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THE EU AND THE EUROPEAN DEFENCE MARKET

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Abstract

The European Union's Member States spend hundred of billion euro every year on defence, of which the sixth part is used for defence procurement. The money on this defence procurement is not spend on a single market (the European Defence Market) but rather on twenty-seven different national markets because the European Union's internal market has not traditionally included defence equipment.

But some of EU countries do not buy their weapons from foreign defence companies (unless they do not have an indigenous defence industry or their national companies do not make the product the government needs). They have the tendency to favour their national suppliers irrespective of the price or quality of equipment they produce.

Therefore and not only it is necessary to create the European Defence Market.

THE EUROPEAN DEFENCE MARKET – ONE OF EU'S PURPOSE

EU governments are gradually coming around to the idea that they need to open up their defence markets, especially at a time when growing budgetary constraints clash with the increasing need for sophisticated military equipment[1].

In 2004 they created the European Defence Agency (EDA), and one of its many tasks is to encourage the convergence of national procurement procedures. In July 2006 the EDA introduced a defence procurement "Code of Conduct" to open up the European defence market. The basic idea behind the Code was to ensure that defence companies from any country could compete for most defence contracts across Europe, excluding multinational equipment programmes and the most sensitive goods like encryption devices. The Code of Conduct (CoC) has worked rather simply: countries that join the CoC vow to open all nonessential defence contracts worth over one million euro to foreign bidders. The code was voluntary and the EDA cannot force governments to comply with it. The Member States have so far shown very little enthusiasm for awarding contracts to outside suppliers. Their protectionist attitude derives from the fact that they regard defence procurement as an area that overlaps with national sovereignty.

But the importance of the CoC lies as much in its principle as its practice. The idea of more open European defence markets has been around for decades, but with little or no progress until the CoC was introduced. Never before have so many European governments agreed that they should open up their defence markets to each other. And the EDA should continue to build on the growing Member State participation in the CoC. For instance, EU governments could encourage further industrial consolidation by

[1] http://www.iss.europa.eu.

extending the EDA's Code of Conduct to future multinational programmes (they are currently exempt) within ten years. This would help increase the transparency of the tender procedure for multinational programmes and encourage more joint tenders and competition for contracts, which should help keep prices down[2].

In December 2007, the European Commission adopted a package of defence-related proposals, the aim of which is to help create a single European defence market for military equipment. This, according to the Commission, "without sacrificing member states' control over their essential defence and security interests". This package would bring the EU closer to its long-term goal of setting up a 'genuine European defence market' for military equipment, in a move applauded by politicians and the defence industry. One of the initiatives in the package was a proposal for a directive on public procurement in the fields of defence and security[3].

Also, this package has contained the following three elements:

- a communication with recommendations for fostering the competitiveness of the sector;
- a directive on defence procurement to enhance openness and intra-European competition in the national defence market;
- a directive on intra-EU transfers of defence products[4].

The proposed directives would open up the defence market, improve European cooperation on armaments and lead to a more competitive European defence industry. The European Commission's role in the defence market is confined to "dual-use" products that are components of both civilian and military equipment. But the defence market would benefit from the Commission's experience in policing the single market for commercial goods and services. However, given the sensitive nature of the defence market, some arms-producing countries are reluctant to give much new regulatory power to the Commission.

The procurement directive would establish four types of procedures to help streamline national procurement procedures. These are: restrictive calls for tender; negotiated procedures with publication; competitive dialogue; and negotiated procedure without publication. The proposal seems both fair and sensible, because it strikes a balance between opening defence markets to allow more industrial competition and the sovereignty imperatives related to defence procurement that governments worry about. Moreover, the text includes not only defence but also security equipment tenders. This is important for two reasons: first, because the frontier between "defence" and "security" equipment is blurring. Second, because the EDA Code of Conduct does not cover security items. Like the CoC, the procurement directive would encourage the opening of European defence markets, but with a broader approach (including security products) and it would be legally binding[5].

The Commission expressed its hope that the proposal would "pave the way for increasing industrial cooperation and optimising supply chains" and make a "crucial contribution to a more competitive European industrial and technological defence industrial base".

The Commission's initiative complements the Code of Conduct on Defence Procurement launched in July 2006, which covers contracts placed outside of EU internal market directives[6].

THE REMOVED BARRIERS FROM EU MARKET FOR DEFENCE EQUIPMENT

To achieve more effective armaments cooperation, European governments need to do a number of things such as pooling more resources,

[2] Keohane, D., *Introduction - Towards a European Defence Market* in Chaillot Paper, nr. 113, p. 7, European Union Institute for Security Studies, Paris, 2008.

[3] http://www.euractiv.com/en/trade/parliament-paves-way-single-eu-defence-market/article-178515.

[4] http://www.euractiv.com/en/security/eu-new-defence-procurement-initiative-broadly-welcomed/article-168918.

[5] Keohane, D., *Introduction - Towards a European Defence Market* in Chaillot Paper, nr. 113, p. 9, European Union Institute for Security Studies, Paris, 2008.

[6] http://www.euractiv.com/en/security/eu-new-defence-procurement-initiative-broadly-welcomed/article-168918.

managing joint equipment programmes better, and in particular opening up their defence markets. The history of European armaments cooperation shows that none of these goals are easy to achieve. NATO, the WEU, and more recently the EU have tried to improve multinational armaments cooperation for decades, with depressingly little success. Defence remains the most "national" of all policy areas, in the sense that the EU's Member States are very reluctant to give up sovereignty to international organisations.

As a result of this protectionism, a number of EU countries do not buy their weapons from foreign defence companies (unless they do not have an indigenous defence industry or their national companies do not make the product the government needs). Many still tend to favour their national suppliers irrespective of the price or quality of equipment they produce. They can do so legally because defence goods are exempt from the EU's single market rules (due to their sensitivity). But the absence of cross-border competition makes European weapons expensive.

In theory, a more integrated European defence market would allow free movement of most defence goods among EU Member States. Greater cross-border cooperation would allow larger economies of scale, increased industrial competition, and thus lower prices, particularly for more advanced equipment. Defence ministries would be able to purchase equipment from the company that offered the best financial and technical package, regardless of its national origin. Keith Hartley of York University has estimated that a single defence market could save EU governments up to 20 percent of their procurement funds.[7] EU governments spend roughly 30 billion euro annually on purchasing defence equipment. Thus, a single defence market could save defence ministries up to 6 billion euro a year.

The European Commission welcomes today's support of the European Parliament for a new directive to overcome fragmentation of the European defence market. The directive on intra-EU transfers of defence-related products, once implemented, will alleviate obstacles to intra-community trade and eliminate most transit formalities, while preserving Member States' control over their defence and security interests. The EP vote is based on an agreement reached with the Council.

Until now, national systems to control transfers of defence equipment have not distinguished between exports to third countries and transfers to other Member States. Applying heterogeneous and disproportionate national licensing systems hampers the security of supply between Member States, costs business over €400 million a year and curtails market opportunities in other Member States for competitive subcontractors from Small and Medium-Sized Enterprises (SMEs).

In order to change this situation, which is incompatible with the aims of the internal market and European security and defence policy, the Directive on intra-EU transfers of defence products will significantly simplify national licensing procedures thereby facilitating cross-border exchanges within the EU. This will help make defence industries more competitive and facilitate SME participation in prime contractors' supply chains. The new legislation should enable

[7] Keith Hartley, 'The future of European defence policy: an economic perspective', *Defence and Peace Economics*, vol.14, no. 2, January 2003, p.107-115.

Member States to meet military needs at lower cost, enhance security of supply for cross-border defence procurement and encourage industrial cooperation[8].

THE DEFENCE INDUSTRIES ARE WORKING TOGETHER TO SUPPORT EUROPE'S DEFENCE

The European defence industry makes a major contribution to the security and defence of European citizens. The key objective of the European Commission's defence industrial policy is to develop an innovative and competitive European Defence Technological and Industrial Base (EDTIB). Such an EDTIB is an important prerequisite for an effective European Security and Defence Policy (ESDP) which is designed to provide the EU with the capacity for autonomous action in order to respond to international crises, without prejudice to actions by NATO. A competitive EDTIB is also required to provide Europe with affordability and the ability to cooperate internationally in the development and production of defence equipment[9].

This industry is mostly concentrated in six Member States (France, Germany, Italy, Spain, Sweden and the UK) although companies producing ancillary equipment and systems are found all over Europe.

The European defence equipment market is technology-intensive with cutting-edge research and development in fields such as electronics, ICT, transport, biotechnology and nanotechnology. Many new technologies developed for defence have also turned into drivers for growth in civil sectors such as in global positioning and earth observation.

However, the European defence market is highly regulated at a national level and fragmented. Europe's defence-related industries (primarily the defence part of sectors such as aeronautics, space, electronics, land systems and shipbuilding) largely operate outside the internal market. Member States have maintained national control over defence equipment markets and related industries.

This fragmentation and divergent national policies creates red tape, hampers innovation and leads to duplication of defence programmes and research. Ultimately this undermines competitiveness of the European Defence industry and the effectiveness of the European Security and Defence Policy (ESDP).

Nevertheless, the situation is now evolving. The economic pressure resulting from reduced defence budgets after the end of the cold war, and the escalating development costs, make the maintenance of a comprehensive national defence industrial base impossible for any single European state. The European defence industry has therefore to enhance its competitiveness as much as possible. The technological evolution towards dual use and multidisciplinary technologies is an important new challenge presenting opportunities and difficulties[10].

THE EU AND THE DEFENCE EQUIPMENT POLICY

The EU's defence equipment policy[11] aims to promote the implementation of the European Security and Defence Policy (ESDP), the improvement of the Union's abilities to fulfill the Petersberg Tasks and the strengthening of European defence companies' industrial situation. The 2006 Code of conduct is paving the way for a partial ending of the defence industry's general exemption from EU's public procurement rules.

According to the Commission, the EU's defence equipment policy should rest on the following key considerations:

- cost efficiency of defence spending;
- maintenance of a competitive defence and technological industrial base;
- security of supply;

8 http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1981&format=HTML&aged=0&language=EN.

9 http://ec.europa.eu/enterprise/sectors/defence/index_en.htm.

10 http://ec.europa.eu/enterprise/sectors/defence/defence-industrial-policy/index_en.htm.

11 http://www.euractiv.com/en/security/eu-defence-equipment-policy/article-117487.

- better access for EU-manufactured goods to third country markets;
- need to respect member states' prerogatives in this sensitive area;
- ethics and fairness in the arms trade.

The Commission believes that "Europe's military equipment policy is in no way intended to copy that of the United States". Europe must make more efficient use of its existing resources, and to this end it must seek to harmonise its equipment standards and create a European defence market.

Besides strengthening political and parliamentary controls over the related processes, the Commission also aims to boost military equipment-related research and development, as foreseen in the 7th Framework Programme.

To provide stakeholders with a clear picture of Europe's defence industry landscape, the Commission proposes launching the monitoring of defence-related industries.

The European Defence Industries Group (EDIG) is advocating the creation of a European Defence Equipment Market (EDEM) - a more transparent and open market within Europe to fulfil military material requirements.

THE FULFILING OF A STANDARDISATION IN DEFENCE

The development, and use, of standards is largely seen as a technical matter rather than an important European policy area. However, standardization of defence equipment is an important basis for the opening-up of national markets and the gradual creation of a single European defence market. The Council of Ministers, in its Resolution on the Standardisation in the Field of Armaments (6953/03), stated "that standardisation is an important pre-condition to fulfil the building of a strong European defence industry". These principles underpin the Commission's policy in this area.

At the heart of this policy, is the development of the "European Handbook on Defence Procurement" (EHDP). The Handbook's primary objective is to provide Defence Procurement managers with the 'state of the art' standards references supported by information on best practice when specifying them in defence contracts. It is also designed to complement the work of NATO in this area and the European Defence Agency (EDA).

The work on the Handbook is being funded by the European Commission and being co-ordinated by European Committee for Standardisation (CEN).

The Commission would like to see the EHDP systematically used in defence procurement contracts. This will reduce divergence in standards, lead to better alignment of national procurement practices, support co-operation and enhance interoperability to the benefit of Member States and industry[12].

CONCLUSION

The European Defence Agency and the European Commission are trying to break up a highly protectionist defence market, which should help improve many defence ministries' bottom lines[13]. Plus streamlining Europe's defence markets would also create new incentives to reform the rules for transatlantic defence trade. If the EDA and the European Commission manage to convince EU governments to open up their

[12] http://ec.europa.eu/enterprise/sectors/defence/standardisation/index_en.htm.

[13] Keohane, D., *Introduction - Towards a European Defence Market* in Chaillot Paper, nr. 113, p. 12, European Union Institute for Security Studies, Paris, 2008.

defence markets, those benefiting would include the defence industry, which would become more competitive; the armed forces, who would get badly needed military equipment at a better price; and the taxpayers, who would get better value for money.