

## PUBLIC PROCUREMENT: NEW COMMISSION INITIATIVES ON MORE OPEN AND EFFICIENT DEFENCE PROCUREMENT



**T**he European Commission has published a Green Paper on defence procurement and outlined its proposals for future initiatives to improve cross-border competition in defence procurement.

### PROPOSED INITIATIVES

Pending the outcome of an extended impact assessment on a Directive, in 2006 the Commission will adopt an 'Interpretative Communication' on the application of Article 296, according to which Member States can derogate from the application of Treaty rules for defence products concerning their 'essential security interests'. This will be a non-legislative measure that reduces the risk of legal misinterpretation and thus ensures better application of existing law by Member States. It will recall the principles governing the use of the derogation in the light of European Court of Justice case law, and will clarify the criteria on the basis of which Member States have to prove when the conditions for the application of the derogation are met.

However, this Communication is unlikely to be sufficient to resolve the inadequacy of the existing public procurement Directives with regard to the specific features of defence procurement. Therefore the option of a specific Directive will now be vigorously pursued. In line with the principle of Better Regulation, any proposed Directive will be accompanied by an impact assessment which will assess its possible costs and benefits.

### RESULTS OF THE GREEN PAPER CONSULTATION

The Commission received 40 responses to its Green Paper consultation on defence procurement from institutions (the European Parliament),

industry and 16 Member States. All respondents welcomed the Green Paper and supported the Commission's objective of overcoming market fragmentation and increasing intra-European competition through an appropriate set of rules for defence procurement.

### EUROPEAN DEFENCE EQUIPMENT MARKET

The development of the European Defence Equipment Market (EDEM) is even more important given the advances in European Security and Defence Policy (ESDP) and the creation of the European Defence Agency (EDA). The work of the EDA and the Commission initiative concern two different segments of the defence market. The two initiatives are complementary and the EDA and the Commission cooperate closely.

### FREQUENTLY ASKED QUESTIONS

What are the benefits of creating a European Defence Equipment Market?

A European Defence Equipment Market would complement work currently being carried out by Member States under the European Security and Defence Policy. The first step under the ESDP is for Member States to identify the military capacities that will be necessary in the future. The second step is for Member States to work together to meet that need, by building an EDEM.

Competition within the EU, the competitiveness of European industry and the efficiency of public spending could all be improved. Current fragmented national markets are no longer sustainable, given the budgetary situation in Member States, continuing increases in research and development costs for major defence programmes and the competitive advantages currently enjoyed by non-European industries. This is why

EU-level initiatives on the regulation of defence procurement markets are needed.

## WHY ARE THERE SPECIAL EU RULES FOR THE DEFENCE PROCUREMENT MARKET?

Public procurement Directives are applicable in principle to all sectors, including defence. However, certain defence products are very specific in nature. Defence industries are strategic and governments play a crucial role as customers, sponsors and regulators. Given the political and military sensitivity of defence systems, secrecy, confidentiality and security of supply are particularly important.

Exceptions to general public procurement rules are therefore provided for in the EC Treaty, as it is not always possible to use for defence contracts the procedures set down in the Directives – for example, open tendering processes based on publication in the Official Journal of the European Union.

## WHAT IS DEFENCE PROCUREMENT AS AN ESTIMATED PROPORTION OF EU GDP?

According to Eurostat estimates, total defence expenditure by the 25 EU Member States in 2003 represented €169 billion (1.7% of GDP), which included €82 billion on defence procurement (0.8% of GDP), of which €30 billion went on defence equipment (0.3% of GDP).

## WHICH MEMBER STATES HAVE THE LARGEST DEFENCE INDUSTRIES?

The most important arms-producing countries with the highest turnover in the EU are the UK, France, Germany, Italy, Sweden and Spain. They represent approximately 90% of defence equipment production in the EU-25. These countries also represent 80% of EU defence procurement expenditure.

## ARE DEFENCE MARKETS COMPLETELY CLOSED?

Member States' combined military expenditure is considerable but it remains mainly split into national markets.

Some progress has been made as a result of the increase in European armaments cooperation. However, even in that context, cross-border procurement remains limited mainly by the principle of 'juste retour' which means that work is split up between suppliers based on national industrial policy criteria.

As far as national procurement decisions are concerned, the degree of openness of defence markets varies greatly between Member States. Since information on defence markets is fragmented and incomplete, it is not possible to present a comprehensive picture. In general, countries which do not themselves produce military supplies on a large scale naturally have more open defence markets than those that do. In general, however, the share of contracts awarded by competitive procedure is still low and national suppliers still tend to be awarded most of the contracts.

## WHY IS IT NECESSARY TO INTERVENE IN DEFENCE MARKETS?

### IS THERE A NEED TO RESOLVE A CRITICAL SITUATION IN THIS SECTOR?

The contributions to the Green Paper from stakeholders express concern about the critical situation of defence markets. The lack of transparency and competition in Member States' procurement practices hinders the competitiveness of European industry and increases the cost of military equipment. This is no longer sustainable for public spending and also for the quality of equipment needed for ESDP efforts.

The absence of a European market is disadvantageous for all stakeholders: governments pay extra costs for a non-competitive market; armed forces may not get the best equipment; and industries pay extra overhead costs (if they participate in foreign bids), suffer from short production runs (if they stick to their home markets) and see their competitiveness compromised (in both cases).

## DOES THE COMMISSION WANT TO ABOLISH THE DEROGATION OF ARTICLE 296 IN THE LONG TERM?

No. Article 296 will remain fully applicable when the conditions of its application are met, regardless of the outcome of this debate.

## WHAT WOULD BE THE IMPACT OF MORE OPEN DEFENCE PROCUREMENT IN TERMS OF COMPETITIVENESS?

As the Commission indicated in its March 2003 Communication 'Towards an EU defence equipment market' (see IP/03/355), the EU needs a competitive Defence Technological and Industrial Base (DTIB) to realise the full potential of the ESDP. Such a competitive base, given the large size of the sector, is also crucial to economic growth and to the overall competitiveness of the European economy and will be a factor in achieving the goals set out in the Lisbon strategy.

The currently fragmented regulatory framework often makes it difficult for companies to adjust to the different national approaches within the EU.

## WHAT ARE THE ADVANTAGES OF MORE OPEN DEFENCE PROCUREMENT?

The advantages of a more open European defence market, adapted to the specific nature of the sector, are generally acknowledged. It would allow companies, especially SMEs, to tender more easily in other EU Member States and thus widen their access to business opportunities within a much larger 'home' market. Longer production runs would allow economies of scale. This, in turn, would help to reduce costs and lead to lower prices. The final beneficiary of that would be the taxpayer. Everybody in Europe should in the end also benefit from the greater economic prosperity created by the improved global competitiveness of European industry, especially given the growing dual-use potential of technologies (military and civilian). A more open market would also boost industrial restructuring across national boundaries to reduce duplication.

## WHAT WAS THE OBJECTIVE OF THE GREEN PAPER?

In September 2004 the Commission issued a Green Paper to consult stakeholders on possible Community initiatives to improve transparency and competition in this field, without putting into question the Article 296 derogation.

*The objective was to assess whether it was necessary to:*

- clarify (with an Interpretative Communication) the current regulation in order to help Member States to distinguish between defence contracts to which Internal Market rules apply and those for which a derogation under Article 296 is justified; and
- improve the existing regulation, by introducing more appropriate and flexible rules, better suited to the specificities of the sector (via a new specific Directive).

## HOW WILL AN INTERPRETATIVE COMMUNICATION ADDRESS THE SPECIAL NATURE OF DEFENCE PROCUREMENT MARKETS?

The Green Paper has opened a debate on how to improve cross-border competition in certain types of defence procurement. The Interpretative Communication will help Member States to establish when defence contracts can derogate from Internal Market rules and therefore from the current Directives, on the basis of essential security interests and according to the conditions of application of Article 296 of the EC Treaty.

The interpretation of the Article 296 derogation is different in various Member States. This situation has resulted in the fragmentation of the defence equipment market. The existing legal

framework is not satisfactory and creates legal uncertainty. An Interpretative Communication will help to clarify the situation.

## WHAT WILL BE THE IMPACT OF THE INTERPRETATIVE COMMUNICATION?

An Interpretative Communication interprets existing law and is adopted by the Commission under its own responsibility. The proposed Communication will therefore take into account the existing legal framework, plus recent developments in the relevant case law of the Court of Justice, and clarify that legal framework by announcing the way the Commission would interpret and apply it in the future.

As regards its content, the Interpretative Communication will provide criteria to be used in order to help Member States to establish more clearly when the conditions for the application of Article 296 – allowing for defence contracts to derogate from general public procurement law – are met and when they are not. In the latter case, normal procurement rules will be applicable.

## WOULD A POSSIBLE NEW DIRECTIVE REPRESENT AN ADDITIONAL REGULATORY LAYER?

No. Legislation on defence procurement already exists: public procurement Directives already apply to defence contracts when they are not covered by Article 296. A new defence Directive would replace the existing Directives, considered by stakeholders to be ill-suited to this market, in order to take into account the specific nature of the defence sector. This would mean more flexible and better-adapted rules.

## WHAT WOULD BE THE IMPACT OF A DIRECTIVE?

A Directive would be adopted by the Council and European Parliament and would constitute new law to be applied throughout the EU. The derogation provided for in Article 296 would remain fully applicable, according to the same conditions as today. But a Directive could establish specific and more appropriate (ie more flexible) rules for the award of contracts which are not covered by the derogation, and which currently should be awarded on the basis of the existing public procurement Directives. It could also improve the classification of contracts, on the basis of different possibilities on which the Green Paper aims to stimulate discussion: a general definition of the categories of military equipment covered by the Directive and/or a list of such categories.

## IF THERE WERE TO BE A DIRECTIVE ALONG THE LINES IDENTIFIED IN THE GREEN PAPER, HOW WOULD IT DIFFER FROM THE EXISTING GENERAL PUBLIC PROCUREMENT DIRECTIVES?

The potential advantage of a new Directive is precisely that it would take into account the specific nature of the defence sector and introduce greater flexibility suitable for that sector. Transparency and non-discrimination would remain the cornerstone of the new regime, just as they are the basis for the general procurement Directives.

*However, a special set of rules to be defined with Member States could be envisaged, including:*

- wider information on the relevant defence contracts through a centralised system of publication
- general use of the negotiated procedure (which would allow contracting authorities, after a call for tenders, to consult and negotiate contract terms with the selected companies)
- scope for contracting authorities to use the negotiated procedure without the prior publication of a tender notice, in certain defined cases
- new specific selection criteria to be applied in assessing tenders, such as confidentiality and security of supply

## WHAT IS THE RELATIONSHIP BETWEEN THE COMMISSION AND THE EUROPEAN DEFENCE AGENCY?

The EDA is an agency of the Council. The EDA tasks cover mainly the development of military capabilities and armaments, which are areas for which Member States are solely responsible. But the EDA also has roles – in research and technology, the defence industry and markets – which interact with Commission competences. The Joint Action establishing the EDA indicates that the agency “*should fulfil its missions in full respect of the competences of the European Community*”.

As far as market issues are concerned, but also on other issues, the Commission and EDA work in close cooperation.

## WHAT IS THE RELATIONSHIP BETWEEN THE COMMISSION INITIATIVE AND THE CODE OF CONDUCT WHICH HAS BEEN ADOPTED BY THE EUROPEAN DEFENCE AGENCY?

The initiatives of the Commission in the field of defence procurement come under the ‘first pillar’ of the EU’s competence and concern defence contracts which are to be procured under EC Treaty rules pertaining to the Internal Market. In contrast, the EDA’s Code of Conduct, which is voluntary and non-binding, comes under the ‘intergovernmental pillar’ and concerns another segment of the defence market, namely contracts which can derogate from EC Treaty rules pertaining to the Internal Market when the conditions for the application of Article 296 (‘essential security interests’) are met. These two initiatives are therefore complementary and can be carried out in parallel.

## WHAT WOULD BE THE IMPACT ON THE TRANSATLANTIC DEFENCE MARKET OF MORE OPEN DEFENCE PROCUREMENT AT EU LEVEL, ESPECIALLY VIA A POSSIBLE DIRECTIVE?

The possible EU initiatives referred to in the Green Paper would aim to foster intra-European rather than international competition. International trade markets will remain governed by WTO rules which provide under Article 23 of the Government Procurement Agreement that defence products are excluded. In consequence, Member States will still have the option, as is the case today, to buy their defence equipment from tenderers – such as US companies – not established in the EU.

*Contributions to the consultation can be viewed at:*

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

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