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The Green Paper on Procurement of Non-Sensitive Defense Equipment

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In September 2003 the European Commission published a Green Paper containing its proposals for restricting the *blatant* abuse of Article 296 of the Treaty of Amsterdam and ensuring that the procurement of civil and dual-use goods and non-sensitive defense equipment by defense ministries is conducted under conditions of intra-community competition as required by the Treaty. The Green Paper does *not* deal with the procurement of sensitive defense equipment as defined in Article 296. Not least in order to ensure legal certainty, the German government should support both the Green Paper's proposals: an interpretative communication and a new public procurement directive.

In March 2003 the Commission announced a number of initiatives intended to create a European market for defense products and technologies and thus improve the economic efficiency of their development, production, and procurement. The proposals included facilitating intra-community transfers of defense equipment, action on competition policy concerning mergers and acquisitions, regulating state aid, and increasing competition in defense procurement. The Green Paper published at the end of September 2004 deals with this last area, and represents a first—extremely modest—move toward more international competition in the defense equipment sector. The Green Paper's recommendations are an integral part of the Commission's aforementioned proposals for action and will have to be implemented synchronously with the other elements. They will also have to be dovetailed with future efforts—especially by the European Defense Agency—to improve harmonization and pooling of national demand, because that is where there is the greatest potential for increasing efficiency. For example, public procurement directives for strengthening intra-community competition make little sense as long as competition is distorted by state aid, or problems in coordinating and combining national requirements force manufacturers to develop and produce small-volume series. However, in view of financial constrictions and gaping holes in the capabilities of the European armed forces, there can be no serious doubt that the Commission's proposed measures for

increasing the efficiency of European defense processes are urgently needed.

The Problem of Article 296

The central obstacle to increasing the efficiency of European defense processes is Article 296 of the Treaty of Amsterdam (formerly Article 223 of the Treaty of Rome), which states that 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." The list of goods to which this applies has remained unchanged since 1958.

Member states' very broad interpretation of the vague phrase "essential interests of its security," and the Commission's toleration of this practice, have allowed Article 296 to become the basis for fragmentation of the European defense equipment markets, for diverging (and often contradictory) national industrial policies, and for an approach to defense equipment cooperation that is currently often inefficient and has little to do with competition.

In other words, if there is to be more intra-community competition and greater efficiency in the defense equipment sector, the use of Article 296 will have to be restricted. The question is, whether the proposals in the Green Paper will actually be effective enough to make progress in that direction.

The Commission's Proposals

The Commission makes two proposals in its Green Paper: preparing an "interpretative communication" and developing a new public procurement directive—adapted to the special needs of the defense equipment sector—for products and technologies not covered by Article 296 (non-sensitive defense equipment). Both serve the goal of drastically restricting the *blatant* abuse of Article 296, but there are no plans to change the article itself or restrict its proper application.

Interpretative Communication

In an interpretative communication the Commission would lay down its interpretation of the legal basis for the application of Article 296. It is entitled to do so without obtaining the agreement of the member states, but in so doing would force its own hand. The premise of the Commission's interpretation, which is based on rulings of the European Court of Justice, is that defense equipment is generally covered by the existing public procurement directives and that recourse to Article 296 represents an exception that must be justified in terms of security interests in each individual case. The Commission would not, however, be able to use an interpretative communication to specify more precisely which defense goods fall within the scope of the exemption, because it is neither empowered to revise the list annexed to Article 296 nor to define the legally vague concept of "essential security interests," although it is possible that cases brought by the Commission (e.g. as the European Security and Defense Policy develops) might cause the European Court of Justice to depart from its extremely restrained practice of allowing member states almost unlimited freedom to define their own "essential security interests." In this case the member states would have to assume that the European Court of Justice would wish to question whether particular contracts were rightly classified as affecting the "essential security interests" of the state involved. In cases where an invitation to tender for non-sensitive defense equipment was restricted to national suppliers—with reference to Article 296—this would result in greater legal uncertainty. An interpretative communication would also make it clear that—contrary to the practice in a number of countries—civil and dual-use goods are not covered by Article 296, even when they are ordered by a ministry of defense. On the

other hand, there would be no change at all for genuinely sensitive defense equipment (except to clarify that an individual justification was required in each case). In other words, Article 296 itself would be unaffected by an interpretative communication.

A Public Procurement Directive for Non-Sensitive Defense Equipment

Issuing an interpretative communication would place the Commission under greater political pressure to ensure that the clarified legal requirements were actually observed. If member states wished to avoid being taken to court by the Commission, they would increasingly have to apply the existing general public procurement directive when ordering civil and dual-use military material (and possibly also non-sensitive defense equipment). Such directives are enacted by the European Parliament and the Council of the European Union to define legally binding rules that must be incorporated into member states' national legislation and observed by purchasing agencies when awarding public contracts. Because many member states believe that the existing directives do not take account of the special circumstances of the defense sector, the Commission offers in the Green Paper to develop a regulatory framework adapted to the specific nature of defense procurement in place of the existing civil directive. It calls on the member states to participate in the consultation process for such a directive (see the list of questions in the Green Paper).

Whether or not the member states should agree to the preparation of a new directive adapted to the special nature of defense procurement will depend in the first place on whether they believe the existing European Union public procurement directives to be appropriate for procurement of non-sensitive defense equipment. If they are not, it makes little sense to wait any longer before starting work on a new directive designed for non-sensitive defense equipment. A stricter line against abuse by the Commission could create legal uncertainty for many companies, because contracts concluded on the basis of an overstretched interpretation of Article 296 would risk being declared null and void by the European Court of Justice. In other words, in order to create legal certainty quickly, the member states would have the choice of strictly adhering to the existing public procurement directive for civil products and services or insisting that a new directive adapted to the special nature of the defense sector be put in place as quickly as possible.

The scope of application of the new directive for the award of non-sensitive defense equipment contracts could be defined by a general definition or a list. A list would be subject to the drawback that a decision of the Council would be required at regular intervals to add new technologies.

In order to take proper account of the special nature of defense procurement, a public procurement directive for non-sensitive defense equipment would have to diverge in a few crucial aspects from the existing civil public procurement directive (2004/18/EG of the European Parliament and of the Council of March 31, 2004). These modifications would relate primarily to the standard procedure of awarding contracts, aspects of logistics and interoperability, and possibly also protection of state secrets. However, such a directive would still differ significantly from any public procurement directive for sensitive defense equipment that might be drawn up as a replacement for recourse to Article 296. For example, in specifically defined cases concerning contracts that touch on essential national security interests, national purchasing agencies would have to be allowed to select suppliers according to security-related criteria rather than simply accepting the lowest bid.

How Should the German Government Respond to the Green Paper?

The Green Paper represents the first real step toward implementing the proposals that the Commission presented in its communication of March 2003 ("Towards an EU Defence Equipment Policy"; COM [2003] 113). It is a relatively modest step that does not even touch on the core areas of European defense equipment development and production. The proposals aim to urge the member states to interpret Article 296 as intended in the Treaty and to offer them an alternative to the existing civil public procurement directive. The question of the extent to which a new public procurement directive would cover defense equipment—in other words, where the line would be drawn in practice between contracts that affect essential national security interests and those where this does not apply—is a matter to be decided in the first place not by the Commission but by the member states.

It is currently to be expected that the public procurement directive offered by the commission will cover only the less important defense equipment projects, and that the member states will continue to apply Article 296 to all the rest.

In this type of smaller project the different national political frameworks probably do not distort competition in the way they do in larger and more important procurement projects because the industries involved are often regarded as non-strategic and therefore do not receive a comparable level of subsidies. Consequently, the objection that competition-distorting factors must first be eliminated does not really apply to implementation of the Commission's current proposals. It would become all the more relevant, the more member states also wished to see the sensitive arms, munitions, and war material (that are covered by Article 296) coming under the powers of a new public procurement directive. Such a proposal—which would go a good deal further than the Commission's current suggestions and is not currently the subject of serious discussion—would undoubtedly have to be accompanied by initiatives to eliminate competition-distorting factors.

Even without an interpretative communication the Commission could set strict limits on the abuse of Article 296, but issuing one would put it under greater political pressure to act. Then it could be expected that the reasonableness of application of Article 296 would be reviewed more often by the European Court of Justice. In order to counteract the resulting legal uncertainty and to overcome the deficiencies of Directive 2004/18/EC, the member states should take up the Commission's offer to prepare a special public procurement directive for non-sensitive defense equipment.

The German government should agree to both measures—the interpretative communication and the preparation of a new public procurement directive for non-sensitive defense equipment—because these two steps would mark a long-overdue move toward an opening of the European defense markets, and also because Germany would tend to benefit from stricter application of Article 296.

However, developing a public procurement directive is a relatively lengthy process. Even if it is not an absolute necessity in the case of non-sensitive defense equipment, the German government could—*in parallel* but not as a precondition—urge that the factors that distort competition in Europe (e.g. state subsidies) should also be eliminated or harmonized (as announced in the Commission's communication COM 113 of March 2003). If the timing of these different activities were to be coordinated, it would be possible to create conditions for fair intra-community competition by the time the new directive is launched.

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