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COMMON SECURITY AND DEFENCE POLICY

Trio Leadership: The Need to Liberalise the European Defence Market

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Global context and new specific challenges

Over the last year, renewed defence spending cuts in many European Union (EU) Member States have increased the need for closer EU defence cooperation. European governments have long acknowledged that significant savings could be gained through more common procurement in defence, joint logistics and common ownership of the most expensive military capabilities. In response to the new defence spending cuts, the EU has introduced a series of initiatives in recent months – including a German-Swedish sponsored plan – to help Member States explore more "pooling and sharing" of their military equipment.

As they respond to the economic crisis, another way European governments must rationalise their defence spending is through strengthening their efforts to integrate their defence markets. Even before the latest budget cuts, EU Member States had acknowledged that maintaining their largely fragmented defence markets was unsustainable. Not only was duplication wasting taxpayers' money, but it was also undermining the European defence industry's competitiveness (on which European military capabilities rely) and hampering the ability of European militaries to deploy side by side.

During the next Trio Presidency – composed of Poland, Denmark and Cyprus, EU Member States will need to start applying two EU Directives that should help the defence industry become more competitive and deliver equipment more cheaply.[1] But the impact of the Directives will largely depend on how much Member States are willing to use the new tools at their disposal. The Trio Presidency should encourage their fellow Member States to fully

1. The European Parliament and the Council, Directive, "Simplifying terms and conditions of transfers of defence-related products within the Community", 2009/43/EC, 6 May 2009, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:146:0001:0036:EN:PDF
and The European Parliament and the Council, Directive, "On the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security", 2009/81/EC, 13 July 2009, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:216:0076:0136:EN:PDF

exploit the new rules, and it should support the European Defence Agency (EDA) and the European Commission in exploring additional ways to liberalise the EU defence market.

Current status

For decades, Europeans have fought side by side within the North Atlantic Treaty Organisation (NATO), the United Nations (UN) and more recently under the aegis of the EU. Yet European governments have maintained a broadly national approach when purchasing their military equipment, relying largely on their domestic suppliers. As a result, European defence markets remain fragmented. This fragmentation has not only proved unnecessarily expensive, it has also hampered the ability of European militaries to work together on international missions.

Until the EU's package of Directives in defence was agreed at the end of 2008 and early 2009, each EU Member State had its own complex regulations governing procurement and exports of defence goods, and most defence procurement was not open to foreign or domestic competition. As a result, defence firms were not able to benefit from the economies of scale that larger markets would provide. The fragmentation of the market also led to wasteful duplication. In 2009, it was estimated that EU countries had a total of nearly 90 different weapons programmes, while the United States (US), whose defence budget was more than twice the size of the EU's defence budgets combined, had only 27.

Europe's defence companies – which operate increasingly across borders – were forced to struggle with complicated and diverging national requirements for exports. For example, many Member States required individual authorisations for each defence-related export, even when the same item (such as a spare part) was sent to the same firm within the EU. So, every time a multinational company wanted to ship components from one of its plants to another one in a different Member State, it had to ask for a new licence. Although such requests were hardly ever rejected, they could take several weeks to process. Worse still, company staff based in different EU countries often needed individual authorisations to talk over the phone. The European Commission estimated that the total cost of these barriers amounted to over €400 million a year.

Most Member States also required individual export authorisations for every sale of military equipment to another Member State's defence ministry. This entailed unnecessary and perverse delays. For example, France and Italy had been using French-built armoured vehicles in their contributions to the UN's mission in Lebanon. When a vehicle owned by French troops broke down, the French could get a new part from the manufacturer in France within days. But if Italian troops needed a spare part, the French manufacturer had to ask for an export authorisation. As a result, Italian troops had to wait several weeks for the export licence to be processed.

Conscious of the unnecessary costs and obstacles to military cooperation resulting from such fragmentation, in recent years EU Member States introduced a series of measures to liberalise their defence markets. The two aforementioned Directives, agreed in late 2008 and early 2009, have been the most ambitious steps so far.

The first Directive – known as the intra-EU arms transfers Directive – is designed to simplify procedures for moving military goods amongst Member States. It requires all Member States to offer general and global licences in addition to individual export licences – until now, many Member States had only provided individual authorisations.[2] The Directive aims to reduce the use of individual export licences. In particular, it encourages Member States to grant general licences when they authorise weaponry or spare parts to be sent to armed forces in another EU country, or when goods are sent as components to trustworthy defence companies in the EU.

The second Directive aims to increase the amount of defence procurement that is open to competition across the EU. For 50 years, defence-related goods had remained largely exempt from the EU's internal market rules. EU countries agreed in 1958 that European rules on competition and the free movement of goods should not apply to military and security when "essential security interests" were at stake (a provision known as Article 346 under the Treaty of Lisbon).

In principle, Member States were only supposed to use the exemption on an exceptional basis, and justify why competitive procurement would pose a security threat. But Article 346 carries no definition of the scope of an essential security interest. Consequently, many governments regarded Article 346 as an automatic exemption. Over the years, they routinely excluded competition from the procurement of even the most non-sensitive defence goods – including helmets, uniforms and military catering. "National security" was often a cloak for protectionism. In theory, the European Commission could have challenged such abuse of Article 346 and brought member governments before the European Court of Justice. But the Commission was wary of pushing too hard in an area that many governments see as central to national sovereignty.

Already in 2005, EU Member States committed themselves to increasing the amount of cross-EU competition in defence goods through a voluntary code of conduct within the EDA. The defence procurement Directive goes further – it is legally binding and offers procurement procedures tailored specifically to defence and security needs so that governments can safely open more of their defence procurement to competition. Under the new rules, ministries of defence benefit from substantial flexibility and security guarantees – bidding companies must protect classified information and be able to ensure delivery is always on time, even in times of crisis.

2. Broadly speaking, goods that benefit from a general licence can move across EU borders without exporters having to ask for specific licences to do so. Global licences are granted to defence companies and allow them to transfer several goods to various recipients

Over the last 18 months, EU Member States have been transposing both Directives into national legislation, and from August 2011 the new defence procurement rules will apply across the EU. The rules governing intra-EU transfers will apply from June 2012, after the European Commission has assessed Member States' implementation efforts during the course of the year.

Potentially, the two Directives could bring significant improvements. More competition in procurement would promote a more efficient industry and better-value defence goods, to the benefit of defence ministries and European taxpayers. Easier transfers of defence goods within the EU would help large defence companies with plants and subcontractors in several Member States. Small and medium-sized enterprises (SMEs) would find it easier to break into markets in other Member States. And national militaries would have shorter delays when importing new equipment, as in the case of the Italian troops in Lebanon.

However, the reforms will only make a significant difference if Member States choose to use them to their full potential, something from which governments might shy away. When resorting to the new intra-EU transfer rules, governments will be able to choose which military goods are safe for general and global transfer licences, and there is a risk that they will issue general and global licences for only a limited range of goods – or perhaps none at all. EU governments remain wary of trusting their neighbours to ensure that their defence goods are not re-exported to undesirable destinations. (While some Member States, such as Germany and the United Kingdom, are known to have very reliable export controls, other countries have suffered from lower standards, in particular some of the new Member States, such as Romania and Bulgaria.) When EU Member States agreed to the new transfer rules, they committed themselves to improving the quality of their export controls and introducing a series of confidence-building measures (including the need for defence companies that want to import goods benefiting from a general licence to be certified by their governments). But if Member States do not consider export controls to be thorough across the EU, there is a significant risk they will only resort to more efficient export licences for their least sensitive military goods.

Governments might also shy away from exploiting the defence procurement Directive, particularly as the current economic crisis could strengthen the temptation to protect national industries and domestic jobs. The scope of what constitutes an "essential security interest" has still not been clearly defined in Article 346, so governments could continue resorting to the exemption. Even when resorting to the new procurement procedures, governments could attempt to manipulate the criteria within their contracts to favour national competitors.

Recommendations

Poland has identified EU defence cooperation as one of the key priorities for its Presidency, although the Polish government has so far expressed an interest in focusing on aspects of EU defence other than the defence market. But Warsaw should widen its efforts into this important field and, with its Trio Presidency partners, encourage fellow Member States to make full use of the new Directives.

The Trio Presidency will not be the main actor in encouraging full implementation across the EU – this will largely be the responsibility of the European Commission, which will have the authority to take reluctant Member States to the European Court of Justice if they abuse the new procurement rules. The Commission will also be making an assessment of how well Member States have implemented the various confidence-building measures relating to the intra-EU transfers Directive.

The Trio Presidency can nonetheless help in the following ways:

- Leading by example: Poland, Denmark and Cyprus should embrace the new defence procurement rules, even though they might, at times, have a detrimental short-term impact on jobs in their national defence industries. The three countries should also ensure their export controls are of the highest standard.
- Increasing the visibility of the new Directives and their potential benefits by organising public events.
- Providing support to the European Commission as it assesses the implementation of the intra-EU transfers Directive across the EU. The Trio Presidency should also encourage the Commission to dare to criticise Member States that fall short. And if required, it should assist in setting up frameworks for EU Member States to share best practices in export controls and certification procedures, so that shortcomings in any European capitals can be addressed before the intra-EU transfer rules start being applied in June 2012.
- Finally, the Trio Presidency should support the EDA and the Commission in exploring additional initiatives to dismantle many of the remaining barriers to trade amongst EU Member States' defence markets, including the different rules governing foreign investment in European defence companies.