83</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>153,27</strong></td>
<td><strong>26,48</strong></td>
<td></td>
<td><strong>2,73</strong></td>
</tr>
</tbody>
</table>

*Indirect costs of intra-community barriers (€ billion)*

Source: SIPRI (2003 figures)
<table>
<thead>
<tr>
<th>Cause of loss / potential savings on procurement activities</th>
<th>Impact</th>
<th>Calculation of potential savings</th>
<th>Savings for removing all intra-Community transfer barriers (billion euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poor scaling effect due to fragmentation</td>
<td>1,80</td>
<td>5% of procurement</td>
<td>Medium 0,09, 5,0% of savings</td>
</tr>
<tr>
<td>Inefficiencies and extra-cost in cooperation programmes</td>
<td>3,25</td>
<td>9% of procurement</td>
<td>High 0,49, 15,0% of savings</td>
</tr>
<tr>
<td>Non-synchronisation of procurement policies</td>
<td>1,80</td>
<td>5% of procurement</td>
<td>Low 0,02, 1,0% of savings</td>
</tr>
<tr>
<td>Juste Retour policies</td>
<td>3,61</td>
<td>10% of procurement</td>
<td>Medium 0,18, 5,0% of savings</td>
</tr>
<tr>
<td>Non-optimal use of dual use components / useless developments</td>
<td>1,08</td>
<td>3% of procurement</td>
<td>Medium 0,05, 5,0% of savings</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>11,54</strong></td>
<td><strong>32%</strong></td>
<td><strong>Total 0,83</strong></td>
</tr>
</tbody>
</table>

Detail of item 4 of the previous table (€ billion)

### iii. Total cost related to intra-community transfers barriers

Adding the direct and indirect cost evaluated in the previous section leads to a total yearly cost of intra-community transfers barriers of **€ 3,16 billion**.

This order of magnitude is consistent with available material published on this issue.

<table>
<thead>
<tr>
<th>Direct costs</th>
<th>€ 430 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indirect costs</td>
<td>€ 2 730 million</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>€ 3 160 million</strong></td>
</tr>
</tbody>
</table>

These calculations, which are partly based on assumptions and should thus be taken with some caution, corroborate the unanimous conviction, expressed by stakeholders in all interviews, that indirect costs by far exceed direct ones.

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62 In his study “A single European market for defence equipment: organisation and collaboration” professor Keith Hartley ranges four “liberalisation scenarios” ensuring much more important annual savings, from £ 3.8 to 7.8 billion (according however to wider liberalisation options including notably a large opening of defence procurement). See HARTLEY, K., – “A single European market for defence equipment: organisation and collaboration” – result of research funded by the ESRC as part of its Single Market Programme, (Grant no. L113251028).
## ANNEX III

### Summary of national licensing requirements\(^{63}\)

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<tbody>
<tr>
<td>AUSTRIA</td>
<td>Yes</td>
<td>(No) export.</td>
<td>176 €. for transport/export/import</td>
<td>An intra-EU transport/export/import</td>
<td>Between 6 months and 2 years</td>
<td>Yes.</td>
<td>Yes. authorisation required for all transit of war material, especially transit by air.</td>
<td>Requirements for transit are the same as those for export.</td>
</tr>
<tr>
<td>BELGIUM</td>
<td>Yes</td>
<td>No.</td>
<td>No</td>
<td>Within EU: 2 to 3 weeks. Outside EU: up to 2 months.</td>
<td>1 year</td>
<td>Yes.</td>
<td>Yes. authorisation required for all commercial transhipments.</td>
<td>Yes, if not in line with arms export policy. Applications are treated in the same way as export applications.</td>
</tr>
<tr>
<td>CYPRUS</td>
<td>Yes</td>
<td>No.</td>
<td>No</td>
<td>1 to 2 working days</td>
<td>No exports have taken place so far</td>
<td>Yes.</td>
<td>Yes.</td>
<td></td>
</tr>
<tr>
<td>CZECH REPUBLIC</td>
<td>Yes</td>
<td>No.</td>
<td>Permit: 5000CSK. Export: 0.5% of the total value of the licence. Import: 500CSK.</td>
<td>60 days</td>
<td>2 to 5 years (trade permit)</td>
<td>Yes.</td>
<td>No, transit is not controlled.</td>
<td></td>
</tr>
<tr>
<td>DENMARK</td>
<td>Yes</td>
<td>Declaration</td>
<td>No.</td>
<td>2 weeks</td>
<td>Between 6</td>
<td>Yes.</td>
<td>Yes. The actual Applications</td>
<td></td>
</tr>
</tbody>
</table>

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\(^{63}\) This annex summarizes the analysis carried out in 2005 by UNISYS Study for the European Commission.
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</thead>
<tbody>
<tr>
<td>ESTONIA</td>
<td>Yes</td>
<td>No</td>
<td>200EEK</td>
<td>4 days, for complex cases much longer (2 months)</td>
<td>Up to 1 year (Export) Up to 1 month (Transit)</td>
<td>Yes.</td>
<td>Yes.</td>
<td>treated in the same way as export applications. Transhipment permits may be withheld if not in line with export policy.</td>
</tr>
<tr>
<td>FINLAND</td>
<td>Yes</td>
<td>No, but deeper evaluation for non-EU destinations.</td>
<td>95 euro and mail charge</td>
<td>1 to 4 weeks</td>
<td>According to each shipment request</td>
<td>Yes.</td>
<td>Individual licence is required for every transfer/transit through Finnish territory.</td>
<td>A transhipment application can be withheld on same basis as export licence (legal basis in line with export policy).</td>
</tr>
<tr>
<td>FRANCE</td>
<td>Yes</td>
<td>No.</td>
<td>France insists to keep reasons for decision non published: no precedent rule!</td>
<td>Authorisation for negotiation and for contracting</td>
<td>2 months</td>
<td>Variable from months to years</td>
<td>Yes</td>
<td>Yes, except as otherwise provided (transit by rail and transhipment)</td>
</tr>
</tbody>
</table>

64 If a license is issued to a Non-EU state, there is a condition that requires the exporter to declare the license to customs.

65 Validity of import/export authorisations is 6 months. May be reduced to 3 months at request of one of concerned ministers. May be extended to 1 year at request of exporter/importer and upon positive advisement from concerned ministers.
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</thead>
<tbody>
<tr>
<td>GERMANY</td>
<td>Yes</td>
<td>No or the contrary of France, precedent case rule applies.</td>
<td>No.</td>
<td>1 to 4 weeks</td>
<td>Depending on the type of transaction(^{66})</td>
<td>Yes.</td>
<td>Yes. authorisation required for all commercial transhipments.</td>
<td>Yes, if not in line with arms export policy. Applications treated in the same way as export applications.</td>
</tr>
<tr>
<td>GREECE</td>
<td>Yes</td>
<td>Yes. Depending if NATO or non-NATO(^{67})</td>
<td>No.</td>
<td>Up to 15 days</td>
<td>3 months</td>
<td>Yes.</td>
<td>Yes. Authorisation valid for 3 months.</td>
<td>Application may be rejected: a) embargo b) supporting documents incomplete or inaccurate c) reasons of national security or interest.</td>
</tr>
<tr>
<td>HUNGARY</td>
<td>Yes</td>
<td>Simplified procedure</td>
<td>An additional activity and</td>
<td>Can take up to 90 days, (one month for each of the 3</td>
<td>1 or 2 years</td>
<td>Yes.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^{66}\) The validity of the license depends on the type of transaction - no licenses unlimited in time. Individual export licenses for military equipment are valid for only 6 months, and may be extended up to 3 terms (each time max 6 months)

\(^{67}\) In case of an export to a non-NATO or non-EU country, a decision of the Cabinet of Ministers is required.
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<tbody>
<tr>
<td>IRELAND</td>
<td>Yes</td>
<td>For intra-community transfer negotiation license must be issued. Administrative costs of around 20 euro.</td>
<td>Intra EU trade: 2 to 3 working days. Extra EU trade: 2 to 3 weeks.</td>
<td>Intra EU trade: 2 to 3 working days. Extra EU trade: 2 to 3 weeks.</td>
<td>12 months and expires when shipment is done.</td>
<td>Yes.</td>
<td>Yes.</td>
<td>Always required.</td>
</tr>
<tr>
<td>ITALY</td>
<td>Yes</td>
<td>Depending if NATO or non-NATO</td>
<td>No</td>
<td>2 to 4 weeks</td>
<td>Average 24 months</td>
<td>Yes.</td>
<td>Yes.</td>
<td>Always required.</td>
</tr>
</tbody>
</table>

68 If the license was for intra EU, the exporter has to declare the export in the local customs office, since there is no border control. For extra EU export, an “automated entry” system is available. Then someone can enter the details of the export into the system to declare goods, on behalf of the exporter. This system is called AEP.

69 If the planned export is directed to NATO and EU countries (or countries that signed special agreements with Italy) or if the movement concerns goods being returned for repair or if it concerns temporary export (exhibitions and shows, testing and evaluation) the preliminary authorization is issued by the Ministry of Defence. If the planned export is directed to non-NATO or non-EU countries, the preliminary authorization is issued by the Ministry of Foreign Affairs (Export Licensing Authority). In this case they still have to obtain a technical agreement from the Ministry of Defence. Additional documents have to be provided: the commercial agreement and a final end user certificate duly legalized by the relevant Italian Embassy. This application will then be examined by an inter-ministerial commission.
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</tr>
</thead>
<tbody>
<tr>
<td>LATVIA</td>
<td>Yes</td>
<td>(No)</td>
<td>Yes 2.5% of the value of the goods and maximum 500 LVL, if the value of the goods is under 1000LVL the fee is 5LVL.</td>
<td>usually 3 to 4 days, one month for complex cases</td>
<td>6 months</td>
<td>Yes.</td>
<td>Specific conditions 70</td>
<td>Export).</td>
</tr>
<tr>
<td>LITHUANIA</td>
<td>Yes</td>
<td>No.</td>
<td>Yes. 120LT. The fee is different for an import licence: 100LTL.</td>
<td>30 days or longer for complex cases</td>
<td>1 year</td>
<td>Yes.</td>
<td>Special rules for military transit 71.</td>
<td></td>
</tr>
<tr>
<td>LUXEMBOURG</td>
<td>Yes</td>
<td>(No)</td>
<td>No</td>
<td>3 working days</td>
<td>4 months 12 months and variable from 3 to 12 months. 72</td>
<td>Yes.</td>
<td>Yes. Special process to follow by the transport company 73</td>
<td>Application submitted to the same rules as for export. May be withheld or rejected if conditions are not met or not in line with national (export) policy.</td>
</tr>
<tr>
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</tr>
<tr>
<td>MALTA</td>
<td>Yes</td>
<td>(No)</td>
<td>A physical examination of the goods is requested</td>
<td>Up to 10 days.</td>
<td>1 year</td>
<td>Yes.</td>
<td>Yes.</td>
<td></td>
</tr>
<tr>
<td>NETHERLANDS</td>
<td>Yes</td>
<td>Depending if Nato or non-Nato(^{74})</td>
<td>No.</td>
<td>NATO-countries: 3 to 4 days, other countries: 3 to 4 weeks</td>
<td>(negociated)</td>
<td>Not in all cases.</td>
<td>No authorisation needed if transshipment within 7 days (air) or 14 days (sea).</td>
<td>Yes, possibility to withhold permission for transshipment exists.</td>
</tr>
<tr>
<td>POLAND</td>
<td>Yes</td>
<td>No.</td>
<td>ISO 9001 certificate is requested for exporters 5 audits Electronic TRACKER system</td>
<td>10 to 30 days</td>
<td>Variable with a maximum of 1 year</td>
<td>Yes.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>PORTUGAL</td>
<td>Yes</td>
<td>The same procedure applies for export outside EU and export inside EU, the only</td>
<td>No, but the import and export forms must be bought from the national printing office.</td>
<td>Usually less than a week. More time can be needed if the country is not in the EU or North America.</td>
<td>Up to 6 months, or 2 to 5 years (trade permit)</td>
<td>Yes.</td>
<td>Yes. Transit always requires an authorisation.</td>
<td>Same requirements as for export licences.</td>
</tr>
</tbody>
</table>

---

\(^{73}\) When it concerns a transit of goods, the company that handles the transport of the goods within in Luxembourg has to request the transit licence. It is important to note that this licence must be requested before the transit takes place. This request must contain the filled-out standard document and the proof of authorisation of export. No fees need to be paid and the licence can be issued within 3 days.

\(^{74}\) For NATO countries, the application procedure takes about 3 to 4 days on average. At least if the application is complete, otherwise it can take longer since the authority has to request additional information, for other countries, the application procedure can take around 3 to 4 weeks, or even longer. Often informative services are called on to investigate the destination and end use of the goods.
<table>
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</tr>
</thead>
<tbody>
<tr>
<td>SLOVAK REPUBLIC</td>
<td>Yes</td>
<td>No.</td>
<td>1% of the value of the military material with a minimum of 1000 SK</td>
<td>60 days, but mostly less</td>
<td>1 year and defined quantity</td>
<td>Yes.</td>
<td>Today no, but will change in the future</td>
<td></td>
</tr>
<tr>
<td>SLOVENIA</td>
<td>Yes</td>
<td>(No)</td>
<td>Small fee (?)</td>
<td>By law answer needs to be given to applicant within 30 days.</td>
<td>The validity of the licenses is not prescribed - it depends on delivery terms agreed in the contract.</td>
<td>Yes.</td>
<td>Yes, The MoD, the Ministry of Interior and the Custom Department need to be informed three days in advance about an incoming shipment.</td>
<td></td>
</tr>
<tr>
<td>SPAIN</td>
<td>Yes</td>
<td>(No)</td>
<td>No.</td>
<td>Up to one month.</td>
<td>6 months for individual licenses</td>
<td>Yes.</td>
<td>Yes. Always required.</td>
<td>Yes, authorisation may be refused if transshipment does not fit with legal conditions or for political reasons (embargoes).</td>
</tr>
<tr>
<td>SWEDEN</td>
<td>Yes</td>
<td>(No)</td>
<td>Close contact between</td>
<td>2 weeks, sometimes 2 hours, provide advance</td>
<td>Global project</td>
<td>No.</td>
<td>Yes. Always required.</td>
<td>Yes. For example if</td>
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</tr>
<tr>
<td>UNITED KINGDOM</td>
<td>Yes</td>
<td>Depending on the type of the goods and where they are going outside the EU, extra verifications are made on the destination and enduse.</td>
<td>Specific “Fast Track” procedure for certain destinations and goods.</td>
<td>Depends on destination, product and type of application, target is 20 days.</td>
<td>Depends on type of licence</td>
<td>Not in all cases.</td>
<td>Not for all transits.</td>
<td>Yes in case of end-use concerns or if the destination is one of the prohibited countries.</td>
</tr>
</tbody>
</table>
**ANNEX IV: Example of implementation of a traceability system**

In a centralized IT system, an electronic traceability key is attached to each transfer. This key, or MRN (Movement Reference Number) would also (in the case of tangible goods) travel physically with the goods.

A **Common Transfer System memory** (CTS) could document transfers and re-export conditions. It could contain:

- MRN key
- EU State and Enterprise of origin
- EU State and Enterprise of destination
- Product ID
- Quantity and/or Value
- Date of transfer and planned duration
- Re-export conditions to facilitate the control of the respect of these conditions by the national authority that will authorise re-export.

**Illustration:**

*CTS: traceability conditions are stored in a common database*

**Main features:**

- Every transfer is documented in the common database;
- Every transfer would be “declared by the supplier”, which should wait for a MRN prior to initiate it;
- Reception of the good will be declared by the receiver;
- Checking quantities and quality requires another message or declaration;
- Consumption or usage of the component in a wider system must be declared too to preserve traceability.
ANNEX V

Summary of the consultation process

1. Desirability of a Community initiative

The reality of the problem is widely acknowledged. Industry was particularly supportive of an initiative, which it perceives as a prerequisite for an efficient market and a competitive defence industry. Few Member States questioned the added value of a Community initiative that would seek to apply the principles of the internal market to weapons and similar goods. Noting the progress achieved in the context of the Council’s Code of Conduct on arms exports and the LoI, these Member States emphasized sensitive issues such as national sovereignty, re-exportation and foreign policy, as well as the issue of the Commission’s competence in this area. Other Member States underlined that an initiative in the EU framework would usefully foster Member States’ security of supply in their purchases of European defence goods.

2. Scope

The vast majority of participants took the view that the common list of military goods covered by the EU Code of Conduct on arms exports would be the ideal basis for defining the scope of any instrument. This is not only because the list already exists, but also because it is specifically designed to apply in the field of export controls. However, most Member States argued in favour of some degree of flexibility to add to or derogate the most sensitive transfers from the list. Industry prefers a common list including also technology transfers and defence-related services.

3. Simplification measures

Member States and most of the industry were opposed to a complete liberalisation (the "licence-free zone"). The specific nature of the products and the risk associated with their re-exportation means that the principle of ex-ante authorization for transfers must be retained. Nevertheless, the procedure should be made easier: instead of individual licenses for every transfer of every product to every single recipient, there is a general preference for general or global licenses covering several transfers of a broad range of goods to various recipients.

4. Control arrangements

It clearly emerged from the consultation that the main reason for restricting intra-Community transfers was the risks (political, national security, protection of human rights) of re-exporting products after they have been transferred within the Community. In addition, manufacturers accepted the legitimacy of checking compliance with possible limitations on re-exports, and proposed as a control measure the certification of companies which receive a transfer.

The aim of certification would be to create reciprocal confidence between Member States in companies' capacity to ensure the terms and conditions of the transfer licence are complied with, in particular the possible conditions relating to re-
exportation and the end-user. This process should be organized via the Community instrument and implemented by the Member States.

Industry supported the certification of enterprises as a prerequisite to receive defence-related products under a simplified licensing regime. Some Member States however raised the issue of different certification practices, despite common criteria, and the risk of administrative burdens, given the maintenance of the licensing systems to non-certified enterprises and exports to third countries. Some participants say that retransfers to non-certified enterprises, e.g. for repair and maintenance, should be covered. One association emphasised that the system should not compartmentalise the European market and discriminate against non-European companies. All the participants were in favour of common criteria, whilst some argued that the general certification criteria (ISO 9000) are insufficient as they primarily address the quality of the production process.

5. Export controls (outside the EU)

Although there is support for strengthening export controls by means of certification, there is not much clarity as regards export policy measures. Opinions vary between those who believe that it must not be touched upon in a Community instrument and those who favour specific measures. The former pointed to current practice in applying the Council's Code of Conduct on arms exports. They do not believe that the model of the dual-use Regulation, which harmonizes policy on exports of dual-use products on the basis of international agreements, is relevant. That position is held by the majority of Member States and by the AeroSpace and Defence Industries Association of Europe (ASD). The ASD also argues for a second option, namely that a white list be negotiated, to include certain trusted non-member countries (for example, Annex II to the dual-use Regulation: Australia, Canada, Japan, New Zealand, Norway, Switzerland, the United States), which could be covered by the EU regime.

6. Traceability

Most participants feared that a centralized traceability system would create additional burdens for companies without offering any added value, given the need to maintain the licensing systems. Conversely, one Member State considered that, given the increasing number of transfers resulting, in particular, from the many cooperation programmes, an information system is the only way to effectively monitor transfers. One enterprise considered that the system of a general licence based on the dual use Regulation could serve as a model to the extent that the registration of exports with the national authorities results in a registration number which appears on the transfer documents. One association underlined the importance of extending traceability to product movements outside the Community.

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75 “Dual-use” goods refer to goods which are, in principle, civil in nature but can (also) be used for military purposes. See Council Regulation (EC) No 1334/2000 of 22 June 2000 setting up a Community regime for the control of exports of dual-use items and technology - OJ L 159, 30.6.2000.