

# INTERNATIONAL GOVERNMENT CONTRACTOR

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## Analysis

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### Europe's Movement Toward A More Competitive Market For Defense Procurement

Europe's market for defense products is no longer sustainable because of inconsistent procurement policies, national biases fragmenting the market, and the lack of a cohesive regulatory framework for awarding cross-border defense contracts.

In March 2003, the European Commission—the executive body of the European Union—announced several initiatives designed to contribute to the gradual creation of a European defense equipment market that is more transparent and open between EU member states, while increasing economic efficiency. The new climate created by these initiatives may have profound impacts on U.S. manufacturers of defense products.

This article describes the recent history of Europe's awakening to this problem and its efforts to create a competitive defense procurement market.

**Common Foreign and Security Policy**—During the Cold War, intra-European cooperation for the security of Western Europe largely remained a NATO monopoly. While the EU served as a forum for discussing security issues, its military significance was marginal. The disappearance of threats from the East highlighted divergences between the major EU members over security and defense policies.

This divide was illuminated during the EU's Maastricht summit in 1991. The United Kingdom acknowledged the need for greater coordination of defense policy matters, but opposed any transfer of such matters to the EU. France and Germany, on the other hand, desired to strengthen their military collaboration. Working to find common ground, the

summit participants agreed to the Common Foreign and Security Policy (CFSP), the first step toward a common defense structure.

The CFSP was established as the EU's second pillar in the 1993 Treaty on European Union, signed at Maastricht. The five broadly stated objectives of the CFSP are:

- to safeguard the common values, fundamental interests, independence and integrity of the EU in conformity with the principle of the United Nations Charter;
- to strengthen the security of the EU in all ways;
- to preserve peace and strengthen international security;
- to promote international co-operation; and
- to develop and to consolidate democracy and the rule of law, and respect for human rights and fundamental freedoms.

Since then, there have been numerous developments in the CFSP, most significantly in the 1999 Amsterdam Treaty. The treaty identifies approaches to pursuing these objectives:

- defining the principles and general guidelines for the common foreign and security policy, which is done by the European Council;
- deciding on common security strategies between and among member states; and
- adopting common positions and joint actions on security issues of common concern.

**European Security and Defense Policy**—While the CSFP focuses on the development of common defense and security *policies*, the EU has also identified fundamental inadequacies in its procurement market, leaving a relatively weak European industrial and technological base for defense equipment. A new framework is emerging to address this dilemma.

In 1998, the British government's *Strategic Defence Review* expressed dismay at the European's operational powerlessness, despite a European GDP that was greater than that of the U.S. The cause of this inadequacy was found in the structure of the EU market for defense products and technology: It is rife with inconsistent policies among its member countries,

national biases, and the lack of a cohesive regulatory framework for awarding cross-border defense contracts.

Most defense contracts by EU member states have been awarded to national suppliers, primarily because of wariness over sharing confidential defense information with suppliers from other nations. Each country has developed its defense procurement system based upon its own territorial security needs. This fragmented system has produced tremendous inefficiencies for the greater EU market and a lack of interoperability among national defense systems. It also has limited economies of scale and the ability to finance significant R&D programs.

As a result of these structural defects in the EU market, European companies find it increasingly challenging to compete with big American defense companies. One by-product is a perceived technology deficit among European defense companies. The contrast between American power and Europe's inability to use force effectively has led to a collective realization of the need for renewed efforts in coordinated capabilities in defense procurement.

In the late 1990s, the Big Three EU states—the United Kingdom, France, and Germany—took the first steps toward this effort by developing the European Security and Defence Policy (ESDP). The ESDP is an institutional framework for open discussions on defense procurement. It includes:

- the European Military Committee, a senior military body and forum for consultation and cooperation among member states;
- the European Military Staff, which develops working methods and operational concepts on compatibility; and
- objectives on cooperation in defense procurement.

See Jean-Yves Haine, *European Defence and Security Policy: An Overview*, EU Institute for Security Studies, available at <http://www.iss-eu.org/esdp/01-jyh.pdf>.

An outgrowth of the EDSP is the focus on the lack of a cohesive regulatory framework for awarding cross-border defense contracts. The EU recently addressed that topic in its “Green Paper on Defence Procurement” available at [http://europa.eu.int/comm/internal\\_market/publicprocurement/dpp\\_en.htm](http://europa.eu.int/comm/internal_market/publicprocurement/dpp_en.htm).

**The Green Paper**—The Green Paper, published in July 2004, attempts to address the regulatory obstacles that member states face in awarding defense contracts across borders.

Under existing EU law, procurements are exempt from competition on national-security grounds if they are conducted specifically for military purposes and are critical to a country's security. This national bias in defense procurement is based legally on Article 296 of the Treaty establishing the European Union, formerly the European Community. According to paragraph 1 of that Article:

- (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 materials; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.

See *Treaty Establishing the European Union*, available at <http://europa.eu.int/eur-lex/en/treaties/selected/livre257.html>.

As recently clarified in Article 10 of Directive 2004/18/EC, EC rules on public procurement apply to contracts in the defense sector. See *Coordination Of Procedures For The Award Of Public Works Contracts, Public Supply Contracts And Public Service Contracts*, Directive 2004/18/EC of 31 March 2004, available at [europa.eu.int/eur-lex/pri/en/oj/dat/2004/l\\_134/l\\_13420040430en01140240.pdf](http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_134/l_13420040430en01140240.pdf). However, member states may depart from the rules whenever they can demonstrate that their essential security interests are at stake.

Most countries extensively use this exemption by deliberately excluding the production, trade, and procurement of military goods and services from the European integration process. National legislation on defense procurement usually provides for exemptions to the application of public procurement rules, with differing degrees of transparency. The publication of rules varies, technical specifications are often very detailed and based on widely differing standards, and the tendering and

selection rules are occasionally unclear. This constitutes a potential difficulty for non-national suppliers.

The Green Paper argues that the EU is an appropriate framework for achieving greater coherence and a more consistent policy with regard to the procurement of defense products. It is one step in a series of initiatives launched in the EC's March 2003 Communication "Towards a European Union Defence Equipment Policy." See IP/03/355, 11 March 2003, available at [http://europa.eu.int/comm/external\\_relations/cfsp/news/ip03\\_355.htm](http://europa.eu.int/comm/external_relations/cfsp/news/ip03_355.htm). The goal of the Green Paper is to stimulate discussions on ways of improving cross-border competition in the European defense market, while remaining sensitive to countries' security and confidentiality needs. It presents two potential approaches for creating a more cohesive regulatory framework in this area.

The first approach is an EC issuance of a non-legislative "Communication" that would clarify the legal framework for defense procurement, as well as provide interpretive guidance. The Communication would not be legally binding, but would provide specific criteria for determining when the national-security exemption could be used. In cases where the exemption does not apply, normal EU procurement rules would be used.

The second, more ambitious approach is the issuance of a new "Directive" on defense procurement, which would constitute new law to be applied throughout the EU. Such a Directive would establish rules for the award of defense contracts *not* covered by the national-security exemption, as a means of enhancing transparency and non-discrimination in EU defense procurement. Specific rules could identify the categories of covered equipment; create a centralized system of publicizing contract opportunities; establish standards for the general use of negotiated procurement procedures and non-competitive procedures in certain cases; and provide common definitions and selection criteria to be used in evaluating proposals.

The approaches discussed in the Green Paper focus on enhancing intra-European competition rather than international competition. Nonetheless, the creation of a more open defense market in the EU could help U.S. firms as well. Companies established in the EU with U.S. capital clearly would be able to par-

ticipate in EU procurements under the same conditions as their European counterparts. In addition, a more competitive European market may lead to new partnerships and teaming arrangements—on both sides of the Atlantic—between European and American businesses.

The Green Paper invites public comment on these potential changes by January 31, 2005, so the contemplated changes will not happen quickly. Companies with interests in the EU defense community should track these developments in the coming year.

**Other Initiatives**—In addition to the Green Paper, initiatives announced in the EC's March 2003 Communication include the creation of a European Defense Agency, which will be addressed in a future IGC article.

