

Whither the EU Internal Defense Market?

Thinking Beyond “Pooling and Sharing”

On the heels of the December 2013 EU Council summit, Europe’s internal market for defense deserves fresh impetus.

Five years after the adoption of the first EU “Defense Package,” calls to strengthen Europe’s defense industry still lack a focused debate on the single defense market and the implementation of related legislation.



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“The creation of this single market—without barriers, without discrimination, without domination—will ensure the pooling of resources...The single market...cannot be based exclusively on men of good will. Rules are indispensable.”

Address given by Jean Monnet at the inaugural session of the Common Assembly

11 September 1952, Strasbourg

The agreement on a European banking union last month inevitably overshadowed the EU Council’s conclusions on the common security and defense policy (CSDP), an event eagerly awaited since the decision in late 2012 to put defense on the EU agenda. Even so, in the end, the Council’s pronouncements held few surprises, with signs of progress as well as disappointment.¹

Both tone and content of the Council’s conclusions are measured, even when the intent was to be assertive, such as when calling on member states to deepen defense cooperation. In classic EU lingo, the Council “welcomes” a number of broadly publicized proposals by the Commission and the High Representative/Head of the European Defense Agency—developing capabilities in the areas of remotely piloted aircraft systems (RPAS), air-to-air refueling, satellite communications and cyber security, as well as support for dual-use research—and “invites” EU bodies to coordinate or take further action (including on crisis management operations, financing of EU

civilian missions, transparency in defense planning, pooled procurement, and support for SMEs). The areas where it “calls” for specific action in 2014 are few, yet noteworthy: an EU Cyber Defense Policy Framework, an EU Maritime Security Strategy, and a road map for developing defense industrial standards and certification procedures for defense equipment (the latter being a particular concern to industry in relation to cross-border RPAS operations).

The overarching theme of the Council’s final declaration can thus be summarized as pooling resources, harmonizing requirements and increasing cooperation in pursuit of greater efficiencies and policy coherence—not a small feat when considering the need to accommodate the often-competing views of 28 stakeholders. Yet, regrettably, one critical issue was left largely unaddressed: the broader internal market for defense and the lack of a corresponding industrial strategy.

Unfinished Business

The Council’s so-called third cluster, titled “strengthening Europe’s defense industry,” was supposed to cover topics of an economic nature, while leaving issues of policy (“increasing the effectiveness, visibility, and impact of the CSDP”) and operations (“enhancing the development of capabilities”) to the first and second clusters respectively. The Council’s conclusions include one reference to the need for a “well-functioning defence market” based on the principles of

openness, equal treatment and transparency, and stresses the importance of ensuring the “full and correct implementation and application of the two defence Directives of 2009.” Ensuring greater cross-border market access to subcontractors and small and medium-sized enterprises—a particular concern of member states with smaller or less-developed defense industries—is a rare recognition of the value of the internal market. In the end, however, the Council falls short of calling for any concrete action to ensure compliance with internal market rules and merely “notes” the Commission’s intent to develop a related implementation roadmap. The Parliament’s earlier call on the Council to “provide the necessary fresh and ambitious impetus and to lay down guidelines, overarching political priorities and timelines for supporting a truly European defence technological and industrial base” went unheeded.²

The EU “Defense Package” of 2009, consisting of the two directives on defense and security procurement (2009/81/EC) and intra-EU transfers of defense-related products (2009/43/EC), was the first critical legislative step towards the creation of an internal EU defense market. In addition to delays in transposing these directives into national law, implementation has been patchy and enforcement weak at best. As of March 2013, all EU member states have at last, if unevenly, transposed the defense procurement directive.³

Directive 2009/81/EC applies to most defense purchases above a certain threshold, as well as

to the procurement of sensitive equipment, works and services that have a security purpose and involve classified information. In the area of defense, the directive allows for several derogations consistent with the exceptions provided for by the Treaty on the Functioning of the European Union (TFEU). Of these exceptions, the most notable for its potential for (and past record of) abuse is Article 346 TFEU. It allows member states to diverge from the directive’s rules if considered necessary to protect their essential security interests.

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Avascent’s analysis of contract awards posted via the EU’s Tenders Electronic Daily suggests that nine months into the defense procurement directive’s full transposition, member states are still far from having embraced or correctly interpreted its intent despite progress in the area of transparency (see separate sidebar). Per its July communication, the Commission intends to ensure that the directive is strictly and correctly applied moving forward.⁴ One hopes that such improved oversight will also come with increased enforcement powers.

The Council’s latest failure to state a clear position beyond “noting” the Commission’s

intent is as disappointing as it is predictable, particularly given that both the Commission and the Parliament have been fairly explicit to date about the shortcomings in implementing existing legislation. The responsibility for making any progress in this area rests squarely with the member states.

France often gets the blame for resisting market liberalization.⁵ But the critique of protectionism cannot be reserved merely for the land of Colbert. Liberal-minded Denmark has been one of the worst violators of the EU's ban on market-distorting offsets. Germany, Europe's leading exporter (with some 60% of its exports sold to the EU), still nourishes a parochial view of its defense industrial base, as made patently clear by the 2012 aborted merger between EADS and BAE Systems.

To be fair, expecting a breakthrough at the first EU defense summit in five years would have been unrealistic. The latest debates about the EU's strategic priorities and its stated ambition for more "autonomous action" are both significant and overdue, however impractical their near-term application might seem. But a focus on increased *cooperation* among EU members should not eclipse much-needed efforts in the area of *competition*.

The term "competitive" or "competitiveness" appears seven times in the Council's 10-page conclusions. Calls for ensuring a competitive European Defense Technological and Industrial Base (EDTIB) are de rigueur in all proclamations on CSDP. Yet, competition in defense has for too long been the creed that dares not speak its name. Progress toward a

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truly functioning EU internal defense market is urgently needed. It cannot wait until June 2015, when the Council is expected to assess progress on its recent conclusions, or even until summer 2016, the due date for the Commission's implementation report on the two defense directives.

Towards a "Second Defense Package"

In many ways, 2014 is a transition year for Europe. While no major national elections are expected this year, elites in Brussels will be undergoing a major facelift, with European Parliament elections scheduled in May followed by tough negotiations to form a new Commission. In addition, the race to replace Denmark's Anders Fogh Rasmussen as secretary general of NATO (after presiding over this last NATO summit in early September) and Britain's Catherine Ashton as the EU's high representative for foreign affairs and security policy, will only intensify in the next six months leading to a decision before year's end. On top of this game of musical chairs come the critical Scottish and Catalan referenda on independence next September and November, respectively. This is no light agenda for the Greek and Italian governments who assume the rotating six-month presidency of the EU Council of Ministers in 2014.

Transitions, however, also offer an opportunity to refocus certain debates. Five years after the first Defense Package was adopted by the Council, a fresh look is needed at both progress to date and required changes for the future. Similar to current discussions on the EU battlegroups and the Lisbon Treaty's clause on "permanent structured cooperation"—both of which remain inoperative—the

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internal defense market deserves a more deliberate review to ensure its proper implementation and evolution over time. The following three propositions could serve as a starting point for such a discussion in 2014.

Prioritize the Single Defense Market

Given broad recognition among EU member states that CSDP should be a recurrent agenda topic at EU summits—Germany's new coalition, for example, has called for holding such reviews annually—2014 offers an opportunity to put this commitment to the test. The Italian EU presidency during the second half of the year, supported by early discussions during the current Greek presidency, could propose the single defense market as an agenda topic leading to the December 2014 EU Council summit.

Give Competition a Voice

The EU's competition policy treats at length a wide array of sectors, including energy and environment, financial services, agri-food industry, transport, telecoms, and pharmaceuticals. Following last year's successful transposition of the defense procurement directive, it would seem timely for the Commission to dedicate a section on the defense industry in its 2014 competition report. This would send a message that defense is as much a part of the EU's internal market as any other industry that claims €96 billion in annual turnover, more than 1.3 million direct and indirect jobs across Europe, and a multiplier of 1.6 on GDP.⁶ It might also spur discussion on the drafting of a much-needed EDTIB strategy, exposing weaknesses in national regulatory frameworks and the application of state aid and merger control provisions.

Evolve the Policy Framework

Given the ink is barely dry on the EU's first Defense Package, some might warn against putting forward additional measures or amendments. Such caution, however, goes against the experience of European market integration. The EU's single market is a palimpsest of evolving legal and policy frameworks—not more so in commoditized markets than in (once) highly protected and fragmented markets such as transport, energy and telecommunications. The liberalization of air transport, for example, took three

successive “packages” between 1987 and 1993, and the EU has since continued to evolve and consolidate related legislation. While practical reasons exclude the passing of new legislation anytime soon, it is not too early to start a debate on potential amendments to Directive 2009/81/EC that take into account important proposals around innovative procurement techniques, facilitating cross-border contracting and joint procurement, as well as further improving transparency of existing processes.

The EU internal market is arguably the greatest success of the European integration project and the principal driver behind Europe’s continued relevance in the world. All of the EU’s impressive achievements—from securing internal peace to projecting a leading role in world trade—can in some measure be traced back to the evolving application of open market principles to intra-Community affairs. Just as post-World War II political reconciliation on the continent was founded

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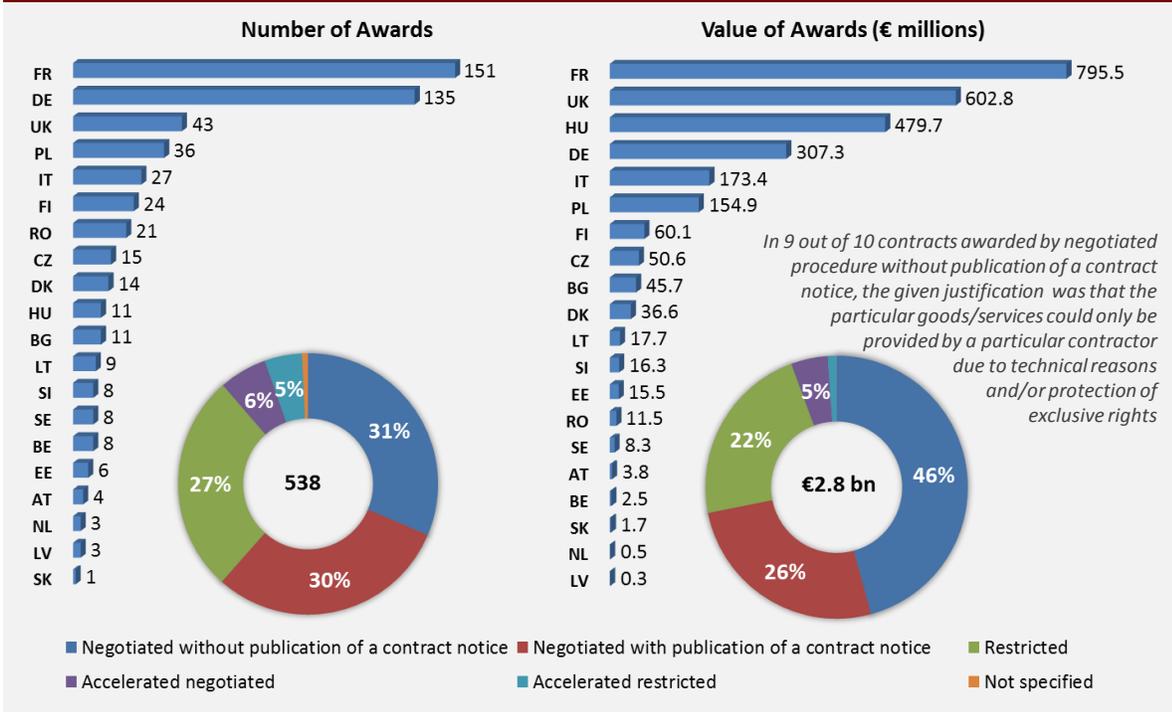
on economic integration, so an effective common policy on security and defense requires its own single market logic to stand on. A basic recognition by EU leaders in 2014 that “trading and competing” is as important as “pooling and sharing” would serve as

tangible proof of their latest affirmation that “defense matters.”

NOTES

1. European Council, Conclusions, EUCO 217/13, Brussels, 20 December 2013.
2. European Parliament, Committee on Foreign Affairs, *Report on the European Defence Technological and Industrial Base (2013/2125(INI))*, Rapporteur: Michael Gahler, 29 October 2013.
3. The due date for the implementation (and full transposition) of the transfer directive was June 2012.
4. European Commission, *A New Deal for European Defence: Towards a More Competitive and Efficient Defence and Security Sector*, COM (2013) 542, July 2013, p. 10.
5. French president Nicolas Sarkozy’s 2012 call for a “Buy European Act” may have been targeted less at Brussels than at Washington, but it reflects a broader underlying unease with economic liberalization, as well as the need to counter a growing, reflexive anti-Europeanism from across Europe’s far left and far right political spectrum. The concept of “Economic Defense Operator in Europe,” recently proposed by the Parliament, certainly merits further discussion but not without due consideration of the transatlantic dimension of the defense market, which remains the most logical extension of the EU single market, however gloomy the near-term prospects for transatlantic defense industrial cooperation. (For a thoughtful discussion of related issues, see Christian Mölling, “Europe, the Transatlantic Defense Industry, and How to Make the Right Choice?” GMF Policy Brief, November 2013.)
6. European Parliament, Directorate-General for Parliamentary Research Services, *Cost of Non-Europe Report*, CoNE 4/2013, December 2013.

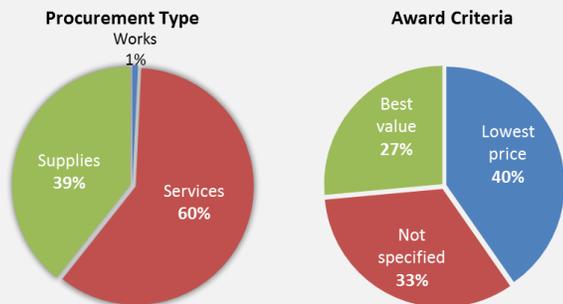
Contract Award Notices under Directive 2009/81/EC (April – December 2013)



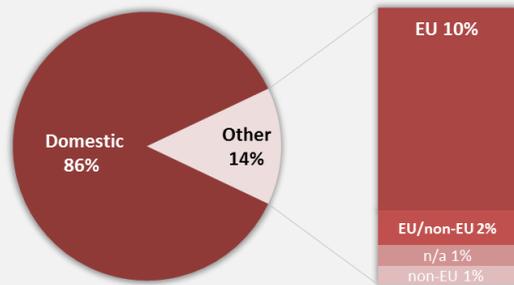
Analytical Highlights

- In the nine months since the directive’s full transposition, 20 EU member states have reported 538 contract awards with a total estimated value of €2.8 billion
- France, Germany and the UK account for over 60% of both total number and value of awards; they also account for some 84% of all recorded best value procurements
- The large number of negotiated procedures without publication of a contract notice and preponderant reliance on domestic suppliers (>85%) suggest still limited market openness
- However, in three cases, a member state chose to report a contract (though with limited information) that would typically be exempt from publication per the directive, an encouraging sign of transparency
- About 20% of total reported value involves an incorrect application of the directive (non-defense contracts outside the definition of "sensitive" purchases or defense purchases not directly related to military equipment or for specifically military purposes). One member state accounts for more than 80% of such incorrectly reported contract awards

All shares below as % of total value



Nearly 80% of "not specified" awards involved a negotiated procedure without publication of a contract notice



"Other" includes non-domestic suppliers as well as cases of prime-level collaboration between domestic and foreign suppliers

Note: Avascents analysis is based on all contract awards sent to the EU’s Tenders Electronic Daily between 1 April and 31 December 2013 (notices were filtered based on the date they were sent rather than published). Actual award dates of reported contracts range from March 2012 to December 2013, suggesting significant reporting delays in some cases. Many contracts contain incomplete data in relation to contract value, contractor name or award date. Values have been standardized in euros (excl. VAT) to facilitate comparison.

Christina Balis leads Avascent's European operations. Based in Paris, she supports corporate and financial clients operating in or looking to expand to Europe and adjacent geographies. She has experience providing strategic advisory services, assessing market opportunities, and supporting merger and acquisition activities across a diverse set of defense, civil, and commercial markets. Dr. Balis worked for a number of years as a consultant with Avascent before transitioning to industry. Prior to rejoining Avascent in late 2011, she was vice president for strategy and corporate development at Serco Inc., the US subsidiary of international service company Serco Group plc. Previously, she was a fellow in the Europe Program of the Center for Strategic and International Studies (CSIS) in Washington, DC. She holds a joint B.A. in European Business Administration from the ESB Business School (Reutlingen, Germany) and Middlesex University (London, UK) and a M.A. and a Ph.D. in International Relations from the Johns Hopkins School of Advanced International Studies (Bologna, Italy, and Washington, DC).

The European Defense Industrial Base Forum is an Avascent initiative to explore and debate issues critical to the performance and long-term viability of Europe's defense establishment. Designed to engage and inform representatives from both the private and public sectors, including the financial community and academic institutions, this forum seeks to provide senior executives and decision-makers with objective, nonpartisan analyses to support strategic action across Europe's diverse defense technology and industrial base.

Comments, questions, and requests to receive future updates may be sent to : europe@avascent.com

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