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The Interparliamentary European Security and Defence Assembly

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FIFTY-FIRST SESSION

The European defence equipment market: Article 296 of the Treaty establishing the European Community and the European Commission's Green Paper – reply to the annual report of the Council

REPORT

submitted on behalf of the Technological and Aerospace Committee
by Franco Danieli, Rapporteur (Italy, Liberal Group)

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[1] Adopted unanimously by the Committee on 9 November 2005.

RECOMMENDATION 769[1]

on the European defence equipment market: Article 296 of the Treaty establishing the European Community and the European Commission's Green Paper – reply to the annual report of the Council

The Assembly,

(i) Affirming the central role of governments in determining their armed forces' defence equipment requirement;

(ii) Taking the view that the rising cost of defence research, technology and development programmes is restricting governments' capacity to meet virtually all of that requirement nationally;

(iii) Considering therefore that cooperation over defence equipment, technology and capability programmes among European governments, in restricted or wider configuration, is currently the best way of dealing with the situation;

(iv) Acknowledging that numerous obstacles – political and economic or in terms of priorities and technological capability – are limiting the scope and efficiency of programmes undertaken in cooperation;

(v) Taking the view that improvement of the military capabilities the European Union member states and NATO countries place at the service of the Alliance and ESDP cannot be achieved without a European armaments policy and common definition and harmonisation of defence equipment and RT&D priorities and needs for the coming years;

(vi) Recognising the leading role of the large European defence equipment producer and customer states as founder members of the Organisation for Joint Armament Cooperation (OCCAR) and signatories of the Letter of Intent/Framework Agreement concerning measures to facilitate the restructuring and operation of the European defence industry;

(vii) Considering that those countries represent the central core of Europe's defence economic, industrial and technological capability;

(viii) Noting that, as a whole, such nations are in favour of maintaining the national security derogation under Article 296 of the Treaty establishing the European Community (TEC);

(ix) Considering that the 15 April 1958 List identifying the equipment and technology subject to the derogation should be updated and merged with the list of European Union military equipment as defined in the EU Code of Conduct on Arms Exports;

(x) Recognising the limitations to the application of Article 296 TEC imposed by European Court of Justice precedents;

(xi) Recognising the competence and salient role of the European Commission in public procurement and in activating and strengthening the European civilian industrial and technological base;

(xii) Considering that its experience in this area is useful for restructuring and developing the defence industrial sector in the European Union member states;

(xiii) Considering that the Green Paper on Defence Procurement, together with national and other responses to the consultation procedure set in train by the European Commission, has contributed vital food for thought on clarification of the legal rules and procedures that apply in this this area of state action;

(xiv) Considering nevertheless that the European Commission's role in that area should be in keeping with the principle of subsidiarity and should focus on advice and technical assistance while strategic decisions remain the responsibility of the European Union member states;

[1] Adopted by the Assembly on 6 December 2005 at the 8th sitting.

(xv) Considering that the European Defence Agency should be the driving force, and provide the forum for intergovernmental discussion on the future of the defence industry, defence RT&D and expanding the European Defence Industrial and Technology Base (EDITB);

(xvi) Considering the intergovernmental Code of Conduct on Defence procurement currently being prepared by the Agency a vital contribution to the future of EDITB but only a first step towards a more integrated and better regulated market – one possibly subject to EDA monitoring and arbitration;

(xvii) Considering that in regard to dual and security technology there needs to be synergy between the member states, the European Defence Agency and the Commission, taking care to avoid competing responsibilities and duplication;

(xviii) Acknowledging that all EU and European NATO member states should be able to take part in cooperation programmes in so far as their financial, industrial and technological capability allows and that due respect should also be paid to the interests of "small-medium" states;

(xix) Recognising the importance of taking account of the interests of and proposals from the defence industry itself in the process of developing a European defence equipment policy;

(xx) Considering, to that end, that the various industries must be closely associated with the work of the EDA Directorates and should, subject to arrangements yet to be defined (in terms of status, right to speak, vote and the like), be represented on the Agency Steering Board;

(xxi) Recognising the essential part played by small and medium-sized suppliers of defence equipment and technology in developing national and European military capabilities, both as contributors to research and as providers of employment;

(xxii) Considering that developing and strengthening the EDITB in the initial stages implies affirmation of the principle of seeking European national or cooperative solutions, in so far as is possible without prejudicing cooperation with third country allies and partners;

(xxiii) Considering that stating a European preference is not synonymous with protectionism, but a necessary step in "rebalancing" international defence industrial and technological cooperation, particularly in regard to the United States,

RECOMENDS THAT THE COUNCIL INVITE THE WEU MEMBER STATES AS MEMBERS OF THE EUROPEAN UNION TO:

1. Envisage updating the 15 April 1958 List identifying the equipment and technology subject to the Article 296 TEC national security derogation and merging it with the list of European Union military equipment as defined in the EU Code of Conduct on Arms Exports;

2. Adopt and implement the intergovernmental Code of Conduct on Defence Procurement being drawn up in the European Defence Agency at the earliest opportunity;

3. Ensure, in the application of the Code, that account is taken of and due respect given to the interests of the "small-medium" European Union member states and of small and medium-sized defence sector businesses;

4. Give the European Defence Agency the task of monitoring and enforcing application of and compliance with the rules defined in the Code;

5. Develop rules and machinery to bring about a reduction in the need for offset in defence procurement and its progressive replacement by an "overall juste retour" in accordance with OCCAR established practice;

6. Facilitate access by the defence industry to the financial aid and technical advice and assistance the Commission offers the civilian sector, particularly for industrial restructuring and dual-use RT&D programmes, subject to rules respectful of the competences of the member states and the Commission and the need for security and confidentiality in this area;

7. Gradually strengthen the European Defence Agency's work and intervention capability by ensuring that it has budget, staff and technical resources commensurate with defence capability and RT&D requirements, those resources being at the service of the member states and the ESDP;

8. Promote close cooperation between the European Defence Agency and NATO's technical agencies, particularly the NATO Consultation, Command and Control Agency (NC3A);

9. Work to achieve a better balance in transatlantic cooperation in the fields of defence equipment and technology by supporting the efforts of European firms to be more competitive in the European market and achieve a greater presence in the US market;

10. Coordinate their views in this connection so as to achieve a common position that could provide a basis for discussion about striking a balance in transatlantic cooperation – both industrial and in regard to technology – that is more even-handed and considerate of European interests;

11. Keep the Assembly informed, through the Council's annual report, of developments in regard to defence equipment at the European level in EU member states and in NATO, in the spirit of Article IX of the modified Brussels Treaty and in accordance with established practice.

EXPLANATORY MEMORANDUM

submitted by Franco Danieli, Rapporteur (Italy, Liberal Group)

I. Introduction

1. With the advent of the European Security and Defence Policy (ESDP) in the final decade of the 20th century the European Union is setting about the task of building an autonomous defence capability that will enable it to contribute militarily to international crisis management "where NATO as a whole is not engaged". This development is one with direct implications for Europe's defence industry with which the Union until very recently had virtually no involvement.

2. The European Defence Equipment Market (EDEM) is still under close surveillance by the member states which are at one and the same time its clients and its regulators. The industries have been freed up through privatisation or the gradual withdrawal of governments by selling off their shares or other capital holdings. However, political and strategic arguments for maintaining a degree of state control over the development of these industries, their operation and production continue to be aired.

3. Major European industrial groups, particularly in the aeronautics, space and defence electronics sectors, share the national markets between them. Such markets are open to a degree but dominated by national considerations – various forms of offsets and trade-offs and transfers of technology and industrial capacity. Individual countries have their own programming and procurement cycles, their own specific rules governing defence contracts and priorities which may converge but which are rarely harmonised with other EU and NATO allies and partners.

4. Rationalisation of the industry has been possible in areas where major, costly programmes of long duration were concerned. Defence aeronautics and space are classic examples of this. In 2005, it is very difficult for a European government to embark on a major aircraft, UAV, rocket or satellite programme on its own. Air and missile defence systems, air to air and ground to air missiles are almost all built through bilateral or multilateral cooperation, largely for economic reasons.

5. Going it alone is reserved for nuclear weapons. Everything else is open to cooperation and competition, subject to some reservations relating essentially to security of supply, technology transfer and national undertakings' involvement in different stages of armaments programmes. But the present situation is no longer really tenable in the medium and longer term. In the land and naval equipment sectors for example, the European market is still too fragmented and this makes it vulnerable to "foreign" takeovers from outside Europe.

6. The lack of any European preference or of provisions identifying sectors that need protecting or conversely thrown open to international competition at European Union level are weakening the scope of initiatives taken in this sphere. Transatlantic cooperation/competition, marked by a blatant imbalance of forces between the European nations and the United States and to a lesser extent, between the industries, is determining the evolution of the EDEM, and having a knock-on effect on ESDP autonomy in relation to the United States.

7. By putting forward proposals on the reform and future of the defence equipment sector in Europe, the European Commission (EC) and the European Defence Agency (AED) are responding to the problems that have been identified but are not as yet in a position to resolve the present contradictions.

8. For the ESDP project one day to become a true European defence, covering collective defence as well, as provided for in the Draft Treaty establishing a Constitution for Europe, the European Union and its member states need to be able to rely on a sound, competitive and autonomous Defence Industrial and Technology Base (DITB) that includes the major transnational groups, undertakings and firms under state control and, most importantly, a network of small and medium-sized dynamic and innovative undertakings in niche sectors such as, for example, software, consultancy, communications systems, data protection and cryptography, various kinds of materials, nanotechnologies, dual-use research and technology.

II. Article 296 of the Treaty establishing the European Community

9. For the last 15 years or so, the European members of NATO and the EU and WEU member states have been attempting to build and develop a shared space for defence equipment research, technology, development, production and trade. In the 1970s, cooperation structures bringing together two or more countries were set up, clustered around several key programmes: in particular for fighter aircraft, air defence systems, for frigates in the naval sector and in the land-based sector for armoured vehicles.

10. Each state made its contribution: technological, industrial and financial, in proportion to its national capacity and resources. Forums for information exchange were established: Eurogroupe (1968) and the Independent European Programme Group (IPEG) (1976). The cold war environment of the time provided the justification for a constant and, relatively speaking, upward level of investment, which made it possible to maintain national capacities, supplemented by off-the-shelf procurement.

11. There was a near reversal of this situation early in the 1990s. With the ending of the cold war, European nations which had been preparing for decades for a third world war in Europe found themselves handicapped in terms of forces and power projection at the outbreak of the war in the Gulf that took place in January and February 1991. (In this respect, Europe has lagged behind the United States ever since). They responded fairly smartly by reviving and reshaping existing forms of cooperation, partially restructuring the defence industry, voluntarily pooling their resources and their technological and industrial capabilities and laying down codes of conduct.

12. In 2005, a new phase in this process began with the affirmation of the part the European Union was increasingly to play in defence and in organising a European Defence Equipment Market. This area, once the sole preserve of the member states, is now increasingly also the province of the European Commission, an ever more significant player in the sector and the European Defence Agency (EDA). In parallel, industrial reconstruction is continuing, subject to both European internal political and economic constraints and those imposed from without through cooperation/competition with the United States.

1. Article 296 TEC and the 1958 List

13. The Treaty establishing the European Economic Community (signed in Rome on 25 March 1957) contained an article, 223, which excluded defence equipment from the competence of the Community. The provision, included at the request of France, became, following successive revisions of the Treaty, Article 296 of the Treaty Establishing the European Community (TEC). Its field of application is set out in a list adopted by the EEC member states on 15 April 1958.

14. This exemption, on the grounds that defence issues are essentially a matter of national sovereignty, is still in force. However, in view of the development of EU capabilities under the ESDP, the wording of Article 296 needs adapting to suit the present-day requirements of the market, the industry and the member states.

15. If the intention of the EU member states is to establish a European Defence Equipment Market (EDEM) within the Union, recognition is thereby implied of a role for both the European Defence Agency (EDA) and the European Commission (EC) in the regulation, organisation and operation of the EDEM.

16. Article 296 TEC states that:

> "1. The provisions of this Treaty [TEC] 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."

17. The scope of this article, which gives the member states discretionary powers as regards the rules to apply in relation to the defence equipment market is nevertheless limited by the provisions of Article 298 as follows:

"Article 298

If measures taken in the circumstances referred to in Articles 296 and 297[2] have the effect of distorting the conditions of competition in the common market, the Commission shall, together with the State concerned, examine how these measures can be adjusted to the rules laid down in the Treaty.

By way of derogation from the procedure laid down in Articles 226 and 227, the Commission or any Member State may bring the matter directly before the Court of Justice if it considers that another Member State is making improper use of the powers provided for in Articles 296 and 297. The Court of Justice shall give its ruling *in camera*."

18. It will be noted that although Article 296*(b)* removes defence equipment from the area of responsibility of the Commission, the depository of states' powers to organise and regulate the operation of the Common Market, yet it is on a proposal from the Commission that the 1958 list can be revised. The 1958 list identifies 15 categories of "arms, munitions and war materiel (…), including nuclear arms", as follows:

1. Portable and automatic firearms;

2. Artillery, and smoke, gas and flame throwing weapons;

3. Ammunition for the weapons at 1 and 2 above;

4. Bombs, torpedoes, rockets and guided missiles;

5. Military fire control equipment: (firing computers and guidance systems, telemeters, position indicators, altimeters; electronic tracking components, gyroscopic, optical and acoustic; bomb sights and gun sights, periscopes;

6. Tanks and specialist fighting vehicles;

7. Toxic or radioactive agents (including counter-measures material);

8. Powders, explosives and liquid or solid propellants;

9. Warships and their specialist equipment;

10. Aircraft and equipment for military use;

11. Military electronic equipment;

12. Cameras specially designed for military use;

13. Other equipment and material; (parachutes and parachute gear, fording equipment specially designed for military use; electric searchlights for military use);

[2] Article 297 provides that: "Member States shall consult each other with a view to taking together the steps needed to prevent the functioning of the common market being affected by measures which a Member State may be called upon to take in the event of serious internal disturbances affecting the maintenance of law and order, in the event of war, serious international tension constituting a threat of war, or in order to carry out obligations it has accepted for the purpose of maintaining peace and international security".

14. Specialised parts and items of material included in this list in so far as they are of a military nature;

15. Machines, equipment and items exclusively designed for the study, manufacture, testing and control of arms, munitions and apparatus of an exclusively military nature included in the list.

19. This list is still in force and may be combined with the catalogue set out in the European Union Code of Conduct on Arms Exports adopted by the Council of the European Union on 8 June 1998. The code contains a Common Military List of the European Union, the most recent version of which is dated 25 April 2005[3]. 22 categories of equipment are listed in line with developments in defence materials and technology since 1958.

2. Scope and limitation of Article 296 TEC: interpretation by the Court of Justice of the European Union

20. The equipment and technology included in the list are *de jure* and *de facto* covered by Article 296. However, changes in the rules governing the European Common Market, defence industry privatisation and inter-European and international competition in this area are weakening this safeguard. Pressures on budgets, recourse to joint programmes and measured application of "best value for money" principles are leading to convergence of defence equipment procurement practice with that employed in the civilian commercial sector. Tenders, while remaining subject to specific constraints, are increasingly open to international firms or other governments.

21. Security and secrecy of supply are two such conditions. The latter is intrinsically tied in with the nature of the equipment, its characteristics and the type of technology employed, either in the finished product or in producing it. The former is a constant source of preoccupation for European governments as there have been unfortunate experiences in the past owing to differences between the countries involved in their political assessment of crises situations. These two conditions are also central when it comes to transatlantic cooperation, either for off-the-shelf procurement or in joint development programmes.

22. Article 296 allows member states to derogate from the rules of the Common Market in the sphere of armaments, but this is not an absolute right. During the cold war and up until the end of the 1980s, the member states invariably adopted a very free interpretation of Article 296. Throughout that period the European Economic Community had no real political dimension and security and defence matters were the responsibility of the member states alone, nationally or within the framework of the obligations laid down in the modified Brussels (WEU) Treaty and the Washington (NATO) Treaty.

23. From the 1980s onwards, the evolution of European societies and economic liberalisation were to contribute to restricting the field of application of the exceptions on grounds of public security provided for in the Treaty establishing the European Community (TEC) and Article 296 of the same. The European Court of Justice (ECJ) as the guardian of the Community treaties played a major part in that process. The European Commission was to take advantage of the legal opening thus offered and from the fact that certain defence equipment components were, increasingly, dual-use in order in its turn to become a player in the emerging European defence equipment market.

24. According to the ECJ two principles have to be observed when invoking or applying the public security exceptions provided for under the TEC:

> "(…) the only articles in which the Treaty [of Rome] provides for derogations applicable in situations which may affect public security are Articles 36, 48, 56, 223 (296 TEC) and 224, which deal with exceptional and clearly defined cases. It is not possible to infer from those articles that there is inherent in the Treaty a general exception excluding from the scope of Community law all measures taken for reasons of public security"; *Johnston*, 15 May 1986, point 26;

[3] "Common Military List of the European Union (equipment covered by the European Union Code of Conduct on Arms Exports) adopted by the Council on 25 April 2005"; Official Journal of the European Union, C127, 25 May 2005; http://europa.eu.int

> "(…) it is for the Member State which seeks to rely on those exceptions to furnish evidence that the exemptions in question do not go beyond the limits of such [exceptional] cases"; *Commission of the European Communities v Kingdom of Spain* (Failure of a Member State to fulfil obligations — Imports and acquisitions of armaments — Sixth VAT Directive — National legislation not complying therewith) 16 September 1999, Point 22.

25. The first judgement concerns the principle of equality between the sexes of access to employment and working conditions, as provided in the European Convention on Human Rights and extended to the European Economic Community through a Council Directive of 9 February 1976 (207-76). The plaintiff, Ms Johnston, was a female officer of the Royal Ulster Constabulary (RUC), Northern Ireland, whose employers refused to renew her contract of employment following a decision to allow police officers of the Royal Ulster Constabulary Reserve to carry firearms in the exercise of law and order duties. The measure did not apply to female officers, a number of whose contracts were consequently terminated or not renewed.

26. The importance of this judgement which has nothing to do with armaments issues is, in the first place, the assertion of the Court's jurisdiction to rule on the merits of the application of exceptions on public security grounds and, secondly, the fact that those derogations are not absolute. Article 296 is part of those measures and consequently falls within the field of the EJC's jurisdiction. As to defence equipment, member states are sovereign in terms of organising and regulating a European market but must take account of the general European Community/European Union legal framework.

27. This point was confirmed by the "*Commission of the European Communities v. Kingdom of Spain*" judgement of 16 September 1999. This decision was extremely important as it directly concerned the application of Article 296. The Spanish Government had invoked the article in order not to apply a Community Directive on the common system of value added tax (VAT). On 14 May 1987, the Spanish Parliament passed a law "concerning budgetary appropriations for investments and operating costs of the armed forces" containing a provision such that "imports into Spain of products from other Member States, including supplies of armaments, munitions and equipment exclusively for military use are exempt from VAT with retrospective effect from 1 January 1986".

28. The European Commission considered that this exception violated the terms of the Sixth Directive on VAT, adopted by the Council of the European Economic Community in 1997 (77/388) except in the case of a clause concerning aircraft and warships. The Spanish Government then invoked Article 296 in its defence arguing that "the Spanish Law, extended by Law No 9/90, must be understood as having been adopted on the basis of that article [TEC 296], since exemption from VAT constitutes a necessary measure for the purposes of guaranteeing the achievement of the essential objectives of its overall strategic plan and, in particular, to ensure the effectiveness of the Spanish armed forces both in national defence and as part of the North Atlantic Treaty Organisation".

29. The ECJ found in favour of the Commission against the Kingdom of Spain on the grounds that the Spanish Government had not demonstrated specifically how exemption from VAT was a "necessary measure for the purposes of guaranteeing the achievement of the essential objectives of its overall strategic plan". According to this precedent, member states must justify and demonstrate in each case their reasons for invoking and applying the public security exceptions laid down in the TEC. It can justifiably be considered that this judgement strengthens the case for reviewing and reinterpreting the clause (Article 296) exempting defence equipment from the rules of the single market.

30. This judgement limits state prerogatives and opens up the prospect of intervention by the Commission and the European Defence Agency on the European defence equipment market. Both institutions have an increasing part to play in this area, alongside governments and industry, in a spirit of complementarity and competition that will prove a decisive influence on the EDEM.

III. The European Commission and the European Defence Equipment Market

31. Until the 1990s, the European defence equipment market was an aggregate of national markets laced strongly with protectionism. The relatively steady growth of national defence budgets ensured a

satisfactory level of orders and off-the-shelf purchases of European (EEC and NATO) products, preferably of either domestic or US manufacture or produced by other allied, friendly or partner countries.

32. Cooperation was limited and characterised by offsets, "juste retour" and various industrial and economic trade-offs. From the 1980s, economic liberalisation, the introduction of new working and production methods and the appearance of new US-style information and communications technologies adapted to conditions in Western Europe were also to have an impact on the defence industry at large and on defence research and technology.

33. The end of the cold war accelerated further this process. There was stagnation and a fall in defence investment notwithstanding the 1991 Gulf war which ushered in a new era of conflict in Europe, Africa and even the current global war on terror. The withdrawal of government from the defence industry led to a round of privatisation, rationalisation and company buyout, transfer and merger, especially in the defence electronics and aeronautics fields and also in services and logistics. In the final decade of the 20th century the number of large aeronautics companies (on the international or national scale) dropped from 30 or so to 11. This movement became the trend also in the land and naval defence sectors, although the result there was less pronounced.

34. The formation of large European industrial groups involved in work for both the civilian and defence markets consolidated the supply side to good effect. However, the demand side, in other words national governments, remains fragmented and piece-meal. Governments have tried to solve this problem by resorting to wider or more restricted forms of cooperation, such as for example the Western European Armaments Group (WEAG), the Western European Armaments Organisation (WEAO), the Organisation for Joint Armaments Cooperation (OCCAR) and the "Letter of Intent"/Framework Agreement concerning measures to facilitate the restructuring and operation of the European defence industry.

35. All such initiatives were taken outside the European Union framework. However the development of a European Security and Defence Policy as set out in the Maastricht Treaty and confirmed in the Amsterdam and Nice Treaties, whose implementation began following the European Council Cologne and Helsinki Declarations, put the European Union at the heart of the debate on European and national military capabilities, including the organisation and operation of the European defence equipment market.

1. Communications and Directives

36. Over that period of development, the European Commission moved from a position of passive observer to one of active contributor. Since Article 296 does not allow it to act as it could in the case of the Single Market, in other words by way of Directives adopted by the Council of the European Union, subsequently introduced into national legislation for application by the countries concerned, the Commission chose rather to take things forward by issuing Communications, the fourth and last of which directly addresses the question of whether to maintain Article 296 as is or reformulate or interpret it more restrictively.

(a) The Commission's proposals (1996-2003)

37. The first Communication of 24 January 1996 deals with "The Challenges facing the European Defence-Related Industry, a contribution for action at European level". In it the Commission puts forward a series of Community measures to apply to the internal and external dimensions of the European defence equipment market, as follows:

> "4. Internal market and technological base
>
> 4.1. Public procurement
>
> (…) applying procurement procedures largely inspired by those applied in the EU's civil sector. (…) the specific character of the defence sector (…) may require some adjustments to the procedures;
>
> 4.1.2.Intra-Community trade

(…) By facilitating intra-Community trade, the completion of a "European defence market" should facilitate both cooperation and integration in the European defence-related industry.

(…) the gradual opening of intra-European borders requires a minimum standard of competition policy and in the long term harmonised export rules. Furthermore, it implies especially, whenever possible, the simplification and rationalisation of controls on intra-Community trade carried out by the States (…).

4.1.3. Research and technological development (RTD) activities

Although they are focused on civil objectives, Community research programmes, like civil research activities at national level, are increasingly of interest for the defence technology base because of:

(1) the overlapping and converging technology needs of the civil and defence sectors in a wide range of areas (dual-use technologies) and

(2) the leading role taken by the civilian markets in the development of a growing number of these dual-use technologies (…);

Community RTD programmes can contribute to the technology base of the defence related industry in several ways:

(1) by strengthening the overall European research infrastructure and scientific base;

(2) by supporting R&D [Research and Development] projects leading (…) to commercial products, processes, standards or improved quality assurance which can also be pursued in the defence sector;

(3) by supporting R&D projects on generic technologies which can lead (…) to either civil or defence-specific applications (…) community programmes can also support research by defence related organisations to develop civil applications of their defence technologies.

4.1.4. Standardisation and technical harmonisation

(…) Standardisation is recognised to be of strategic importance for the efficiency of the internal market (…).

Union-wide standardisation policies are relevant to the defence-related industry in such key areas as information technology, telecommunications, power supply; laser technology, new materials, aerospace and quality systems and conformity assessment. In many of these areas, civil standardisation activity is proceeding faster than similar work organised for purely military purposes and civil standards are becoming more widely used in defence procurement. (…) Hence, further convergence of civil and military use of standardisation (…) should be one of the main objectives of EU policy in respect of the defence-related industry (…).

4.1.5. Competition policy

In the light of the emergence of a Community market for the defence industry (…) there is a place for the Community competition policy. It can facilitate (…) the concentrations and cooperations between companies which do not call into question effective competition. Moreover, rigorous control of State aids will make it possible to distinguish between aid necessary for restructuring (…) and aid used for defensive reasons (…) [to subsidise civil production]. (…)

In a sector such as the defence-related industry, the introduction of effective competition should therefore result in considerable productivity gains, in the form of cost reductions and increased innovation which could only improve the industry's exporting capacity. (…)

However, the application of competition law to the defence-related industry must take into consideration the specific features of this industry. It must also be (…) receptive to information and comments from Member States' Ministries of Defence (MODs) in their capacity as main

clients of the defence-related industry and allow Member States to take appropriate measures in order to protect national security (…) [Article 296 TEC exception]. (…)

Competition policy in the defence-related industry should be implemented progressively (…)

Finally, it is evident that the Commission will take into consideration, in the operation of its competition policy for the defence-related industry, the manner in which in particular governments of third countries which produce armaments formulate and apply competition law to their own industry.

4.2. The external dimension

4.2.1. Export policy

(…) the development of common policies inside the European Union in order to secure the industrial basis of the sector should be complemented by a corresponding level of harmonisation of national export policies and export-control systems. [The European Union Code of Conduct on Arms Exports, adopted in 1998, is a first important step in this direction].

4.2.2. Export controls on dual-use goods and technologies

[In December 1994 a Community regime for the control of exports of dual-use items and technology for the control of dual use goods established by Council Regulation and a common action in the same area was adopted under the CFSP. The 1994 system has been amended on two occasions and makes clear that "responsibility for deciding on applications for export authorisations lies with national authorities", in the framework of the common commercial policy and the international commitments member states have given under export control and non proliferation regimes.]

4.2.3. Import duties on military equipment

The common customs tariff provides for the application of customs duties to most military or dual-use (…) equipment imported from third countries (…).

(…) in certain Member States, unilaterally (…) exemptions [are granted] from customs duties. The Commission considered, and still does, that the tariff arrangements for imported products, even military or dual-use equipment, are the sole responsibility of the Community (…).

[On this point, the European Court of Justice (ECJ) in its 1999 judgement (*European Communities v. Kingdom of Spain*) seems partly to concur with the Commission.]

4.2.4. Trade relations

The development of a European defence equipment market, to the extent that it would lead to greater self-sufficiency in different market segments, has potentially far-reaching implications for relations with third countries, and particularly with the United States, which is the main third country supplier of arms to the European Union Member States.

Exploitation of the Community dimension in defence procurement does not imply unilateral opening at Community level of the defence market to third-country suppliers (…)".

38. This incursion by the Commission into an area that had been the special preserve of the member states or one discussed only in the context of intergovernmental cooperation had no immediate practical consequences. In 1997, the Commission backtracked with a further Communication entitled "Implementing the European Union strategy on defence-related industries". Noting government inaction within the Union framework the Commission called for the adoption of a common position on developing a European armaments policy and for the implementation of a plan of action for defence-related industries" based on the proposals contained in the 1996 Communication.

39. In regard to the application of Article 296 (223 at the time), the Commission proposed restricting its own field of action by classifying materials for the defence sector into three categories:

– "Products intended for the armed forces but not for military use therefore not covered by Article 223 TEC nor by Article 2 of the Directive 93/96 (markets declared secret, protection

of vital interests, national security, etc). As these products are already subject to the Community public procurement rules, the Commission will specify where appropriate, in the most suitable form, the conditions for the application of these rules;

– Products intended for the armed forces and for military use, but not constituting 'highly sensitive defence equipments'. The Commission could work out a fairly flexible set of rules, while respecting the principles of transparency and non-discrimination inspired by the existing Community public procurement rules;

– 'Highly sensitive equipments' covered by the scope of Article 223 TEC. These products could be exempted from the rules referred to above when safety or the protection of vital national interests of the country in question so require. A notification mechanism for this purpose should be foreseen in order to entrust a degree of control and transparency."

40. As in 1996, there was no follow-up by the member states to the Commission's proposals. In the years that followed, they continued to cooperate in the WEAG and WEAO frameworks and the largest producers (90% of defence investment and materials procurement) set up OCCAR and signed the Letter of Intent (LoI) which in 2000 became the Framework Agreement concerning measures to facilitate the restructuring and operation of the European defence industry.

41. From 2000, when political and military crisis-management structures were set up in the European Union, the matter of organising the European defence equipment market within the EU again surfaced, leading in 2003 to the decision to create an "Agency in the field of defence capabilities development, research, acquisition and armaments", which in 2004 became the European Defence Agency.

42. These initiatives, however, seem too slow and hesitant in terms of implementation or future results in the view of the major defence-related industries. For the latter, the absence of a Union policy on a European defence equipment market is an obstacle denying them access to Community support funds for research, innovation and restructuring.

43. The Commission will naturally set itself up as the mouthpiece for the interests of the industry in such a way as to strengthen its hand in an area which is still essentially the province of nation states, although less and less exclusively so. The "Strategic Aerospace Review for the 21st Century" (STAR21 report), drafted and published in July 2002 by a European Advisory Group on Aerospace (EAGA)[4] is an example of such convergence of interests. This document sets out clearly the state of play within the aeronautics and aerospace industry in Europe, including in regard to defence, and puts forward a series of proposals for restructuring the sector.

44. On 11 March 2003, the Commission published a new Communication on "European Defence – Industrial and Market Issues". This document came out at a crucial time for the European Union, engaged, through the Convention on the Future of Europe, in an ambitious recasting of its operations and objectives. The Commission took up the broad outlines of the 1996 and 1997 texts, giving consideration to the development of ESDP and the industrial and technological landscape in the Europe of the Fifteen prior to the 2004 EU enlargement.

45. Seven major fields of action were identified:

– "Standardisation: Stakeholders recognise the need for harmonised European approach to defence standardisation. The Commission is working on this issue with CEN to assist co-operation between Ministries of Defence and industry to develop (…) a handbook cataloguing standards commonly used for defence procurement;

– Monitoring of defence related industries: Stakeholders need a clearer picture of the defence industrial and economic landscape in Europe. To achieve this, the Communication proposes to launch a monitoring activity on defence-related industries;

[4] This Group, formed in 2001, is made up of seven aerospace industry leaders, 5 European Commissioners, the EU Common Foreign and Security Policy High Representative and two members of the European Parliament.

– Intra-community transfers: (…) a simplified European licence system could help to reduce the heavy administrative procedures, which impede the circulation of components of defence equipment between EU countries. The Commission proposes to launch an impact assessment study (…) and (…) start elaborating at the end of 2004 the appropriate legal instrument;

– Competition: Competition improves market efficiency and protects innovation. Consequently, and without excluding the possibility of exceptions consistent with the Treaty [an implicit reference to Article 296 TEC] the Commission intends to continue its reflection on the application of competition rules in the defence sector;

– Procurement rules: Harmonised procurement rules for defence equipment would also increase market efficiency. On this basis, a reflection on how to optimise defence procurement at national and EU levels should be initiated in the EU. The end goal would be to have a single set of rules for procuring defence equipment in Europe.

There have been several important Court judgements in recent years that are relevant to this work – especially in helping to define the scope of Article 296. The Commission will issue an Interpretative Communication by the end of 2003 on the implications of these judgements. In parallel, it will work on a Green Paper which might be issued in 2004 as a basis for discussion with stakeholders [the member states, the EDA and the industry].

– Export control of dual use goods: International export control regimes exist – but in most cases, the EC is not a member. The consequence is that Member States often adopt uncoordinated positions[5], which may unnecessarily limit export opportunities for EU civil industries and may affect the functioning of the internal market after enlargement. The Communication proposes to raise this issue in relevant Council bodies.

– Research: The Communication proposes to consult Member States and industry in 2003 to identify common needs and to establish a security-related research agenda. In this respect, the Commission intends to launch a pilot project[6].”

46. Unlike in previous years, the EU member states acted upon the Commission’s recommendations. In its Conclusions published in the EU Official Journal of 26 June 2003, the Council welcomed the Communication of the Commission and “recognised (…) the importance of putting in place arrangements, which could lead to greater cost-effectiveness, improved harmonisation of standards, and more efficient planning and procurement of defence equipment and RTD based on technological innovation”, at the same time affirming its competence to take strategic decisions on such questions.

(b) Directive 2004/18/EC

47. This nod in the direction of the Commission on the part of the Council would encourage the latter to explore ways of asserting the Community’s competence over the European market in defence equipment. In 2004, the Commission adopted a Directive with indirect consequences for the reserved area delineated in Article 296 and launched the drafting and consultation process for the Green Paper.

48. The Commission cannot legislate directly on the subject of defence equipment contracts, firstly because of the public security exception under Article 296 TEC and also because member states have not agreed to share their prerogatives and sovereignty in this area. However defence contracts are also public contracts and the Commission made play of this aspect in Directive 2004/18/EC on “the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts”.

[5] The 1998 Code of Conduct on Arms Exports and the 2000 European Union dual-use export control system are declaratory, voluntary and non-binding in as much that there is no independent supervisory machinery and no provision for sanctions.

[6] The Preparatory Action in the field of Security Research (PASR). Funding for PASR, which is to form part of the Seventh framework programme of the European Community for research, technological development and demonstration activities (2007 to 2013), is estimated at 3960 million euros for the period (including space applications).

49. The Directive applies to public contracts awarded by contracting authorities in the field of defence, subject to Article 296 of the Treaty. However, it does not apply to public contracts "when they are declared to be secret, when their performance must be accompanied by special security measures in accordance with the laws, regulations or administrative provisions in force in the Member State concerned, or when the protection of the essential interests of that Member State so requires". Another exception is allowed in the case of "a concluded international agreement relating to the stationing of troops and concerning the undertakings of a Member State or a third country".

50. The reserve made under Article 296 TEC refers to the 1958 list. However, the ability to invoke that exception is limited nowadays by a number of factors, among them the precedents of the European Court of Justice and the fact that the major transnational and international industrial groups that dominate the private defence sector are no longer under direct state control. If they are wedded to the idea of a dynamic, competitive open market, protectionism is only an option in the shorter term.

51. By means of this directive, which has gone unchallenged by the member states, the Commission has extended its remit to include public defence contracts, taking advantage of differences of views at the intergovernmental level and the support of a substantial majority within the industry, calling for more consistency and transparency in regard to the goals, organisation and operation of the European defence equipment market. The Green Paper marks a new phase in the Commission's attempts to assert its competence in this sphere.

2. Towards a Community-regulated EDEM: Green Paper on Defence Procurement

52. On 23 September 2004, the Commission published a document entitled "Green Paper on Defence Procurement" which was open to public consultation. Those consulted included the member states, the defence industry, the Council Agencies, the Economic and Social Committee and other interested parties. By the time the consultation period ended the Commission felt it was in a position to claim *de jure* and *de facto* competence in this area possibly with the adoption of interpretive and legislative texts. This "offensive" also took the guise of a public relations exercise, one of whose messages was that "member states had maintained national control over defence equipment markets and related industries with reference to Article 296 TEC. The consequence is a continuing fragmentation of markets and industries at national level and a loss of competitiveness in particular with respect to American competitors".

53. In the Commission's view, a national and intergovernmental approach to EDEM was one of the main causes of the present difficulties. The saving principle of "subsidiarity" served to justify Community action, in response to which member states, divided on the issue, fudged matters somewhat by giving the European Defence Agency the task of developing and putting forward a voluntary code of conduct for organising a European defence market, which they would agree to comply with. Nevertheless, the Commission has plenty to offer. It has a good understanding of such matters, stemming from its experience with civil public contracts. It also has the support, explicit and implicit, of a section of the private industrial sector and the Agency's mandate provides for cooperation between the two institutions[7].

(a) The Green Paper: state of play; way forward

54. The Green Paper, with whose preparation the member states and defence sector industries have been involved, divides into two sections. The first consists of observations and analyses of the current situation in regard the European defence equipment market; the second sets out the Commission's proposals for the reform of policies which have been in place in this sphere for nearly half a century. The Commission's intention is to increase the economic efficiency of Europe's defence sector by creating the conditions for the development of "a truly European market (…) for strengthening the competitiveness of European industry, improving the allocation of defence resources and supporting the development of the Union's military capabilities under the European Security and Defence Policy (ESDP)".

[7] A Commission representative sits, without voting rights, on the European Defence Agency Steering Board.

55. The Green Paper identifies seven key features of EDEM today:

- Fragmented defence markets: self-evidently the European Community is made up of nation states drawn together in a community of interests, either shared or convergent. Defence, in all its aspects: military, political, economic and social, is one of the last bastions of state sovereignty. In regard to the defence market such progress as has been recorded: the formation of large industrial groupings or deepening of intergovernmental cooperation (OCCAR and the Letter of Intent/Framework Agreement) are more the outcome of economic constraints, like the reduction in numbers of the armed forces and falling defence budgets since the end of the cold war and a reordering of economic priorities, than of true policy design. The result is a process of restructuring that is incomplete, in particular in the naval and land defence sectors, and a persistently high degree of compartmentalisation and fragmentation of industrial and technological capability among member states;
- Dominant role of the state: there is no integrated European defence. The ESDP represents considerable progress in terms of cooperation but its content and the manner and speed of its construction are solely at the member states' discretion. Member states are also the main[8] and in some areas the defence industries' only customers, as well as partly owning them, either directly or as majority shareholders or through a capital holding giving them a blocking vote. They fund almost all defence research and technology work, giving marked preference to national contracts, and control export markets, including the intra-Community market, through systems of export licences;
- Security of supply and confidentiality requirements: this is of shared concern to states and industrial firms, including those in the civil sector. Aeronautics and space, telecommunications and information technology, modern pharmaceuticals and biotechnology for either civil or security and defence application are subject to differing degrees of control and clearance. Yet these two criteria make it easier for states to resort to forms of "economic nationalism" and protectionism in regard to their national capacities;
- Complexity of arms acquisition programmes: it is not so much that the procurement process is complicated *per se* as the matter of the availability of budget resources. An armaments programme, whether undertaken alone or in cooperation, typically extends over many years, if not decades. It is subject to changes in defence priorities, technological progress, at the mercy of political change and sometimes pressure from without. Recourse to dual-use technology and sub-contracting raise additional difficulties in cases of foreign technology transfer or technical or financial failure on the part of sub-contractors;
- Community exemption system: this refers to Article 296 TEC. However, as interpreted by the Commission, this exemption is neither automatic nor absolute. The ECJ's judgements in the *Johnston* and *Commission of the European Communities v Kingdom of Spain* cases support the Commission on this point while the member states differ in their wish to preserve Article 296 intact. In practice, at present, the Commission is obliged to resort to the Court each time it considers that there is a violation of the law, a situation that scarcely troubles many major armaments producing states at all, given the time it takes for cases to be heard and the inconsequentiality of the sanctions imposed, as compared to the strategic and economic considerations involved;
- Differing national legislation: subject to substantial budgetary constraints, member states use the legal instruments they have to hand to protect their national interests. The defence market is sovereign and supreme and because of the peculiarities already mentioned still falls largely outside the accepted rules governing civil contracts[9]. Harmonising rules at European level is one objective behind the various intergovernmental cooperation initiatives there have been

[8] International organisations or non-state players like the major private security companies are also recognised customers of the armaments industry.

[9] The Commission specifically refers to the publication or otherwise of invitations to tender, technical specifications, selection criteria for suppliers, the tendering procedure and the award of contracts.

over the last 10 years from the setting up of WEAG to the LoI/Framework Agreement. The process nevertheless has a flaw: it is a voluntary one and suffers from a lack of integration in the short and medium term;

– Special procedures for cooperation programmes: even if the rule of fair industrial return or "juste retour" per programme is running out of steam, the European nations involved in cooperation programmes still seek to maximise their technological and industrial superiority and their national share. The division of labour among several sites, as with the Airbus A-400M transporter aircraft, is an example of the kind of trade-off that has taken the place of the traditional "juste retour". The practice of "offsetting" or swapping holdings in industries is still widespread. The Belgian system for example[10] provides in the case of defence contracts for the percentage offset commitment to be split between the following three categories:

> "Direct participation;
>
> Semi-direct offsets;
>
> Indirect offsets;
>
> (…)
>
> Offset orders placed with Belgian industry must be for high-grade technology and represent a new or additional line of business for the beneficiary Belgian undertakings.
>
> Investment is not acceptable as an offset.
>
> Technology transfer is not acceptable as an offset but the Belgian added value on export sales generated by the transfer in principle is acceptable.
>
> (…)
>
> Tenderers may be required to divide their total economic offset obligation between the country's three Regions (in principle for contracts to an estimated value in excess of 11 M euros)."

56. Having put forward its analysis of the present state of play in the European defence equipment market, the Commission suggests two main options for rationalising and developing that market with a view to making it more economically efficient and competitive: "clarifying the existing legal framework and establishing specific rules in the field of defence, taking into account the sector's characteristics". For the first, the Commission proposes having recourse to an Interpretive Communication based on the ECJ judgments to date on Article 296 TEC. The Communication would be non-binding on the member states but would strengthen the Commission's role in relation to defence contracts.

57. In both the "continental" and "Anglo-Saxon" legal systems a judgement or legal precedent can invariably be overturned in line with developments in positive law, society, policy, the economy and so on. An Interpretive Communication based on current Court precedents in regard to the scope of Article 296 TEC would tend to lend it permanence and restrict states' ability to invoke the public security exception. In the light of the present difficulties with the European defence market, both in the way it functions and in the face of international competition and a rising trend towards an "economic nationalism" based on US practice in defence markets (national preference), Article 296 TEC is regarded by larger and medium-sized European armaments producing states as an instrument for protecting their national industrial and technological capacities.

58. The interpretive Communication would run the risk of opening the floodgate to repeated disputes between the Commission and member states before the ECJ, while the present state of affairs

[10] Belgium became the fifth member of the Organisation for Joint Armaments Cooperation (OCCAR) on 27 May 2003. One of the peculiarities of this cooperation framework was the "non-application" of the "juste retour" rule per programme, which was replaced by an "overall juste retour" covering several years and several programmes. See OCCAR Convention, Article 5, 28 January 2001; http://www.occar-ea.org/

allows both parties far more flexibility in reaching a satisfactory agreement. However, the Commission is resolved to secure its competence in relation to defence contracts, which is also a way of making clear that it is a European executive power on an equal basis with national governments. The other option discussed in the Green Paper is a Directive, the ultimate weapon of Community law, which once approved by the Council, must become part of the national law of the member states.

59. The Commission continues to make a case for the need to respect the field of application of Article 296 TEC, at the same time making clear that this should be under the "conditions defined by the case law of the Court". It also acknowledges that the Green Paper proposals "would not prejudice any complementary measures taken by the member states in appropriate fora". This point of view is logical but carries a further shade of meaning in as much that when it comes to the organisation, running and development of the EDEM, the member states are the ones whose decisions really count. The Commission's action is welcome but must be seen in terms of subsidiarity and complementarity. A Directive in this sensitive area would reverse the roles.

60. With its habitual legal punctiliousness, the Commission gives a detailed description of what could be a "new specific legal instrument for defence procurement (goods, services and work), such as a directive to coordinate the procedures for awarding such contracts". It would pursue three main objectives:

- "greater legal certainty, since it would improve the classification of contracts: (a) those covered by current directives; (b) those covered by the new directive; and (c) those excluded from any Community rules;
- more information at Community level on the contracts in question, and therefore greater opening of the markets, which would allow European defence industries to participate equally in calls for tender in all the Member States;
- the introduction of the necessary flexibility for the award of these contracts by the creation of a body of rules suited to the specific features of such contracts".

61. The Green Paper further specifies that such an instrument could also serve as a reference point should a member state decide not to make use of the Article 296 TEC derogation even when it would have been entitled to do so. Recourse to Article 296 TEC is a sovereign prerogative of nation states for use as arising. The public security exception may be invoked in some cases but not in others and it is not impossible in law to apply it selectively depending on the type of contract in question. If there is no Community regulation, states are free to contract in the manner they deem most to the advantage of their material interests. If a member state takes a sovereign decision not to invoke Article 296 TEC, this does not imply automatic recognition of Community competence. The Commission's interpretation would seem to imply the contrary.

62. In respect of the content of the Directive as proposed in the Green Paper, the Commission suggests that:

- "The field of application could be determined on the basis of a general definition of the category of military equipment covered and/or a list. The list could be that of 1958 or another more accurate, updated list such as that of the Code of Conduct on arms exports;
- There would be a provision modelled on directives in other sectors stating that the Directive would not prejudice the possibility of invoking Article 296 TEC under the conditions defined by the Court. It would also identify cases in which the conditions for application of the exemption were clearly fulfilled (e.g. nuclear equipment);
- The awarding authorities would be the ministries of defence and agencies acting on their behalf and other ministries buying military equipment. Application of the Directive to other bodies, such as the new Defence Agency, would have to be determined by the appropriate fora;
- Implementation of the Directive would not prejudice the possibility of exemptions conferred on the Member States under WTO agreements such as the Government Procurement Agreement;

– The procedures should ensure observance of the principles of transparency and non-discrimination, bearing in mind the specific characteristics of these contracts. The rule could be general use of the negotiated procedure with prior publication of a contract notice. Use of an unpublished negotiated procedure could be envisaged in certain cases determined on the basis of exemptions laid down in existing directives and, where appropriate, other cases based on national legislation;

– Publication could be through a centralised system at Community level using a harmonised publication bulletin. The subject of the contract could be described in terms of technical performance in order to prevent potential discrimination between suppliers. The selection criteria approved should ensure non-discrimination and equal treatment of companies and take account of the specific features of defence contracts, such as confidentiality, security of supply. They should also take into consideration the clearance necessary under defence secrecy rules;

– The award of the contract would take place on the basis of defined criteria. This would require a discussion on the gradual elimination of practices such as direct and indirect offsets".

(b) Reaction to the Green Paper: the intergovernmental code of conduct.

63. The publication of the Green Paper was followed by a consultation procedure based on a questionnaire[11]. The procedure closed on 23 January 2005. The Commission Directorate-General for the Internal Market has published the contributions of 16 EU member states, Australia and Norway; the EU Institute for Security Studies (EISS) and the European Defence Agency; 13 firms, industrial associations and professional bodies; the French National Assembly; the European Economic and Social Committee and of two international experts and a UK Christian-based non-governmental organisation "Brethren in Britain". Some of these replies are worth close examination.

(i) France

64. The stance taken by France is the most clear-cut: The Interpretive Communication would not add anything new towards achieving the intended goal which was to make defence spending more effective and strengthen the European Defence Industrial and Technology Base (EDITB). The Directive would not help achieve the intended goal of improving the cost effectiveness of defence spending without there first being convergence of member states' procurement policies. That convergence could only be achieved though political instruments. France would prefer there to be an experimental intergovernmental instrument for market rationalisation, a code of conduct on the procurement policy to be developed and introduced within the framework of the European Defence Agency.

65. France's reply contains pointers for this new code of conduct which the EDA was tasked with producing in March 2005. Overall objectives are globally to increase the effectiveness of defence spending and contribute to the strength and competitiveness of the DITB. These principles find a wide consensus among European nations but the problem is how to achieve them. France proposes concentrating efforts in three specific areas:

– breaking down the compartmentalisation of markets;

– promoting European solutions;

– giving mutual guarantees of security of supply and open access to critical technologies.

66. The proposed code of conduct rests on five major principles:

General: involvement of all the Agency's member states, but with an opt out, which implies from the outset the exclusion of Denmark which is not an EDA member; the experimental nature of the code, primacy of national law; partnership between the Agency and the

[11] See Appendix.

Commission to exploit information gathered in the framework of the code of conduct; guarantee of security of supply.

Freedom of access: open competitive tendering among suppliers established in the signatory states of the code and recognised members of the EDEM; competition if possible right down the contractual chain, particularly when subcontracting; commitment by members to adopt legislation that conforms to those two principles.

Transparency and equal treatment: EDA is a centre of information exchange on the procurement process and its outcome, legal systems of references, contracting procedures and methods of appeal. Selection of bids must be on the basis of clearly defined admissibility criteria communicated in advance to tenderers.

Justification: this principle supplements transparency in the sense that member states undertake to justify their choices to the Agency: absence of competitive tender, limitation to certain suppliers because of overriding national security considerations thus avoiding systematic recourse to Article 296 TEC, resorting to offsets.

Assessment: here the Agency has a role in recording the position of defence contracts "in number and in amount"; those let within and outside the EDEM; those published, as compared with total procurement.

67. Throughout its reply to the Green Paper, France advances two basic arguments: the first in support of maintaining the intergovernmental character of European armaments cooperation and of the organisation, rules and operation of the European defence equipment market; the second implicitly directed towards protecting that market through the principle of European preference and through safeguards against unfair competition from third parties (the United States).

(ii) United Kingdom

68. The UK reply to the Green Paper includes a non-paper containing proposals for rationalising and improving the European defence equipment market. British philosophy in this area can be summarised as "best value for money" the application of which has made the UK market the most open and transparent in Europe. The armed forces have benefited from this policy which translates undeniably as a high level of capability, but at the price of a growing dependency on external suppliers, either American or other European.

69. As far as the options put forward by the Commission go, either for an Interpretive Communication or a specific Directive, the United Kingdom considers that "attention should be focused primarily on examining the prospect of enhancing the effectiveness of the existing mechanisms rather then developing new measures".

70. Viewed from this angle the sole purpose of the Communication is "ensuring a more consistent application of existing EC [European Community] legislation by Member states". The Commission would also have the power to monitor defence contracts covered by Article 296 through information provided by governments. This is provided for under the planned code of conduct currently being prepared by the European Defence Agency. However the Commission would have no automatic right of access to that data. A Communication of this nature should be drafted with the direct and inclusive involvement of governments.

71. The Directive is given short shrift: "(…) we have less appetite for a new directive covering defence procurement, even one that does not cover those items exempted by Article 296 TEC. Clearly, we would be opposed to any regulation that impinges upon the use of Article 296 TEC (or that seeks to regulate it) (...)". Instead of a Directive, the United Kingdom also proposes a voluntary code of conduct which governments would subscribe to and whose application would be overseen by an "independent" third party: possibly the European Defence Agency.

72. The UK proposal for a code of conduct starts with an acknowledgement that there is not at the present time any organised defence equipment market. What there is is a collection of national markets not governed by common rules, other than the few provisions set out in the Letter of Intent/Framework

Agreement concerning measures to facilitate the restructuring and operation of the European defence industry of 27 July 2001. That Agreement is most important, even if its application is for the most part a matter of good faith and at the discretion of the signatory states[12], as they represent more than 90% of defence production, procurement and investment in defence research, technology and investment[13] within the European Union.

73. The United Kingdom proposes a market based on a voluntary commitment by member states to comply with a number of rules to "improve market access and create a level playing field for competition". The code, whose application would be monitored by an independent third party [EDA] would operate as follows:

> "Member States would open the generality of their procurements above certain thresholds to international competition;
>
> They would report to the nominated independent body (...) after announcement of contractor selection on the management of each competition and the selection criteria employed;
>
> The nominated body would be entitled to express a view as to whether (...) market rules had been respected, and to publish periodic reports on behaviours exhibited".

This approach, which does not provide for any entitlement to appeal, would seek to "encourage good practice amongst the Member States through publication and peer pressure". Like the French proposal it is essentially intergovernmental, founded entirely on the good will and commitment of EU member states, and particularly the major defence producers and customers.

74. The UK proposal sets out five areas of application of the code:

- Market scope: The member states decide what the Code will or will not cover. The proposal refers to "responsible discretion" in this area. It should in principle cover all defence equipment "except that which the member states exclude on specific national security grounds" and those which they are agreed, because of their dual-use characteristics or because state sovereignty is not a consideration should be subject to Community rules on public contracts (Directive 2004/18/EC, for example). The reference to exclusion for national security reasons is all too close to the public security exemption clause in Article 296 TEC referring back to the 1958 list. The UK government suggests a more restrictive interpretation, pointing directly to "nuclear and very highly classified programmes" as being excluded from the code's field of application. In other cases, exemptions would be discussed by the member states through the European Defence Agency.
- The scope of international competition: in principle and in line with existing WEAG (Western European Armaments Group) rules[14] invitations to tender for equipment contracts should be open to companies within the member states. Their proposals should be considered eligible and treated fairly. If a national preference is specified, this should be notified to the Agency for information or consultation. States are free to select suppliers outside the EU.

Offsets are to be discouraged although they are at present an integral part of defence equipment markets. The UK resorts to them in its defence procurement. "The UK welcomes imported technology solutions providing that new development and product build might be conducted indigenously, and encourages overseas companies to invest in the UK to form part of the national competitive industrial base and/or to deliver the offset obligations of the parent company. The UK's market model is therefore founded more on economic considerations than on factors relating to the Defence Technological Industrial Base (DTIB)". The British proposal advocates responsible management of

[12] France, Germany, Italy, Spain, Sweden and the United Kingdom.
[13] "Conditions for European defence RTD collaboration", Stefan Törnqvist, FOI-Swedish Defence Research Agency; Six Countries Programme (6CP) workshop "Linking Defence and Security R&D to Innovation: the challenge ahead"; Brussels, 19 November 2004; http://www.6cp.net.
[14] WEAG activities ceased in June 2005. WEAG *acquis* was transferred to the European Defence Agency. The other WEU armaments organisation, the Western European Armaments Organisation (or WEAO) continues to operate (Research Cell) until spring 2006.

such matters, to avoid, in the event of delocalisation of production within the EDEM its replacement by "comparable products from a non-EDEM-based supplier who is offering in-country offset".

– Security of supply: Here the principle that applies is that of best value for money. The UK "does not consider it essential that a single country needs to develop and sustain within its borders all of the technologies needed for the delivery of military capability". Were this so, there would be no point to the formation and rationalisation of the European market. Moreover, by the same token, given the extent to which major private armaments producers are now transnational or multinational, the UK considers it "inappropriate for Member States to insist on ownership of a company being a relevant consideration in procurement decisions. Rather, Europeans should develop specific agreements with the companies concerned that satisfactorily assure security of supply for the customer state".

The argument takes good account of the reality of the European market but insufficient account of the limited number of defence equipment suppliers, especially for heavy, highly complex, high added value systems. Without the more or less generalised practice of a European preference, American companies, alone or in cooperation with European undertakings would have already seized control of those segments of the European defence equipment market. In this sphere, a company's "nationality" still counts, given, in the case of the United States, the technology transfer restrictions of all kinds that can affect the ability to act of a government dependent upon them.

This aspect is one underlined in a "private" opinion on the Green Paper. The author, Tony Edwards, former Head of UK Defence Exports (1998-2002), compares British practice with French practice in so far as the arrangements governing the defence markets of both countries are concerned. His conclusions are that:

> "France is now the leader in Europe in terms of Defence and Aerospace industrial capability. This has been achieved by exploiting the various exemptions to EU Regulations necessary to protect and nurture the national Defence and Aerospace industry. One of the keys has been the intelligent exploitation of dual-use technologies by the French Government in collaboration with EADS (...), Airbus, Snecma and Thales.
>
> At the same time, the UK without an explicit, effective and funded Defence Industrial Policy and Strategy has relinquished its lead, first to the US and latterly to France (...). The UK has opened up its defence equipment market to the whole world (...) while relentlessly pursuing a procurement policy based on the belief that value for money only comes from competition. (The only nation in the world to do so.) In this environment, UK-owned companies have chosen to sell themselves to the highest bidders (usually US, French, German or Canadian). At the same time the UK Government has relinquished its grip on the industry and has abdicated to market forces. The UK maintains its capability to project power by an extraordinary reliance on the US for technology, equipment, support and intelligence (...).
>
> Conclusion
>
> If the EU is to develop a credible Foreign Policy it will need supportive Defence, Defence Industrial and Technology policies and strategies. The funds required are at least double the current EU-wide spending in order to achieve and maintain a rough equivalence in capability with the US. The key will be persuading the UK to let go of its special relationship with the US and instead accept French leadership of the European-wide Defence and Aerospace Industries. The UK Government has three options: *a)* accept the French-led EU alternative described above, *b)* increase the current MoD budget by at least 25-30% in order to continue muddling through by riding both horses (Atlantic and Europe) or *c)* rely almost entirely on US technology and equipment and thereby accept that UK Foreign Policy becomes synonymous with that of the US"[15].

[15] "Green Paper on Defence Procurement: Submissions to DG Internal Market" by Tony Edwards, Visiting Professor, Royal Military College of Science, Chairman of the Air League, former Head of UK Defence Exports; http://europa.eu.int/

– State aid: subsidies, tax exemptions and credits, finance and loans at different rates of interest to those in civilian markets are forms of government aid to the defence industry. They vary from country to country and create distortions to competition. However, it would be illusory to suppose there could be any harmonisation or codification of principles in the short or medium term. The United Kingdom proposes a straightforward policy of notification: "(...) the Code of Conduct should include an undertaking that Member States should report all instances of State aid that come under the scope of Article 296, setting out their reasons for so doing in a letter of explanation submitted to fellow Member States through the Independent body monitoring the Code [EDA]".

– DITB: the creation of an EDEM according to the principles set out in the proposed code of conduct "could prompt further rationalisation of industrial capacity and hence specialisation of the industrial capability in any one nation". Harmonisation of equipment procurement requirements, programmes and rules would contribute to increasing Europe's industrial capacities. This would be the time to develop and implement an industrial defence policy, which the European Defence Agency would monitor.

75. The principles of the code of conduct put forward by the United Kingdom are compatible and complimentary to those of France and form the basis of the draft Code the Agency is to unveil by the end of 2005. There are also some differences, stemming from the political approaches of each with regard to industrial policy: voluntary, based on "economic nationalism" and government intervention in the case of France; and on "best value for money" and "competition and trade" in the case of the United Kingdom. Given the influence both countries carry in Europe's defence policy, the solution must necessarily come from compromise around areas of agreement where they are known to agree.

(iii) Other contributions

76. In its reply to the Green Paper, Germany proposes a six-point programme of action for the defence market at European Union level ("Aktionsprogramm für den Rüstungsmarkt"), similar to that undertaken from 1980-1990 to complete the (civil) single European market, as follows:

– continuing privatisation of European defence industries;

– harmonisation of armaments export markets (deepening the code of conduct on armaments exports);

– reduction and gradual elimination of subsidies and aids slowing down the reorganisation of the industry and giving rise to distortions in competition;

– calling a halt to offsets;

– setting up a centralised system for notifying contracts above a certain threshold to encourage wider participation in invitations to tender, based on the experience acquired in WEAG in that area;

– inclusion of defence research, technology and development programmes in the EU framework programme for research and technological development (FPRD).

In German eyes, these forms of action are a preliminary to a future, more integrated involvement, to include some Community aspects in the field of the European defence equipment market. Harmonisation of national approaches is necessary before a common policy in this area is envisaged. Germany feels that the Interpretive Communication or the Specific Directive proposed by the Commission are not appropriate, so long as EU member states fail to agree on the way towards developing and organising a European defence equipment market.

77. Italy feels that "the goal of a more transparent and open European defence market (...), aimed at increasing economic efficiency in the industrial sector as well as ensuring a better allocation of the limited budget resources (...), has to be seen in the frame of the process of political, economical, financial and legal integration presently ongoing within the EU". Italy's analysis most appositely ties in member states' choices about how the defence market is organised with their respective foreign policies.

> "(…) the progressive convergence of the national defence markets is directly tied to the progressive harmonisation of the foreign policies (...). Such different policies determine a situation in which each member state has different requirements in terms of military forces and systems. Consequently the demand for military goods (...) is fragmented by national needs and requirements of systems (...)".

78. Italy's contribution stresses the progress made in achieving better cooperation among governments, notably through a common programme management system between certain of them (OCCAR) and the establishment of the European Defence Agency – subject to one reservation "This is going to be a lengthy process and it is too early to reach a conclusion on its success". Italy suggests four-fold action:

> "harmonisation of the EU rules and regulations governing issues such as
>
> – the transit of defence materials within the Union;
>
> – the technical regulations;
>
> – security of supply; and
>
> – the EU Code of Conduct for military exports".

79. Thorough attention is paid in Italy's reply to the Green Paper to security and defence research, technology and development issues. Control over sensitive technologies is singled out and it is proposed that "(...) a special regime should also be foreseen for R,T&D contracts". Italy also takes the view that there is a need in the debate on the European defence equipment market to dissociate European programmes – implemented between EU member states and therefore possibly subject to common rules – and programmes managed by NATO and NATO Agencies involving non-EU NATO members.

80. Security of supply, security of information and the urgency attaching to certain equipment procurement decisions, standardisation and logistics and maintenance cycles are further aspects to consider when establishing a European defence equipment market. But it is also important to prevent monopoly or dominant positions (whether of a country or a company) emerging as a result of rationalisation or industrial consolidation to obstruct competition.

81. The Netherlands points to the specific characteristics of the defence market and considers that the Commission's proposals, the Interpretive Communication and the specific Directive "can contribute to the progressive formation of a transparent European Defence equipment market accessible to all members of the Union". The Netherlands authorities also admit that these proposals fall short of what is needed to achieve it and that the member states must be willing to enter into discussion … at the political level and then accept what comes out of it. The other solution would be to maintain the *status quo* which would mean very slow progress over time with little in practical terms to show for it.

82. The Interpretive Communication can be useful in pinning down the scope of Article 296 TEC more firmly and harmonising its application. Member states must be directly involved in drafting it. The specific Directive could, if the Commission were to set the process in motion "trigger discussions between the [Union] member states (…) on the subject of establishing a European [defence equipment] market". This is what governments have in fact already started to do by entrusting, on the basis of the French and UK contributions, the preparation of a code of conduct on EU defence markets to the European Defence Agency.

83. The Netherlands acknowledges the decisive role of the major European armaments producers in achieving the EDEM, particularly in terms of industrial reorganisation and consolidation and the development first of the national and then the European DITB. However, the other European nations must also be involved in this and small and medium-sized defence undertakings integrated into the process.

84. The Netherlands commitment to a European DITB stems from a need on the part of Dutch industry but the country intends to retain its freedom of evaluation and choice over the origin of its

procurements. “Ties of cooperation and relations (…) at the transatlantic level are also necessary for developing leading-edge defence equipment”. This stance is in line with its decision to take part in the American Joint Strike Fighter aircraft (JSF-F35) programme. The Netherlands would be in favour of the abolition of offset and other forms of trade-off, and regard such practices, which distort competition, as not particularly efficient economically.

85. Sweden also expresses reservations in regard to the two instruments the Commission is proposing. It is in favour of retaining the public security exception in Article 296 TEC and feels, like France and the United Kingdom, that governments should be closely involved in any initiative on the part of the Commission in regard to defence contracts. The European Defence Agency is the appropriate framework for discussion and coordination in this area. There is a need to clarify the notion of two ideas: “security” and “defence” given the way these two concepts are embedded in the European Union’s internal and external action. Here too, the EDA has a role to play in the light of its responsibilities in Research and Technology and the use of security and dual-use technology in defence equipment programmes.

86. Finland is also wedded to the intergovernmental approach in the light of its own experience based on the concept of a “credible national defence”. This involves “material preparedness, requiring certain national defence industrial know-how and industrial capacity”, which is not synonymous with protectionism. Finland emphasises the relative ease of access to its own defence market (its air force is equipped with American F-18 Hornet aircraft, its heavy tanks are German and some armoured vehicles and artillery components are of Russian origin for example) and its active involvement in European cooperation, particularly through the EDA.

87. The way of attaining the ideal European market, the Finns believe, is though active cooperation between all those concerned: governments, firms, the European Defence Agency and the Commission. The last “could be used as a tool to collect data and build up the required measures and practices”. A fiercely independent nation, Finland acknowledges that “certain national defence prerequisites must be taken into account. As a non-aligned nation we place a strong emphasis on the aspect of security of supply and security of delivery”.

88. This issue has not yet been solved satisfactorily by the EU member states, making Article 296 TEC the more relevant. As far as the Commission’s proposals go, Finland feels that any Community initiative has to be taken in close collaboration with governments. It identifies the EDA as the place in which the member states can agree on a common approach in regard the scope of Article 296 TEC and the cases in which it should be applied.

89. Greece’s position is that any initiative taken by the Commission or the EDA in this particular field [EDEM], should be without prejudice to the competency of member-states upon defence acquisitions and should not affect the member-state’s national security. It feels that the Interpretive Communication does not suffice and runs the risk of making the application of Article 296 TEC even more complicated. On this point Greece finds itself in agreement *inter alia* with France, Germany and the United Kingdom. Greece emphasises the need for guarantees of security of supply and information characteristic of defence contracts.

90. For the “small-medium countries”, of which Greece is one, internal consolidation brings to the fore the issue of international competitiveness which is one of the major objectives of the EDEM. In that context, Greece feels that there must be acknowledgement of the part played by small and medium-size businesses with their “essential contribution to the manufacture of dual-use and military products for defence and security users”, which need various forms of help to overcome their vulnerability and deal with the competition.

(iv) A degree of support for the Commission’s proposals

91. The idea of an Interpretive Communication nevertheless found support with eight EU member states:

– Austria feels that the Interpretive Communication would help clarify the legal position as regards the grounds for invoking the public security exception under Article 296 TEC.

However, it would not be adequate to provide a basis for specific Community rules on defence contracts (Directive option). Harmonisation of the existing rules falls primarily within the intergovernmental area. Under the terms of Directive 2004/18/EC a further Directive could only apply to non sensitive defence equipment.

– Denmark wants clarification of the legal framework governing the procedures that apply to defence contracts, both covered by Directive 2004/18/EC and those concerning equipment and technology subject to the public security exception under Article 296 TEC. Here the Communication has an educative function, while drawing up and implementing the measures necessary for setting up the EDEM is left to governments.

– Spain highlights the link between the European defence equipment market and the Defence Industrial and Technology Base (DITB). In that optic the Spanish authorities call for active cooperation between the Commission, the European Defence Agency and the EU member states "aiming at the creation of a non-protected European-wide open market, internationally competitive and geographically balanced, as a main tool towards a widening and higher integration of the Second Pillar of the European Union" [the intergovernmental regime that covers the CFSP and ESDP].

Spain feels that the need for transparency and information justifies an Interpretive Communication. It gives three reasons for this view: the many, different national systems that exist, the complicated nature of the procurement process for defence equipment and technology, considering the stakeholders and different interests in play, differing national priorities particularly in foreign policy matters and their implications for defence choices.

– Lithuania considers that it would be sufficient to explain the existing legal framework through an Interpretative Communication of the Commission.

– Hungary's view is that the purpose of the Communication should be to define the concept of "essential national security interests" to which Article 296 TEC and also Directive 2004/18/EC refer. Similarly, "it is necessary to clarify the relation of the defence procurement regulation of the EU to that of NATO". This point is also raised in Italy's contribution. The European Defence Agency is the appropriate forum for developing procurement rules in compliance with the existing Community regime (for civil or defence contracts where the Article 296 TEC exception is not invoked).

– Poland feels a common response is needed to resolve the problems of the European defence equipment market, particularly fragmentation and weak competitivity. The Interpretive Communication the Commission proposes can contribute to helping find a solution, by defining clearly "the scope of possible derogation based on [Article 296 TEC]". Taking that interpretation as its point of departure the Commission would be in a position to evaluate the impact of the public security derogation on defence contracts, preparatory to drawing up a legislative text.

Within the framework of intergovernmental cooperation priority must be given to multinational programmes, to settling the matter of security of supply and information and the possibility of derogating from the common rules in emergencies. Poland, here seconded by Greece, also concedes that small and medium-sized businesses have an important part to play in the defence sector. The Polish authorities also express reservations about the policy of industrial consolidation being fostered by the larger European armaments producing governments that seeks to build large transnational companies "tending to monopolise the market".

– Portugal's view is that an Interpretive Communication would be "useful and necessary but not sufficient". It would be a first step towards harmonising the rules and procedures governing defence contracts between European member states. Only after that dialogue could a Directive be envisaged. Portugal is very much in favour of common rules and procedures so as to "increase cooperation, transparency and competitiveness". Such an approach is necessary in the face of a fragmented market "or a group of markets, whereby nations act, under national interests, not linked by integrated strategic behaviours".

The Portuguese contribution likewise maintains that the European Defence Agency "must be regarded as the leading body to develop the arrangements to achieve an EDEM". In order to do so it would be appropriate to take account of acquired in other international armaments cooperation forums [NATO].

– The Czech Republic supports the proposal for an Interpretive Communication on Article 296 TEC. That interpretation could serve to support development of a new legal instrument which would nevertheless be at the initiative of governments not the Commission. The Czech authorities also propose sharing out the work so that:

  The European Union Military Staff and the European Defence Agency would work together to identify and define the military capabilities required for ESDP; and

  The European Defence Agency should "take over the full responsibility for armaments issues, issues of the Defence Technology Industrial Base (DTIB) and those of the European Defence Equipment Market (EDEM").

(v) The offset debate

92. Taking the replies of the member states overall to the questionnaire the Commission includes in the Green Paper, there is one area of marked difference between the major armaments producing states and the "small-medium countries" to which Greece makes reference. In reply to the final question "How do you think offset practices should be handled?" this latter group of countries state they want them to be retained or would agree to them being replaced by other more effective mechanisms based on similar principles.

93. Austria, the Czech Republic, Finland, Poland, Portugal and Spain are quite clear: trade offs and offset are essential for a sizeable number, if not the majority of European countries:

– Poland feels that offset practices are one of the instruments allowing that country to upgrade the technological level of its industry and for the latter gradually to adjust to European market conditions. Poland therefore proposes a process for systematically reducing the need for offsets, consisting in deepening industrial and technological cooperation between European nations of all sizes – large, medium and small.

– Portugal takes the view that in a closed environment where a few nations are responsible for 90% of defence-related transactions, for the vast majority of European countries, offsets are paramount to help them develop their own defence industries and to acquire the necessary know-how.

– The Czech Republic makes another very important point by highlighting the fact that "offset policy is also an instrument for maintaining or increasing the rate of employment". This concern for employment is shared, more or less explicitly, by all member states when it comes to defence industrial capacity. It is a consideration that is often very much present although rarely openly admitted when countries apply the public security exception provided under Article 296 TEC.

– The Spanish perspective holds that offsets are part of providing a service and are a "tool to guarantee security of supply of technologies and services throughout the life cycle of the purchased system (maintenance, technical support for its operation (...)". The reciprocal relationships between industries that are forged as a consequence of industrial participation, create the conditions necessary for cooperation over the process of consolidating the European DITB.

– The Finnish position also arises out considerations of a national constitutional order. Offsets are written into contracts worth over 10 million euros, a condition "based on the requirement set by the Finnish Parliament when authorising the funds for defence materiel procurements". Finland takes the view that the advantages gained to the country in terms of "security of supply or (...) technology transfer programmes" outweigh the fact that such arrangements are less than economically efficient.

94. The whole question of offsets is a very sensitive one given the factors riding upon it: security of supply, transfers of technology and know-how, industrial development and employment. Although not resorting to such practices seems desirable and acceptable to the larger nations, the others, in other words the majority of Union member states, are not ready to make that sacrifice without the guarantees of a "fair return" (juste retour) or at least some form of consideration which would justify to public opinion in their respective countries their holding steady or possibly increasing their defence spending.

(vi) A parliamentary contribution from the French National Assembly

95. The French National Assembly is the only parliamentary assembly that responded to the consultation on the Green Paper. It thus deserves to have its contribution considered on a par with those from governments. It expresses reservations about the Communication which, "superimposed on the decisions of the Court of Justice would not necessarily constitute clarification as it would offer an interpretation of them that was to an extent authoritative but hardly definitive".

96. It does, however, regard the specific Directive as "possibly an essential tool for breaking down the rigid compartmentalisation of Europe's national defence markets (…) a specific Directive drafted so as to comply with Article 296 is imperative for strengthening the European Defence Industrial and Technology Base."

97. The idea of protecting European industry in the face of unequal international competition especially in the Euro-Atlantic geopolitical area is also raised by the French National Assembly. It argues in favour of continuing the process of industrial concentration and consolidation in Europe and considers that European competition rules "are not applicable as they stand to public defence contracts" (…). In support of this position it refers to the two factors of security of supply and secrecy of information when making out its case:

> "(…) the provision made in European law in regard to control of [industrial] concentration are unsuitable for this industry. Obviously, large European groups must not evade anti-trust laws. But the relatively advantageous position of an undertaking in a segment of the world market [Europe] does not necessarily mean that it is generally prey to competition. If the intention is to create a firm industrial base, there is a need for Community regulations, in defining abuse of a dominant position in the sector, to take not only the relatively narrow European market into account but the entire world market. The Commission and the Luxembourg Court are already studying similar cases in the civil aeronautics sphere [where the EADS group and its Airbus subsidiary are in a dominant position]".

(vii) Australia and Norway: parties to the development of a European Defence Equipment Market

98. Australia's and Norway's contributions to the Green Book show that the European Defence Equipment Market is an issue with a political and geographic resonance that extends beyond the borders of the European Union. Australia has a relatively small national industrial capacity, making it very dependant on external supply, both American and European. Norway, a NATO member, has industrial interests to protect and is looking to intensify cooperation with the European Union in ESDP matters.

99. In its contribution, Australia begins by pointing to the fact that it invests two billion euros annually on defence equipment (procurement and maintenance), among which products of European origin account for a sizeable part. Australian companies also have access to the European market but the balance of trade is markedly in Europe's favour. Naturally Australia has no comment to make on the rules, organisation and present or future operation of the defence equipment market. The aim of its contribution is to draw attention to the market's external dimension, both as a supplier (an aspect clearly of major interest to the larger European weapons producing states) and also as an equipment and technology customer on world markets:

> "(...) we [Australia] would be concerned if the Green Paper's focus on EU Member States alone could unintentionally disadvantage Europe's traditional defence allies and trading partners, such as Australia, through the possible imposition of restrictions on non-European access to the

> European market. Australian defence decisions are made on a value for money basis, which should encourage mutually open markets".

Norway takes a stance alongside the "small-medium countries" of the European Union. Its contribution makes explicit reference to its need to protect its interests as against the larger countries:

> "(...) we have some concerns if the immediate effect is that countries with small and relatively transparent economies (…) pay the costs of being exposed to greater competition and a more transparent regime. Thus (...) the suggested [adjustments] in the European defence market presuppose[s] that certain elements are in place in order to provide small players with a chance to obtain a fair market access".

100. This aspect relating to the equity of the European market is also underlined in the reply to the question on offsets:

> "The practice of offset is relevant to Norway, where almost 55% of the defence procurements are awarded [to] foreign companies. Norway regards offset as an important tool to allow the Norwegian defence industry to access foreign markets, which otherwise would be closed. However, Norway declines requirements for offset when we participate in international armaments cooperation where the authorities and industry from the participating parties all contribute in rough accordance with their investment.
>
> Norway does not oppose the abolishment of offset as such, provided that other countries do the same. In this context, countries with a small defence industry will be particularly exposed when implementing non-offsets policy".

101. As to the Commission's proposals Norway feels that the Interpretive Communication "is necessary to clarify the existing legal framework and helpful in order to achieve a more homogeneous national practice within the European Economic Area (EEA)". It also feels "it is important that a new directive does not favour large suppliers within the European defence equipment market at the expense of small suppliers from other countries. A new directive should ensure small suppliers an appropriate position within and reasonable access to the European defence equipment market". Such rules are not an end in themselves but a stage in the process leading to the formation and implementing of "a common European Union defence equipment policy". Coming from a country outside the EU, this is an affirmative act of faith, since none of the contributions from the EU member states calls directly for this type of approach.

102. This issue of a European armaments or defence equipment policy, debated constantly since the signature of the Maastricht Treaty, is central to the whole question of whether or not to build a true common European defence equipment market. On perusal of the contributions on the Commission's Green Paper from the various nations, virtually total convergence of views is observable on the final objective, but no real agreement on how to get there. Now, the Code of Conduct under discussion within the European Defence Agency has to take all those positions into account, even though the larger countries, in particular France and the United Kingdom, provided the impetus with their proposals for reference documents. This intergovernmental debate, which is being followed closely by the European defence industries, and the draft Code that the Agency is to submit for consideration at the end of the current year or early in 2006 could be the subject of a further associated report from the WEU Assembly's Technological and Aerospace Committee.

IV. The Green Paper and beyond?

103. Since 1996, thanks to the development of the CFSP and ESDP, the European Commission has continually sought to become an essential, if not the most decisive player in regard to the defence industry. The industrial or technological aspects of defence equipment procurement have given the Commission the opportunity to position itself politically and justify its position on legal or technical and economic grounds. Thus the 1997 Communication was discussed in the EU Council working group on armaments policy POLARM, which adopted a recommendation in favour of making a practical start on implementing it. However, governments took no action on the proposal.

104. The 2003 Communication and Directive 2004/18/EC were launched at a crucial time for the future of the Union, coinciding with the debates in the Convention on the Future of Europe and the preparation and presentation for ratification by nations of the draft Treaty establishing a Constitution for Europe, a document which, albeit in a controversial and imperfect fashion, introduced a degree of defence integration into the Union above and beyond crisis management, which provides the doctrinal and operational basis for ESDP. The solidarity clause, collective defence, structured and enhanced cooperation, the hard core and so on – all these notions would gradually enable the Union to punch its weight in security and defence matters or, from another point of view, in the event of a conflict of strategic interests between Europeans and the United States, completely shatter it.

105. Yet the European Union is not a state, notwithstanding the fact it has the attributes of one: executive (Commission), legislative (European Parliament) and judicial (European Court of Justice). It is an association of sovereign states united in a community of shared strategic (global) or sectoral interests. States delegate their sovereign authority to it in certain areas and under certain conditions, in accordance with the subsidiarity principle, and in return national interests for the entire body of the member states, large, medium and small, are better served. In that context, the Commission is not the "European Government" but an administrative and expert body whose responsibility it is to implement community policies and ensure that the member states put their own decisions into practice.

106. There is no calling into question the Commission's competence in regard to (civil) European contracts. However, the two-fold set back in the form of the failure, in the referendums held in France and the Netherlands, to ratify the draft Treaty establishing a Constitution for Europe, provides an opportunity to consider the scope of Community powers in economic matters. The Union is an effective worldwide economic player, but global efficiency causes shortcomings at national level that are increasingly less well tolerated by public opinion in both the "old" and the "new" Europe.

107. Add to this governments' failure to reach agreement and political instability and uncertainty stemming largely from factors producing widespread economic malaise from which no European country is exempt. In such an environment, protectionist tendencies abound, with predictable impact on the European Union budget. In the sensitive area of defence equipment, technical considerations such as security of supply, protection of information or maintaining and developing the Defence Industrial and Technology Base at times serve to mask concerns about employment and industrial activity, economic development and tax receipts.

108. Some governments interpret the European Commission's involvement in the defence sector as an intrusion into an area of national sovereignty which is, if truth were known, one of the last bastions of government economic action, either as a customer or a supplier. For their part, many European defence undertakings, private or still state-controlled, want to benefit from the Community Structural Funds or EU support for research, technology and technological development. Fragmentary foreign and defence policy rather than compartmentalisation and fragmentation of the current EDEM is the reason behind many of the present difficulties. The framework of the nation state is no longer able to support a sufficient level of investment to develop the DITB and in due course cover current capacity requirements.

109. Cooperation and pooling resources is a constructive way of going about things, but is not necessarily the reflection of a true willingness to share. It is also a constraint, a forced choice. For even if programmes are common, budgets are nevertheless subject to national schedules and other forms of uncertainty. A country can commit itself today to procurement of a given number of Airbus A-400M military transport aircraft or Eurofighter aircraft and tomorrow scale down its involvement because of a change of government, an economic crisis or, in some cases, a more tempting offer from a third country supplier, frequently the United States. Consistency and commitment to European cooperation is just as necessary, if not more so, than the political promises expounded in declarations of various kinds.

110. The Commission, because it is also in touch with governments over civil procurement, is aware of these difficulties and takes advantage of the lack of a shared intergovernmental vision to take forward its own ideas and influence the terms of the debate – with a degree of success if one is to judge from the "small-medium countries'" replies to the Green Paper. These also reflect a measure of

frustration at seeing their interests relegated to the background in favour of some higher European interest, those of the large armaments producer and customer nations.

111. The latter remain divided among themselves and in competition with one another whether over the choice of fighter aircraft, surface ships and submarines, fighter drones and observation UAVs, or as regards priorities in information technologies, surveillance and intelligence and net centric systems. At the same time, all governments concerned recognise that in these major areas convergence is more necessary than ever.

112. Fostering close European cooperation in rationalising the defence industry sector and defence RTD&E is also an extension of national defence efforts. Once they reach their limits international cooperation takes over from them, in the shape of OCCAR, the Letter of Intent and especially the European Defence Agency. However, this is not a responsibility shared with the Commission whose role here should not overstep subsidiarity and administrative and technical assistance to strengthen first and foremost national DITBs, and at times the common or cooperative EDITB.

113. Recognising the Commission as having competence in its own right, along with the right to regulate defence procurement and the functioning of the defence sector and the ability to influence the definition of defence and security RTD&E priorities among Union member states would be to add another layer of complexity in an area that continues to be controversial and highly sensive at the national level.

114. The Commission knows that it will be very difficult to have a specific Directive on public defence procurement adopted and implemented. It might never get to the stage of being approved by the EU Council of Ministers and even if it did, governments could then invoke the public security exception provided for under Article 296 TEC. That article cannot be amended without opening a debate on revision of the TEC – hardly an appropriate move given the failure of the draft Constitution. However, the Commission also knows that a directive has a life of its own and that the time may one day come when, as national policies change, it will find acceptance among governments.

115. Through its Green Paper, the Commission has at least succeeded in gathering a fair swell of support from governments for developing an intergovernmental Code of Conduct. This is a responsive step that has the merit at least of widening the debate on what Norway, which is not an EU member state but is actively engaged alongside the EU in ESDP development has called a common European Union defence equipment policy. The Code of Conduct is only one stage in the pursuit of that strategic objective.

116. If it is not achieved, governments will one day find their defence industries gradually disappear: that they will either suffer failure, or be relegated to subcontractor status, or lured away by the dream of US gold. Obviously, there will always be a majority European equipment input to the armed forces over the next 20 years or more but it will be proportionately a small one, increasingly dependent on systems, sub-systems and components designed and produced by Lockheed-EADS, Boeing-BAe systems or Northrop-Thales for example, within a huge, transatlantic integrated defence equipment market.

117. European autonomy: political, in security and defence or in relation to industrial, technological economic and social matters, has its price and this, while not easy to quantify exactly, is almost certainly a high one. Governments must take on board their responsibilities but being part of the Union also implies solidarity, sharing and trade off. The Commission does not stand for a political goal, a rigid notion of European Union. It is simply one instrument in the service of "a secure Europe in a better world", of a European strategy supported by all the member states, that they themselves alone can achieve by casting aside national insularity for a shared vision of the future of Europe and European defence.

APPENDIX

Green Paper of the Commission on defence procurement – questionnaire

1. Do you think it would be useful/necessary/sufficient to explain the existing legal framework in the way presented?

2. Are there other aspects of the Community system in question that should be clarified?

3. Do you consider the rules of existing directives suited/unsuited to the specific characteristics of defence contracts? Please give your reasons.

4. Would a specific directive be a useful/necessary instrument for creating a European defence equipment market and strengthening the industrial and technology base of European defence?

5. What is your opinion regarding the use of a possible directive for purchases by other bodies, such as the European Defence Agency?

6. Procedures: do you believe the negotiated procedure with prior publication to be suitable for the specific needs of defence procurement? In what situations should use of the negotiated procedure without publication be allowed?

7. Scope: what would be the most appropriate way of defining the field of application? A general definition? If so, what? A new list? If so, what? A combination of a definition and a list?

8. Exemptions: do you think it would be useful/necessary to define a category of products that would be excluded categorically from the directive?

9. Publication: do you think a centralised publication system would be appropriate, and, if so, how should it function?

10. Selection criteria: what criteria do you think should be taken into account in addition to those already laid down in existing directives to take account of the specific features of the defence sector? Confidentiality, security of supply, etc.? And how should they be defined?

11. How do you think offset practices should be handled?