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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE AND THE COMMITTEE OF THE REGIONS**

**A STRATEGY FOR A STRONGER AND MORE COMPETITIVE EUROPEAN
DEFENCE INDUSTRY**

IMPACT ASSESSMENT SUMMARY

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1. Political context

In the past, the Commission has several times highlighted the challenges the European defence industry is facing and has underlined the need to create a European defence equipment market¹. The initiatives taken by the European Defence Agency (EDA) and the Commission since 2004, and the preparation of two concrete legislative proposals by the Commission make it necessary to outline the EU's strategic policy framework and the challenges ahead for the European defence industry and the key institutional actors.

In autumn 2007, a package of three defence related policy proposals will be presented:

- A Communication “A Strategy for a Stronger and more Competitive European Defence Industry”
- A proposal for a Directive on the procurement of defence goods
- A proposal for a Directive on intra-Community transfers of defence equipment.

This impact assessment will accompany the Communication which sets out the wider context in which initiatives affecting the European defence industry are adopted. It will identify policy options for the Commission aimed at achieving further progress with regard to the problems identified (see 3 below). It will also be proportionate to the nature of the policy document under consideration since any future legislative initiative taken on the basis of this Communication would be accompanied by its own separate impact assessment. This is also the case for the two legislative proposals foreseen for adoption as immediate steps which are accompanied by separate impact assessments.

2. Stakeholder consultations

Given the specificity of the sector and the limited impact on the general public regarding industrial policy measures in the defence sector, a targeted stakeholder consultation was carried out by a consultant tasked by the Commission in 2006. As the Communication will be a strategic framework document, which will focus on certain problems and possible ways to address them, stakeholders were consulted to identify problems and gather opinions on areas where further action could be considered. A consultation questionnaire was prepared by the Commission, and over 140 organisations were invited to respond (the Ministries of Defence of EU-27 and the Candidate Countries, 20 national industry associations, 3 third countries², the European Defence Agency, 15 national trade unions dealing with the defence sector, large defence companies, small and medium-sized defence companies and research institutes specialised in security and defence economics).

The responders could be kept anonymous, but stakeholders could provide more information about their organisation if they wished to do so.

¹ COM(97) 583, 12.11.2007; COM(2003) 113, 11.3.2003.

² United States, Russia, Israel.

40 responses were received from 18 identifiable countries across the EU. The respondents comprised:

- 12 responses from Member States;
- 14 responses from large enterprises and industry associations;
- 6 responses from Small and Medium Enterprises (SMEs); and
- 8 responses from ‘other’ organisations (trade unions, research organisations and responses of unknown origin).

Not all EU Member States reacted to this consultation. However, most issues were also discussed by Member States’ representatives in the Ministerial Steering Board Meetings of the EDA, which took place on 13 November 2006 and 14 May 2007. No responses from third countries were received.

Furthermore, several meetings were organised in co-operation with the EDA to discuss specific issues with industry representatives and the Aerospace and Defence Association of Europe.

The vast majority of the stakeholders consulted were of the opinion that the existing framework conditions in which they operate are not adequate to ensure the long-term competitiveness of the European defence industry. Obstacles perceived by many stakeholders were for example the lack of common rules for a European defence equipment market, the unbalanced defence trade relationship between the EU and the US and the lack of coordination of national defence research and technology.

3. Problem definition

The “Initial long-term Vision for European Defence Capability and Capacity Needs” adopted in 2006 by the Ministerial Steering Board of the EDA states that an industrial policy is needed, which “*averts a steady contraction and decline of the European defence industry by increasing investment, consolidating the European technological and industrial base and harnessing Europe’s full potential*”³.

The problems identified can be grouped into three broad areas:

Framework conditions for industry

The development of new, ever more sophisticated defence related technologies becoming increasingly expensive and leading to a situation where **national defence budgets can no longer finance top quality products**. New defence programmes are not sufficiently co-ordinated at the European level, which leads to **duplication** and impedes synergies and economies of scale for the companies involved in **different programmes**.

³ Long-Term Vision, EDA, adopted by the EDA Ministerial Steering Board on 3 October 2007, p. 3.

Defence **research and development** is also mainly undertaken **at a national level**, which leads to duplication of programmes and less efficiency than a more coordinated approach.

Defence market issues

Member States tend to procure defence goods from national suppliers. This leads to **market fragmentation**, national supply chains and obstacles for co-operation at the European level.

National foreign policy priorities can lead to a situation in which transfers of defence products to other EU Member States are stopped. This leads to a **lack of security of supply** of defence equipment for the customer.

The absence of a Community regime for **security of sensitive industrial information** can lead to discrimination against suppliers from other EU Member States.

SMEs are mainly involved in national supply chains. If cross-border procurement at European level develops further – as can be expected with the adoption of the Code of Conduct on Defence Procurement adopted by the EDA in 2006 – care has to be taken that **SMEs** must also benefit from the opportunities at European level.

Current **offset practices**, which are often part of a procurement contract, could lead to distortions in the internal market.

Given the mainly nationally organised supply chains, **standardisation of defence equipment** at European level is not sufficiently developed. A European Defence Equipment Market needs a common system of standards to simplify cross-border procurement.

The creation of a European defence equipment market could lead to **market distortions** if **EU competition legislation** is not effectively applied for this sector.

Other areas

The defence **trade relationship with the United States** is very **unbalanced**. Most EU defence companies have only marginal access to the US market, whereas US companies have almost full access to the EU market.

Market reform inevitably results in change and the **need to adjust**. Whilst this can bring overall benefits to the economy and citizens, some workers and regions may lose out in the shorter run.

All these problems mentioned above have an EU dimension and call for action at EU level. Member States alone will not be able to achieve progress in most of these matters on their own. It is therefore considered that an involvement of the Commission and the EDA create substantial added-value.

4. Objectives

A competitive European Defence Technological and Industrial (EDTIB) base is necessary to support the European Security and Defence Policy. Failure to safeguard a competitive defence industrial base, and loss of autonomous design and innovation capabilities, limits available choice and increases the dependency on non-European suppliers of defence goods. A

competitive EDTIB requires an efficient European Defence Equipment Market (EDEM). A well-functioning European market requires an improvement to currently fragmented legal and regulatory framework, which is based on national legislation and imposes many burdens on companies.

Framework conditions for industry

- (1) Member States should increasingly **pool demand on defence markets** in order to overcome market fragmentation and to remove obstacles for cross-border industrial cooperation. This objective can only be achieved if Member States take action, possibly supported by the European Defence Agency.
- (2) Member States should increasingly **pool demand for military research and development** of new defence related technologies. Duplication of research programmes due to the reason that military research is primarily undertaken at national level leads from a European perspective to inefficiency of spending. This objective can mainly be achieved by Member States' action, but the Commission can contribute to the objective by coordinating the security research programme of the Community with research initiatives supported by the EDA.

Defence market issues

- (3) Provisions to take into account the need for **security of supply and security of information** would be of utmost importance to build trust among Member States and ensure the proper functioning of a European Defence Equipment Market. However, as these issues touch on national security interests of Member States, any proposal in this area would in a first step focus on further analysis on possibilities for an EU regime.
- (4) The involvement of innovative **SMEs** in the supply chain of the European defence industry should be fostered. The EDA is addressing SME issues with its Code of Best Practice in the supply chain. As SMEs are an important element of the industrial policy of the EU, it is important that the Commission monitors the involvement of SMEs in the defence supply chain and proposes measures if obstacles for SME participation are observed.
- (5) Work towards the phasing-out of offsets. Offsets as part of defence procurement contracts can distort competition in the internal market and indirect offsets are likely to raise legal problems. However, offsets are widely used in the EU and abroad and often even required on the basis of national legislative acts. The Commission and EDA could study the issue of offsets further and propose measures towards the phasing out of offsets in the future.
- (6) Make use of **standards** for defence equipment to ensure cost efficiency and interoperability of defence equipment. A European Handbook for Defence Procurement is available for the Member States, but the use of these standards for defence procurement is not binding. The Commission and the EDA could further encourage the use of the standards published in the Handbook.
- (7) Ensure **fair competition** on the European market. The stepwise creation of a truly European Defence Equipment Market will need to ensure that measures which could

put some companies in a more advantageous position than others (for example through state aid) are appropriately controlled. The Member States must be capable of justifying any recourse to Article 296 when granting state aid or taking other measures within the scope of the EC Treaty in sectors concerning their essential security interests.

Other areas

- (8) Work towards **more balanced transatlantic relationships**. The defence trade imbalance between the EU and the USA would need to be analysed and addressed by the Commission in an appropriate forum.
- (9) Identify and address **access barriers to third markets**. Defence trade barriers with third countries could be included by the Commission in the Market Access Database to gather an inventory of possible obstacles.
- (10) **Anticipate change** and adjustment costs and accompany them, as necessary, with appropriate measures. The Commission would consult stakeholders and study economic adjustment processes in the defence industry to be able to develop measures or strategies to timely address possible adjustment problems.

5. Development of policy options

In a next step, three policy options addressing these specific objectives were identified:

Option 1: Do nothing or “business as usual”

This option would imply that no initiatives at EU level were launched by the Commission with the aim of strengthening the EDTIB or creating an EDEM, in line with the specific objectives. However, this does not necessarily mean that no action would be taken at all, because some Member States might in certain cases decide to act among themselves on the basis of bilateral agreements or voluntary arrangements.

Option 2: Immediate action in all areas where the defence industry is currently treated differently to other industrial sectors

Such an approach would imply that immediate steps be taken in order to integrate defence goods fully into the single market by, for example, removing all obstacles to free movement inside the EU, immediately prohibiting offsets, regulating trade with third countries at EU level, attacking restrictions on freedom of investment and applying competition rules to the full by systematically launching *ex officio* investigations in defence-related industries. Even more ambitious steps such as opening European demand for defence goods and financing European defence R&D, would imply making available the corresponding budget at EU level.

Option 3: A step by step approach, intensifying the process with immediate steps where appropriate and working with other stakeholders to identify and prepare further areas of work

This approach would focus on initiatives that could probably be agreed with Member States in the short term and would identify areas where action should be taken in the medium term or where further study was needed for the long term. It would however not address all identified

problems immediately but rather aim at intensifying the dialogue with stakeholders and cooperating with other key actors.

6. Assessment of Impacts

Each policy option was assessed with view to its economic, social and environmental impacts. Given that the Communication will be a policy document which prepares the ground for later more concrete initiatives, the economic, social and environmental impacts were assessed qualitatively.

The assessment resulted in a ranking of policy options reflecting their estimated impact on the objectives. The comparison of options showed that option 3 would not only have the greatest impact on the achievement of the specific objectives but would also avoid the major negative consequences in the longer and shorter term respectively, of options 1 and 2. The sensitivity of the defence sector and the need for stakeholders to act together to achieve the most efficient results necessitate a careful approach ensuring a wide consensus. Hence, it can be concluded that taking immediate steps in specific, identified and agreed areas and highlighting the need for further steps in other areas seems to be at this point in time the best way forward. This option does not entail specific new expenditure programmes or regulatory measures.

7. Monitoring and evaluation

The Commission will evaluate the progress made with a view to the problems and objectives described in 3-4 years. This evaluation will cover initiatives of the Commission, the EDA and Member States, which contribute to strengthening the EDTIB and creating an EDEM as set out in this impact assessment and Communication.

As future legislative actions will be accompanied by separate impact assessments, it does not seem appropriate at this point in time to define indicators for their implementation.

The Commission will also monitor the developments in the defence sector continuously in its daily work with the European Defence Agency. In particular, it will, on a regular basis conduct a competitiveness study of the sector. Once finalised, the mapping of the European defence industry undertaken as a follow-up of the 2003 Communication, should also improve knowledge and data on the defence industry in Europe.