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COMMISSION STAFF WORKING DOCUMENT

Accompanying document to the

INTERPRETATIVE COMMUNICATION

on the application of Article 296 of the Treaty in the field of defence procurement

Impact assessment summary

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Impact assessment summary

1. Background information on defence markets

Defence expenditure in the EU is worth about 170 b€ (1.7% of GDP), which includes about 82 b€ for defence procurement in general and 30 b€ for the acquisition of new equipment in particular.¹

Most of this expenditure is split into relatively small and closed national markets. Fragmentation at the national level remains in fact the main feature of Europe's defence sector on the demand and the supply side as well as the regulatory framework. This fragmentation is considered as a costly and inefficient obstacle to both intra-European competition and cooperation.

2. Specific Problem: extensive use of Article 296 TEC in defence procurement

Defence procurement law is an important element of this market fragmentation. At the Community level, there is – in contrast to other sectors such as energy or transport – no specific Directive coordinating national procurement rules in the defence sector. It is thus Procurement Directive 2004/18/EC which applies to public contracts awarded by authorities in the field of defence, subject to Article 296 of the Treaty.

Article 296 TEC allows Member States to exempt the procurement of arms, ammunition and war material from community rules, if this is necessary for the protection of their essential security interests. According to the Court, this exemption is limited to "*exceptional and clearly defined cases*" and does "*not lend itself to a wide interpretation*".² In practice, however, many Member States have exempted defence contracts almost automatically from community rules, no matter whether they fulfil the conditions for the use of Article 296 TEC or not. According to the findings of the Green Paper consultation launched in September 2004³, there are mainly two reasons for this:

(1) **The conditions for the use of Article 296 TEC are not clear, because:**

- (a) The concept of "essential security interests" is vague;

¹ Source: EUROSTAT and calculations by the Commission.

² Judgement of 16 September 1999, Case 414/97, Commission v. Spain, par. 21.

³ COM(2004) 608, 23 September 2004.

- (b) Paragraph 2 of Article 296 TEC mentions a list of war material which can be exempted. However, this list is not very precise and has never been published or revised since it was established in 1958;
- © New threats and technologies have blurred the dividing line between military and non-military security. This makes the decision on what is "defence" and what is "essential for security" even more complex.

(2) **Directive 2004/18/EC is considered ill-suited to many defence contracts**, since it does not take into account defence specific features. Member States are therefore often reluctant to apply the Directive to defence procurement, even when the conditions for the exemption are not fulfilled.

As a result of the extensive application of Article 296 TEC, the majority of defence contracts in the EU are awarded on the basis of national procurement rules. This hampers intra-European competition and has a negative impact for both industry's competitiveness and public spending.

3. Clarifying the conditions for the use of Article 296 TEC

As Guardian of the Treaty, it is the Commission's duty to ensure compliance with European Law. It is thus for the Commission to examine, if necessary, whether procurement cases fulfil the conditions for the use of Article 296 TEC, but also to ensure that the provisions of that Article are applied throughout the Union.

The clarification of the conditions for the use of Article 296 TEC is a necessary step to achieve this objective. In theory, there are three options for such clarification:

- The Commission could propose a revision of the 1958 list. However, such a revision would be a politically difficult and awkward exercise with a high potential for an unsatisfactory outcome.
- The concept of "essential security interests" could be specified. However, defence policy is not a Community policy, and it is not in the Commission's competence to define Member States' essential security interests.
- Based on the provisions of the Treaty and the relevant case law, the Commission can issue an Interpretative Communication explaining the use of Article 296 TEC. Such a Communication can clarify the limits of and conditions for the use of the exemption, but also the responsibilities of both the Commission and Member States.

The Interpretative Communication has its limits, in particular since it can neither specify what Member States "essential security interests" are nor determine ex ante which defence contract can be exempted. However, it is the only appropriate instrument to clarify the conditions for the use of Article 296 TEC and can give – in spite of its limits – useful guidance to awarding authorities for the assessment of the applicability of the exemption.

4. Analysis of the impact

- **Economic and financial impact:** The impact of the Interpretative Communication on defence markets probably varies between the various market segments: for the procurement of non-military goods, it will certainly enhance intra-European competition. For the procurement of military goods not concerning essential interests of security, Member States may try to continue to apply Article 296 TEC as long as community rules adapted to the specificities of defence items are missing. For the procurement of military goods concerning essential interests of security, the impact is zero, because they fall within the scope of application of article 296 TEC.
- **Impact on competitiveness:** The Interpretative Communication would have an impact mainly on non-warlike items, which represent normally the lower end of the technological spectrum. In consequence, it would contribute little to the competitiveness of defence industries.
- **Impact on administrative costs:** A more rigorous implementation of existing law should not involve organisational or structural changes for national administrations. Administrative costs should be close to zero.
- **Political and institutional impact:** Clarifying the borderline of Article 296 TEC, the Interpretative Communication is a useful complement to both the intergovernmental Code of Conduct administered by the European Defence Agency (which tries to increase transparency for defence market segments covered by Article 296 TEC) and possible Commission initiatives to establish community rules suited to defence contracts not covered by Article 296 TEC.

5. Conclusions

An Interpretative Communication is the only appropriate instrument to clarify the conditions for the use of Article 296 TEC. It can contribute to better compliance of the Treaty and enhance openness of defence markets, although its economic impact will probably be limited by and large to non-military material. Combining the Interpretative Communication with a new defence specific Directive may well be the most appropriate approach to cope at the Community level with the difficulties of applying Article 296 TEC.