COMMISSION STAFF WORKING DOCUMENT

Annex to the Proposal for a

DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on the coordination of procedures for the award of certain public works contracts, public supply contracts and public service contracts in the fields of defence and security

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1. INTRODUCTION

For more than 40 years after the failure of the European Defence Community project in 1954, defence and security matters were excluded from the process of European integration. This was true not only of European defence policies and armed forces, but also for market and industry issues. As a consequence, defence markets in the European Union remained de facto outside the Internal Market and fragmented at the national level.

Since the end of the Cold War, this fragmentation has become increasingly problematic. Facing a combination of budget constraints, rising costs for military equipment and the restructuring of the armed forces, national markets in Europe have often become too small to produce and procure high quality equipment at affordable prices. This is the case in particular for complex equipment which involves high costs for research and development. Far-reaching reforms have thus become indispensable for Europe to maintain a viable European Defence Industrial and Technological Base (EDITB) and equip its armed forces adequately. In this context, the establishment of a competitive European Defence Equipment Market (EDEM) is recognised as particularly important.

Following the development of the European Security and Defence Policy (ESDP), the EU has become the main framework for action to achieve this objective. A major step forward was the establishment of the European Defence Agency (EDA) in 2004. As an agency of the EU Council, EDA is supporting Member States' efforts to develop the military capabilities needed for ESDP. Focussing on the demand side of the market, EDA tries in particular to harmonise military needs, pool research efforts and foster European armaments cooperation.

Complementing Member States' efforts, the Commission also launched an initiative to support the establishment of an EDEM. In its Communication "Towards a European Defence Equipment Policy" of March 2003[1], the Commission presented a series of proposals for action in areas related to defence industries and markets (standardisation, EDITB monitoring, intra-community transfers, procurement rules, dual-use exports and research). This Communication was thus the starting point for the Commission's activities in the field of defence procurement.

2. PROCEDURAL ISSUES AND CONSULTATION

From January to April 2004, the Commission organised several workshops with representatives from governments and industry to collect information on current defence procurement practices and to identify the expectations of stakeholders vis-à-vis possible Community action in this field.[2]

These workshops prepared the ground for the Green Paper on defence procurement, adopted in September 2004.[3] The Green Paper invited all stakeholders to comment on how to improve the legal framework for defence procurement in the EU. At the end of the consultation period in May 2005, the Commission had received 40 written contributions from 16 Member States,

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1 COM(2003) 113, 11 March 2003.

2 Minutes of these workshops are available upon request at DG MARKT, C3.

3 COM(2004) 608, 23 September 2004.

institutions and industry.[4] Given the sensitivity of the issue and the relatively small number of actors involved, this was considered a good level of participation.

The Green Paper consultation confirmed that the existing legislative framework for defence procurement in Europe is deficient. At the EU level, the Public Procurement (PP) Directive applies to public contracts awarded by contracting authorities in the field of defence, subject to Article 296 of the Treaty establishing the European Communities (TEC). According to stakeholders, this framework is not functioning properly, mainly for two reasons:

- Uncertainties persist regarding the use of Article 296 TEC, which allows Member States to derogate from EC rules laid down in the PP Directive if this is necessary for the protection of their essential security interests. Since the scope and the conditions for the use of the exemption are vague, the application of Article 296 TEC to defence procurement remains problematic and varies considerably between Member States.
- The current PP Directive, even in its revised version (2004/18/EC), is generally considered ill-suited to many defence contracts, since it does not take into account some special features of those contracts. As a result, many Member States are reluctant to use the PP Directive for defence procurement and try to interpret Article 296 TEC as broadly as possible in order to exempt defence contracts from EC rules.

To tackle these two problems, the Commission announced in December 2005 two initiatives:[5]

1) Adoption of an "Interpretative Communication on the application of Article 296 TEC in the field of defence procurement";

2) Preparation of a possible new directive on defence procurement, adapted to the specificities of defence contracts.

This two stage approach, which was also supported by the European Parliament,[6] allowed a measured reaction to the issues raised. Within a fairly short time period, the Commission would be able to consult on and produce guidance for Member States on the use of Article 296 TEC, which could then be put to immediate use. A longer time frame would be needed to give appropriate consideration and discussion before taking deciding about further legislative action, which, if proposed, would itself require time to prepare, adopt and transpose.

The Interpretative Communication was adopted on 6 December 2006, after intensive consultation of industry and Member States.[7] Explaining the conditions for the use of Article 296 TEC, the Communication gives guidance to national contracting authorities for their assessment of whether procurement contracts can be exempted or not.

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4 Contributions at: http://www.europa.eu.int/comm/internal_market/publicprocurement/dpp_en.htm.

5 COM(2005) 626, 6 December 2005.

6 The EP resolution of November 2005, based on the so-called "Würmeling" report the Committee on the Internal Market and the opinion of the Committee on Foreign Affairs all recommended to pursue both initiatives in parallel. See: http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2005-0440&language=FR&ring=A6-2005-0288

7 COM(2006)779, 6 December 2006 The draft Communication was discussed with Member States at the ACPP, bilaterally and at EDA.

In order to cope with the second problem identified in the Green Paper consultation, the Commission has continued in parallel to prepare a possible new directive adapted to the specificities of defence. Again, stakeholders have been closely involved at every stage. Between December 2006 and April 2007, Member States gave their input on the scope and the content of a possible Directive, in particular via the Advisory Committee on Public Procurement (ACPP). Discussions in the ACPP helped to identify why current EC rules were deemed ill-suited to defence procurement, what the field of application of a possible new Community instrument should be, what the main problematic issues are and how they should be dealt with. After each meeting, Member States were invited to give detailed written contributions. On top of this, the Commission had numerous bilateral discussions with Member States and EDA. Industry was also involved, in particular via meetings with national and European Associations (see Annex 20). Throughout this consultation, stakeholders have contributed in a constructive way to the Commission's work, giving valuable input both for this impact assessment and for the proposal itself. No stakeholder, and in particular no Member State, has shown opposition on the principle itself of the exercise.

Governments and industry were also consulted in the framework of the Impact Assessment. In this context, five studies were commissioned, in particular to collect more quantitative information. Three studies were commissioned from the College of Europe (BE) to: 1) analyse the defence budgets of ten Member States, categorising spending by sectors and products; 2) examine the "Tenders Electronic Daily" (TED)[8] in order to assess the extent to which contracting authorities use the Official Journal of the European Union (OJEU) for the publication of defence contract notices, 3) assess how many and which defence contract notices are published only at the national level.[9]

Two further studies dealt with economic and market aspects. The first one, conducted by Rambøll Management (DK), provides facts and figures on the supply base in Europe, examines procurement practices in the EU and attempts to measure the administrative burden of new procurement rules for both companies and contracting authorities. The second study, by Yellow Window (BE), is a market study which establishes a categorisation of defence products and tries to measure the economic impact of the new procurement rules on defence markets and in particular on cost-savings for each type of product.

The present report is based both on the findings of the five above-mentioned studies and on the consultation the Commission has organised with Member States and industry since the beginning of 2004.[10] The dialogue the Commission has carried out with stakeholders for several years has made it possible to collect a great deal of qualitative information on defence markets and procurement practices. The studies outsourced in order to obtain economic and financial information, by contrast, could not always deliver the expected results.

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8 TED is the on-line version of the Supplement S to the OJEU containing calls for tenders, contract awards and pre-information notices. TED can be accessed at http://ted.europa.eu.

9 Publication at the national level was considered as an indicator for the use of national competitive procedures without application of the PP Directive. In these cases, Member States try not to evade competition per se, but "only" the application of EC rules. One can therefore assume that these contracts could come under EC rules if the latter took into account their specific features.

10 Given the time schedule of this Impact Assessment, the information used in this report focuses on the EU-25 (although some qualitative input was provided by Romania and Bulgaria in the framework of the ACPP). Given the political sensitivity of the matter and questions of confidentiality, certain references to the particular situations or practices of individual Member States were expunged.

There are a number of reasons for this, which are related to the specificities of defence markets: since there is no commonly agreed terminology and categorisation of “arms, munitions and war material”, it has been difficult to exploit economic and industrial databases. Member States defence budgets have also been hard to analyse and compare, since they are structured and organised in very different ways. Moreover, many defence suppliers have both military and civil activities, making it difficult to clearly identify “defence market operators” and the importance of defence activities for their overall business. An additional problem is the lack of reliable information aggregated at the EU level. Existing sources are disparate, often incomplete and differ considerably. Even at the national level, the political and strategic sensitivity of these markets makes any quantitative analyse a difficult exercise.

Facing such challenges, it has proved to be very difficult to provide precise quantitative data. Even market operators with important international activities often have only an incomplete picture of defence markets in the EU and remain extremely cautious about market forecasts. Consequently, the following analysis is based mainly on qualitative data.

The present report addresses both defence procurement (military equipment, namely arms, munitions and war material, procured for armed forces) and sensitive security procurement (equipment with similar features as military equipment, but procured for non-military security forces). However, the focus of the analysis is on defence. There are several reasons for this: Most of all, since the beginning of the process, the Commission's initiatives in this field have been driven by a specific demand of stakeholders for community action in defence procurement; sensitive non-military security came up, at Member States' request, only at a later stage as an additional facet of the debate. (This also accounts for the fact that the five outsourced studies only concern defence, not security equipment.) Moreover, before the emergence of asymmetric security threats (catastrophic terrorism in particular), sensitive non-military security procurement attracted little attention, and public expenditure in this area has not been monitored in a systematic, detailed way. This, together with the complexity of the demand side of the non-military security market (see section 4.2.), makes it particularly difficult to gather financial and economic data in this area.

However, the specific focus on defence seems justified: 1) It is procurement in the field of non-military security which has developed in recent years specificities similar to defence procurement (not the other way around). In many respects, a qualitative analysis of the latter therefore covers automatically the former. 2) The focus of the Commission’s initiative remains on defence. With regard to non-military security, the question is "merely" whether a possible community instrument for defence should also become applicable to certain particularly sensitive non-military security procurements.

As part of the Commission’s commitment to improving the quality of Impact Assessments, an independent internal Impact Assessment Board (IAB) has been set up. This Impact Assessment was reviewed by the IAB at a meeting on 27 June 2007, and shortly after the IAB published its opinion. In general, the opinion was positive, and the IA was praised for its well structured problem analysis; making good use throughout the document of feedback from the extensive stakeholder consultation and proposing appropriate monitoring and evaluation arrangements. The recommendations for improvements are detailed below, with a short commentary indicating how and where these recommendations have been accommodated within the current version of the report:

1)	*The presentation of the impact analysis should be organised in a clearer and more coherent way*: as discussed in the IAB meeting steps were already in hand to address this issue. Sections 6 and 7 have been reworked, summary tables have been added and the logical flow of the "screening" of the sub-options has been reviewed;
2)	*Provide better explanation as to why the proposed new rules can effectively cover both defence and sensitive security procurement*: references drawing comparisons between the two different markets have been added throughout the text (in particular sections 3.7, 6.2.4.);
3)	*The problem statement should be more focused and concise*: in recognition of this request, some editing has been done to shorten this section (e.g. section 3.1, 3.2.1 and 3.3). However, we feel it is important to communicate the detail of this issue to a wider audience, and thus have not moved to annexes sections which might be considered as less relevant;
4)	*The objectives should be better linked to broader policy agendas:* more explanation has been added in section 4.1 where the general objectives are presented and, where reasonable, references are made in the impact section (e.g. competitiveness);
5)	*The longer term aspects of the social impact analysis should be reinforced:* some short additional statements (drawing on general theory) have been added to the section discussing the impacts on employment (6.2.4.4).

3. PROBLEM DEFINITION

3.1. Background information on defence and security markets

This section provides an overview of the operation of (1) defence and (2) security markets in the EU. Without being exhaustive, it aims at describing some of the main features of these markets in order to put the procurement issue into perspective and facilitate the understanding of the problems encountered in this specific area.

4.1.1. Defence Markets – specificities and problems

Defence markets cover a broad spectrum of products and services, ranging from non-war material, such as office equipment and catering, to complex weapon systems (tanks, fighter aircraft, aircraft carriers, etc.) and highly sensitive material, such as nuclear, biological and chemical equipment. The sensitivity of defence equipment (arms, munitions, war material) for Member States' security interests can vary depending on political and military circumstances. In general, however, its sensitivity is proportional to its technological and strategic importance. At the upper end of the technological spectrum, weapon systems are often developed for the specific demands of a very small number of customers. Such systems normally have long development and life cycles and high non-recurring costs. This, in turn, makes it necessary for governments of producing countries to bear a large share of research and development (R&D) costs.

Given the importance of defence equipment for Member States' security, national governments play a predominant role in the organisation and operation of defence markets. As sole clients, they determine the demand for products and thus define both the size of the market and the technological portfolio of the industry. As regulators, they control arms trade via export licences and shape the way companies operate and organise themselves. State

control can also include industrial restructuring and ownership. In many cases, States are still shareholders in defence companies and/or hold "golden shares", which provide influence over strategic business decisions.

It is very difficult, if not impossible, to produce accurate figures about the total number of firms operating in defence markets, the number of staff they employ and the types of products they produce.[11] The figures we have been able to collect are presented in Annex 7 and relate to firms operating in the areas of land and naval defence and military aerospace. These indicate that in 2005, the turnover of firms in these sections of the defence market was just over €52 bn with exports totaling around €17 bn. In terms of employment, these sectors provided jobs for around 614,000 people.

In 2005, combined defence expenditure in the EU-25 was worth about €174 bn, which includes €85 bn for defence procurement. This, in turn, includes about €30 bn for the acquisition of new military equipment, €10 bn for R&D, €20 bn for maintenance and €5 bn for infrastructure, with an additional €15 bn for (mostly non-military) operating expenditures.[12] European defence expenditure was in constant decline throughout the 1990s and has stabilised recently at a lower level (on average 1.7% of GDP in 2005). Moreover, this expenditure remains split into relatively small and closed national markets, with the six major arms producing Member States (the so-called LoI countries) representing 83% of it.[13]

On the other hand, development costs of new weapon systems have increased dramatically, starting to exceed the financial means of even the big EU Member States.[14] The discrepancy between flat, stagnating budgets and increasing costs has had a damaging effect in two respects. First, it has resulted in obvious gaps in Europe's military capabilities.[15] Second, the lack of funding is damaging the European Defence Industrial and Technological Base (EDITB). Lack of investment in research in particular is jeopardising industry's capacity to prepare for the future and to remain competitive vis-à-vis U.S. counterparts.[16]

Even (highly unlikely) defence budget increases would not resolve these problems: since most European armed forces have been streamlined and downsized, national markets are in general

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11 Whilst some companies may produce only defence products, others can supply to both the civilian and military sectors, making them difficult to classify. Even if it were possible to identify and measure the statistics of these companies, such calculations would still tend to underestimate the number of firms as there are many sub-contractors who provide products to this sector. Some such companies may not even know that they are indirectly part of the defence market – for example if they produce components. See for example "Sector Futures: Defence industry" by the European monitoring centre on change: http://www.eurofound.europa.eu/emcc/content/source/eu06019a.html?p1=ef_publication&p2=null

12 See Annex n°1: Defence total and procurement expenditure in M€ (2000-05). Defence total expenditure as published by EUROSTAT amounts to 174b€, whereas the EDA displays an amount of 193b€. The difference may be caused by different assignments of retirement pensions in some countries.

13 FR, DE, ES, UK, SW, IT. In 2000, these 6 Member States signed the so-called Letter-of-Intent (LoI) Framework Agreement, which aims at facilitating defence industrial cooperation. Aggregated defence procurement expenditure of these "LoI nations" is €70 bn out of €85 bn for EU-25 in 2005.

14 In France, for example, the overall cost of the Mirage III (entry into service in 1960) was FF7.74 bn (at 1992 prices), that of the Mirage F-1 (entry into service 1973) FF26.7 bn, Mirage 2000 (1983) FF104.5 bn and that of the Rafale programme (2002) FF202 bn. See Burkard Schmitt, "From cooperation to integration, Defence and Aerospace Industries in Europe", *Chaillot Paper* 40, Paris, July 2000, p. 6 ff.

15 See Burkard Schmitt: *European capabilities – how many divisions?*, in: EU Security and Defence Policy, The first five years (1999-2004), EU institute for Security Studies, Paris 2004.

16 See Annex n°4: Defence procurement expenditure EU – US (2005).

too small today to generate adequate economies of scale.[17] For complex weapon systems in particular, per-unit costs will simply be too high if the production run is limited to the needs of a single European country.[18]

The relatively small size of European defence markets makes the existing fragmentation along national lines increasingly problematic. This fragmentation persists at all levels:

1) On the demand side, 27 national customers have great difficulties in harmonising their military requirements and pooling their purchasing power into common procurement projects. In 2005, EU Member States spent only 18% of their equipment expenditure on cooperative projects, whereas 82% was spent nationally.[19] Consequently, numerous duplications exist. In total, 89 different weapon programmes exist in the EU compared to only 27 in the US (although the US spend three times as much on equipment as the EU combined).[20]

2) The regulatory framework consists of 27 different sets of national rules and procedures for all relevant areas (exports, transfers, procurement, etc.), plus specific arrangements for cooperative programmes; this regulatory patchwork is a major obstacle to both competition and cooperation and creates considerable extra-costs;[21]

3) On the supply side, defence industries remain fragmented along the lines of (national) market structures. Some transnational companies exist in aerospace and electronics, but market fragmentation hinders them from rationalising their organisation and exploit potential economies of scale. In naval and land armaments, consolidation is less advanced and cross-border industrial ties remain an exception.

If this situation persists, Member States will increasingly face difficulties to maintain a sound and viable EDTIB and to develop the military capabilities necessary for implementing the ESDP.

3.1.1. The blurred dividing line between defence and security

The evolution of the international context and the emergence of a new security environment have had market implications as well. Today's transnational and asymmetric threats, such as international terrorism or organized crime, necessitate special security measures not only at

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17 The cost increases provoked by reduction of current programmes illustrate this: the unit cost of the Rafale, for example, rose from FF 379 to 688 million in eight years due to postponements and lowering of production targets. The same effect can be seen in other programmes, such as the NH 90 helicopter. See Paul Quiles and Guy-Michel Chauveau, *L'industrie de défense: quel avenir?*, Report 203, Defence Committee, National Assembly, Paris, 1997, p. 43.

18 Economies of scale are particularly important for defence products, because of the high (fixed) R&D costs. In military aircraft, for example, R&D expenditures represent ca. 30% of the total programme costs. With investments on such a scale, it is essential to spread R&D costs over a larger production runs in order to reduce the unit costs. It is reckoned that development costs per unit fall by 50% if production is raised from 200 to 400 units. Added to this are learning effects, which, for military aircraft, are estimated to generate savings of 20% of production costs for each doubling of the production run. See Pierre Dussage, *l'Industrie française de l'armement*, Paris, 1999, pp. 123-128.

19 See Annex n°3: Defence equipment and R&D expenditure in cooperation (2005).

20 See Richard Bitzinger, "European Defense's Never-ending Death spiral", *RSIS Commentaries*, 4 April 2007; Hartmut Küchle, *The cost of Non-Europe in the Area of Security and Defence*, EP, 2006.

21 For example, the extra-costs created in 2003 only by obstacles to intra-Community transfers were estimated at €3,16 bn. Unisys, *Intra-Community Transfers of Defence Products*, European Commission, Brussels, 2005, p. 6.

the borders, but also inside the EU. Against these threats, non-military security forces increasingly use equipment which is, from a technology point of view, similar to defence equipment used by the armed forces. Such security equipment is often a slightly different (and less performing) application of the same technology and produced by the same suppliers as defence equipment. At the same time, certain security equipment must be interoperable with defence equipment, since non-military and military forces increasingly operate together to fulfill the same missions (for example border control). There is thus a growing market for security equipment, which has in many ways similar features as defence equipment and can be equally sensitive (in terms of technical complexity, but also in terms of confidentiality).

Given these similarities and commonalities, the public market for such sensitive non-military security equipment can be considered as an appendix to the traditional defence market. However, major differences persist: most importantly, the demand side of the market is much more complex for security than for defence, concerning not only national governments, but also regional and local authorities, as well as great variety of end users (police, customs services, intelligence agencies, civil protection agencies, etc.).

The great variety of security customers makes it also difficult to identify the expenditures for this kind of security equipment and thus measure the size of the market. In 2005, security (public order and safety) expenditure in the EU-25 was worth about €195 bn, which includes about €57 bn for security procurement in general.[22] These expenditures cover procurements for a broad range of security services (police, fire-protection, law courts, prisons, etc.) and include both sensitive and non-sensitive security procurement.

3.2. Specific Problem: "mismatch" between theory and practice in defence and security procurement in the EU

The previous section has shown that fragmentation of defence markets in the EU creates problems with major financial and economic consequences in a variety of areas. The following sections will focus on one area – procurement law – and one specific problem, namely the extensive use of the exemptions from Community Law provided by Article 296 TEC and Article 14 of the PP Directive.

The Court's case law gives quite clear indication for how to use these exemptions. Moreover, the recent Interpretative Communication on the application of Article 296 TEC in the field of defence procurement clarified remaining uncertainties. The problem thus does not lie with the theory, but with a mismatch between theory and practice.

3.2.1. Defence procurement: Article 296 (1) (b) between theory and practice

- ***Theory***

At the Community level, it is the PP Directive (2004/18/EC) on the procurement of goods, works and services which applies to "*contracts awarded by contracting authorities in the field of defence, subject to Article 296 of the Treaty*" (Article 10 of the Directive). Article 296 TEC reads as follows:

(1) The provisions of this Treaty 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;

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[22] See Annex n°8: Security total and procurement expenditure in M€ (2000-05).

(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 April 1958, of the products to which the provisions of paragraph 1(b) apply.

The non-application of the PP Directive is a measure "*connected with the production of or trade in arms, munitions and war material*". Member States can therefore use Article 296(1)(b) TEC to exempt the award of defence contracts from EC rules, provided the conditions laid down in the Treaty as interpreted by the Court of Justice are fulfilled. At the same time, the scope of Article 296(1)(b) TEC is limited by the concept of "essential security interests" and the list of military equipment mentioned in paragraph 2 of that Article.

Article 296(1)(a) TEC goes beyond defence, aiming in general at protecting information which Member States cannot disclose to anyone without undermining their essential security interests. This can also concern the public procurement of sensitive equipment, in both the defence and the (non-military) security sector.

The Court of Justice has consistently made it clear that any derogation from the rules intended to ensure the effectiveness of the rights conferred by the Treaty must be interpreted strictly. Moreover, it has confirmed that this is also the case for derogations applicable "*in situations which may involve public safety*". In *Commission v Spain*, the Court ruled that articles in which the Treaty provides for such derogations "*deal with exceptional and clearly defined cases. Because of their limited character, those articles do not lend themselves to a wide interpretation*".[23] On the basis of the Court's judgement, the Commission has specified in its Interpretative Communication of December 2006 that both the field and the conditions of application of Article 296 TEC must be interpreted in a restrictive way.[24]

- ***Practice***

In contrast to the Court's ruling, many Member States have used Article 296 TEC extensively, exempting from EC rules almost automatically the procurement of military equipment. During the consultation process, stakeholders confirmed that many contracting authorities in the field of defence normally do not apply the PP Directive to the procurement of arms, munitions or war material, and often not even to the procurement of non-war material. In other words: what should be the exception is, de facto, often the rule.

The relatively low publication rate in the OJEU for public procurement by awarding authorities in the field of defence confirms the extensive use of Article 296 TEC:[25] Between 2000 and 2004, the (then) 15 EU Member States published in the OJEU contract notices for on average 13% of their overall defence procurement (in value terms). This figure includes

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23 Judgment of 16 September 1999, Case C-414/97 *Commission v Spain*, par. 21; judgment of 15 May 1986, Case C-222/84 *Johnston*, par. 26.

24 COM (2006)779, 6 December 2006.

25 For the purposes of this assessment, we take the publication in the OJEU as an indicator for the use of EC procurement rules, knowing that awarding authorities may also publish contracts to which the directive does not apply. In theory, this can also happen in defence. Consequently, the non-application of community rules might be even more frequent than publication rates suggest.

both the procurement of non-war material and military procurement. Moreover, these publication rates differ greatly between Member States, ranging from 1% to more than 20%. On average, however, the publication rate was in decline from 16% in 2000 to 8 % in 2004.[26]

The publication rate is low for defence procurement in general, but it is particularly low for arms, munitions and war material. In their responses to the Yellow Window study, half of the EU Member States who participated in the survey declared to "generally" publish in the OJEU contract notices for non-military procurement in the field of defence, such as uniforms or certain services. Only one fourth, by contrast, declared to use the OJEU generally also for the procurement of military goods, as well as services and works related to them. In these cases, Member States publish mainly contract notices for the procurement of "simple", low value equipment, such as busses or trucks, as well as non-sensitive works and services.[27]

3.2.2. Security procurement: between Article 296 (1) (a) and Article 14 Directive

A similar, albeit more recent problem exists with regard to the procurement of sensitive equipment for non-military purposes. Such contracts do not fall in the field of application of Article 296(1)(b) TEC. However, security interests may justify their exemption from EC rules on the basis of Article 14 of the PP Directive, provided that the conditions for its application are met,[28] or on the basis of Article 296(1)(a), if the application of EC rules would oblige a Member State to disclose information prejudicial to the essential interests of its security.

In theory, the Court's ruling on the exceptional character of exemptions applies also to procurement of sensitive non-military security equipment, whether the exemption is based on Article 296 (1)(a) or Article 14 of the PP Directive. In practice, however, Member States deal with these contracts as they do with defence contracts, i.e. exempt them systematically.

Moreover, contracting authorities often mix up Article 296 (1)(a), (1)(b) and Article 14 of the Directive to justify exemption of non-military security procurements. This confusion of legal arguments is due to the above-mentioned developments in the field of security and defence, with the distinction between external and internal security, military and non-military security becoming increasingly blurred. This is true not only at the conceptual, but also at the operational and technological levels:

- Facing transnational and asymmetric threats, non-military security services sometimes use equipment which is technologically similar to defence equipment;
- In today's strategic environment, military forces and security forces often operate closely together to fulfill the same missions;
- In some Member States, parts of the armed forces have both military and non-military tasks for which they often use the same equipment.

This constitutes an additional challenge for the current legal framework in the EU, which is still based on the traditional distinction between defence and non-military security.

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26 See Annex n°11: Rates of publication in the OJEU of defence contracts.

27 See Annex n°14 Assessment of Member States' procurement practices.

28 Article 14 of Directive 2004/18/EC stipulates: "*This Directive shall not apply to public contracts when they are declared to be secret, when their performance must be accompanied by special 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 the Member State so requires.*"

3.3. Cause of the problem: EC rules are ill-suited to sensitive security and defence procurement

Consultations with stakeholders have pointed out to one salient root cause for the extensive use of the exemptions provided by Article 296 TEC and article 14 of the PP Directive: the ill-suitability of EC rules to most defence and sensitive non-military security procurements.

Although EC public procurement law applies to contracts awarded in the fields of defence and security (subject to Article 296 TEC and Article 14 of the Directive), it was drafted for and suited to the procurement of civil supplies, works and services. Defence and sensitive non-military security procurement, however, is different by its very nature. It can decide on life or death of (European) soldiers and citizens, is directly related to the security of Member States and therefore often influenced by political and strategic considerations. At the same time, technical, financial and time-related complexities make many of these procurement processes extremely challenging. To deal with these specificities effectively, contracting authorities need both flexibility (to formulate and meet their needs adequately) and specific safeguards (to protect Member States security's interests), which the PP Directive does not provide.

3.3.1. The need for flexibility

Stakeholders consistently expounded that the complexities of defence programmes revolve around three main elements: the technological intricacies of defence equipment (which make it difficult for procurement authorities to 'translate' at the outset a functional requirement into detailed technical specifications), their long life cycles and the sophisticated architecture their financing requires. In order to manage effectively such complexities, stakeholders explained, project managers need flexible procedures.

Defence equipment is procured to obtain a specific military capability and to gain superiority over potential enemies. It often includes state-of-the-art **technologies**, which are integrated at various levels into complex architectures (components into products, products into systems, systems into systems of systems, the whole lot into national armed forces). On top of that come interoperability requirements with the armed forces of other NATO and EU members. Procurement authorities must make sure that every single technical detail of the equipment they wish to procure is fitting in the overall architecture and at every level. One of the ways to ensure standardisation and interoperability is resorting to defence-specific standards.[29]

In order to meet their military capability needs, procuring authorities either ask a producer to develop new equipment tailor-made to their specific requirements, or purchase off-the-shelf equipment which will then be customized to their requirements. In particular in the first, but to a lesser degree also in the second case, they need to discuss with potential suppliers all characteristics of the equipment they wish to procure in order to manage intricate trade-offs between costs, efficiency and technological superiority.

Moreover, defence equipment often has extremely **long life cycles**. The time between the expression of an operational need and the end of a weapon system's life may be as long as 50 years. Throughout its in-service life, regular maintenance and technological upgrades are necessary to ensure the performance of a system. Such needs are met in various ways across

[29] Member States, within their Ministries of Defence or standardizing bodies, as well as military organizations, have over the years developed specific defence standards. This was necessary as military equipment often has characteristics which do not have equivalents in the civil sector.

the EU. In any case, arrangements for maintenance and upgrading, which remain into effect for many years, normally imply in-depth negotiations between contracting authorities and potential suppliers on numerous technical and financial aspects.

The development of new technologies, complex system integration and long-life cycles can imply high **financial risks** and make it often impossible to assess from the start the price of a defence programme, even more its life cycle costs. The financial set-up of such contracts is thus highly complex, with Member States asking companies to share the financial risks. In order to tailor the necessary financial arrangements for each specific programme, again, awarding authorities need to negotiate thoroughly with potential suppliers.

A similar degree of flexibility can be necessary for the procurement of sensitive non-military security equipment. The latter is often developed from the same technology base and / or constitutes modified versions of defence applications. Facing non-military threats, non-military security applications are often less performing than their military counterparts. However, in many areas, they are technologically very sophisticated (IT security). They can also be integrated in complex system of system architectures (for example for the protection of vital infrastructures). Moreover, modern security concepts, be it for border protection, crisis management or disaster relief, often foresee close cooperation between different security forces (police, fire brigades, etc.) and between security and military forces. In these cases, interoperability can become as important for security equipment as for defence equipment. For certain types of security equipment, technological complexity and interoperability can thus raise similar needs for flexible awarding procedures as in defence.

Scrutinizing EC law with these observations in mind, it seems that **existing Community rules hardly offers the degree of flexibility which is necessary to meet such complexities.**

First, it does not recognize standards specifically developed for defence purposes within national or regional defence-specific standardizing bodies.[30]

Secondly, the standard procedures of the PP Directive – the open and restricted procedures – are based on two assumptions: 1) The contracting authority is able to specify from the outset not only all technical specifications, but also all the other features of the contract: whether or not it needs training packages, maintenance and upgrade provisions - for how long-, the costs and risks-sharing arrangements associated with them, etc. 2) The tenders can meet from the outset each and every one of the needs of the contracting authority and indicate the prices without any changes or adjustments. For the reasons outlined before, both assumptions are hardly ever met for the procurement of defence and sensitive non-military security equipment.

The competitive dialogue procedure introduced by the new PP Directive can be resorted to when a contracting authority does not know the technical and/or financial solution to its need, or which one of a number of solutions is the best. This can happen in defence procurement, but does not cover all complexities which necessitate negotiations between awarding authorities and potential suppliers (lead times, costs, risk-sharing, IPR, maintenance, upgrading, subcontracting, etc.). The competitive dialogue may therefore be an option for some cases, but not a satisfactory solution to the shortfalls identified above.

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[30] The PP Directive takes up the definition contained in Directive 98/34/EC (dealing with technical standards and regulations) and recognizes only civil standards developed by the (civil) standardizing bodies listed in the Annex of Directive 98/34/EC.

The PP Directive allows also more detailed negotiation between contracting authorities and economic operators, but only in exceptional cases. According to Article 30 of the Directive, the negotiated procedure with prior publication is justified (a) "*in the event of irregular tenders"* and (b) *"in exceptional cases, when the nature of the works, supplies, or services or the risks attaching thereto do not permit prior overall pricing*" (which does not mean though that only negotiations on price are permitted). However, in the field of defence procurement, instances where "prior overall pricing" is impossible are but one of the many cases where negotiations are necessary. Above all, resorting to this possibility is explicitly circumscribed to "exceptional" cases, whereas the need to negotiate is rather the rule for the procurement of defence and sensitive security equipment.

In a few, even more exceptional cases, the PP Directive also allows to negotiate contracts without publication of a contract notice. Some of these cases can apply to defence and sensitive security contracts (protection of IPR), but others appear ill-suited to the specificities of the latter: this is the case in particular for "*reasons of extreme urgency brought about by events unforeseeable by the contracting authority in question*", the circumstances of which are "*not in any case [..] attributable to the contracting authority*". Yet, where defence and security are concerned, situations of "extreme urgency" may very well have been foreseeable.

To sum up, the standard procedures of the current PP Directive appear too rigid for the award of many sensitive defence and security contracts. Cases where it is possible to use the negotiated procedure (with or without prior publication) seem both too limited and ill-defined for such procurement. Of course, other types of procurement may well be complex as well, and more flexible rules might come in handy in these cases too. However, for defence and sensitive non-military security procurement, such flexibility is not just "handy", but literally *vital* for the security of States, their soldiers and citizens.

3.3.2. Ensuring security of supply and security of information

- ***Security of supply***

The security of supply imperative was unanimously pinpointed by all stakeholders as one of the major specificities of defence procurement.[31] This does not come as a surprise, since the adequate and timely supply of defence equipment is crucial for the effectiveness of military power. In military operations, supply problems can cost the lives of European soldiers, lead to military defeat and have major negative consequences for Member States security.

Security of supply in defence has various aspects. From an industrial point of view, suppliers must have the capacity to deliver defence equipment (including spare parts, maintenance and upgrades) over a long period of time (because of the long life cycles of many defence systems). In addition, in times of crisis or war, suppliers must be able to meet urgent additional demands for incremental or accelerated deliveries.

From a political point of view, security of supply becomes particularly challenging if the supplier is established outside the territory of the buying country. In this case, security of supply depends not only on the technical capacity of the supplier, but also on the political decision of the country where the supplier is established to grant an export authorisation. This

[31] The LoI defines security of supply in defence as “a nation's ability to guarantee and to be guaranteed a supply of defence articles and defence services sufficient to discharge its commitments in accordance with its foreign and security policy requirements”.

is the case also within the EU, since intra-Community defence transfers are still subject to export licenses and cannot circulate freely between Member States. Some intergovernmental agreements exist to facilitate such transfers, but they are limited to certain Member states and cover only specific products or companies. The bulk of defence transfers between Member States depend on individual export licences, be it for the delivery of the main equipment, spare parts or incremental supplies in case of crisis. What is more, many defence systems made in Europe contain US components and sub-systems. In these cases, the transfer from one Member State to the other necessitates also approval from US authorities (ITAR system).

Consequently, contracting authorities cannot simply take it for granted that a supplier established in another Member state will obtain the necessary authorizations, including in times of emergency (not to mention bureaucratic delays). A current Commission initiative is aiming to at least facilitate the transfer of defence products, but for the time being, security of supply remains a major obstacle for cross-border defence procurement in the Union.[32]

In general, security of supply is less important for non-military security equipment, because technologies are often dual-use (and therefore do not always depend on export licences), but also because production increase in times of crisis is less relevant. However, this does not mean that, in certain areas, security of supply cannot be crucial: urgent additional deliveries of equipment may become necessary, for example, when Gendarmerie forces participate in crisis management operations outside the EU, or when a major terrorist attack takes place on the territory of an EU Member State. In other areas, such as the protection of critical infrastructures, security systems are often technologically complex and tailor-made to the specific needs of individual customers, which makes the long-term security of supply for maintenance, upgrades and spare parts particularly important.

C**urrent EC rules do not take into account security of supply imperatives to such a comprehensive extent**. The ECJ has recognized security of supply as a legitimate award criterion within the context of the PP Directive[33], which keeps the range of award criteria fully open as long as they are "linked to the subject-matter of the contract in question (Article 53)". But the multiplicity of facets security of supply takes on in defence and security are difficult to embrace by an award criterion.

- ***Security of information***

Security of information has also regularly been brought up as one of the major specificities of defence and sensitive non-military security procurement. This does not come as a surprise, since many of these contracts involve classified information which must, by definition, be protected against unauthorised access.

Security of information comes up at various levels of a procurement procedure. During the publication phase, Member States might not want to disclose all technical specifications of the product, service or work they want to procure in order to protect their security interests. For example, an accurate description of a maintenance service might reveal sensitive information about the weapons needing maintenance; an infrastructure work might as well expose

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32 See http://ec.europa.eu/enterprise/regulation/inst_sp/defense_en.htm#cons.

33 See in particular Judgement of 28 March 1995, Case 324/93, Evans Medical and Macfarlan Smith.

information on the capabilities needing storage. Some information may even be so sensitive that it can only be given to the company to which the contract is awarded in the end.[34]

Security of information is also important during the performance of the contract. Given the sensitivity of most defence equipment, potential suppliers must have the capacity to store and handle confidential information in a proper way. This capacity – which is usually referred to as "industrial security" – concerns both the infrastructure and the personnel involved in the execution of the contract.

Here again, the requirements for contracts in the field of non-military security can be very similar to those in defence. In many cases, the procurement of equipment for non-military security forces involves sensitive information which needs protection against unauthorised access. This may be the case in areas where defence and security services cooperate (for example communication systems for border control or crisis management operations abroad). Security of information is also important for the procurement of equipment used for the protection of critical infrastructures or the fight against terrorism and / or organised crime.

Article 6 of the PP Directive deals with "confidentiality", but only as regards disclosure by the contracting authority of "*information forwarded to it by economic operators which they have designated as confidential" including "in particular, technical or trade secrets and the confidential aspects of tenders*". This may indeed happen during the procurement procedure and performance of a contract for defence and sensitive non-military security equipment. Yet, this provision only protects confidential information originated by economic operators, not by the contracting authority. Moreover, it does not deal with industrial security requirements. **Current EC rules fail to take account of this specificity of defence and security**.[35]

3.4. Patchwork of national regulations and practices

In the absence of suited EC rules, Member States have used the exemptions provided in Article 296 TEC and Article 14 of the PP Directive extensively. This allows them to cope with the specificities of defence and sensitive security procurement contracts. At the same time, they do so in a completely non-coordinated manner, on the basis of their own national inherited traditions: some Member States have specific legislative rules, in particular for defence procurement covered by Article 296 TEC, when others rely only on non-legislative guidance for project managers. In any case, each Member State follows different rules as regards publication, technical specifications, procedures, and address the specificities of defence procurement in its own way. This diversity results in a fragmentation of defence and sensitive non-military security procurement rules across the EU.

3.4.1. Publication

The chief question as regards publication is to publish or not to publish a *contract notice*. For obvious reasons of national security, no Member State publishes all its defence and security

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[34] For the procurement of an air-to-air missile, for example, all selected candidates may receive the technical specifications for the missile itself to prepare their offer, but only the winner of the contract may receive the specifications for the integration of the missile into a combat aircraft.

[35] In order to streamline the argument, the present report only develops those elements which stakeholders unanimously pointed out as problematic. A number of other points were raised by one or a few Member States: duration of framework agreements, limitations for additional deliveries, works and services allowed with the negotiated procedure without publication, lack of explicit reference to defence-specific award criteria. Most of these issues, however, are at least indirectly related to security of supply.

contract opportunities. However, the extent to which contract notices are published (either at the EU or at the national level) differs widely. *Thresholds* for publication play a significant part in this context. Those thresholds vary from less than 100.000€ to 1M€, *i.e.* by more than 1000%. They may vary even within Member States, according to the nature of the equipment procured or the different types of publication media used. Finally, in some Member States, defence contract notices are not published at all as a rule.[36]

National practices differ also with regard to the advertisement of *contract award notices*. In many Member States, no contract award notices are published in the field of defence. In others, all award notices are published in order to foster competition down the supply chain, and even when no contract notice was published in the first place. Between those two extremes, all situations co-exist across the EU.

Many more questions yet arise as regards how, when, where and for who contract notices are published and, here again, the sole common point between Member States is diversity. Contract notices can be published through various *publication media*: official journals, public procurement bulletins, and/or defence-specific procurement bulletins. Despite a current trend to publish contract opportunities online, contract notices are often (also) published in paper format or on CD-ROM. Moreover, the *model* used for the publication also varies. Even within one Member State, different models can be used depending on the contracting authority.

The *frequency of publication* is also a diverging point. In some countries procurement portals are updated daily (for example FR), in others, publication may be on a weekly, quarterly basis, or at variable intervals (for example SW). Contract notices are also unevenly *accessible*. Whereas some Internet portals are accessible to anyone, free of charge, others are only accessible to paying subscribers (UK) or authorised ones (PT). Finally, publication is most of the time in the national *language*, except in a few countries where notices are (also) published in English (in particular in Scandinavia).

3.4.2. Technical specifications

Member States resort to different sorts of *defence standards* to detail the technical specifications of the subject-matter of the contract. Some have developed their own national defence standards, drafted and maintained either within Ministries of Defence or national standardisation bodies. In addition, Member States which are part of NATO, have signed standardisation agreements which, when ratified and implemented, become compulsory. These standardisation agreements define minimal common requirements in order to guarantee interoperability between armed forces. They must sometimes be specified and/or adapted to national specificities and, to this end, transposed into (different) national defence standards.[37]

In the face of this plethora of standards, project managers themselves face difficulties when setting out technical specifications in contract documents. This is why Member States have

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[36] See answers to the questionnaire for the second session of experts Working Group on 15 March 2004.

[37] On top of that, the UK is Member of the ABCA, which is the American, British, Canadian, Australian Armies' Standardisation Program. ABCA Standards were formerly called ABCA Quadripartite Standardization Agreements (QSTAGs) and ABCA Advisory Publications were formerly called ABCA Quadripartite Allied Publications (QAPs)**.** For a non-exhaustive list of national and international defence standards, see the UK list of standardizing bodies available online at: http://www.dstan.mod.uk/s_b_list.htm.

often developed *hierarchies of standards*.[38] These hierarchies vary significantly from one Member State to the other. Some take up the hierarchy set up in EC law, even when applying Article 296 TEC: European standards are then the first choice for defence procurement, and a defence standard is mentioned only when no equivalent civil standard exists.[39] Other Member States on the contrary consider defence standards to have priority.[40]

3.4.3. Procedures

It is generally stated that the usual procedure for defence procurement is the negotiated procedure. This may however be overly simplistic, applying an EC law category (the "negotiated procedure") to practices that have remained preserved from European legislative coordination. In fact, though defence procurement procedures normally allow for negotiation at some point, they may take on differing national characteristics which wander more or less far from European procedures.

A few Member States actually do use the negotiated procedure as a "standard" procedure for defence procurement, either with or without publication. Most Member States, however, adapt other sorts of procedures to the negotiation requirements of defence procurements, or even use their very own types of procedures.[41]

3.4.4. Selection of suppliers

Member States pointed out during consultation processes that candidates are often evaluated on the basis of their "reliability". This highly subjective concept may, in part, rest on long-term relationships and trust which, in turn, can be, materialized through framework agreements or *lists of agreed suppliers*. Here again, Member States set up and manage their lists their own way. Such lists may simply include all previous suppliers of the Ministry of Defence whereas, at the other extreme, in some Member States, registration is based on very selective criteria and may pre-condition the admission of suppliers to negotiations.

In addition, many Member States use *security of information* as a selection criterion, usually evidenced by the facility security clearance (FSC) granted to candidates by their national security authorities (NSA). In this case, diversity lies less with the type of evidence requested (FSCs), than with the diversity of mutual recognition arrangements of national FSCs between Member States. In the absence of a Community security of information regime, Member States resort to agreements of various nature: general, sectional or ad hoc security agreements

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38 See: http://ec.europa.eu/enterprise/defence/eu_defence_policy.htm#Official%20documents. Supported by the Commission, EDA is currently working on a European Handbook for Defence Procurement. However, there is still no common practice in the way Member States set out specifications and resort to standards. For more information see: http://www.defense-handbook.org/.

39 This is the case in UK for example: see Selection of Standards For Use in Defence Acquisition document, available online at: http://www.dstan.mod.uk/select1.htm.

40 In *FR* for example, "international" (including US) defence standards are at the top of the list, followed by "international" (including European) civil standards, and finally national defence and civil standards. See Directive sur la politique de défense pour les programmes d'armement n° 100009 DEF /DGA /D002234 DEF /EMA / OL du 21 décembre 1995.

41 *UK*, for example, generally employs the restricted procedure with iterative tendering (to allow for the selecting down of candidates throughout the process) and, sometimes, direct award. In both cases, negotiations are carried out with candidates. Another example is *SW*, where contracting authorities usually resort to the "simplified procedure", a kind of mixture between the open and negotiated procedures whereby, after publication of an invitation to tender, all economic operators are free to participate by submitting a tender and the awarding authority may negotiate with one or more tenderers.

for specific products or contracts. Finally, Member States which belong to NATO also use NATO's procedures for security of information.

3.4.5. Security of supply

Security of supply is a complex issue which pervades defence procurement procedures from start to finish. It is thus impossible to classify in one category such as “selection criteria”, “award criteria”, or contractual requirement. Though the concern is common among Member States, they address it their own way. For the sake of clarity though, two stages can be distinguished: the selection of suppliers, and the putting together of tenders.

- ***Security of supply as a selection criterion***

Some Member States use security of supply as a criterion to select suppliers and request to this end different types of evidence. The first type of evidence is connected to the industrial aspects of security of supply. Some contracting authorities ask, for example, information on the candidate's industrial capacity and the skills of its personnel, or its capacity to rapidly increase supplies in case of emergency. The second type of evidence relates to political factors. In some Member States, contracting authorities may ask, for example, information on the composition of shareholding, the location of technological assets (including patents), the value created on the national territory and an export licence.

- ***Security of supply as an aspect of tenders***

Security of supply is also a key negotiation topic, whether it is considered as condition for the performance of the contract or whether used as award criterion. Here again, the double facet (industrial and political) of security of supply is addressed in various ways.

In many Member States, contracting authorities ask for export licences at this stage of the procedure. Industrial and technological factors play again a role. Contracting authorities may include in the contract documents provisions on the nature of the technologies and the industrial means used by the economic operator, or on rights of use in technical information to reconstitute national supply facilities in the case of an interruption of supplies. Security of supply may also be examined along the supply chain. As an award criterion, some Member States evaluate the management of the supply chain and the location of subcontractors. As a condition for the performance of the contract, in other Member States, contractual clauses may include rights of the contracting authority to establish a control over subcontracting.

3.4.6. Offsets

Offsets are compensations that many governments require when they procure defence equipment from non-national suppliers. The principle is to ensure an economic return on defence investment. Offsets can take various forms: they can be directly related to the subject-matter of the contract (for example industrial participation of local companies in the production of the procured equipment), indirect but limited to the military sphere (for example sub-contracts awarded by the supplier to local defence companies for other military products), or indirect non-military (for example the supplier’s commitment to mobilise foreign investments in civil sectors of the buying country’s economy).

Offset policies and practices vary tremendously among Member States.[42] Some of them do not require offsets at all, for others, offsets are compulsory above certain thresholds, in some cases, they are decided upon on an ad-hoc basis. Those Member States who require offsets do so on different *legal basis*: some have laid down the obligation to provide offsets in national law, others have "only" specific guidelines.

The *thresholds* for the contract value above which offsets become mandatory differ also (from less than 1M€ to 15M€). In some Member States, these thresholds vary, depending on the origin of the company or on the type of procedure used. The *volume* of offset requirements hinges around a minimum of 80 to 100% of the contract value, but they can reach up to 200 %. Member States often set specific obligations connected to the *lead times*, sector or business *activity* in which offsets must be provided.

Offsets are also handled differently in the *procurement process*. They can come as a condition for the performance of the contract, with offsets packages negotiated between the tenderers and Ministries of Defence or of Economy, either before or after the contract is awarded. In other Member States, they are considered as an award criterion. After the contract is awarded, the offset deal is either included in the main contract, or forms a separate agreement which comes into force simultaneously with the procurement contract.

3.5. Implications on transparency, non-discrimination and openness

The consequence of the non-application of EC rules and the use of diverse national procurement procedures is often the non-compliance with the principles of the Treaty, in particular transparency and non-discrimination. This hampers openness and fair competition on European defence markets.

3.5.1. Transparency

Transparency is a crucial aspect of fair and open competition and one of the founding principles of the Treaty as regards public procurement. In the field of defence, exemption from EU law hampers transparency in many ways:

- ***Publication***

For public procurement to be public-*ised*, it must usually be preceded by the publication of a contract notice or an invitation to tender, which is accessible to the general public or at least potential bidders and contains all information necessary for the submission of pertinent tenders. As described above, this is at best partially the case for defence and security:

* Publication in the OJEU offers the highest degree of publicity EU-wide, but is used only in a minority of defence and sensitive non-military security contracts[43];

* Publication rates and practices at the national level differ greatly, in particular with regard to thresholds for publication;

* Since July 2006, EDA offers its Electronic Bulletin Board (EBB) as an additional forum to post notices for defence contracts. However, the EBB is only open to Member States subscribing to the Code of Conduct.[44] Moreover, the threshold for

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42 See for example *Countertrade & Offsets* at: http://www.cto-offset.co.uk/. Information was also gathered during the sessions of the experts Working Group for the preparation of the Green Paper in 2004.

43 See Annex n°11: Rates of publication in the OJEU of defence contracts.

44 Denmark and Hungary have not subscribed to the Code of Conduct.

publication is high (1 M€), publication is not mandatory and only concerns procurement exempted from EC rules on the basis of Article 296 TEC (thus a different market segment than the one the EC has jurisdiction over).

The industry experts working group gathered for the preparation of the Green Paper emphasized that, for larger enterprises the lack of publication is less problematic as they have contacts in Member States to identify contract opportunities. For SMEs however, it is not always easy to obtain contract notices. In this context, the relatively high thresholds for publication are particularly problematic, since smaller contracts – which are particularly interesting for SMEs – are often not published. However, even when contract notices are published, great difficulties persist: in the absence of a centralised publication media with standardised forms, companies must monitor a multitude of information sources, which differ greatly from each other and are often extremely user-unfriendly. All this creates considerable administrative and financial burden, which is again particularly difficult to bear for SMEs.

In this context, industry has identified the language barrier as the most important problem both for SMEs and larger companies. There are a variety of reasons for this: for publications in the OJEU, the Common Procurement Vocabulary (CPV)[45] provides for a system of standardised codes which helps market operators to spot relevant contract notices from all awarding authorities throughout the Union, independently of the language of origin. Similar systems do not exist at the national level. Moreover, when contract notices are published in national media, they are mostly published only in the national language and therefore difficult to access for many foreign companies. Last but not least, limitation to the national language significantly increases the costs for the elaboration of the tender itself and hinders direct communication (Q&A and negotiations) between contracting authorities and candidates.

- ***Procedures***

Transparency in public procurement relies not only on publication, but also on the setting out in advance of the rules of procurement procedures, such as deadlines, selection/award criterion and conditions for the performance of the contract. Such rules must be public and not change during the procedure. This allows market operators to know how to tender for a contract and how they will be evaluated.

Such transparency is not necessarily the rule in all Member States. It happens, for example, that contracting authorities merely state that the "most economically advantageous tender" will be selected, without specifying by which factors (price, quality, lead time, etc.) economic advantages will be assessed. In that case, tenderers can but draft their tenders in the dark. At the end of the procedure, they do not know why their tender was selected or not and, in the latter case, cannot challenge the contracting authority's decision in court. In practice, contracting authorities have full room to evaluate bids in a discretionary way.

Given all that, it is not astonishing that the Study conducted by Rambøll confirmed that lack of transparency is a significant issue that adversely affects open and fair competition. Out of 116 companies who replied to the questionnaire, 44 stated that lack of transparency of local

[45] The CPV is a classification system which endeavours to cover all requirements for supplies, works and services. By standardising the references used by contracting authorities to describe the subject matter of their contracts, the CPV improves the transparency of public procurement covered by Community directives. The CPV attaches to each numerical code a description of the subject of the contract, for which there is a version in each of the official languages of the EU.

procedures is a barrier to cross-border transfer "to some extent", and 29 "to a high extent": in total thus, 62% of those companies identify lack of transparency as a problem in defence markets. This is particularly true for SMEs.[46]

3.5.2. Non-Discrimination

The principle of non-discrimination of non-national companies within the EU is at the heart of the Treaty and the European project. In defence markets, however, extended use of exemptions from the Treaty have made it possible for Member States to perpetuate practices which result (and sometimes aim at) discriminating non-national companies.

- ***National preference regulations***

Some Member States' legislation provide for explicit national discrimination, with obligations to procure from national suppliers when possible or when the price difference between a national and a non-national tender is below a certain percentage.

Other Member States use selection or award criteria which may also have discriminatory effects. This is the case, for example, for the value created on the national territory, or provisions on the location of the execution of the contract. Such provisions may not systematically exclude companies without production activities on the territory of the contracting authority, but they undoubtedly discriminate against them.

- ***Misuse of security of supply***

It is fully legitimate for contracting authorities to endeavour to guarantee the security of their supply, in particular in areas as sensitive as defence and security. It is also true that the absence of a Community-wide security of supply regime presents an additional problem to cross-border awards of defence contracts. However, this problem can also serve as a pretext to discriminate non-national suppliers. One should not forget that Member States de facto hardly ever refuse licences for military sales to governments of other EU countries.[47] On top of that, the growing economic difficulties of many defence firms, which often lead to changes of ownership or in industrial organisation, may become a bigger risk to long-term security of supply than political interference of an exporting Member State.

The Rambøll Study confirms that many defence companies face the misuse of security of supply: "According to interviewed company representatives, national procurement agencies use the argumentation of security of supply to limit the entrance of non domestic competition. Some companies have experienced that local presence was to some extent a prerequisite for being competitive in the tender process. Some companies have then taken the consequence and established a local presence while others have avoided these types of tenders. Security of supply is thus used as a logistic barrier, and companies in such cases need to have local presence /local office/ local employment in the purchasing Member State in order to tender."[48]

Among the 116 companies which answered Rambøll's questionnaire, 48 considered "lack of fairness towards foreign companies", in particular through invocation of security of supply requirements, as a barrier to cross-border procurement to "some extent", and 25 to "a high

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46 See Annex n°16: Assessment of the barriers to cross-border procurement in the EU.

47 In 2003, only 15 licenses for Intra-community transfers were reported as rejected by the last annual Code of Conduct report, compared to 12627 that were granted. Unisys, *Intra-Community Transfers of Defence Products*, European Commission, Brussels, 2005, p. 6.

48 Final Report of the Economic Study on Defence Public Procurement, Rambøll Management, p. 28.

extent". In total, 63% of the companies who participated to the survey stated that "lack of fairness towards foreign companies" was a problem in defence markets.

- ***Negative effects of offsets***

Depending on their nature, offsets can have different discriminating effects:

First, they discriminate non-national suppliers, since their local competitors are by definition not required to provide offsets. Given the financial importance of most offset deals, it is an enormous advantage not to bear this burden.

Second, even if all competitors are required to provide offsets (i.e. no local producer participates), the latter have discriminating effects:

* They give a considerable advantage to big prime contractors, which normally have better means than smaller competitors to arrange offset deals (broader portfolio, more programs for sub-contracting, large networks of industrial partnerships);

* If military offsets are required, prime contractors have to sub-contract to companies located in the buying country. Consequently, they cannot use the most competitive sub-contractors to organize their supply chain, but must give preference to sub-suppliers of a certain nationality. This practice, which is particularly harmful to SMEs, is clearly against the founding principles of the Internal Market.

* If non-military offsets are required, which is normally the case, the same effect spills over into civil markets: non-military contracts are then awarded on the basis of nationality rather than competitiveness. This practice stands in contrast even with Article 296 TEC itself, which clearly states that measures taken under that Article "*shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes*."

3.5.3. Lack of openness

Lack of transparency and the existence of discriminatory rules and practices inevitably hamper the openness of defence markets between EU Member States.

The annual reports of the EU Code of Conduct on Arms Exports confirm the low level of intra-European trade[49]. For 2005, the value of intra-European arms transfers can be estimated at around €3.4 bn, whereas the total value of the public procurement of military equipment in the EU was €26.4bn.[50] This means that, at EU level, only about 13% of military equipment (in value) is procured from other European suppliers[51].

This does not mean that defence contracts in general would be awarded without competition. On the contrary, according to Member States responding to the Yellow Window questionnaire on current procurement practices, about three quarters of Member States "normally" open defence contracts to international competition (average based on all defence product types),

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49 Within the framework of the EU Code of Conduct on Arms Exports, Member States report at the end of each year the number and value of licences issued, and the value of arms exports. UK, however, provides only the value of licences issued (not the value of arms exports). Additionally, it should be noted that these figures also include transfers from company to company (not only public procurement) For more information, see http://consilium.europa.eu/cms3_fo/showPage.asp?id=408&lang=en#exp4.

50 See http://www.eda.europa.eu/genericitem.aspx?area=Facts&id=179)

51 See Annex n°13: Defence intra-community transfers and penetration rates.

but only one quarter usually publish these contracts in the OJEU (and thus award them according to EC rules).[52]

Most of the time, however, Member States give preference to domestic suppliers even when competition "officially" takes place. A study published at the end of the 1990s demonstrated that contracts published in the WEAG bulletin were won most of the time by national companies[53]. For example, in 1996/97 in the UK, 95% of procurement opportunities conducted in the framework of the WEAG was awarded to domestic companies. In France, the percentage was 100% for the same period. There is no indication that this situation has significantly improved since the demise of the WEAG. Between 1st July 2006 and 1st March 2007, for example, 14 Member States published more than 130 contract opportunities on the EBB of EDA. However, only one single cross-border contract was awarded by April 2007, nine months after the launch of the EBB.

3.6. Effects on stakeholders

The widespread exemption of defence and sensitive non-military security procurement, and its implications for transparency, non-discrimination and openness of these markets create a situation which, in the long run, is disadvantageous for all stakeholders:

- Taxpayers pay extra-costs with governments not (always) buying the most competitive equipment; Armed forces may not get the best value (equipment) for money;
- Industries face discrimination and pay extra overhead costs (if they participate in foreign bids), suffer from short production runs (if they stick to their home markets) and see their competitiveness compromised (in both cases);
- Contracting authorities act on difficult grounds, since they must either use ill-suited EC procurement rules or ignore the Court's ruling and the Commission's Interpretative Communication;
- The Commission's role as Guardian of the Treaty is handicapped, with infringement policy caught in a dilemma of either tolerating non-compliance of procurement practices with the Court's case law or imposing the use of ill-suited EC rules.

3.7. Problem summary

In contrast to the Court's case law, Member States use Article 296 (1)(b) TEC extensively to exempt the procurement of defence equipment from EC rules. The same problem, albeit less prominent, exists for sensitive non-military security procurement, where Member States use either Article 296 (1)(a) TEC or Article 14 of the PP-Directive to evade from EC rules.

In both cases, the cause of the problem lies in the lack of EC rules suited to the specificities of these contracts. The main features of defence and sensitive non-military security procurement are: complexity, special requirements for security of supply and security of information. Since current EC procurement rules have been developed for non-military and non-sensitive procurement, they do not sufficiently take into account these features.

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52 Yellow Window market study, pages 90-98.

53 Sandra Mezzadri, "L'ouverture des marchés de la défense: enjeux et modalités", *Occasional Paper* n° 12, Institute for Security Studies, 2000, p. 12.

As a consequence of the non-application of EC rules, most defence and sensitive non-military security equipment is procured on the basis of national rules and procedures. The latter differ greatly in terms of publication, tendering procedures, selection and award criterion, offsets, etc. This regulatory patchwork is a major obstacle on the way towards a common European defence equipment market and opens the door to non-compliance with the Treaty principles in important parts of defence markets in Europe. Lack of transparency and widespread discrimination of suppliers from other Member States lead to a lack of openness of these markets, with negative effects for all stakeholders.

The problem is more difficult to identify and to quantify for security than for defence procurement. The main reason for this is that defence is more "visible" (one single customer – Ministry of Defence, one user – armed forces – and one clearly identifiable budget in each Member State; big procurement programmes with high costs; political debate on military capability shortfalls, etc.). Sensitive non-military security, by contrast, is a more diverse and "discrete" phenomenon, in particular because of the multitude of customers, users and budgets at national, regional and local levels.

Each security service has its own specific equipment which has different similarities with defence equipment. The protection of public transport infrastructures, for example, can be technologically complex and involve highly confidential information. Interoperability with the equipment of armed forces, by contrast, is probably less important than in other contexts, such as the surveillance of maritime borders, where navies and coast guards often operate together. In all these cases, security and defence equipment have features in common, which lead to similar challenges in the field of procurement. Consequently, the problem (widespread exemption from EC rules), its cause (contract specificities to which EC rules are ill-suited), and its consequences (lack of openness) are often the same.

3.8. How would the problem evolve, all things being equal?

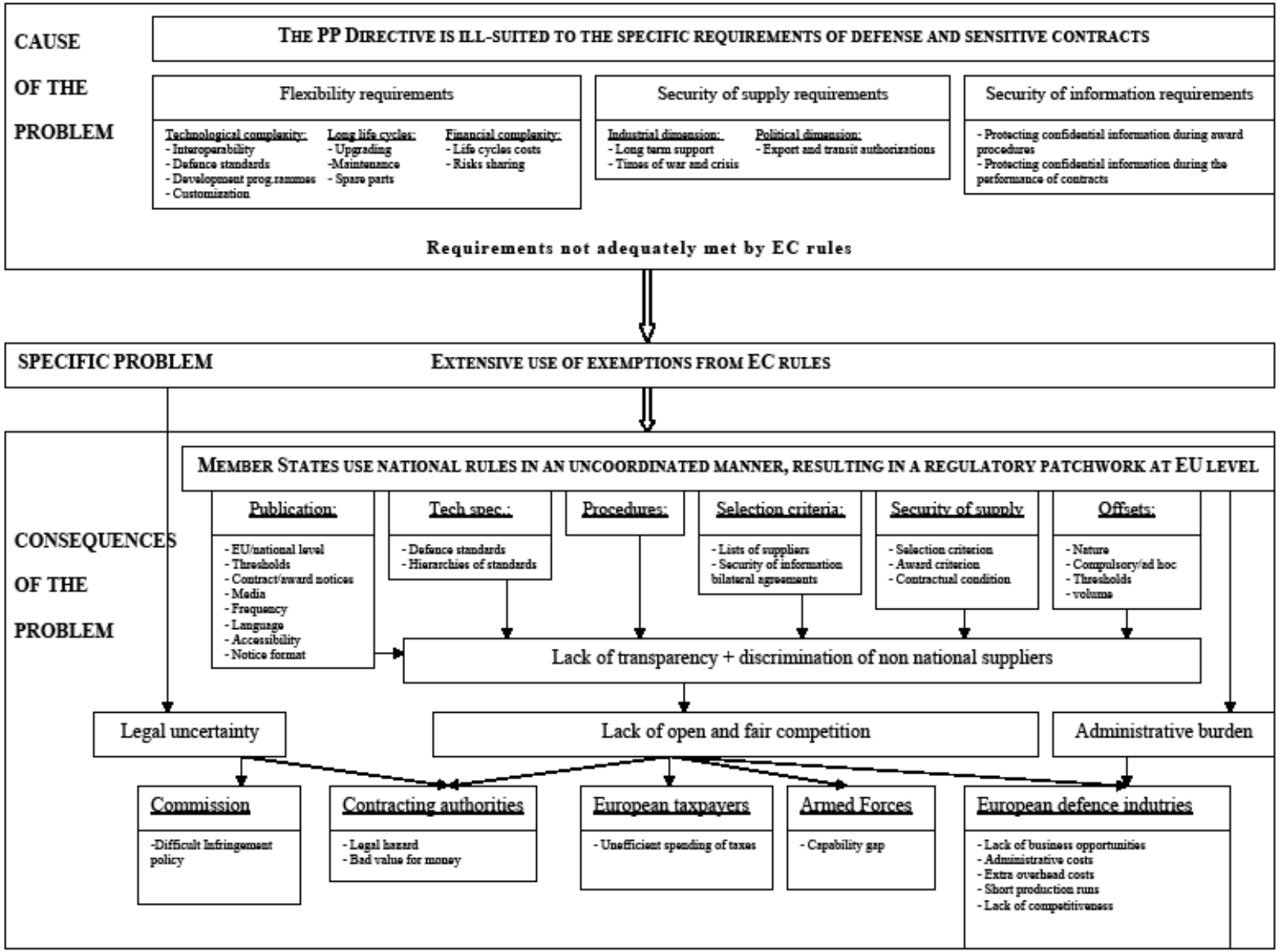
If no action was taken, the widespread exemption of defence and sensitive non-military security equipment from EC procurement rules would probably continue. The bulk of defence and sensitive non-military security equipment would still be procured via un-coordinated national procedures, which is unsatisfactory in terms of transparency, allows for discrimination and limits the openness of the market for intra-European competition. The specificities of these procurements would make it extremely difficult for contracting authorities to comply with the Court's case law and implement the principles of the Commission's Interpretative Communication. Public procurement in these markets would thus continue on a legally problematic basis and in an economically unsatisfactory way.

3.9. Is the EU best suited to act?

The widespread use of the exemption from EC law in the field of defence and sensitive non-military security procurement is incompatible with the Treaty and the Court's case law. In this case, the Commission, as Guardian of the Treaty, has the duty to act to solve the problem.

The specific problem results from the inefficiency of the EC legal framework. Article 296 TEC and Article 14 of the PP-Directive cannot be applied in accordance with the Court's case law, since current EC procurement rules are ill-suited to defence and sensitive non-military security procurement contracts. In this case, the EU is not only the best suited, but the only possible actor to address this problem: EDA, as an intergovernmental agency of the EU Council, has no competence on Community rules and can only put forward non-binding arrangements outside the scope of EU law. Consequently, only the Commission can take an

initiative to cope with the cause of the problem.


CAUSE OF THE PROBLEM
THE PP DIRECTIVE IS ILL-SUITED TO THE SPECIFIC REQUIREMENTS OF DEFENSE AND SENSITIVE CONTRACTS
Flexibility requirements
Technological complexity:
- Interoperability
- Defence standards
- Development prog.rammes
- Customization
Long life cycles:
- Upgrading
-Maintenance
- Spare parts
Financial complexity:
- Life cycles costs
- Risks sharing
Security of supply requirements
Industrial dimension:
- Long term support
- Times of war and crisis
Political dimension:
- Export and transit authorizations
Security of information requirements
- Protecting confidential information during award procedures
- Protecting confidential information during the performance of contracts
Requirements not adequately met by EC rules
SPECIFIC PROBLEM
EXTENSIVE USE OF EXEMPTIONS FROM EC RULES
CONSEQUENCES OF THE PROBLEM
MEMBER STATES USE NATIONAL RULES IN AN UNCOORDINATED MANNER, RESULTING IN A REGULATORY PATCHWORK AT EU LEVEL
Publication:
- EU/national level
- Thresholds
- Contract/award notices
- Media
- Frequency
- Language
- Accessibility
- Notice format
Tech spec.:
- Defence standards
- Hierarchies of standards
Procedures:
Selection criteria:
- Lists of suppliers
- Security of information bilateral agreements
Security of supply
- Selection criterion
- Award criterion
- Contractual condition
Offsets:
- Nature
- Compulsory/ad hoc
- Thresholds
- volume
Lack of transparency + discrimination of non national suppliers
Legal uncertainty
Lack of open and fair competition
Administrative burden
Commission
-Difficult Infringement policy
Contracting authorities
- Legal hazard
- Bad value for money
European taxpayers
- Unefficient spending of taxes
Armed Forces
- Capability gap
European defence indutries
- Lack of business opportunities
- Administrative costs
- Extra overhead costs
- Short production runs
- Lack of competitiveness

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4. OBJECTIVES

4.1. General objective

The Commission's general objective is to establish an open and competitive European Defence Equipment Market (EDEM) in support of the EU's Security and Defence Policy (ESDP). Following the Union's comprehensive security approach, such an EDEM would cover both military segments (arms, munitions and war material) as its core, and non-military, sensitive segments.

Ideally, such an EDEM would allow suppliers established in one Member State to serve without restriction public customers in all Member States. The advantages for both the supply and the demand side are evident: European companies would obtain a much larger 'home' market, could restructure across national boundaries to reduce duplication, create centres of excellence and take advantage of longer production runs. At the same time, competition would encourage suppliers to optimise production capacity and help to lower costs, thus saving scarce public finances.

All this is generally recognised today, and there is a growing consensus on the necessity to act towards the establishment of an EDEM.[54] As sole customers of defence equipment, it is for Member States to reform the demand side of the market, and the establishment of the EDA in 2004 illustrates their political determination to do so. The Commission can support Member States' efforts, in particular via the establishment of a more coherent regulatory framework.

In its Communication from 2003,[55] the Commission put forward proposals for action and further reflection in several areas where the Community can contribute to the establishment of an EDEM. In some of these areas concrete results have already been achieved (e.g. research), in others, initiatives are still on-going (e.g. standardisation and monitoring). The current initiative on procurement rules goes hand in hand with a simultaneous initiative on intra-community transfers. Both initiatives aim, in particular, at enhancing open and fair competition on defence markets between EU Member States. This contributes also to the competitiveness of European industries and is in line with the Lisbon Strategy.

4.2. Specific objective

In the field of public procurement, the general objective of an EDEM implies a properly functioning regulatory framework at the EU level for the award of contracts in the field of defence and security. This means that EU procurement law must effectively implement the principles of the Treaty for the Internal Market in the field of defence and security and, at the same time, ensure Member States security interests.

4.3. Operational objective

The operational objective is to limit the use of the exemptions provided in Article 296 TEC and Article 14 of the PP-Directive to exceptional cases, in accordance with the Court's case law. The majority of contracts in the field of defence and security, including those for the procurement of arms, munitions and war material, should thus be awarded on the basis of EC rules. This would limit the use of uncoordinated national rules and facilitate the implementation of the principles of the Treaty. The realisation of this objective, however, must not conflict with Member States' security interests.

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54 See for example most recently "Strategy for the European Defence Technological and Industrial Base", adopted on 14 May 2007. http://www.eda.europa.eu/genericitem.aspx?area=Organisation&id=211 .

55 COM(2003) 113, 11 March 2003.

5. POLICY OPTIONS

5.1. No further EU-action

Without further EU action, EDA's Code of Conduct and the Commission's Interpretative Communication would remain the only instruments in the field of defence procurement.

Interpretative Communication on the use of Article 296 in the field of defence procurement

The Interpretative Communication does not change EU procurement rules, but explains the conditions for the use of Article 296 for the exemption of defence contracts from the Treaty. It respects Member States' prerogatives in defence, but also highlights the exceptional character of the exemption and the Commission's right to verify, if necessary, whether the use of Article 296 is justified. The Communication does not determine ex ante which contracts can be exempted from EC rules, but gives guidance to national contracting authorities for their assessment of whether procurement contracts fulfil the conditions to be exempted or not. At the same time, it serves as a reference for the Commission's infringement policy.

Code of Conduct

The Code of Conduct on defence procurement, administered by EDA, entered into force on 1 July 2006. Its aim is to foster competition for (certain) defence contracts exempted from EC rules on the basis of Article 296 (EDA and the Commission's remit therefore do not overlap).

To achieve this objective, the Code suggests a set of general principles applicable on a voluntary basis. These principles are non-binding, very general, and not all EU Member States have subscribed to them (27 minus HU, DK). Member States can publish contracts to which they want to apply the Code's principles on the EBB, a common electronic platform. These contracts are then awarded on the basis of national rules and procedures. Particularly important military procurement (cooperative projects, research, NBC equipment) is exempted from the Code, and sensitive non-military security equipment is not covered at all.

5.2. Non-legislative Measures

With the adoption of the Interpretative Communication, the Commission took already the most prominent non-legislative measure which is at its disposal. On top of that, three further non-legislative measures are conceivable.

5.2.1. Explaining the use of Article 14 of the Directive

The Commission could also issue an Interpretative Communication specifically on the use of Article 14 of the PP Directive for sensitive non-military security procurement. Following the example of the Communication on defence procurement, such a document could try to explain the conditions for the exemption of such procurement in the light of the Treaty principles and relevant case law.

5.2.2. Developing a more proactive infringement policy

Up until now, the number of infringement cases in the defence sector has been limited. The reason for this is twofold: first, very few market operators have complained about procurement decisions of contracting authorities, second, the Commission's infringement policy in this field has been rather lenient. Now that the Interpretative Communication has spelt out the conditions for the use of Article 296, the Commission could develop a more active infringement policy in the field of defence procurement. It could do the same for procurement in the field of security, although the conditions for the exemption of these contracts have not been explained (the Interpretative Communication does not cover security).

5.2.3. Training of national authorities and Commission staff

The Interpretative Communication on defence procurement gives guidance to national contracting authorities for their assessment of the applicability of Article 296. However, this guidance remains inevitably general and must be applied to individual procurement contracts. To make such case-by-case assessment effective, it would make sense to organise specific training courses for national authorities, explaining the Commission's interpretation on the basis of concrete cases. As a natural complement, training courses could be organised for Commission staff to explain the specificities of defence procurement. The same could be done in for sensitive non-military security procurement.

5.3. Legislative measures

The Commission could take a legislative measure to introduce into EC procurement law specific rules for the award of defence and sensitive non-military security contracts to which the existing PP Directive is ill-suited. In this case, different options exist at three levels: the nature of such a legislative measure, its field of application and its content.

5.3.1. The nature of the instrument

Different types of legislative instruments can be used to introduce specific rules into EC law:

* A regulation would set detailed rules exhaustively for the award of defence and sensitive non-military security contracts. It would be binding in its entirety and directly applicable in all Member States. This means that (in contrast to public procurement rules in other sectors) the procedures for the award of such contracts would be precisely defined at EU level, and strictly identical throughout the EU.

* A Directive would content itself with setting binding results to be achieved by Member States. Its rules would be transposed into national legal orders and thus adapted to Member States' specificities. Consequently, national procedures for the award of defence and sensitive non-military security contracts would not be strictly identical throughout the EU, but coordinated around a set of core dispositions. Three different types of Directives could be envisaged in order to introduce into EC law specific rules for the award of defence and sensitive non-military security contracts:

    a) A defence sector directive, applying to all contracts awarded by contracting authorities in the field of defence and security (mainly Ministries of Defence and Interior). In this case, the field of application would not be defined by the type of equipment procured, but by the nature of the contracting authority.

    b) A directive applying to sensitive contracts for defence and security specifically. In this case, the field of application of the new rules would not be defined by the nature of the contracting authority, but by the type of equipment procured. This means that contracting authorities would have to ask themselves whether the equipment they wish to procure is a defence or sensitive non-military security equipment (in which case they would be covered by the new directive) or not (in which case the PP Directive applies).

    c) An amending directive, inserting specific rules suited to the specificities of defence and sensitive non-military security contracts into the PP Directive (which currently applies to all public procurement except in the water, energy, transport and postal services sectors, covered by Directive 2004/17/EC).

5.3.2. The field of application

The definition of the field of application of the new rules is crucial, since it determines for which contracts exemption from EC law could at least potentially be avoided: at the same time, the notions “defence procurement” and "sensitive non-military security procurement” must be specified in order to clearly distinguish those contracts which could come under the new rules from those which would remain under the current PP Directive and those which could still be exempted. In this context, different options exist at three different levels:

* General approach: should the scope be defined via a list or a general definition?
* Exclusions versus exemptions: should certain contracts be explicitly excluded, or would a general reference to the possible use of Article 296 (for the exemption of defence contracts) and Article 30 (for security contracts) be enough?
* Thresholds: Should new specific thresholds be introduced or the thresholds of the current PP Directive apply?

5.3.3. The content

Consultations with stakeholders confirmed that EC rules for defence and sensitive non-military security procurement would have to take into account the specific needs for flexibility and security (of information and of supply). This concerns in particular the use of the negotiated procedure, guarantees as regards confidentiality, special provisions for security of supply and interoperability, and offsets. For each of these issues, various options exist, with different impacts on transparency and non-discrimination:

* How to ensure security of supply: via a generic selection criterion or as part of the technical capacity of the market operator (industrial dimension)? Via the requirement for export licences or a more flexible formula, taking into account the close political relationship between Member States (political dimension)?
* How to ensure security of information: via possible restrictions during the publication and negotiation phases? Via a generic selection criteria, or as part of the technical capacity of the market operator (industrial security)?
* What to do with offsets: should the new rules allow offsets, for example as an award criterion? Should they try to regulate offsets?
* How to gain flexibility in the award process: using the negotiated procedure when necessary or as a standard procedure? Would non-publication be an open choice or limited to specific cases?

5.4. Discarded Options

5.4.1. Non-legislative Measures

- ***Explaining the use of Article 14 of the PP- Directive***

Explaining the conditions for the exemption of non-military sensitive procurement via a new Interpretative Communication would be a difficult task: Article 14 of the PP Directive is based on Treaty Articles 30, 45 and 46. The latter, however, are more generic than Article 296 and therefore less suited as a basis for detailed interpretation. An additional difficulty lies in the lack of relevant case law. Besides these difficulties, this measure would face the same limits as the Interpretative Communication on Defence Procurement: it would clarify the conditions for the use of the exemption, but not do away with the main problem, i.e. the fact that current rules are ill-suited for sensitive non-military security procurement.

- ***Developing a more proactive infringement policy***

A rigorous infringement policy can certainly reinforce the impact of the Interpretative Communication. In fact, merely explaining the principles for the use of Article 296 may be insufficient to change well-established habits of contracting authorities which have lived for 50 years with the general assumption that all defence- and security-related procurement is automatically exempted.

However, in the current legal framework, infringement policy has its limits. For non-military procurements, it may convince Member States to use current community rules. This would limit the worst cases of misuse of Article 296. For the procurement of most military equipment, however, even a rigorous infringement policy would probably have little impact. As long as ill-suited community rules are the only alternative to the use of Article 296, Member States will certainly interpret the field of application of the exemption as broadly as possible. In consequence, a strict infringement policy can easily increase the number of legal disputes between Member States and the Commission. This can be problematic, in particular when contracts exempted from EC rules are posted on EDA's EBB. At the same time, the absence of suited EU procurement rules makes it easy to use the specificities of military equipment as justification for the exemption. The same is true for the procurement of sensitive non-military security equipment under Article 14 of the PP Directive.

Consequently, a rigorous infringement policy can reinforce the impact of the Interpretative Communication mainly on non-military procurement. However, under current circumstances, it would probably have a very limited impact on the procurement of military and sensitive non-military security equipment.

- ***Training of national authorities and Commission staff***

The same is true for training courses for staff members of the Commission and national awarding authorities. Both measures would help to establish a better understanding of existing law and avoid implementation problems. However, such measures would again have limited impact. They would not overcome the structural deficiencies of the existing legal framework and, at best, only help to limit the worst cases of misuse of Article 296.

To conclude, non-legislative measures are useful, and the Commission should indeed both develop a more proactive infringement policy and envisage special training courses. However, such measures do not eliminate the cause of the specific problem and are therefore by themselves insufficient to achieve the objective of reducing the use of the exemptions provided by Article 296 of the Treaty and Article 14 of the Directive They may be able to cope with the worst cases of misuse, i.e. cases where current EC rules are in fact suited. However, EC rules would still remain difficult to apply to the bulk of defence and sensitive non-military security contracts. The mismatch between current practice and the Court's case law would thus persist.

Non-legislative measures were therefore set aside early on in the consultation process, in favour of a legislative instrument. Being aware of the legal problems which arise from the widespread use of the exemptions, Member States have supported the Commission in this choice. Caught between the difficulties of using ill-suited procurement rules, on the one hand, and the risk of being challenged by the Commission for abuse of the exemption, on the other, the vast majority of Member State's have recognized the advantage of new Community rules that would make it easier for them to respect the Court's case law.

5.4.2. Legislative Measures

The limits of non-legislative measures confirm that the main cause of the problem is the absence of EC rules suited to defence and sensitive non-military security equipment. Consequently, the use of the exemption in this sector can only be limited to exceptional cases

if EU procurement law contains rules and provisions which take into account the specificities of defence and sensitive non-military security contracts. Since such rules and provisions currently do not exist, they must be created. This, in turn, necessitates a legislative measure.

Nevertheless, certain legislative measures can also be discarded:

- ***Regulation***

A regulation would automatically limit the field of application of the new rules to the award of defence and sensitive non-military security supply contracts[56]. The objective of limiting the use of Article 296 could thus only be achieved in part – as works and services would remain covered by ill-suited rules, and thus probably exempted more often than not. Secondly, a regulation is the strictest Community instrument. Defence and sensitive non-military security supply contracts would thus be awarded with a more limiting and stricter legislative framework than all other public contracts. This seems inappropriate, because defence and security are particularly sensitive sectors, and would be in contradiction with the objective of providing Member States with greater flexibility.

A directive thus seems better-suited: it would be applicable to supply, services and works contracts, and content itself with coordinating national procedures, therefore leaving Member States some flexibility to take into account their national specificities. This seems particularly important in an area where Member States have very different defence spending levels, industrial capabilities and hence, different procurement practices and interests. However, not all types of possible Directives are equally suited.

- ***Defence sector directive***

A defence sector directive applying to all contracts awarded by contracting authorities in the field of defence and security would also include rules for the procurement of "civil" and non-sensitive equipment. For the latter, the new sector Directive would then either repeat the rules of the existing PP Directive or contain new specific rules. The former option represents an unnecessary duplication of existing law and is incompatible with the Commission's Better Regulation policy. The second option would result in a situation where similar equipment (for example, office furniture) would be procured through different rules depending on the identity of the contracting authority (the Ministry of Defence or the Ministry of Education, for example). Not only would this be unjustified (as the new rules would partly apply to contracts to which existing rules are currently suited) but it would also bring considerable legal uncertainty within EC and national law.

[56] According to Articles 47(2) and 55 TEC, a directive is the only appropriate instrument for legislative action as regards the freedom of establishment and the freedom to provide services. In accordance with Article 95, a regulation could be envisaged with a view to guaranteeing the free circulation of goods.

Screening of policy options against specific and operational objectives

Policy options\ Objectives	**Specific objective**: establishment of a functioning defence and sensitive non-military security procurement regulatory framework	**Operational objective**: limitation of the use of derogations from EC rules
No further EU action	not achieved – does not address root causes of problem	partially achieved – worst cases of misuse of Article 296 reduced (due to IC)
Non-legislative measures		
IC on Article 14	partially achieved – 1) improved clarity on appropriate use of Article 14 2) longer and more complex legal exercise than the IC on Article 296 3) no improvement to the current regulatory framework – cannot address root causes of problem	partially achieved – 1) worst cases of misuse of Article 14 reduced; 2) worst cases of misuse of Article 296 reduced as result of related IC; 3) no/minor impact on derogations as a whole
Proactive infringement policy	partially achieved – 1) enforces conclusions of the IC on Article 296 (and Article 14 if IC written) 2) case law could over time increase understanding and application 3) does not address root causes of problem	partially achieved – 1) worst cases of misuse reduced; 2) may impact on wider use of derogations over time – depends on resources available
Training	partially achieved – 1) some improvement of knowledge of current EC regulatory framework 2) does not address root causes of problem	partially achieved – 1) worst cases of misuse reduced 2) encourages use of current EC law whenever possible. 3) no/minor impact on derogations as a whole
Legislative measures		
Regulation for defence & security contracts	partially achieved – 1) establishes a functioning, but very rigid regulatory framework 2) ONLY applies to public supply contracts.	partially achieved – only applies to public supply contracts
Sector Specific Directive	achieved – establishes a functioning and flexible regulatory framework, but: possible spill-over effects to civil contracts and legal uncertainty	achieved – limits use of derogations to exceptional cases.
Stand-alone Directive for defence & security contracts	achieved – establishes a functioning and flexible regulatory framework via a separate instrument clearly devoted to the specificities of such contracts	achieved – limits use of derogations to exceptional cases
Amending Directive for defence & security contracts	achieved – establishes a functioning and flexible regulatory framework via sector-specific rules integrated into current framework	achieved – limits use of derogations to exceptional cases

5.5. Retained Options

The following options were thus retained for further consideration:

- Do nothing (option 1), or
- Take a legislative measure to introduce new rules for the procurement of defence and sensitive non-military security equipment (option 2), either via an amending directive or a stand-alone directive.

The choice between amending directive and stand-alone directive is a matter of legislative technique, not of substance. The field of application and the content of the new rules, which are decisive for their impact, are in fact the same for both. Consequently, a full assessment of all impacts for the two instruments would be in large parts repetitive and not appropriate. We therefore consider the options for the choice of the instrument as sub-options, at the same level as the field of application and the content.

6. ANALYSIS OF IMPACT

6.1. Option 1: Do nothing

Without further EU action, the main problem – the widespread exemption of military and sensitive non-military security procurement from EC rules – would certainly persist.

The Interpretative Communication can curb the use of Article 296 TEC for the procurement of non-military equipment. The latter is (normally) not sensitive and does not have specificities justifying the exemption from "normal" procurement rules for security reasons. The bulk of defence procurement, however, concerns military equipment with specificities to which current EC rules are ill-suited. One can thus fairly assume that national contracting authorities will continue to exempt the procurement of such equipment on the basis of Article 296 TEC. The same will certainly be the case for the procurement of sensitive non-military security equipment, which is not addressed at all in the Interpretative Communication.

The mismatch between EU law and the Court's interpretation, on the one hand, and Member States' procurement practice, on the other, would thus persist.

The Code of Conduct of EDA can, at best, limit the negative consequences of the exemption provided in Article 296 TEC. Besides, its impact is limited by its membership (not all Member States), field of application (only certain defence contracts, and no security contracts at all) and non-binding character. Moreover, the Code does not do away with the patchwork of national procurement rules. It only offers the possibility to advertise certain contracts and contains a non-binding self-commitment of its subscribing Member States to use their respective procurement procedures without discriminating non-national suppliers.

Whether the Code of Conduct will make a difference within its field of application (i.e. defence contracts exempted from EC rules) remains to be seen; similar non-binding agreements in the past had very little impact. As of today, the Code has lead to one single cross-border contract award, and there is a tendency among contracting authorities to apply the Code to non-sensitive procurements, which could probably even come under current EC procurement rules. In other words, the Code does not limit the extensive use of Article 296 TEC, and may even become an alibi for reducing the use of community rules further.[57]

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[57] This was indirectly confirmed by one Member State who declared in his written contribution to the CCMP consultation that he has never used Article 296 TEC for security reasons, but may do so in the future in order to be able to publish contract notices on the EBB.

All in all, on the basis of the existing legal framework, the core market segments for military and sensitive non-military security procurement would not gain greater transparency and openness. The negative consequences on costs, efficiency and competitiveness would therefore by and large persist.

6.2. Option 2: Introducing new rules for the procurement of defence and sensitive non-military security equipment

Within option 2, there are three main issues which need to be addressed: 1) The type of legal instrument which is to be used to introduce new specific rules into EU procurement law; 2) the field of application of these rules, and 3) their detailed content aimed at addressing the current weaknesses in the PP Directive with respect to defence and sensitive security.

For each of these three issues, there is a range of actions (hereafter sub-options) which can be taken. The following table summarises the different sub-options which will be considered further. Specific criteria will be used to analyse the various sub-options of each issue. The combination of the best-suited sub-options will then allow to define more clearly option 2 and to assess – in a final step –its wider impacts.

Short Name	**Sub-option**
Issue 1 – Type of Legal Instrument [LI]	
[LI] sub-option a	Introduce amending Directive to 2004/18
[LI] sub-option b	Introduce stand-alone Directive for Defence and Sensitive Security Public Procurement
Issue 2 – Field of Application [Scope]	
[Scope] sub-option a	Identify scope by a list of equipment to be covered by new rules (plus related services and works)
[Scope] sub-option b	Identify scope by a general definition of type of equipment to be covered by new rules
[Scope] sub-option c	Deal with exemptions by explicitly excluding the main cases in the new rules
[Scope] sub-option d	Deal with exemptions by referring to derogations allowed by the Treaty
[Scope] sub-option e	Set new thresholds for these contracts
[Scope] sub-option f	Keep current thresholds used in the PP Directive
Issue 3 – Content of Legislation	
Security of Supply[SoS] – Political Dimensions	
[SoS] sub-option a	Assuming de facto free circulation in EU
[SoS] sub-option b	Request all necessary licences
[SoS] sub-option c	Request evidence
Security of Supply [SoS] – Industrial Dimensions	
[SoS] sub-option d	Treat as generic selection criterion
[SoS] sub-option e	Treat as a technical capacity
[SoS] sub-option f	Treat as mix of technical capacity and future guarantees
Security of Information [SoI] – During the Procurement Procedure	
[SoI] sub-option a	No publication
[SoI] sub-option b	No disclosure
Security of Information [SoI] – During (and after) the Performance of Contracts	
[SoI] sub-option c	Treat as generic selection criterion
[SoI] sub-option d	Treat as selection criterion (with mutual recognition of security clearances)
[SoI] sub-option e	Treat as selection criterion (FSCs with security agreement)

[SoI] sub-option f	Treat as technical capacity
Offsets	
[Offsets] sub-option a	Allow offsets
[Offsets] sub-option b	Prohibit offsets
[Offsets] sub-option c	Do not mention offsets
Procedures [Proc] – Choice of Procedure	
[Proc1] sub-option a	Negotiated procedure when necessary
[Proc1] sub-option b	Negotiated procedure as standard procedure
Procedures [Proc] – Cases of Non-publication	
[Proc2] sub-option c	Allow open choice
[Proc2] sub-option d	Limit to specific cases

6.2.1. Choice of the legal instrument [LI]

Two legal instruments were retained to introduce new provisions into EC law: a Directive amending the PP Directive and a stand-alone procurement Directive. Since the two do not differ in substance, they are assessed on the basis of the following criteria: enhancement of the *acquis*, conformity with Better Regulation principles, legal certainty and overall visibility.

[LI] sub-option a: Amending Directive

Such a directive would amend the PP Directive so as to include the rules and provisions specific to defence and sensitive non-military security procurement. All modifications would be inserted in the relevant articles, paragraphs and annexes of the PP Directive.

This approach would be in line with the Better Regulations principles and build on the consolidation provided by the legislative package.[58] However, amending the PP Directive would make the work of the legislator much more complicated, since Council and Parliament would have to debate a "reader-unfriendly" text with numerous references to the existing PP Directive. Once adopted, the new rules would be "spread" throughout the PP Directive. The final result would thus be hardly visible. This, in turn, would make it far more difficult for Member States to implement the new rules.

In addition, this approach may imply considerable risks for the preservation of the *acquis*. The Legislative Package was adopted only recently, after difficult negotiations on some particularly sensitive issues. It has not even been transposed in all Member States. A proposal for amending the PP Directive may be taken by the legislator(s) as an opportunity to (re-)open discussions (also) on provisions other than those related to defence and security. This is not at all the objective of the present initiative, which is aimed at addressing one specific issue. It may jeopardise the current implementation and enforcement of the new PP rules, and even lead in some cases to a retreat in the *acquis*.

Furthermore, this approach would limit the flexibility for the drafting of the new rules. The latter would thus probably be more rigid and less tailor-made to the specificities of these contracts. Only strictly necessary modifications could be incorporated; all current provisions considered suitable enough, by a stretch of interpretation, would be left as they read today. This may not be clear enough for contracting authorities. In addition, the rules applicable to

[58] Directive 2004/18 consolidates the three previous public procurement directives, Directive 93/36/CEE, Directive 93/37/CEE and Directive 92/50/CEE.

defence and sensitive non-military security procurement would also not be very apparent within the text of the Directive. Some uncertainty as to the applicable law would thus remain.

[LI] sub-option a would also mitigate the impact of the introduction of the new rules into EC law. As contracting authorities would not obtain a new legal instrument in its own right, they might be tempted to continue to exempt defence and sensitive security contracts from the EC rules. Last but not least, the initiative, which has far-reaching political dimensions in terms of building a European Defence Equipment Market, would lose political visibility.

Because of these drawbacks (in particular concerning reader-unfriendliness and the limitation of room for manoeuvre for drafting tailor-made provisions) Member States have clearly and unanimously rejected the option of an amending Directive during the consultation process.

[LI] sub-option b: Stand-alone Directive

Adopting a stand-alone Directive would reintroduce fragmentation into Public Procurement law, as there would be two legislative acts instead of one. However, there already are two public procurement directives today, namely Directive 2004/18/EC and Directive 2004/17/EC covering the water, energy, transport and postal services sectors. There are goods reasons to consider defence and sensitive non-military security as even more specific spheres as water, energy, transport and postal services. Dealing with them in an autonomous act seems therefore proportionate.

Furthermore, this approach would allow safeguarding the *acquis* achieved by the legislative package in 2004. Discussions in the Council and the Parliament could not put into question the current provisions of the PP Directive and would be circumscribed to the new rules for defence and sensitive non-military security procurement.

On top of that, a stand-alone Directive would allow drafting tailor-made rules and provisions which would explicitly refer to defence-specific conditions. This would make them clear and easy to use for contracting authorities, hence would be in line with the Commission's Better Regulation Policy. This argument was also strongly emphasized by Member States which unanimously expressed their preference for a stand-alone Directive.

It would also become unambiguous that the new Directive should be the rule for the procurement of defence and sensitive non-military security equipment, as otherwise it would be of no use. It would mark the policy change of the Commission as regards enforcing the case-law of the Court of Justice as regards article 296 TEC. Finally, adopting a new directive would enhance the visibility of the Commission’s initiative for the outside world.

A stand-alone Directive would bring significant gains in legal certainty and visibility. Moreover, it would allow safeguarding the acquis of the legislative package and has the support of all Member States. For all these reasons, *[LI] sub-option b* seems preferable.

Comparison of sub-options “Legal Instrument” [LI] against decision criteria

	Enhancement of the acquis	**Better Regulation**	**Legal certainty**	**Visibility**
[LI] sub-option a: Amending Directive	– –	– / +	–	– –
[LI] sub-option b: Stand-alone Directive	+	– / +	+ +	+ +

– : negative effect + : positive effect

6.2.2. Field of application [Scope]

Defining the field of application of the new rules raises a number of questions: How should it be defined: via a list or a general definition? How to deal with exclusions? And what are the

appropriate thresholds? All options must be assessed against the main objective, i.e. reducing the use of the exemption to exceptional cases. Consequently, the potential field of application of the new rules should be kept as wide as possible. At the same time, Member States' Treaty-based rights not to apply EC law for essential security reasons must be respected.

6.2.2.1. List or general definition?

There are two possibilities of for defining the field of application of the new rules:

– A list of equipment, including related services and works (*[Scope] sub-option a*);

– A general definition of the type of equipment to which the new rules will apply (*[Scope] sub-option b*).

In theory, a list is a more precise instrument, granting more legal certainty than a general definition, which is always subject to interpretation. However, in this case drawing up a list appears as a thorny and possibly inefficient exercise. Accordingly, most Member States expressed their preference for a general definition during the consultation process.

With regard to defence procurement, the new rules aim at reducing the use of Article 296 TEC. The latter allows exempting from EC law the procurement of arms, munitions and war material included in the list of 1958, if this is necessary for the protection of essential security interests. The new rules would then logically apply to the procurement of the same type of equipment, subject to Article 296 TEC.

Trying to specify the field of application further via a new list would mean having two different lists, both covering arms, munitions and war material. The two might have different levels of detail, but would inevitably overlap in many areas. This, in turn, could create problems of interpretation and implementation. **Consequently, a general definition combined with a reference to Article 296 TEC seems better suited (*[Scope] sub-option b*).** Such a definition could, for example, state that the new rules apply to "arms, munitions and war material, as well as related services and works, subject to Article 296 TEC."

The challenge is different with regard to sensitive non-military security contracts. Whereas Article 296 TEC and the list of 1958 define the scope in the field of defence, a similar reference is missing in security. In principle, one could imagine combining a general definition for defence and a new specific list for security. However, the problem here is even more complicated, since possible procurements are so diverse. On the other hand, using a general definition entails the risk of misuse of the new rules, i.e. their application to procurement contracts to which the PP Directive is suited. This risk could be limited by using restrictive criteria circumscribing "sensitive". Such criteria could be:

– A "mission" criterion, which describes the security areas where commonalities and similarities to defence are most evident; this criterion could be inspired by the European Security Research Agenda[59];

– A "qualitative" criterion, specifying why a procurement contract is to be considered as sensitive. In the field of non-military security, this would be the case in particular for contracts which involve confidential information.

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[59] The final report of the European Security Research Advisory Board (ESRAB), "Meeting the Challenge: the European Security Research Agenda" is intended to meet the Commission's requirements for the seventh framework programme for research and technology development in the field of security. The ESRAB report identifies a number of mission areas, such as border security, protection against terrorism and organised crime, critical infrastructure protection, etc. This report is available online at http://ec.europa.eu/enterprise/security/index_en.htm.

Consequently, a general definition (*[Scope] sub-option b*) seems best-suited for sensitive non-military security as well. It should include, on the one hand, restrictive criteria, and, on the other, a reference to Article 30 TEC, allowing exemptions for cases where the new rules would not be sufficient to protect Member States' security interests.

Such a definition could state, for example, that the new rules are applicable to public contracts for the procurement of supplies, services and works which are needed for the fight against terror or organised crime, the security of borders, and the execution of which necessitates special security measures or access to classified information, subject to Article 30 TEC.

6.2.2.2. Exemptions

During the consultation process, a number of hypotheses where Member States would certainly continue not to apply community procurement rules for security reasons were identified, in particular ultra-sensitive areas, such as equipment for nuclear, biological and chemical warfare or cryptography, but also certain research contracts. Here again, two sub-options exist:

– Explicitly excluding the main cases of exemptions (*[Scope] sub-option c*);

– Referring to the Treaty derogations (in particular Article 296 for Defence and Article 30 for Security), without spelling out specific hypotheses (*[Scope] sub-option d*).

The challenge here is to keep the field of potential application of the new rules as wide as possible and, at the same time, leave flexibility with Member States for their decision to use the derogations provided by the Treaty. **The best way to achieve this is to limit the number of explicit exclusions to a minimum and to refer to the derogations mentioned in the Treaty (*[Scope] sub-option d*).**

6.2.2.3. Thresholds

Thresholds are an important element for defining the application of public procurement rules. During the consultation process, two main sub-options were raised:

– Setting new thresholds, specifically adapted to defence and sensitive non-military security markets (*[Scope] sub-option e*).

– Keeping the current thresholds of the PP Directive (*[Scope] sub-option f*);

Some Member States suggested setting a defence-specific threshold of 1 million € for supply and services contracts (following EDA's Code of Conduct). The rationale for this suggestion was that defence contracts often have a high value, so that lower thresholds would be useless.

At the same time though, close examination of Member States' procurement practice shows that the average value of contracts varies greatly. Consequently, the 1Million € threshold may be sufficient in some Member States, but be too high for others.[60] Moreover, contracts of lower value could be particularly interesting for SMEs, who currently face the greatest difficulties to identify contract opportunities in other Member States. **Therefore, it seems advisable to keep the thresholds set in the current PP Directive (*[Scope] sub-option f*).**

Comparison of sub-options "field of application" [scope] against decision criteria

	Limiting the use of exemptions from EC rules
Definition	

[60] See Annex n°12: Average amounts of defence contracts published in the OJEU.

[Scope] sub-option a: lists	+
[Scope] sub-option b: general definitions	+ +
Exemptions	
[Scope] sub-option c: defining specific cases for exemption	+
[Scope] sub-option d: referring to the derogations allowed in the Treaty	+ +
Thresholds	
[Scope] sub-option e: setting high thresholds for defence procurement	+
[Scope] sub-option f: keeping current EC thresholds	+ +

– : negative effect + : positive effect

6.2.3. Content of Legislation

The current practice of exempting defence and sensitive security procurement from EC rules allows Member States to fully ensure their security interests, if necessary at the cost of the principles of the Internal Market, i.e. transparency, non-discrimination and equality of treatment. Bringing defence and sensitive non-military security procurement within the jurisdiction of the Community (by limiting the use of exemptions), by definition improves the implementation of these principles in these markets and hence has a positive impact on competition, value for money and competitiveness of industries. On the other hand, the new provisions must also offer sufficient safeguards and flexibility to ensure Member States' security interests. Otherwise, they will simply not be applied and the current practice of widespread exemption will continue. All sub-options which could undermine Member States' security interests must thus automatically be discarded. Security safeguards and flexibility, however, can potentially limit the positive effect of the new rules on transparency, non-discrimination and equality of treatment. All sub-options for the content of new rules must thus be assessed against the double criterion of safeguarding Member States' security interests and implementing the principles of the Internal Market.

In other words: The general impacts of the new rules depend on their ability to maximise transparency, non-discrimination and equality of treatment without impacting negatively on Member States' security. If the rules focus on security safeguards at the cost of the implementation of Treaty principles, Member States may use them and reduce the recourse to the exemption, but the positive impacts on openness and transparency would be very limited. If, by contrast, the new rules fully implement Treaty principles at the cost of security interests, Member States will not apply them and continue to use the exemption. In both these cases, the impact of the new rules would be close to zero.

6.2.3.1. Security of Supply [SoS]

As illustrated in the problem definition, security of supply has both a political and an industrial dimension. To deal with each of them, several sub-options exist.

- ***Political dimension***

[SoS] sub-option a: Presuming de facto free circulation in the EU

Since, in practice, only very few export licences are refused for transfers between EU Member States,[61] one sub-option would be to consider the political dimension of security of supply within the Community as irrelevant. Consequently, there would be no need to set a specific provision dealing with this.

[61] Unisys, *Intra-Community Transfers of Defence Products*, European Commission, Brussels, 2005, p. 6.

This assumption, however, is too optimistic. In fact, Member States often use informal channels to "test the water" before formal requests are made, and, at this stage, negative opinions may be issued. In addition, even if refusals are rare, they are still possible. Simply taking it for granted to be delivered when procuring in another Member State would thus present adverse risks for Member States' security interests. To make the new rules applicable, they must give contracting authorities the possibility to ask for some sort of assurance that the necessary licences will be granted. Without a community-wide transfer regime guaranteeing the free circulation of defence equipment, this sub-option is thus to be excluded.

[SoS] sub-option b: Requesting all necessary licences

In this case, contracting authorities would be allowed to ask, as a condition for the performance of the contract, all necessary licences, *i.e.* export, transfer and transit licences, for the main delivery and all future additional deliveries or services.

This sub-option offers maximum safeguards for Member States, but leaves the way open to significant discrimination. It would be in fact extremely difficult for suppliers to obtain in advance all necessary licences (including for future deliveries or maintenance services), let alone within the time limits of procurement procedures. Such a constraint would thus excessively weigh on tenderers and favour national suppliers (who do not need licences).

[SoS] sub-option c: Requesting evidence

In this case, contracting authorities would have the right to request from tenderers, as a condition for the performance of the contract, to provide evidence of their ability to meet their export, transfer and transit obligations. The choice of which evidence to provide would be up to the candidate (for example actual licences, commitments from the tenderers' national authorities to grant the licence when requested; proof of having obtained similar licences in the past, etc.). At the same time, it would be up to contracting authorities to assess whether the evidence provided is sufficient – and explain, if need be, why it is not considered so.

This sub-option may not avoid all discriminatory side-effects, but it gives contracting authorities and tenderers flexibility for pragmatic solutions. It would also be consistent with the forthcoming instrument on the simplification of intra-EU transfers of defence products, which will make it easier for suppliers to provide evidence of their ability to meet transfer obligations. ***[SoS] sub-option c* seems thus a reasonable compromise between security interests and the principles of the Internal Market.**

- ***Industrial dimension***

As outlined in the problem definition, the industrial dimension of security of supply contains various facets, which can be treated differently.

[SoS] sub-option d: security of supply as a generic selection criterion

The industrial dimension of security of supply relates to the economic operators' capacities and should therefore be dealt with as a criterion for the selection of suppliers. Considering the difficulty to cover exhaustively all issues connected to security of supply (especially since they may vary according to the equipment and political and strategic circumstances), the most flexible sub-option would be an "open" security of supply clause allowing contracting authorities to request "evidence of the capacity to provide security of supply". The choice of the evidence requested and accepted would be left to contracting authorities.

This sub-option would grant Member States with maximum security. However, it would offer few guarantees to candidates in terms of transparency (because this criterion would not be very clear) and equality of treatment (because this criterion would not be very objective).

[SoS] sub-option e: security of supply as a technical capacity

In this case, the industrial dimension of security of supply would again be dealt with through selection criteria, but as part of the technical capacities criterion. In order to cover exhaustively the risks connected to security of supply, the criterion should cover candidates' industrial and technological capacity not only to execute the contract, but also to provide the necessary in-service and through-life support and to meet possible additional needs in cases of war or crisis. In order to ensure that such criterion is objective and clear, the candidates' capacities should be evidenced by concrete proofs such as a description of the technical equipment and material.

This sub-option would ensure sufficient transparency and equality of treatment. Yet, Member States, during the consultation process, insisted that security of supply does not only concern present, but also future capacities (to deal with the long life cycles of many defence systems). This sub-option thus did not offer sufficient safeguards for Member States' security interests.

[SoS] sub-option f: security of supply as a technical capacity plus guarantees for the future

This sub-option combines sub-option e with guarantees for the future. It allows contracting authorities to request from selected candidates proof of their current technical capabilities and an undertaking to actually meet additional needs when necessary and to inform the contracting authority of future changes in their organisation (such as restructuring or transfers of activities), likely to affect their security of supply commitments.

This offers sufficient security of supply (though any such provision will always be a second best option compared to the liberalisation of transfers) and at the same time ensures transparency and equality of treatment. ***[SoS] sub-option f*** **thus seems best-suited to meet security interests and Treaty principles.**

6.2.3.2. Security of information [SoI]

Security of information must be guaranteed both during the procurement procedures and during (and after) the performance of the contract.

- ***Security of information during the procurement procedure***

[SoI] sub-option a: no publication

The most secure way to avoid disclosing confidential information is not to publish notices for contracts containing such information. However, this sub-option is very detrimental to the principle of transparency, especially since contracting authorities could misuse the possibility of not publishing notices for other reasons than security of information. In addition, it does not necessarily offer sufficient safeguards for Member States' security interests either, as it does not cope with security of information after the publication stage.

[SoI] sub-option b: no disclosure

In this case, contract notices would be published without disclosure of confidential information. Moreover, in some cases, certain technical specifications can only be given to the successful bidder. This may happen if information is so sensitive that limiting its dissemination as much as possible is necessary to the protection of Member States' security interests. It can also occur when the equipment purchased must be integrated into another weapon system or a system of system: in this case, the contracting authority may only give the technical specifications of the subject-matter of the contract itself, but only disclose the information necessary for systems integration to the successful bidder. In any case, the possibility not to disclose such information shall never prevent tenderers to draft adequate tenders. Moreover, during the negotiations, contracting authorities should provide the same

information to all economic operators. ***[SoI] sub-option b*** **seems best-suited, since it allows safeguarding security of information while still ensuring equality of treatment and a fair level of transparency.**

- ***Security of information during (and after) the performance of contracts***

[SoI] sub-option c: security of information as a generic selection criterion

Like security of supply, companies' ability to ensure security of information is best taken into account as a selection criterion, as it relates to the capacities of economic operators.

Again, the most flexible sub-option is to draft an "open" security of information clause, stating that contracting authorities may request suppliers to "provide evidence of their capacity to provide security of information". The choice of the evidence requested and accepted is then left to contracting authorities. This sub-option would grant Member States with maximum security and flexibility, but offer insufficient guarantees in terms of transparency (because the criterion would not be very clear) and equality of treatment (because it would not be objective).

[SoI] sub-option d: selection criterion (with mutual recognition of security clearances)

Contracting authorities usually request (national) Facility Security Clearances (FSCs) to check candidates' ability to secure information. Presentation of an appropriate FSC thus seems to be the most logical evidence in order to substantiate the security of information criterion. However, clearances can only be granted to companies by the National Security Authority (NSA) of their host Member State.

[SoI] sub-option d would presume that all FSCs are equal and therefore mutually recognised by all Member States. In this case, contracting authorities could only ask for such a national FSC. This would have positive effects for transparency (the criterion would be clear), equality of treatment (it would be objective) and non-discrimination (all national FSCs would be on an equal footing). However, it would not respect Member States' security interests as, in the absence of a harmonization of industrial security criteria, Member States cannot be forced to recognize other Member States' security clearances. In addition, this would contradict most Member States' national security regulations on classified information.

[SoI] sub-option e: selection criterion (FSCs with security agreement)

Certain Member States have bilateral security agreements and thus recognize mutually their respective national security clearances. A third sub-option would thus be to allow contracting authorities to accept FSCs only from companies established in a Member State with which bilateral security agreement exists. This sub-option would provide very strong security guarantees to Member States. However, it would establish *de jure* discrimination, as it would strongly favour national companies and companies from countries having signed a security agreement with the host Member State of the contracting authority.

[SoI] sub-option f: security of information as a technical capacity

Like security of supply, a security of information criterion could be substantiated and specified if considered as one aspect of technical capacities. Security of information could thus be defined as the "technical capacity to handle, store and transmit securely classified information". Such capacity could be exemplified by the candidates' industrial premises, industrial and administrative procedures, information handling processes and staff situation, which the contracting authority would have the right to enquire about. Ultimately though, contracting authorities would have the choice of the evidence they would request in order to assess candidates' ability to ensure security of information.

Member States' security would thus be adequately protected. The principle of transparency would be better taken into account than in [*SoI*] sub-option c (the criterion would be clarified). All discriminatory risks would not be done away with, as a national FSC or a non-national FSC underpinned by a bilateral security agreement would de facto be more reliable than any other type of evidence. However, this shortcoming seems acceptable, since bilateral security agreements exist between most Member States who have a noteworthy defence industry. ***[SoI] sub-option f*** **therefore seems a fair compromise between security interests and Treaty principles.**

6.2.3.3. Offsets

In this context, offsets are a category apart, since they (normally) do not concern security interests, but economic and financial interests. Whatever the new rules do with offsets, their direct impact on Member States' security interests would be close to zero.

[Offsets] sub-option a: allowing offsets

The new rules could accept offsets, for example as award criterion or condition for the execution of the contract, and try to regulate them in order to cut back the current diversity of offset policies. This would certainly foster transparency and help to reduce the negative impact of offsets on non-discrimination. However, since offsets usually entail discrimination by their very nature, they stand in direct contrast to the Treaty (EC primary law). Consequently, public procurement rules (EC secondary law) cannot allow nor regulate them.

[Offsets] sub-option b: prohibiting offsets

The new rules could also explicitly forbid offsets within the Internal Market. This would be however misleading: prohibiting offsets explicitly when using EC rules could in fact imply that they were allowed for contracts exempted from these rules under Article 296 TEC. This, however, is wrong. Offsets, in particular non-military offsets, are legally highly problematic even if they are required in the context of contracts covered by Article 296 TEC.

[Offsets] sub-option c: not mentioning offsets

In this case, offsets would not appear in the new rules. It would thus be up to Member States to assess, in the light of the Treaty and the Commission's Interpretative Communication, the compatibility of offsets with EC law. This sub-option seems to be most suited, in particular since offsets are a problem by itself which goes far beyond the current initiative and concerns also the area exempted from EC law. Expecting EC procurement rules to solve the offset problem would thus be mistaken and could even endanger the initiative (given the sensitivity of the issue). ***[Offsets] sub-option c*** **therefore seems best-suited.**

6.2.3.4. Procedures [Proc]

Two questions arise as regards procedures: the choice of the procedure(s) itself (themselves); and the cases where non-publication is admitted.

- ***The choice of procedure***

[Proc1] sub-option a: negotiated procedure when necessary

Since negotiations are often required to cope with the complexity of defence and sensitive non-military security contracts, the use of the negotiated procedure could be allowed *when necessary*. In this case, open and restricted procedures would remain the standard, the use of the negotiated procedure would be broadened, but still remain an exception. Since the negotiated procedure implies by its very nature a risk for equality of treatment, this sub-option would better implement the principles of the Internal Market.

On the other hand, it would be extremely difficult to set clear and objective conditions to determine when the use of the negotiated procedure is *necessary*. For security and defence contracts, negotiations may be necessary on an endless list of issues (security of supply, security of information, system integration, interoperability needs, specification of performance, customization, etc.). Yet, without clear and objective conditions, restrictions for resorting to the negotiated procedure would result in failing the objective of providing suited and more flexible rules for the procurement of defence and sensitive equipment.

[Proc1] sub-option b: negotiated procedure as standard procedure

In this case, the only condition for the use the negotiated procedure would be the nature of the procurement (arms, munitions, war material, or sensitive non-military security equipment).

Despite the inherent risks of this procedure for equality of treatment, this would represent a significant progress compared to the present situation, as the negotiated procedure, as all Community procedures, implements the principle of transparency and non-discrimination (with clear and objective procedure rules for deadlines, selection and award criteria, defined in advance and made public). Moreover, it would establish the publication of contract notices on TED as a rule, which in itself would be a major improvement to the current situation. At the same time, this sub-option would grant contracting authorities with the flexibility they need when they procure defence and sensitive non-military security equipment. ***[Proc] Sub-option b*** **thus seems the best way to provide flexibility and, at the same time, implement the core principles of the Internal Market.**

- ***Cases of non-publication***

[Proc2] sub-option c: open choice

Consultations highlighted the fact that there may be many defence-specific cases where a contract can be awarded to a single economic operator or where restricting competition is legitimate (for example to procure rapidly in times of crisis, fulfil interoperability requirements, streamline logistics, standardize equipment, etc.). Given this multitude of reasons, contracting authorities could be left the choice to publish notices or not. This would give them maximum flexibility, but it would also seriously impair free and open competition, as it would be very easy to misuse this flexibility.

[Proc2] sub-option d: specific cases

A more proportionate and cautious approach is to limit non-publication to specific cases, such as "urgency". Further legitimate cases could be additional deliveries of spare parts, long term maintenance and modernization. This approach would deal with the specificities of defence procurement while limiting encroachments on open competition. It would keep publication as a rule and thus significantly enhance the transparency of defence and security markets compared to the present situation (see section 4.6.1.). **Drawing a list of specific cases where non-publication is allowed appears to be the best way to reconcile security interests and the principles of the Internal Market.**

Comparison of sub-options for the content of the legislative measure against decision criteria

	Security interests	**Treaty principles**
Security of Supply [SoS] – Political Dimensions		
[SoS] sub-option a: De facto free circulation	–	+ +
[SoS] sub-option b: Requesting licences	+ +	– –
[SoS] sub-option c: Requesting guarantees	+	+

Security of Supply[SoS] – Industrial Dimensions		
[SoS] sub-option d: Generic selection criterion	+ +	–
[SoS] sub-option e: Technical capacity	+	+ +
[SoS] sub-option f: Technical capacity + guarantees for the future	+ +	+ +
Security of Information [SoI] – During the Procurement Procedure		
[SoI] sub-option a: No publication	+ +	–
[SoI] sub-option b:No disclosure	+ +	+
Security of Information [SoI] – During (and after) the Performance of Contracts		
[SoI] sub-option c: Generic selection criterion	+ +	–
[SoI] sub-option d: Mutual recognition of FSCs	–	+ +
[SoI] sub-option e: Mutual recognition + security agreements	+ +	– –
[SoI]sub-option f: technical capacity	+	+
Offsets		
[Offsets] sub-option a: Allow offsets	0	– –
[Offsets] sub-option b: Prohibit offsets	0	+/–
[Offsets] sub-option c: Not mention offsets	0	+/–
Procedures [Proc] – Choice of Procedure		
[Proc1] sub-option a: Negotiated procedure when necessary	–	+ +
[Proc1] sub-option b: Negotiated procedure as standard	+ +	+
Procedures [Proc] – Cases of Non-publication		
[Proc2] sub-option c: Open choice	+ +	–
[Proc2] sub-option d: Specific cases	+	+

– : negative effect 0 : neutral effect + : positive effect

6.2.4. Wider impacts: costs and benefits for stakeholders

Hence, Option 2 (introduction of new specific rules into EC procurement law), can now be more clearly defined as the option of introducing a stand-alone Directive for defence and sensitive security procurement, where:

- The field of application is defined via a general definition based on the equipment being procured;
- Exemptions are dealt with by referring to derogations allowed by the Treaty;
- Procurement thresholds are the same as in the current PP Directive;
- The political dimension of security of supply is coped with by allowing contracting authorities to request evidence from tenderers of their ability to meet their export, transfer and transit obligations. The industrial dimension of security of supply is dealt with through a selection criterion as part of the technical capacities criterion, combined with guarantees for the future provided in the tender;
- Security of information imperatives, during the procurement procedure, will be fulfilled by allowing the non-disclosure of such sensitive and secret information

that they can only be disclosed to the successful bidder. Regarding the performance of the contract itself, security of information will be considered a selection criterion as part of the technical capacities criterion;

- Offsets are not mentioned in the new rules;
- The negotiated procedure becomes the standard procedure, and non-publication is limited to specific cases.

The following assessment of the wider impacts will be based on this definition. Any improvement / deterioration is based on changes from the current situation.

The impacts of a defence and security specific procurement Directive depend considerably on its acceptance, primarily by awarding authorities but also by suppliers. Article 296 TEC (and 30 of the Treaty for public security) will continue to allow Member States the possibility to exempt security and defence contracts if necessary for the protection of their essential security interests. The definition of what is "necessary", "essential" "security" and "interests", and consequently the conditions for the use of the exemption, are, by nature, not static, but can evolve over time depending on political and strategic developments (end of the Cold War, emergence of new asymmetric security threats, evolution of European integration, etc.). There will always be cases where Member States do not apply EC rules, simply because they do not want – for security reasons – to open certain contracts to competition. **The ambition of the new Directive would be "only" to take the specificities of defence and sensitive security procurement into account and thus make recourse to the exemptions less necessary.**

Moreover, defence and sensitive security procurement has been traditionally excluded from the Internal Market. This has created an important cultural gap between awarding authorities in these fields and First Pillar instruments. It will certainly take some time for these authorities to internalise the usability and advantages of any new legislative requirements, but acceptance of EC procurement rules in these fields will certainly evolve positively over time, if they take into account all necessary security concerns. At the same time, the “acceptability” challenge may be somewhat different between defence and security, since in the former all contacting authorities are central, whereas they can also be regional or even local in the latter (This is the case in particular in Member States with a federal structure).

6.2.4.1. Legal Impacts

The proposed directive would comprehensively address the problems which have been raised in relation to the current public procurement legislation and should thus remove many of the reasons which lead awarding authorities to resort to Article 296 TEC and Article 14 of the PP Directive. Thus it should be possible for more sensitive defence and security procurement to be carried out according to one set of common rules, significantly improving the transparency of the procurement process – which should benefit all parties, but has been raised by SMEs as a particular concern[62]. It should also make it easier for suppliers to bid outside their home Member State if they so wish. This transparency should also make it easier for a supplier (or other interested party, such as the Commission) to raise any concerns, if they believe that procurement has not followed the new rules. The most measurable impact of this improved transparency should be an increase in the publication rate at EU level of defence procurement, which would be an advantage in particular for SMEs (see below section 7.2.4.3.).

The creation of a defence and security specific procurement directive should considerably improve the current fragmented regulatory framework for defence procurement. This should

[62] Final Report of the Economic Study on Defence Public Procurement, Rambøll Management, p.43.

significantly improve legal clarity – by considering the scope of the new directive, the guidance provided in the Interpretative Communication on when to apply Article 296 TEC, and the existing procurement legislation, all affected awarding authorities should be able to assess which legislation to apply and justify their decision if necessary. This should improve legal certainty for all parties and should mean that more defence and security procurement is conducted "on a level playing field", where all parties know the rules and suppliers should feel that they have a fair chance of winning a particular contract if they decide to bid.

6.2.4.2. Administrative Impact

Trying to foresee the impact on administrative costs of introducing new rules for defence and sensitive security procurement is a difficult exercise, particularly given the difficulties in defining exactly which firms make up the market. However, Rambøll's study indicates that the expected impacts of the proposed new Directive on administrative costs would be quite low both for companies and awarding authorities[63].

According to this study, "the majority [of companies] does not expect any impact, but a relatively large part expects positive impacts of a Directive and very few fear negative impacts."[64] This expectation does not come as a surprise: at present, companies operating in the market for defence and sensitive security equipment have to deal with 27 different sets of rules. Becoming familiar with the rules laid down in the new Directive might mean that these firms incur some costs in the short term. In the mid- to long-term, however, the coordination of award procedures should simplify their administrative procedures and thus lower their costs. Unfortunately, it has not been possible to quantify these costs as many of the companies "do not calculate or estimate their tender costs".[65] At the same time, greater transparency in general and centralised publication, underpinned by the CPV, should facilitate access to contract opportunities. This should lower companies' overhead (bid) costs, which would be particularly beneficial for SMEs who have limited resources in this area.

In relation to awarding authorities, the study concluded that the application of more transparent rules might result in a slight increase of administrative costs in the short run, though these would probably decrease again after an adaptation phase following the introduction of the new rules. The study found that "the majority of respondents assesses that a new Directive could be implemented without any significant additional current costs" but that "the other part believes that the costs would increase 10-50% p.a."[66] Further analysis shows that less than 25% of respondents were expecting additional administrative current costs, but as it was not possible to obtain reliable estimates of the existing current costs, it would be difficult to quantify the impact of the proposed changes. Although estimates of one-off costs varied between €0 and over €1 million, the net impact on the administrative costs of awarding authorities due to the implementation of a new Directive should be largely offset over time by cost-savings achieved from the procurements themselves.

6.2.4.3. Economic impacts

The Yellow Window market study confirms that it is very difficult to assess the economic impacts over time of any legislative measure in these areas, especially in a quantitative manner. This is due to several reasons:

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63 See Annex n°17: Assessment of the impact on administrative costs of a defence-specific Directive.

64 Final Report of the Economic Study on Defence Public Procurement, Rambøll Management, p. 38.

65 Ibidem, p. 43.

66 Ibidem, p. 41.

1. The development of defence and security markets in general is difficult to forecast, since the demand for these products depends on political and strategic factors, which are not always foreseeable. A major international crisis, for example, could boost defence budgets, just as a major terrorist attack on EU territory would certainly lead to further demand for sensitive security equipment.

2. Given the sensitivity of these markets, there is generally little information available on future equipment planning. Consequently, the evolution of the demand – in terms of types and numbers of equipment to be procured – is difficult to forecast;

3. Given the long life cycles of many defence products, these markets develop in long-term waves. Predicting when a wave of renewal will start is very difficult, because customers adapt their procurement policy to budget constraints: more often than not, envisaged new procurements are postponed and / or stretched over time, replaced by upgrades of existing equipment, etc.

In other words, defence and security markets are driven by a great variety of factors, which makes it by definition almost impossible to measure the economic impact of one specific legislative measure in one particular area.

However, given the specificities of these markets, one can assume that the new instrument will, at least at the beginning, impact mainly on those market segments which are at the lower end of the technology spectrum. The more complex defence and security equipment is, the more important it becomes strategically, and the more a buying Member State may be inclined to consider it necessary for its essential security interests not to open up procurement to competition. An indicator for identifying these market segments are probably the research and development costs related to the procurement project (the higher the R&D costs, the more complex and strategically important the equipment.)

On the other hand, only a few big arms producing countries have the industrial capabilities on their territory to develop and produce such equipment. The others ***have*** to buy it from abroad, and even today, they generally do so in competition. In these cases, there are little reasons for not applying the rules of the future directive.

The economic impact may well be particularly high in the market for sensitive non-military equipment. Since the latter are often applications from defence products, they involve lower R&D costs and may be considered as less sensitive than their defence "counterparts". Moreover, they may have in many cases "security of information" as their main, if not only security-relevant feature. For all these reasons, contracting authorities may find it at least initially easier to apply the new rules to security than to defence procurement.

To sum up, one can assume that the new rules will be applied in particular at the lower end of the technology spectrum, where strategic interests are less important and numerous producers exist in many Member States. With regard to the high-end of the technology spectrum, the directive will probably be used in non-producing countries rather than in producing countries, since the latter may wish in certain cases not to use competition in order to maintain industrial capacities they consider as essential for their security interests.

- ***Competitiveness***

The Yellow Window market study illustrates in fact that a considerable amount of defence contracts are already opened to some degree of competition.[67] According to Member States responding to the Yellow Window questionnaire on current procurement practices, about

[67] See Annex n°14: Assessment of Member States' procurement practices.

three quarters of all defence product types are already "normally" open to international competition, but only one quarter is actually published in the OJEU (and thus awarded according to EC rules). In these cases, the problem is often the lack of transparency and fairness vis-à-vis suppliers from other Member States, which then results in a lack of openness and widespread preference for national suppliers.

Here, new Community rules can certainly help to improve the situation. The expected improvements to the transparency of the defence market discussed above should generate positive impacts on the industry and its competitiveness. This is the case at least for all those defence and sensitive security supplies, works and services which are already today procured in competition, but on the basis of national procedures. If competition already takes place, the only reason not to apply Community rules to these procurements is in fact that the former are not-suited. Once this problem is solved, exemption for these cases is no longer justified.

The Yellow Window market study bears witness to the difficulty of assessing the impact on competitiveness in a quantitative manner.[68] The study was however able to provide some qualitative feedback. The majority of companies welcomed the initiative and expected "positive impacts" on sales of their specific products in 14 of the 20 market segments which were analysed. Expectations vary, of course, from sector to sector and company to company. However, one producer of hand guns, for example, expected its sales to increase by 50% and its production costs to decrease by 20% within five years after the adoption of Community rules applicable to his products.[69]Other producers are less optimistic, but very few producers expected new Community rules to have a negative impact on their business.

If sales opportunities increase and competition improves, businesses active in these areas should, over time, be better placed to compete not only within the EU, but also on the global stage. Overall, it is clear that if these markets do indeed become more transparent and competitive, European defence and security industries should be well placed to contribute to the Lisbon objective of creating “a competitive, dynamic, knowledge-based economy”.

- ***Cross Border trade***

According to the annual report of the EU Code of Conduct on Arms Exports, Member States procured in 2005 only 13% of their military equipment from other Member States. From the Ramboll Study, it seems that the companies in the sample made around 25% of their turnover from sales to other EU Member States. The majority of their turnover is for sales in the home markets (56%) with the remaining 19% representing sales outside the EU. These proportions did not vary significantly when considering SMEs vs larger firms.[70]

As a general rule, the Yellow Window study found that suppliers felt that the greater opening up of markets should enhance companies’ chances to win cross-border contracts, thereby allowing the most competitive European companies to realize economies of scale and develop their activities. This will reduce unit costs, thereby making their products more competitive on the global market. On the other hand, competition between companies will become fiercer as they lose their "reserved" home market. The least competitive ones will probably suffer from the opening up of “their” market to foreign competitors. Consequently, those companies who pursue an offensive strategy – aiming at accessing other markets – were more positive vis-à-

68 See Annex n°18: Assessment of the economic impact of a defense-specific Directive.

69 Yellow Window market study, page 32.

70 Final Report of the Economic Study on Defence Public Procurement, Rambøll Management, p. 16.

vis a possible EC procurement Directive than those who are defensive and depend solely on their national home market.[71]

Hence it would appear that many firms operating in this field recognise the potential opportunities of cross border trade. Whilst some of them are already operating across national borders, others have been put off – possibly due to perceived barriers resulting from different legal regimes and a lack of knowledge about how the different rules work.[72] The improved transparency and clarity which should result from the introduction of the new rules should address this problem and lead to more cross border bidding by suppliers, in particular SMEs.

- ***Price/Value For Money***

In general, the implementation of the principles of the Internal Market, allowing open, fair and transparent competition, can be expected to allow better value for money. This has been the case in civil markets, and there is no reason why this should not be the case in defence and sensitive security markets (although the effects may be smaller, because of the inherent tension between security interests and Internal Market principles). The use of Community rules should therefore allow Member States to make better use of their limited resources and benefit from higher quality equipment. Taxpayers' money, ultimately, will be spent more efficiently, and citizens will be better protected.

However, the problem is still to quantify this impact. Here, a look at the publication rate can give at least some indication: in 2002, for example, publication rates for defence in the OJEU were about 11%, as compared to about 25% for central administrations except defence administrations. A 1% increase in this publication rate would mean that around €750 million more of defence procurement was being advertised to suppliers. Although we have not been able to calculate a publication rate for security procurement, in a total market worth around €57 bn, every 1% published in the OJEU would equate to €570 million of contracts being offered to a wider audience. If the new rules allowed reaching the same publication rate as for "civil" public procurement, the total value of defence supplies, works and services procured according to EC rules would increase by more than €10 bn (from €8,2 to €19 bn).[73] Even if we assume a more conservative increase in the defence publication rate, halving the gap between the current publication rates of defence and civil procurement would still mean that over €5 bn more of defence related procurement contracts were being published according to EC rules. Again, what this would mean in actual cost savings is difficult to predict, but if price savings of 5% could be achieved on this amount, around €250 million would be returned to the public purse for use elsewhere.

6.2.4.4. Social and Environmental Impacts

- ***Employment***

The main potential social impact of the proposed new Directive would be on employment. Competitive companies should be able to take advantage of the opportunities resulting from greater transparency and more cross border procurement and could find themselves in a position where they create more jobs, especially high-skilled ones. Others which were not able to do this, or who found themselves loosing contracts, could have to reduce their workforce. In other words, possible job losses may be expected in non-competitive sectors and companies, but would then be compensated by the creation of new jobs in competitive companies. Due to the complexity of the market, and the lack of knowledge of the distribution

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71 Yellow Window market study, page 20.

72 See Annex n°16: Assessment of the barriers to cross-border procurement in the EU

73 See Annex n°19: Simulation of the impact on the value of contracts awarded with EC rules

of firms operating in this area, it is not possible to assess the possible impacts on employment due to this initiative although some changes are likely. However, it should be stressed that employment in the defence sector has already decreased considerably, even in the absence of open and fair competition, as a result of the significant decrease in defence expenditure following the end of the Cold War[74]. The main factor affecting employment in the defence sector is thus more the size of demand than the degree of competition and open markets.

- ***Environment***

Commission services (DG ENV) are currently drafting a Communication which seeks to increase the amount and quality of Green public procurement (GPP) in the EU, in view of improving the environmental performance of products and stimulating eco-innovation. Increased competitiveness in defence markets, which account for a considerable part of the overall public procurement budget, would seriously increase the potential for applying GPP also in these markets.

6.2.4.5. Consistency/coherence with other measures

The impacts of the proposed new procurement rules depend on their ability to address the problems as presented above. However, this effectiveness does not only depend on the procurement rules themselves, but on related issues which fall outside the scope of procurement law. This is the case in particular for security of supply, security of information and standards. Fortunately, several initiatives are on their way to improve the current state of affairs in these areas: hand in hand with the proposal for a procurement directive, the Commission is preparing a proposal for a Community-wide transfer regime, which will simplify export licensing procedures among Member States. This will greatly improve security of supply in the EU and hence reduce the discriminatory potential of the security of supply provisions included in the new procurement rules. The same is true for security of information, where the Commission is considering an initiative for a Community-wide regime. Last but not least, the ongoing work on the Defence Standardisation Handbook, which is conducted by EDA and the Commission, will harmonise defence specific standards and hence reduce again the risk of abusing technical specificities in a discriminatory way. All this confirms that procurement rules are one element of a much broader picture, which makes it difficult to assess their impact in isolation.

6.2.4.6. International impacts

For many defence (and certain sensitive non-military security) products and services, competition takes place at a global rather than a European scale. This is the case in particular for complex systems at the upper end of the technology spectrum, for which European suppliers compete in particular with their US counterparts. This competition takes place in third countries, but also in non-producing EU Member States (who often procure their equipment from US suppliers). Whereas many defence markets in Europe are open to US suppliers, the US market remains hardly accessible for European suppliers.

However, this dimension has not been covered in the present study, since the introduction of specific defence and security rules into EC procurement law would not change the situation for arms trade with third countries. The latter would in any case remain governed by WTO rules, and more specifically the Government Procurement Agreement (GPA).

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[74] See Burkard Schmitt, "From cooperation to integration: defence and aerospace industries in Europe", *Chaillot Paper* 40, Institute for Security Studies, Western European Union, Paris, 2000

Article XXIII paragraph 1 of the GPA states that "*nothing shall be construed to prevent any Party from taking any action or not disclosing any information which it considers necessary for the protection of its essential security interests related to the procurement of arms, ammunition or war material or to procurement indispensable for national security or for national defence purposes*". This provision is broader than Article 296 TEC and covers explicitly defence and security. This means that Member States can decide to apply EC rules and at the same time refer to Article XXXIII in order not to apply GPA rules. This is the case for sensitive non-military security and defence procurement. As to the latter, the GPA applies in any case only to those supplies and equipment which is listed in Annex 1 Part 3 in Appendix 1 to the GPA. This list covers only non-warlike material, which comes under the current PP Directive (and to which the new EC rules would thus not apply).

In other words, new EC procurement rules for defence and sensitive procurement would not impact on Member States' decision to open or not competition to non-EU suppliers. Awarding authorities would still be free to invite only EU companies or to include non-EU companies.

7. MONITORING AND EVALUATION ARRANGEMENTS

7.1. Monitoring

Even before the possible adoption of the Directive, the Commission will follow the assessment and consultation work presently carried out at economic, legal and political level.

At the economic level

The same ***indicators*** as used in the present Impact Assessment will continue to be calculated year by year:

– ***The "Publication rate"*** will be calculated as a ratio between the value of publication at EU level and EU-wide defence expenditure.

  The publication of defence contract notices will be measured (number, estimated value) through the MAPP database, i.e. extracted from the TED website of the Official Journal. These notices concern all contracts awarded by authorities in the field of defence, whether they concern non-war material or military equipment. The implementation of the new CPV codes, including several new defence-specific sections, will make the extraction of specifically military contract notices easier.

  Defence (total, procurement and equipment) expenditures will be spotted, with two possible sources:

  – - the "Government expenditure by function" series as published annually by EUROSTAT (both for defence and security),

  – - the "Indicators of Strategic Targets" as published by EDA, based on an annual survey to the participating Member States.

– ***The "Penetration rate"*** will be calculated as a ratio between the value of intra-Community transfers and EU-wide military expenditure.

  Defence intra-community transfers will be spotted, through the annual report on the implementation of the EU Code of Conduct on arms exports, published by the Council (information on the number of granted licences, value of granted licences and value of transfers).

In every case, the statistics published by the various public bodies of the European Union (EUROSTAT, Council, EDA) will be privileged in the collection of figures.

Once the Directive is adopted, the Commission will evaluate its application and its economic impact on a regular basis.

Besides, the Commission will continue its dialogue with the Aeronautic Space and Defence industries association of Europe (ASD), the organization representative for the defence sector, as recognized by the Commission in its CONNECS database.

At the legal level

The Commission services responsible for the file will pay a special attention to the case law relevant to defence procurement.

At the political level

The Commission will continue its political dialogue with the Member States, both in multilateral precincts such as the ACPP, and through bilateral talks to be carried out in European national capitals and in Brussels.

The Commission will continue to participate to the various fora of EDA, following especially the implementation of the Code of Conduct in the light of the Interpretative Communication on the application of Article 296 in the field of defence procurement.

7.2. In the mid term: interim evaluation

Following the legislative process for the adoption of the Directive, and its implementation by the Member States, a first assessment of the administrative impact first on the Member States and then on the companies should be foreseen in 5 years.

An ad-hoc study would be commissioned to a specialized consultancy, with a consultation (through questionnaires) of both Member States and companies. Those stakeholders should be informed of the "Better regulation" rules of the Commission, especially the need to evaluate the impact of the Directive, as soon as it is adopted. The "Administrative cost model" will be presented to them, in order to give them enough time to implement statistical tools to measure this impact, especially a set of indicators to be defined in cooperation with the Commission services responsible for this file.

7.3. In the long term: comprehensive evaluation

Given the life cycle of defence equipment (and their related services, especially maintenance), an evaluation of the economic impact should be contemplated in the long term (no sooner than 10 years).

Again an ad-hoc study would be commissioned to a specialized consultancy, based on the techniques of market studies. The study will focus on the impact of the Directive on prices and quantities, but also on intra-Community sales, and on the Defence Technological and Industrial Base (DTIB) especially the restructuring of the sector.

8. CONCLUSION

It is generally recognised that Member States use Article 296 TEC extensively to exempt the procurement of arms, munitions and war material from EC rules. The same problem exists, albeit less prominently, for the exemption of sensitive non-military equipment via Article 296 (1)(a) TEC or Article 14 of the PP-Directive. This practice stands in contrast to the case law of the Court of Justice and contributes to the fragmentation of defence markets in the EU.

Since the publication of the Green Paper on defence procurement in September 2003, the Commission consulted extensively all stakeholders via the ACPP and the EDA, bilateral meetings, questionnaires and public debates. Throughout this consultation process, all

stakeholders pointed out one salient root cause for the widespread use of the exemption, i.e. the difficulty to use current EC procurement rules for defence and sensitive non-military security equipment. This judgement may be partly exaggerated. Awarding authorities in these fields may sometimes not be familiar with the details of community law and therefore ignore the flexibility the current rules already offer. However, it seems plausible that the existing rules are ill-suited to the procurement of most defence and sensitive non-military security equipment, since it does not take into account some of the main features of such contracts. The higher the level of complexity, the less suited current EC rules appear.

Reducing the use of the exemption to exceptional cases therefore necessitates a legislative measure introducing into EC procurement law rules adapted to the specificities of defence and sensitive security equipment. The present report has assessed various options for the nature of the instrument, the field of application and the content of these rules. Its main conclusions are:

- A stand-alone directive seems the best-suited instrument;
- The field of application should be defined via a general definition;
- The Directive should apply to arms, munitions and war material, as well as to certain sensitive security equipment, subject to Articles 30 and 296 TEC;
- Special provisions are needed for security of information and security of supply,
- The negotiated procedure with prior publication should be the standard procedure.

The challenge for the new rules is to find the right balance between the principles of the Internal Market and Member States security interests. This may in some cases lead to difficult compromises. In general, however, this initiative has the potential to make a difference. Bringing arms, munitions and war material, as well as sensitive security equipment into the Internal Market, is by itself already a strong political signal for the EU's readiness to build an EDEM. Coordinating national procedures, the Directive will reduce the regulatory patchwork. It will become easier for Member States to use EC rules, but also more difficult for them to justify possible exemptions. This, in turn, will reduce the number of exemptions and hence improve transparency, non-discrimination and openness of defence markets.

Adoption of a specific Procurement Directive on defence and sensitive security contracts is the logical follow up to the Interpretative Communication of December 2006, which explains the conditions for the use of Article 296 TEC in the field of defence procurement. At the same time, it is a natural complement to the Code of Conduct of the EDA, which aims at fostering transparency and openness for those defence contracts which fulfil the criteria for the application of Article 296 TEC.

To make the new EC rules as effective as possible, the Commission should envisage a series of accompanying measures: In this context, special training courses for Commission staff and the allocation of additional resources for an active monitoring defence and security markets seem particularly important. On top of that, the Commission should pursue ongoing initiatives in related areas, namely security of supply and standardisation, but also envisage new actions, particular in the field of security of information and offsets.

All this shows that the preparation of EC procurement rules for defence and sensitive non-military equipment is only one, but an important step towards the establishment of a European Defence (and Security) Equipment Market.

COMMISSION STAFF WORKING DOCUMENT

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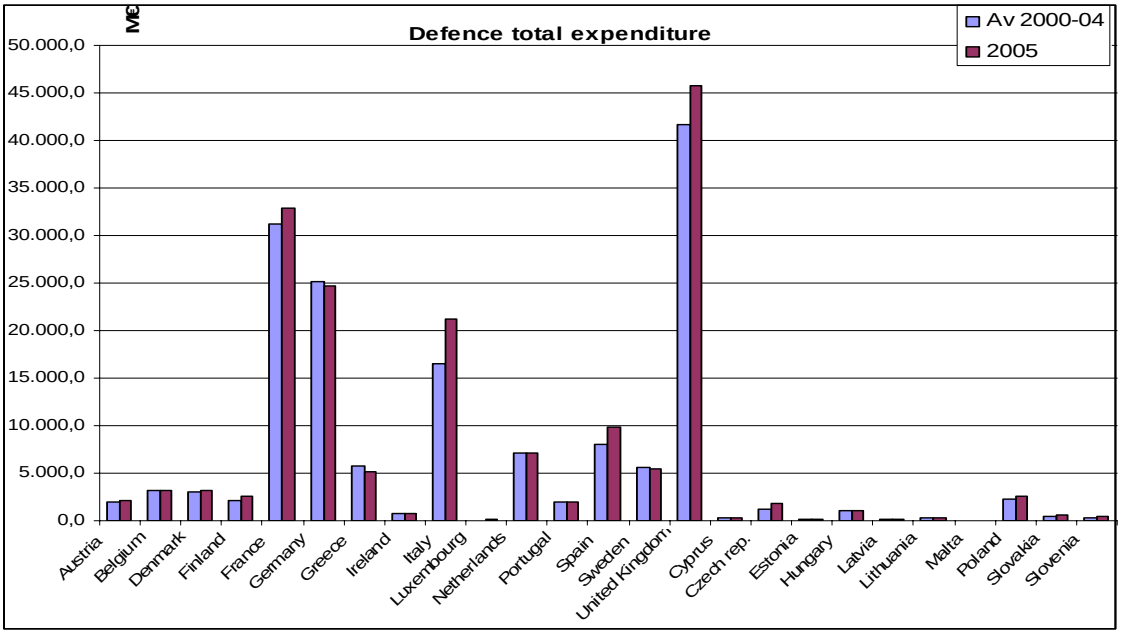
Defence total and procurement expenditure in M€ (2000-05)

8.1. Defence total expenditure in M€ (2000-05)

	2000	2001	2002	2003	2004	Av 2000-04	2005
Austria	1.962,3	1.920,4	1.973,0	2.027,8	2.077,4	1.992,2	2.167,5
Belgium	3.028,8	3.194,3	3.226,2	3.221,3	3.221,3	3.178,4	*3.221,3* e
Denmark	2.746,5	2.895,0	2.969,0	3.031,6	3.183,6	2.965,1	3.222,7
Finland	2.017,0	1.975,0	2.041,0	2.201,0	2.424,0	2.131,6	2.588,0
France	29.694,0	30.811,0	32.179,0	31.011,0	32.260,0	31.191,0	32.897,0
Germany	25.080,0	25.030,0	25.460,0	25.180,0	24.690,0	25.088,0	24.700,0
Greece	6.234,4	5.638,0	6.272,0	5.491,0	5.404,0	5.807,9	5.129,0
Ireland	698,9	799,0	756,5	754,1	825,9	766,9	*825,9* e
Italy	12.929,0	14.174,0	16.228,0	19.477,0	19.998,0	16.561,2	21.251,0
Luxembourg	56,6	65,8	68,2	73,3	75,6	67,9	77,0
Netherlands	6.747,0	7.043,0	7.107,0	7.344,0	7.178,0	7.083,8	7.100,0
Portugal	1.947,9	1.854,5	1.865,8	1.856,6	1.975,5	1.900,1	2.010,9
Spain	7.028,0	7.369,0	8.112,0	8.311,0	9.228,0	8.009,6	9.876,0
Sweden	6.211,5	5.502,7	5.519,2	5.611,6	5.466,6	5.662,3	*5.466,6* e
United Kingdom	41.962,0	39.735,0	41.531,1	41.736,2	43.703,8	41.733,6	45.713,7
EU-15	**148.343,9**	**148.006,7**	**155.308,0**	**157.327,5**	**161.711,7**	**154.139,6**	**166.246,6**
Cyprus	208,6	344,2	428,1	377,7	272,2	326,2	281,4
Czech rep.	1.054,2	1.101,3	1.266,1	1.566,1	1.219,4	1.241,4	1.812,8
Estonia	:	94,2	107,9	148,1	144,4	123,7	163,6
Hungary	:	:	:	945,0	1.078,0	1.011,5	*1.078,0* e
Latvia	81,6	91,9	116,6	120,7	137,7	109,7	154,5
Lithuania	:	:	233,9	242,9	251,7	242,8	298,9
Malta	30,5	33,0	33,1	38,5	44,8	36,0	44,9
Poland	:	:	2.675,9	2.254,0	2.044,8	2.324,9	2.585,1
Slovakia	:	:	:	516,4	339,3	427,9	623,4
Slovenia	227,7	268,8	287,5	307,5	347,2	287,7	380,7
EU-10				**6.516,9**	**5.879,5**	**6.131,7**	**7.423,3**
EU-25				**163.844,4**	**167.591,2**	**160.271,3**	**173.669,9**

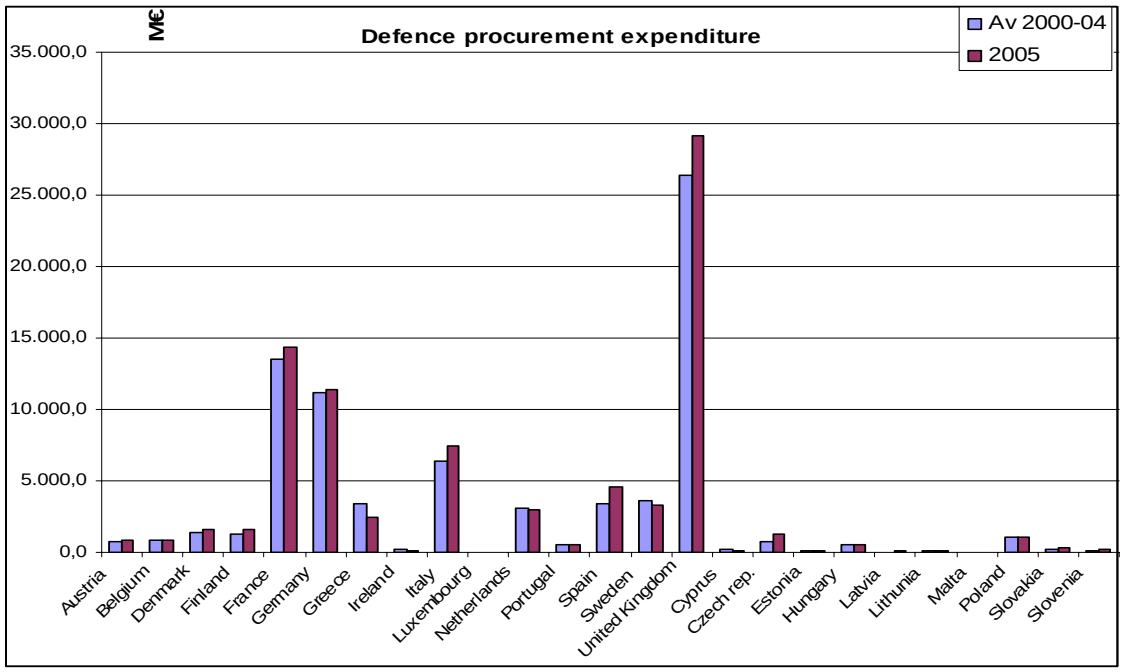
Source: EUROSTAT (series: General government expenditure function, Classification of the functions of government: 2 Defence, National accounts indicator: TE Total expenditure)



8.2. Defence procurement expenditure in M€ (2000-05)

	2000	2001	2002	2003	2004	Av 2000-04	2005
Austria	710,8	643,1	650,6	721,6	772,4	699,7	799,3
Belgium	931,7	952,8	899,4	799,2	*799,2*	876,5	*799,2* e
Denmark	1.281,5	1.457,3	1.403,4	1.423,9	1.553,7	1.424,0	1.619,5
Finland	1.148,0	1.066,0	1.163,0	1.285,0	1.476,0	1.227,6	1.620,0
France	12.397,0	13.467,0	14.099,0	13.182,0	14.401,0	13.509,2	14.358,0
Germany	11.050,0	11.160,0	11.450,0	11.250,0	11.110,0	11.204,0	11.380,0
Greece	4.308,1	3.204,0	3.727,0	3.115,0	2.768,0	3.424,4	2.493,0
Ireland	158,2	229,0	170,8	152,9	158,5	173,9	*158,5* e
Italy	5.583,0	5.874,0	6.082,0	7.583,0	6.817,0	6.387,8	7.477,0
Luxembourg	15,1	14,1	17,9	19,1	17,7	16,8	16,1
Netherlands	3.167,0	3.136,0	3.027,0	3.193,0	3.095,0	3.123,6	2.996,0
Portugal	733,7	557,0	419,9	464,9	540,5	543,2	502,9
Spain	2.633,0	2.887,0	3.419,0	3.700,0	4.279,0	3.383,6	4.549,0
Sweden	4.079,6	3.645,1	3.545,2	3.457,6	3.348,1	3.615,1	*3.348,1* e
United Kingdom	27.220,0	24.487,4	25.914,8	26.405,0	27.793,0	26.364,0	29.099,1
EU-15	**75.416,7**	**72.779,8**	**75.989,0**	**76.752,2**	**78.929,1**	**75.973,4**	**81.215,7**
Cyprus	104,6	229,4	301,6	218,3	117,0	194,2	120,5
Czech rep.	607,6	633,7	714,6	983,8	706,0	729,1	1.228,9
Estonia		68,6	77,8	111,0	99,9	89,3	110,0
Hungary				474,4	486,5	480,5	*486,5* e
Latvia	26,3	34,8	46,0	50,1	64,9	44,4	65,3
Lithuania			97,8	98,4	94,6	96,9	123,3
Malta	4,4	3,8	4,2	9,4	15,3	7,4	15,1
Poland			1.310,5	1.042,4	905,5	1.086,1	1.054,3
Slovakia				289,6	205,4	247,5	357,2
Slovenia	100,1	126,4	127,7	126,5	146,6	125,5	161,2
EU-10				**3.403,9**	**2.841,7**	**3.101,0**	**3.722,3**
EU-25				**80.156,1**	**81.770,8**	**79.074,3**	**84.938,0**

Source: EUROSTAT (series: General government expenditure function, Classification of the functions of government: 2 Defence, National accounts indicators: P2 Intermediate consumption + P5 Gross capital formation)



9. DEFENCE PROCUREMENT AND EQUIPMENT EXPENDITURE IN VALUE (2005)

The European Defence Agency, created by the Council in 2004, performs among other tasks a financial monitoring of defence expenditure, based on the calculation of "Indicators of Strategic Targets". These indicators are calculated annually since 2005, on the basis of figures collected among the participating Member States through a questionnaire.

9.1. Defence procurement expenditure in value (2005)

	2005 (b€)
Research & Development	9,0
Equipment	26,4
Infrastructures	5,4
Maintenance & Operations	40,2
Defence procurement	**81,0**

Interpretation: Figures for R&D also include grants and loans

Source : European Defence Agency (24 participating Member States, excluding Denmark)

9.2. Defence equipment expenditure in value (2005)

	2005 (M€)	
Austria	184	0,7%
Belgium	223	0,8%
Finland	539	2,0%
France	5.618	21,3%
Germany	3.445	13,1%
Greece	1.400	5,3%
Ireland	94	0,4%
Italy	2.119	8,0%
Luxembourg	24	0,1%
Netherlands	1.215	4,6%
Portugal	223	0,8%
Spain	2.166	8,2%
Sweden	1.217	4,6%
United Kingdom	6.699	25,4%
EU-14	***25.166***	***95,4%***
Cyprus	48	0,2%
Czech republic	213	0,8%
Estonia	20	0,1%
Hungary	106	0,4%
Latvia	14	0,1%
Lithuania	37	0,1%
Malta	9	0,0%
Poland	633	2,4%
Slovakia	95	0,4%
Slovenia	39	0,1%
EU-10	***1.214***	***4,6%***
EU-24	**26.380**	**100,0%**

Source: European Defence Agency (24 participating Member States, excluding Denmark)

10. DEFENCE EQUIPMENT AND R&D EXPENDITURE IN COOPERATION (2005)

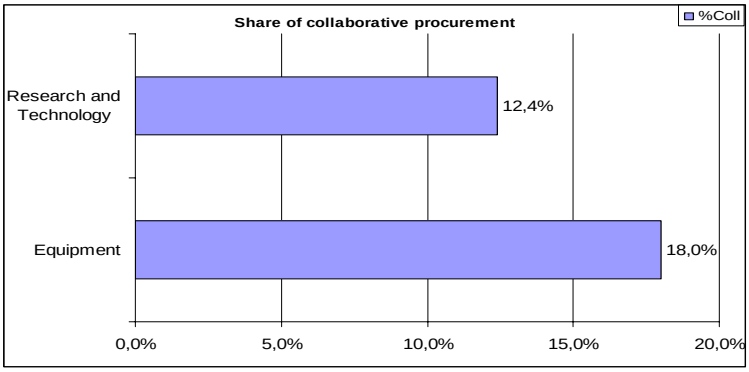
	Coll	% Coll	EU Coll	% EU
Research & Technology	273	12,4%	206	75,4%
Equipment	4.746	18,0%	4.222	90,0%

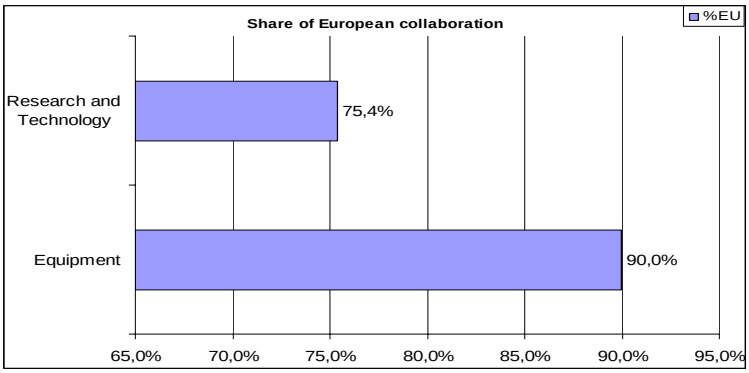
Methodology: the survey is focused on Research & Technology and Equipment

%Coll: Collaborative procurement out of total procurement

%EU: European collaboration out of total collaboration

Source: European Defence Agency (a limited number of Member States have provided data)





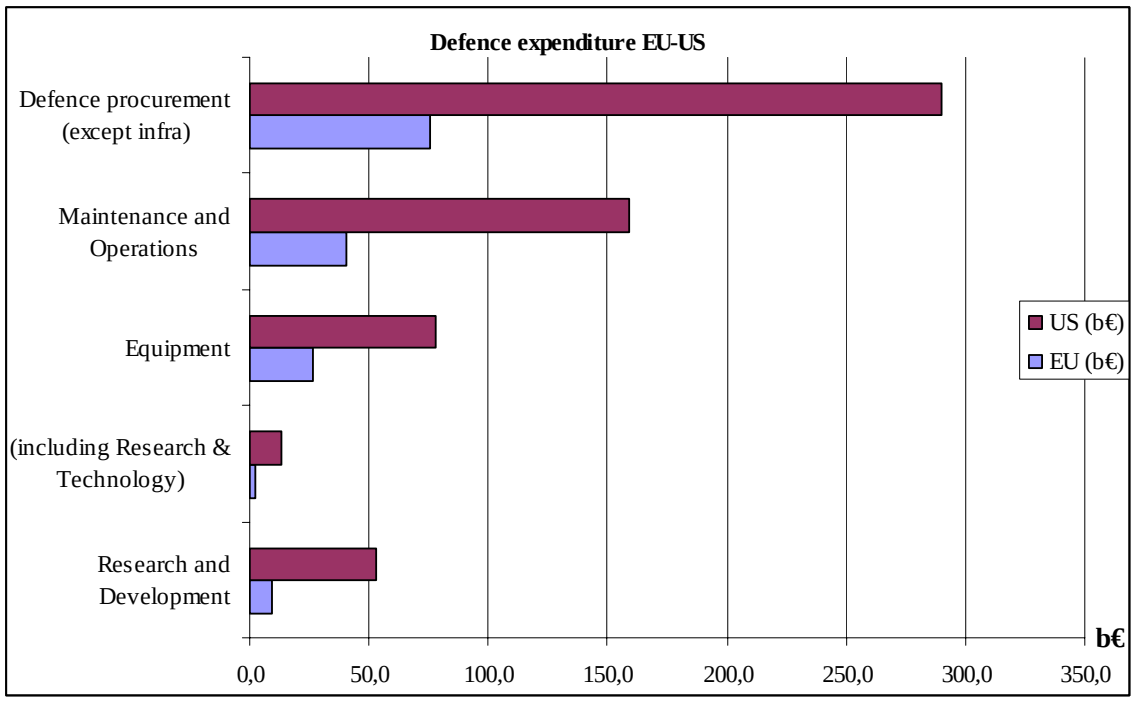
11. DEFENCE PROCUREMENT EXPENDITURE EU – US (2005)

	EU (b€)	US (b€)	US/EU
Research and Development	9,0	53,2	5,9
(including Research & Technology)	2,2	13,4	6,1
Equipment	26,4	77,6	2,9
Maintenance and Operations	40,2	159,0	4,0
Defence procurement (except infra)	**75,6**	**289,8**	**3,8**

Interpretation: €/$ exchange rate is based on average for 2005: 1.2441

Data for infrastructures are not available for the US

Source: European Defence Agency (24 participating Member States, excluding Denmark)



DEFENCE PRODUCT TRANSFERS ON THE TRANSATLANTIC MARKET IN $ (2001)

From Europe to North America

	Canada	United States
Belgium	26.345.414	28.689.038
Finland	17.718	1.573.065
France	13.166.904	74.859.945
Germany	6.706.045	30.082.264
Italy	1.062.399	39.376.590
Portugal	0	1.493.200
Spain	44.743	23.400.447
Sweden	8.461.531	41.939.762
United Kingdon	174.268.912	503.683.522
EU	**230.073.665**	**745.097.833**

Source: Stockholm International Peace Research Institute

From North America to Europe

	Canada	United States
Austria	131.420	5.071.000
Belgium	5.132.747	173.372.000
Denmark	45.804.409	112.818.000
Finland	466.379	149.256.000
France	12.912.539	149.384.000
Germany	8.663.714	338.517.000
Greece	3.548.913	452.086.000
Ireland	433.188	262.000
Italy	14.216.870	107.691.000
Luxembourg	3.548.826	1.152.000
Netherlands	39.117.189	418.017.000
Portugal	18.835	43.635.000
Spain	1.637.264	272.970.000
Sweden	1.681.628	8.370.000
United Kingdon	98.233.378	369.671.000
EU-15	235.547.300	2.602.272.000
Cyprus	0	0
Czech Rep.	132.153	37.652.000
Estonia	18.309	2.516.000
Hungary	6.808	7.085.000
Latvia	162.378	3.221.000
Lithuania	0	1.510.000
Malta	0	0
Poland	3.551	9.654.000
Slovenia	0	1.488.000
EU-10	323.199	63.126.000
EU-25	**235.870.499**	**2.665.398.000**

Source: Stockholm International Peace Research Institute

Trade balance rate on the transatlantic market

2001	Canada	USA
rate	**1,0**	**3,6**

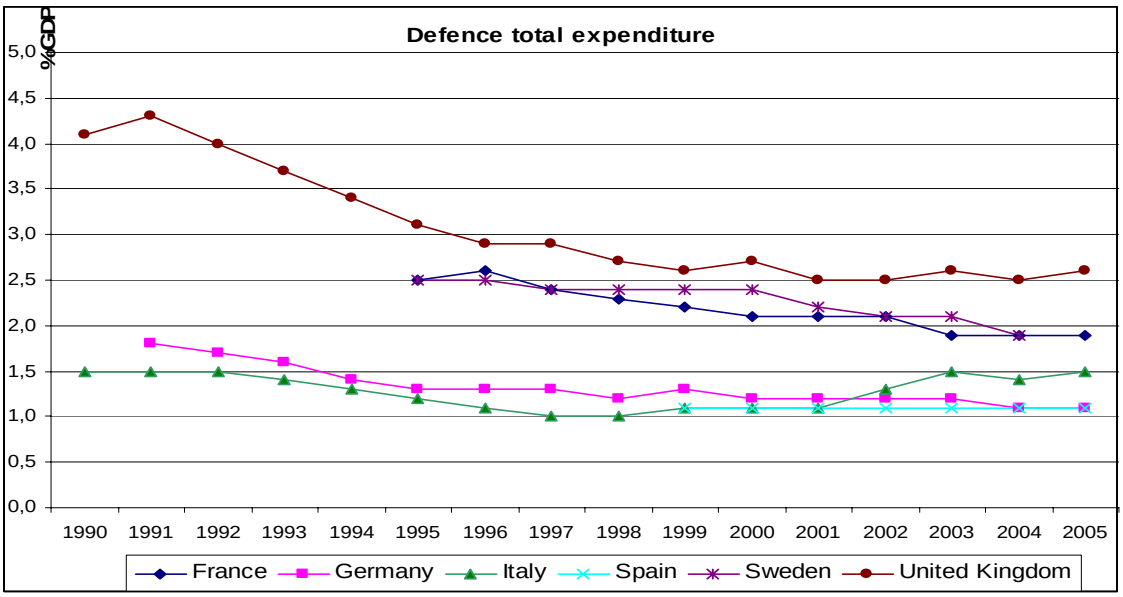
Defence total and procurement expenditure in % of GDP (1990-2005)

11.1. Defence total expenditure in % of GDP (1990-2005)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Austria						1,0	1,0	1,0	1,0	0,9	0,9	0,9	0,9	0,9	0,9	0,9
Belgium	2,0	2,0	1,7	1,7	1,6	1,5	1,4	1,4	1,3	1,3	1,2	1,2	1,2	1,2		
Denmark	2,0	2,0	1,9	2,0	1,9	1,8	1,8	1,7	1,7	1,7	1,6	1,6	1,6	1,6	1,6	1,5
Finland	1,5	1,8	2,1	2,0	2,2	2,0	2,1	2,0	1,8	1,7	1,5	1,4	1,4	1,5	1,6	1,6
France						**2,5**	**2,6**	**2,4**	**2,3**	**2,2**	**2,1**	**2,1**	**2,1**	**1,9**	**1,9**	**1,9**
Germany		**1,8**	**1,7**	**1,6**	**1,4**	**1,3**	**1,3**	**1,3**	**1,2**	**1,3**	**1,2**	**1,2**	**1,2**	**1,2**	**1,1**	**1,1**
Greece	4,9	4,5	4,6	4,9	6,0	2,7	2,7	2,8	3,0	3,1	5,0	4,2	4,4	3,5	3,2	2,8
Ireland	1,4	1,4	1,4	1,3	1,2	1,0	0,9	0,9	0,8	0,7	0,7	0,7	0,6	0,5	0,6	
Italy	**1,5**	**1,5**	**1,5**	**1,4**	**1,3**	**1,2**	**1,1**	**1,0**	**1,0**	**1,1**	**1,1**	**1,1**	**1,3**	**1,5**	**1,4**	**1,5**
Luxembourg	0,9	0,9	0,7	0,7	0,6	0,6	0,6	0,6	0,5	0,3	0,3	0,3	0,3	0,3	0,3	0,3
Netherlands						1,9	1,9	1,7	1,6	1,6	1,6	1,6	1,5	1,5	1,5	1,4
Portugal	2,0	2,2	2,1	2,2	2,1	1,7	1,7	1,5	1,4	1,5	1,6	1,4	1,4	1,4	1,4	1,4
Spain										**1,1**	**1,1**	**1,1**	**1,1**	**1,1**	**1,1**	**1,1**
Sweden						**2,5**	**2,5**	**2,4**	**2,4**	**2,4**	**2,4**	**2,2**	**2,1**	**2,1**	**1,9**	
United Kingdo	**4,1**	**4,3**	**4,0**	**3,7**	**3,4**	**3,1**	**2,9**	**2,9**	**2,7**	**2,6**	**2,7**	**2,5**	**2,5**	**2,6**	**2,5**	**2,6**
EU-15										**1,7**	**1,7**	**1,6**	**1,7**	**1,7**		
Cyprus									2,0	3,2	2,1	3,2	3,8	3,2	2,1	2,1
Czech rep.						1,9	1,6	1,7	1,5	1,7	1,7	1,6	1,6	1,9	1,4	1,8
Estonia												1,4	1,4	1,7	1,5	1,5
Hungary														1,3	1,3	
Latvia											1,0	1,0	1,2	1,2	1,2	1,2
Lithuania													1,6	1,5	1,4	1,4
Malta									0,8	0,8	0,7	0,8	0,7	0,9	1,0	1,0
Poland													1,3	1,2	1,0	1,1
Slovakia														1,8	1,0	1,6
Slovenia											0,0	0,0	0,0	0,0	0,0	0,0
EU-25														**1,6**		

Bold characters: countries signatory of the so-called Letter-of-Intent (LoI) Framework Agreement

Source: EUROSTAT (series: General government expenditure function, Classification of the functions of government: 2 Defence, National accounts indicator: TE Total expenditure)

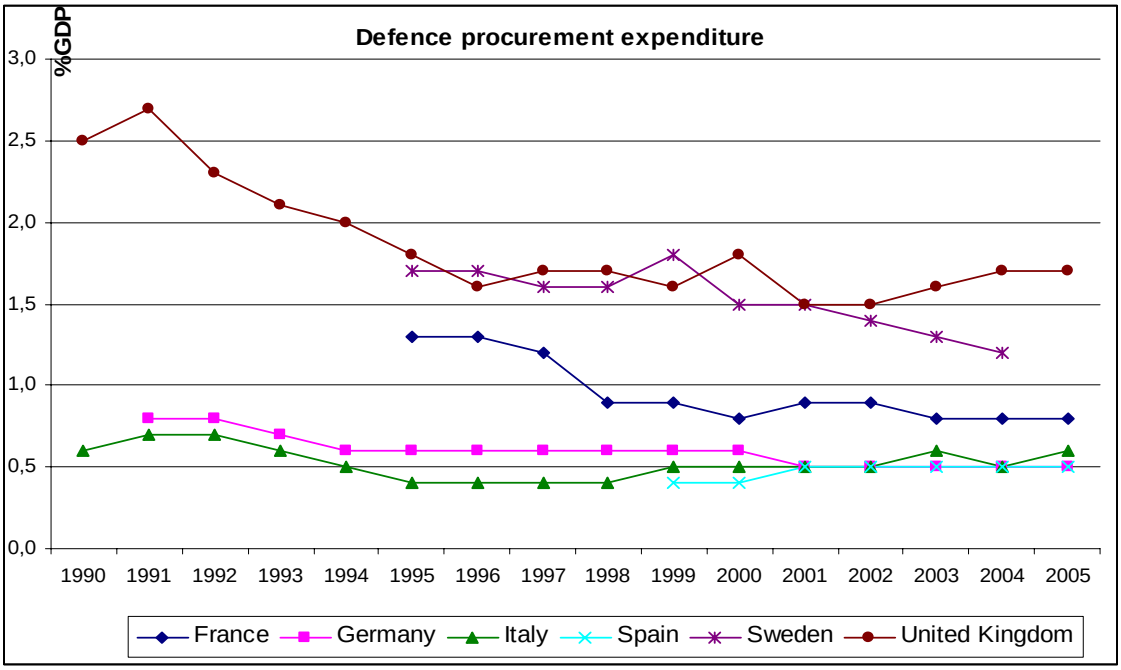


11.2. Defence procurement expenditure in % of GDP (1990-2005)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Austria						0,4	0,3	0,3	0,3	0,3	0,4	0,3	0,3	0,4	0,3	0,4
Belgium	0,6	0,7	0,6	0,5	0,5	0,3	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,3		
Denmark	0,9	0,9	0,9	0,9	0,9	0,8	0,8	0,8	0,8	0,8	0,8	0,8	0,8	0,7	0,8	0,8
Finland	0,9	0,9	1,2	1,2	1,4	1,2	1,3	1,3	1,2	1,0	0,9	0,7	0,8	0,8	1,0	1,0
France						**1,3**	**1,3**	**1,2**	**0,9**	**0,9**	**0,8**	**0,9**	**0,9**	**0,8**	**0,8**	**0,8**
Germany		**0,8**	**0,8**	**0,7**	**0,6**	**0,6**	**0,6**	**0,6**	**0,6**	**0,6**	**0,6**	**0,5**	**0,5**	**0,5**	**0,5**	**0,5**
Greece						0,9	1,2	1,2	1,4	1,6	3,4	2,4	2,6	2,0	1,6	1,4
Ireland	0,1	0,2	0,2	0,2	0,2	0,2	0,2	0,1	0,1	0,1	0,1	0,2	0,1	0,1	0,1	
Italy	**0,6**	**0,7**	**0,7**	**0,6**	**0,5**	**0,4**	**0,4**	**0,4**	**0,4**	**0,5**	**0,5**	**0,5**	**0,5**	**0,6**	**0,5**	**0,6**
Luxembourg	0,2	0,2	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Netherlands						0,7	0,9	0,8	0,7	0,8	0,7	0,7	0,6	0,7	0,6	0,6
Portugal						0,6	0,6	0,6	0,5	0,5	0,6	0,4	0,3	0,4	0,4	0,4
Spain										**0,4**	**0,4**	**0,5**	**0,5**	**0,5**	**0,5**	**0,5**
Sweden						**1,7**	**1,7**	**1,6**	**1,6**	**1,8**	**1,5**	**1,5**	**1,4**	**1,3**	**1,2**	
United Kingdom	**2,5**	**2,7**	**2,3**	**2,1**	**2,0**	**1,8**	**1,6**	**1,7**	**1,7**	**1,6**	**1,8**	**1,5**	**1,5**	**1,6**	**1,7**	**1,7**
EU-15										**0,8**	**0,9**	**0,8**	**0,8**	**0,8**		
Cyprus									0,8	1,9	1,0	2,1	2,7	1,8	0,9	0,9
Czech rep.						1,0	0,8	1,0	0,8	0,9	1,0	0,9	0,9	1,2	0,8	1,2
Estonia												1,0	1,0	1,3	1,0	1,0
Hungary														0,7	0,6	
Latvia											0,3	0,3	0,5	0,5	0,5	0,5
Lithuania													0,6	0,6	0,6	0,6
Malta									0,1	0,1	0,1	0,1	0,1	0,2	0,4	0,3
Poland													0,6	0,5	0,4	0,4
Slovakia														1,0	0,6	0,9
Slovenia											0,0	0,0	0,0	0,0	0,0	0,0
EU-25														**0,8**		

Bold characters: countries signatory of the so-called Letter-of-Intent (LoI) Framework Agreement

Source: EUROSTAT (series: General government expenditure function, Classification of the functions of government: 2 Defence, National accounts indicators: P2 Intermediate consumption + P5 Gross capital formation)



12. DEFENCE TOTAL EXPENDITURE AS A % OF PUBLIC EXPENDITURE (2000-05)

	2000	2001	2002	2003	2004	Av 2000-04	2005
Austria	1,8%	1,8%	1,8%	1,8%	1,8%	1,8%	1,8%
Belgium	2,5%	2,5%	2,4%	2,3%	2,3%	2,4%	2,3%
Denmark	2,9%	2,9%	2,9%	2,9%	2,9%	2,9%	2,9%
Finland	3,2%	3,0%	2,9%	3,0%	3,2%	3,0%	3,3%
France	4,0%	4,0%	3,9%	3,6%	3,7%	3,8%	3,6%
Germany	2,7%	2,5%	2,5%	2,4%	2,4%	2,5%	2,4%
Greece	9,7%	8,5%	8,9%	7,2%	6,4%	8,0%	6,1%
Ireland	2,1%	2,1%	1,7%	1,6%	1,6%	1,8%	1,6%
Italy	2,4%	2,4%	2,6%	3,0%	3,0%	2,7%	3,1%
Luxembourg	0,7%	0,8%	0,7%	0,7%	0,6%	0,7%	0,6%
Netherlands	3,7%	3,5%	3,3%	3,3%	3,2%	3,4%	3,1%
Portugal	3,7%	3,2%	3,1%	2,9%	2,9%	3,2%	2,9%
Spain	2,9%	2,8%	2,9%	2,8%	2,8%	2,8%	2,9%
Sweden	4,2%	3,9%	3,7%	3,6%	3,4%	3,7%	3,4%
United Kingdom	6,7%	6,1%	6,0%	6,0%	5,8%	6,1%	5,7%
eu15	***3,7%***	***3,5%***	***3,5%***	***3,5%***	***3,4%***	***3,5%***	***3,4%***
Cyprus	5,6%	8,4%	9,5%	7,1%	5,0%	7,1%	4,7%
Czech Rep.	4,1%	3,6%	3,4%	4,1%	3,1%	3,6%	4,1%
Estonia		3,9%	3,9%	4,9%	4,5%	4,3%	4,5%
Hungary				2,6%	2,7%	2,6%	2,7%
Latvia	2,6%	2,9%	3,3%	3,5%	3,4%	3,2%	3,3%
Lithuania			4,5%	4,4%	4,2%	4,4%	4,3%
Malta	1,8%	1,8%	1,7%	1,8%	2,2%	1,9%	2,1%
Poland			2,9%	2,6%	2,4%	2,6%	2,4%
Slovakia				4,5%	2,5%	3,4%	4,4%
Slovenia	2,3%	2,5%	2,5%	2,6%	2,8%	2,5%	2,9%
eu10				***3,2%***	***2,8%***	***3,0%***	***3,1%***
eu25				***3,4%***	***3,4%***	***3,5%***	***3,4%***

Source: EUROSTAT and calculations by the Commission

13. DEFENCE INDUSTRIES - KEY CHARACTERISTICS (2004-05)

Within the framework of the seven initiatives launched in the field of defence by the communication "European Defence Industrial and Market Issues" (2003), one of them so-called "Monitoring of defence-related industries" aims at mapping the defence industrial sector. Given the extent of that initiative that seeks exhaustiveness, the undertaken studies are still in progress.

Another possible source is the Aerospace and defence (ASD) industries association of Europe. This organization is representative of the defence sector in Europe, and as such registered in the "Consultation, European Commission and Civil Society" (CONECCS) database of the stakeholders of the Commission.

Turnover

b€	2004	2005
Civil aeronautics	46,6	56,0
Military aeronautics	25,7	25,6
Aeronautics (civil and military)	***72,3***	***81,6***
Space	***4,8***	***4,4***
Land defence	17,2	17,2
Naval defence	9,6	9,3
Land and naval defence	***26,8***	***26,5***
Aerospace and defence	**103,9**	**112,5**
(incl. Defence)	**52,5**	**52,1**

Source: Aerospace and defence (ASD) industries association of Europe

Exports

b€	2004	2005
Civil aerospace	32,9	36,7
Military aerospace	7,8	6,6
Aerospace (civil and military)	***40,7***	***43,3***
Land and naval defence	***10,2***	***10,5***
Aerospace and defence	**50,9**	**53,8**
(incl. Defence)	**18,0**	**17,1**

Source: Aerospace and defence (ASD) industries association of Europe

Interpretation: for 2005, Aerospace does not include space

R&D

b€	2004	2005
Civil aeronautics	5,7	5,6
Military aeronautics	4,7	4,5
Aeronautics (civil and military)	***10,4***	***10,1***
Space	***0,5***	***0,5***
Land and naval defence	***2,3***	***2,0***
Aerospace and defence	**13,2**	**12,6**
(incl. Defence)	**7,0**	**6,5**

Source: Aerospace and defence (ASD) industries association of Europe

Employment

Employment by sectors

b€	2004	2005
Civil aeronautics	270,9	294,8
Military aeronautics	149,8	135,0
Aeronautics (civil and military)	***420,7***	***429,8***
Space	***30,0***	***28,2***
Land defence	96,2	101,4
Naval defence	54,1	54,6
Land and naval defence	***150,3***	***156,0***
Aerospace and defence	**601,0**	**614,0**
(incl. Defence)	**300,1**	**291,0**

Source: Aerospace and defence (ASD) industries association of Europe

Employment by countries

	2005	
Austria	5,6	0,9%
Belgium	7,9	1,3%
Denmark	2,1	0,3%
Finland	3,8	0,6%
France	***164,1***	***26,7%***
Germany	***85,4***	***13,9%***
Greece	9,5	1,5%
Ireland	5,3	0,9%
Italy	***51,3***	***8,4%***
Luxembourg	0,6	0,1%
Netherlands	18,6	3,0%
Portugal	5,3	0,9%
Spain	***30,8***	***5,0%***
Sweden	***19,2***	***3,1%***
United Kingdom	***159,1***	***25,9%***
EU-15	**568,6**	**92,6%**
Including LoI-6	**509,9**	**83,0%**
Cyprus	n/a	n/a
Czech rep.	13,5	2,2%
Estonia	n/a	n/a
Hungary	n/a	n/a
Latvia	n/a	n/a
Lithuania	n/a	n/a
Malta	n/a	n/a
Poland	11,8	1,9%
Slovakia	n/a	n/a
Slovenia	n/a	n/a
NMS-10	**25,3**	**4,1%**
Norway	5,3	0,9%
Switzerland	5,3	0,9%
Turkey	9,5	1,5%
non-EU	**20,1**	**3,3%**
Europe	**614,0**	**100,0%**

Source: Aerospace and defence (ASD) industries association of Europe

Interpretation: these employment figures encompass the whole aerospace and defence industries (i.e. including civil aeronautics)

List of the largest arms-producing companies (excluding China), 2004

Rank 2004	Rank 2003	Company (parent company)	Country/ region	Sector	Arms sales 2004	Arms sales 2003	Total sales, 2004	Column 6 as % of column 8	Profit 2004	Employ 2004
1	2	Boeing	USA	Ac El Mi Sp	27 500	24 370	52 457	52	1 872	159 000
2	1	Lockheed Martin	USA	Ac El Mi Sp	26 400	24 910	35 526	74	1 266	130 000
3	3	Northrop Grumman	USA	Ac El Mi SA/A Sh Sp	25 970	22 720	29 853	87	1 084	125 400
4	**4**	**BAE Systems**	**UK**	**A Ac El Mi SA/A Sh**	**19 840**	**15 760**	**24 687**	**80**	**–855**	**90 000**
5	5	Raytheon	USA	El Mi	17 150	15 450	20 245	85	417	79 400
6	6	General Dynamics	USA	A El MV Sh	15 150	13 100	19 178	79	1 227	70 200
7	**8**	**EADS**	**Europe**	**Ac El Mi Sp**	**9 470**	**8 010**	**39 455**	**24**	**1 280**	**110 660**
8	**7**	**Thales**	**France**	**El Mi SA/A**	**8 950**	**8 350**	**12 780**	**70**	**246**	**55 480**
9	9	United Technologies,UTC	USA	El Eng	6 740	6 210	37 445	18	2 788	209 700
10	11	L-3 Communications	USA	El	5 970	4 480	6 897	87	382	44 200
11	**10**	**Finmeccanica**	**Italy**	**A Ac El MV Mi SA/A**	**5 640**	**4 550**	**10 764**	**52**	**681**	**51 030**
12	13	SAIC	USA	Comp (Oth)	4 670	3 700	7 187	65	409	42 400
13	12	Computer Sciences Corp., CSC	USA	Comp (Oth)	4 330	3 780	14 059	31	810	79 000
S	**S**	**MBDA (BAE Systems, UK/ EADS, Eu**	**Europe**	**Mi**	**3 850**	**2 710**	**3 851**	**100**	**. .**	**10 000**
14	**14**	**Rolls Royce**	**UK**	**Eng**	**3 310**	**3 020**	**10 877**	**30**	**375**	**35 400**
15	**18**	**DCN**	**France**	**Sh**	**3 240**	**2 150**	**3 240**	**100**	**260**	**12 280**
16	23	Halliburton	USA	Comp (Oth)	3 100	1 790	20 466	15	–979	97 000
S	S	KBR (Halliburton)	USA	Comp (Oth)	3 100	1 790	12 468	25	. .	. .
17	17	General Electric	USA	Eng	3 000	2 400	152 866	2	16 819	307 000
S	S	Pratt & Whitney (UTC)	USA	Eng	2 990	3 030	8 300	36	. .	34 180

Source: Stockholm International Peace Research Institute (SIPRI)

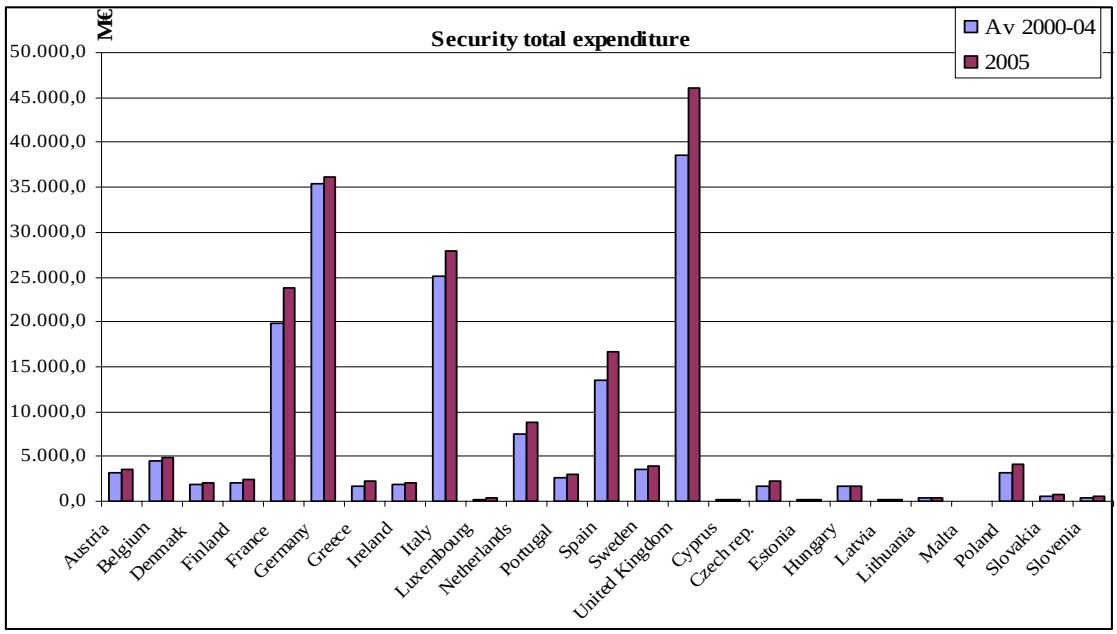
Interpretation: A = Artillery, Ac = Aircraft, El = Electronic, Eng = Engines, Mi = Missiles, MV = Military Vehicles, SA/A = Small Arms and Ammunitions, Sh = Ships, Sp = Space, Oth = others, Comp = components. S = Subsidiary

14. SECURITY TOTAL AND PROCUREMENT EXPENDITURE IN M€ (2000-05)

14.1. Security total expenditure in M€ (2000-05)

	2000	2001	2002	2003	2004	Av 2000-04	2005
Austria	2.983,8	3.038,6	3.138,1	3.232,7	3.352,4	3.149,1	3.547,8
Belgium	3.881,8	4.095,7	4.661,5	4.797,8	*4.797,8*	4.446,9	*4.797,8 e*
Denmark	1.639,6	1.770,2	1.842,7	1.910,7	2.017,2	1.836,1	2.119,8
Finland	1.792,0	1.885,0	1.899,0	2.041,0	2.268,0	1.977,0	2.393,0
France	16.806,0	18.467,0	20.159,0	21.515,0	22.284,0	19.846,2	23.846,0
Germany	33.700,0	35.150,0	36.070,0	36.120,0	36.370,0	35.482,0	36.190,0
Greece	971,8	1.703,0	1.862,0	1.952,0	2.245,0	1.746,8	2.330,0
Ireland	1.510,8	1.728,0	1.846,7	1.915,3	2.077,4	1.815,6	*2.077,4 e*
Italy	23.435,0	23.797,0	24.648,0	25.983,0	27.310,0	25.034,6	27.945,0
Luxembourg	189,2	210,3	239,5	267,7	285,3	238,4	307,7
Netherlands	5.793,0	6.861,0	7.791,0	8.352,0	8.667,0	7.492,8	8.824,0
Portugal	2.125,3	2.315,5	2.547,6	2.847,1	2.878,9	2.542,9	3.004,2
Spain	10.963,0	12.871,0	13.556,0	14.483,0	15.496,0	13.473,8	16.577,0
Sweden	3.430,5	3.342,0	3.674,4	3.862,9	3.860,4	3.634,0	*3.860,4 e*
United Kingdom	33.533,5	35.895,0	39.519,4	40.201,4	43.999,9	38.629,8	46.072,0
EU-15	**142.755,3**	**153.129,3**	**163.454,9**	**169.481,6**	**177.909,3**	**161.346,1**	**183.892,1**
Cyprus	210,1	182,2	241,1	283,0	311,8	245,6	273,7
Czech rep.	1.450,1	1.524,1	1.719,4	1.818,2	1.912,5	1.684,9	2.256,3
Estonia		169,3	198,7	219,9	222,3	202,6	260,9
Hungary				1.496,7	1.704,4	1.600,6	*1.704,4 e*
Latvia	195,0	213,6	222,7	227,4	246,7	221,1	276,1
Lithuania			289,2	311,7	336,8	312,6	370,0
Malta	66,9	74,6	74,9	77,5	75,2	73,8	77,0
Poland			3.130,9	3.247,9	3.224,9	3.201,2	4.188,4
Slovakia				571,1	428,7	499,9	787,9
Slovenia	375,5	413,6	449,5	479,7	496,1	442,9	487,0
EU-10				**8.733,1**	**8.959,4**	**8.485,1**	**10.681,7**
EU-25				**178.214,7**	**186.868,7**	**169.831,2**	**194.573,8**

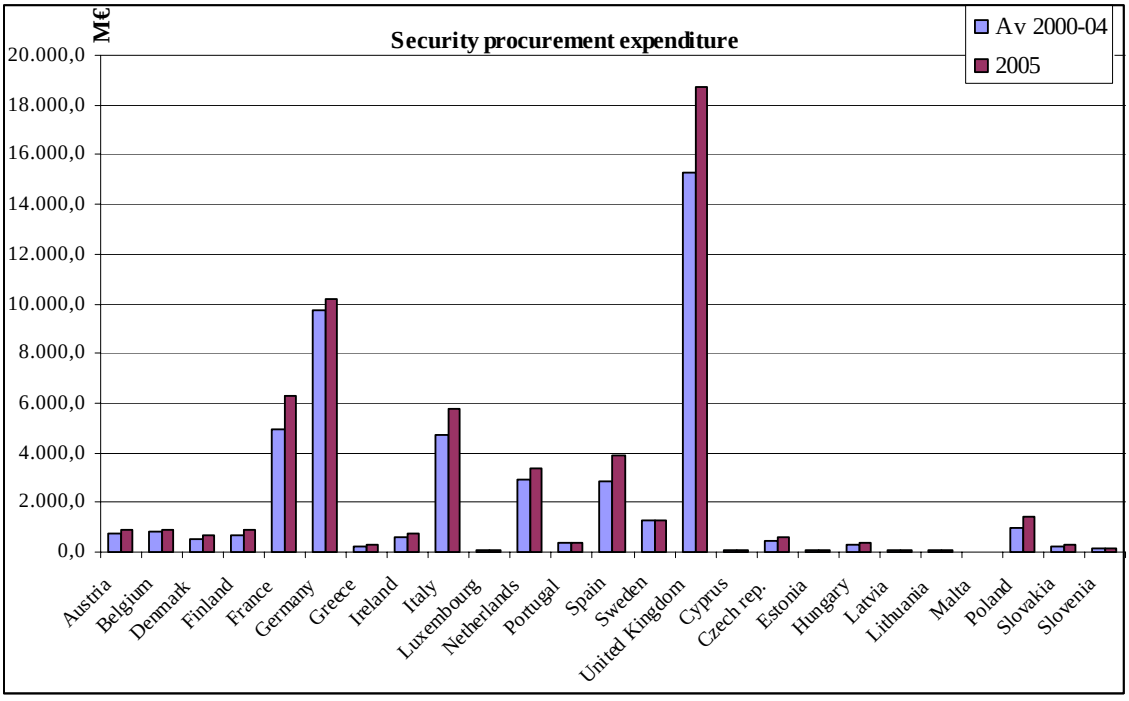
Source : EUROSTAT (series: General government expenditure function, Classification of the functions of government: 3 Public order and safety, National accounts indicator: TE Total expenditure)



14.2. Security procurement expenditure in M€ (2000-05)

	2000	2001	2002	2003	2004	Av 2000-04	2005
Austria	673,6	714,2	787,4	787,2	850,8	762,6	889,1
Belgium	699,6	715,6	834,0	885,4	*885,4*	804,0	*885,4 e*
Denmark	477,2	531,6	549,1	581,6	625,8	553,1	675,6
Finland	619,0	650,0	603,0	677,0	853,0	680,4	883,0
France	3.878,0	4.362,0	4.973,0	5.447,0	5.894,0	4.910,8	6.275,0
Germany	8.840,0	9.710,0	10.060,0	9.880,0	10.100,0	9.718,0	10.170,0
Greece	156,9	188,0	195,0	222,0	263,0	205,0	266,0
Ireland	481,7	590,6	669,6	700,9	726,6	633,9	*726,6 e*
Italy	3.765,0	3.868,0	5.088,0	5.371,0	5.685,0	4.755,4	5.805,0
Luxembourg	41,1	49,7	61,7	76,9	83,2	62,5	89,6
Netherlands	2.136,0	2.657,0	3.169,0	3.336,0	3.426,0	2.944,8	3.402,0
Portugal	378,6	384,5	348,3	412,4	390,9	382,9	377,5
Spain	1.979,0	2.529,0	2.922,0	3.119,0	3.591,0	2.828,0	3.924,0
Sweden	1.108,6	1.162,6	1.358,6	1.349,0	1.288,8	1.253,5	*1.288,8 e*
United Kingdom	12.202,2	14.118,7	15.821,4	16.730,0	17.524,2	15.279,3	18.694,1
EU-15	**37.436,5**	**42.231,5**	**47.440,1**	**49.575,4**	**52.187,7**	**45.774,2**	**54.351,7**
Cyprus	22,3	31,4	36,9	45,5	54,6	38,1	51,5
Czech rep.	344,2	365,4	500,1	480,2	525,8	443,1	612,2
Estonia		62,9	76,4	83,0	78,8	75,3	108,3
Hungary				281,1	342,5	311,8	*342,5 e*
Latvia	34,9	45,6	43,5	25,9	67,6	43,5	81,2
Lithuania			60,3	69,8	78,8	69,6	89,3
Malta	18,5	14,6	13,6	15,5	13,0	15,0	13,5
Poland			845,4	983,0	1.064,7	964,4	1.428,3
Slovakia				186,5	222,3	204,4	280,7
Slovenia	102,2	109,7	119,3	126,5	134,1	118,4	132,0
EU-10				**2.297,0**	**2.582,2**	**2.283,7**	**3.139,5**
EU-25				**51.872,4**	**54.769,9**	**48.057,9**	**57.491,2**

Source : EUROSTAT (series: General government expenditure function, Classification of the functions of government: 3 Public order and safety, National accounts indicators: P2 Intermediate consumption + P5 Gross capital formation)



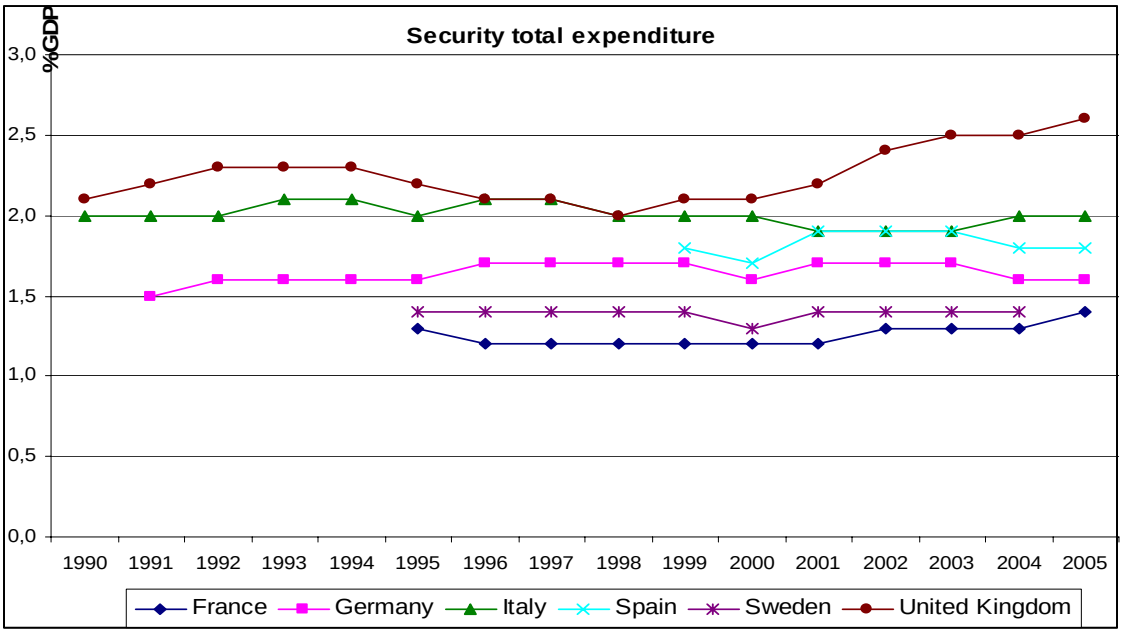
15. SECURITY TOTAL AND PROCUREMENT EXPENDITURE IN % OF GDP (1990-2005)

15.1. Security total expenditure in % of GDP (1990-2005)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Austria						1,5	1,5	1,5	1,5	1,5	1,4	1,4	1,4	1,4	1,4	1,4
Belgium	1,2	1,2	1,4	1,4	1,4	1,4	1,5	1,5	1,5	1,5	1,5	1,6	1,7	1,7		
Denmark	1,1	1,0	1,0	1,0	1,0	1,0	1,0	1,0	1,0	1,0	0,9	1,0	1,0	1,0	1,0	1,0
Finland	1,3	1,5	1,6	1,5	1,5	1,5	1,5	1,4	1,4	1,4	1,4	1,3	1,3	1,4	1,5	1,5
France						**1,3**	**1,2**	**1,2**	**1,2**	**1,2**	**1,2**	**1,2**	**1,3**	**1,3**	**1,3**	**1,4**
Germany		**1,5**	**1,6**	**1,6**	**1,6**	**1,6**	**1,7**	**1,7**	**1,7**	**1,7**	**1,6**	**1,7**	**1,7**	**1,7**	**1,6**	**1,6**
Greece						0,7	0,7	0,7	0,8	0,8	0,8	1,3	1,3	1,3	1,3	1,3
Ireland						1,7	1,7	1,6	1,7	1,5	1,4	1,5	1,4	1,4	1,4	
Italy	**2,0**	**2,0**	**2,0**	**2,1**	**2,1**	**2,0**	**2,1**	**2,1**	**2,0**	**2,0**	**2,0**	**1,9**	**1,9**	**1,9**	**2,0**	**2,0**
Luxembourg	0,9	0,8	0,8	0,9	0,8	0,7	0,8	0,8	0,8	0,9	0,9	0,9	1,0	1,0	1,1	1,0
Netherlands						1,4	1,4	1,4	1,4	1,5	1,4	1,5	1,7	1,8	1,8	1,7
Portugal						1,6	1,7	1,7	1,8	1,7	1,7	1,8	1,9	2,1	2,0	2,0
Spain										**1,8**	**1,7**	**1,9**	**1,9**	**1,9**	**1,8**	**1,8**
Sweden						**1,4**	**1,4**	**1,4**	**1,4**	**1,4**	**1,3**	**1,4**	**1,4**	**1,4**	**1,4**	
United Kingdom	**2,1**	**2,2**	**2,3**	**2,3**	**2,3**	**2,2**	**2,1**	**2,1**	**2,0**	**2,1**	**2,1**	**2,2**	**2,4**	**2,5**	**2,5**	**2,6**
EU-15										**1,7**	**1,6**	**1,7**	**1,7**	**1,8**		
Cyprus									1,7	2,1	2,1	1,7	2,2	2,4	2,5	2,0
Czech rep.						2,6	2,5	2,4	2,2	2,4	2,4	2,2	2,1	2,2	2,2	2,3
Estonia												2,4	2,6	2,6	2,4	2,4
Hungary														2,0	2,1	
Latvia											2,3	2,3	2,2	2,3	2,2	2,1
Lithuania													1,9	1,9	1,9	1,8
Malta									1,8	1,6	1,6	1,7	1,7	1,8	1,7	1,7
Poland													1,5	1,7	1,6	1,7
Slovakia														2,0	1,3	2,1
Slovenia											1,8	1,9	1,9	1,9	1,9	1,8
EU-25														**1,8**		

Bold characters: countries signatory of the so-called Letter-of-Intent (LoI) Framework Agreement

Source : EUROSTAT (series: General government expenditure function, Classification of the functions of government: 3 Public order and safety, National accounts indicator: TE Total expenditure)

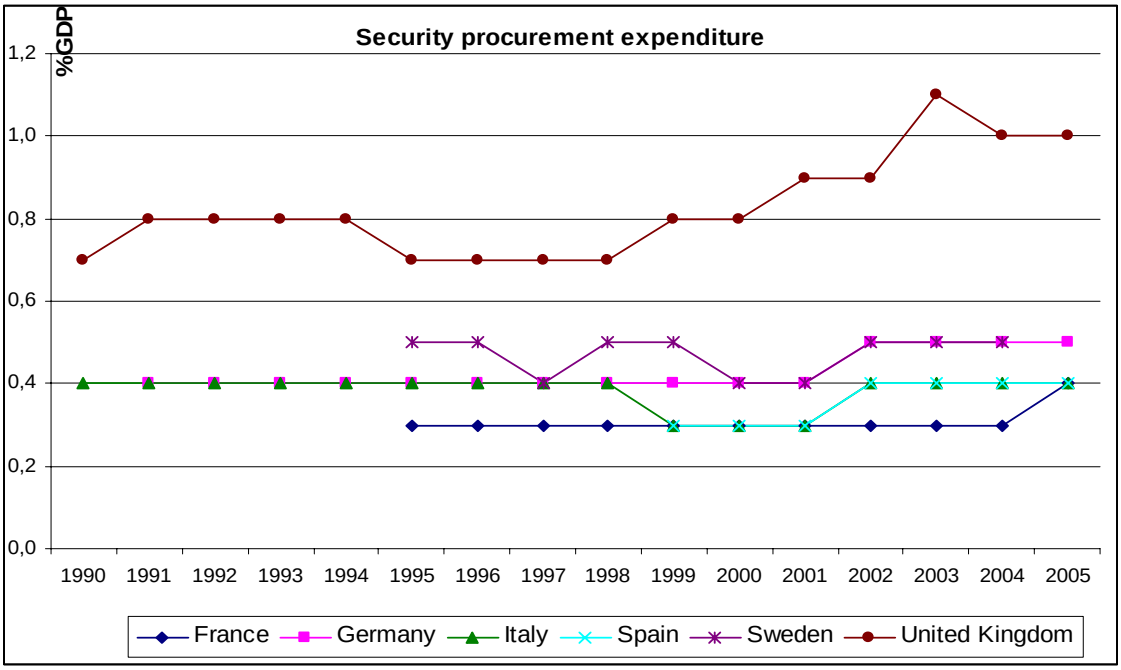


15.2. Security procurement expenditure in % of GDP (1990-2005)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Austria						0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,4
Belgium	0,2	0,2	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3	0,3		
Denmark	0,4	0,4	0,3	0,3	0,3	0,3	0,3	0,2	0,3	0,3	0,3	0,3	0,3	0,4	0,4	0,4
Finland	0,3	0,3	0,4	0,4	0,4	0,4	0,4	0,4	0,4	0,5	0,4	0,5	0,4	0,5	0,6	0,6
France						**0,3**	**0,3**	**0,3**	**0,3**	**0,3**	**0,3**	**0,3**	**0,3**	**0,3**	**0,3**	**0,4**
Germany		**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,5**	**0,5**	**0,5**	**0,5**
Greece						0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1	0,1
Ireland						0,5	0,5	0,5	0,6	0,5	0,4	0,5	0,5	0,5	0,5	
Italy	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,4**	**0,3**	**0,3**	**0,3**	**0,4**	**0,4**	**0,4**	**0,4**
Luxembourg	0,2	0,2	0,2	0,2	0,2	0,2	0,2	0,3	0,2	0,2	0,2	0,2	0,2	0,3	0,3	0,4
Netherlands						0,5	0,6	0,5	0,6	0,6	0,5	0,6	0,7	0,7	0,7	0,6
Portugal						0,3	0,3	0,4	0,4	0,3	0,3	0,3	0,3	0,3	0,3	0,2
Spain										**0,3**	**0,3**	**0,3**	**0,4**	**0,4**	**0,4**	**0,4**
Sweden						**0,5**	**0,5**	**0,4**	**0,5**	**0,5**	**0,4**	**0,4**	**0,5**	**0,5**	**0,5**	
United Kingdom	**0,7**	**0,8**	**0,8**	**0,8**	**0,8**	**0,7**	**0,7**	**0,7**	**0,7**	**0,8**	**0,8**	**0,9**	**0,9**	**1,1**	**1,0**	**1,0**
EU-15										**0,4**	**0,4**	**0,5**	**0,5**	**0,5**		
Cyprus									0,2	0,2	0,2	0,3	0,3	0,4	0,5	0,4
Czech rep.						0,7	0,5	0,5	0,5	0,5	0,5	0,5	0,6	0,6	0,6	0,6
Estonia												0,9	1,0	1,0	0,9	1,0
Hungary														0,4	0,4	
Latvia											0,4	0,5	0,5	0,3	0,6	0,6
Lithuania													0,4	0,4	0,5	0,5
Malta									0,5	0,4	0,4	0,4	0,4	0,4	0,3	0,3
Poland													0,4	0,5	0,6	0,6
Slovakia														0,6	0,7	0,7
Slovenia											0,5	0,5	0,5	0,5	0,5	0,5
EU-25														**0,5**		

Bold characters: countries signatory of the so-called Letter-of-Intent (LoI) Framework Agreement

Source : EUROSTAT (series: General government expenditure function, Classification of the functions of government: 3 Public order and safety, National accounts indicators: P2 Intermediate consumption + P5 Gross capital formation)



16. SECURITY TOTAL EXPENDITURE AS A % OF PUBLIC EXPENDITURE (2000-05)

	2000	2001	2002	2003	2004	Av 2000-04	2005
Austria	2,8%	2,8%	2,8%	2,8%	2,8%	2,8%	2,9%
Belgium	3,1%	3,2%	3,5%	3,4%	3,4%	3,3%	3,4%
Denmark	1,7%	1,8%	1,8%	1,8%	1,9%	1,8%	1,9%
Finland	2,8%	2,8%	2,7%	2,8%	3,0%	2,8%	3,0%
France	2,3%	2,4%	2,5%	2,5%	2,5%	2,4%	2,6%
Germany	3,6%	3,5%	3,5%	3,4%	3,5%	3,5%	3,5%
Greece	1,5%	2,6%	2,6%	2,6%	2,7%	2,4%	2,8%
Ireland	4,6%	4,4%	4,2%	4,1%	4,1%	4,3%	4,1%
Italy	4,3%	4,0%	4,0%	4,0%	4,1%	4,1%	4,1%
Luxembourg	2,3%	2,4%	2,4%	2,5%	2,4%	2,4%	2,4%
Netherlands	3,1%	3,4%	3,6%	3,7%	3,8%	3,6%	3,8%
Portugal	4,0%	4,0%	4,2%	4,5%	4,3%	4,2%	4,3%
Spain	4,5%	4,9%	4,8%	4,8%	4,8%	4,8%	4,8%
Sweden	2,3%	2,4%	2,5%	2,5%	2,4%	2,4%	2,4%
United Kingdom	5,4%	5,5%	5,7%	5,8%	5,8%	5,6%	5,8%
eu15	***3,6%***	***3,6%***	***3,7%***	***3,7%***	***3,8%***	***3,7%***	***3,8%***
Cyprus	5,6%	4,4%	5,4%	5,3%	5,7%	5,3%	4,6%
Czech Rep.	5,6%	5,0%	4,6%	4,7%	4,9%	4,9%	5,1%
Estonia		7,0%	7,2%	7,3%	6,9%	7,1%	7,1%
Hungary				4,1%	4,2%	4,2%	4,2%
Latvia	6,1%	6,6%	6,3%	6,6%	6,2%	6,4%	6,0%
Lithuania			5,6%	5,7%	5,6%	5,6%	5,3%
Malta	3,9%	4,0%	3,9%	3,7%	3,6%	3,8%	3,6%
Poland			3,4%	3,8%	3,7%	3,6%	4,0%
Slovakia				5,0%	3,2%	4,0%	5,6%
Slovenia	3,7%	3,8%	4,0%	4,0%	4,0%	3,9%	3,7%
eu10				***4,3%***	***4,2%***	***4,2%***	***4,4%***
eu25				**3,7%**	**3,8%**	**3,7%**	**3,8%**

Source: EUROSTAT and calculations by the Commission

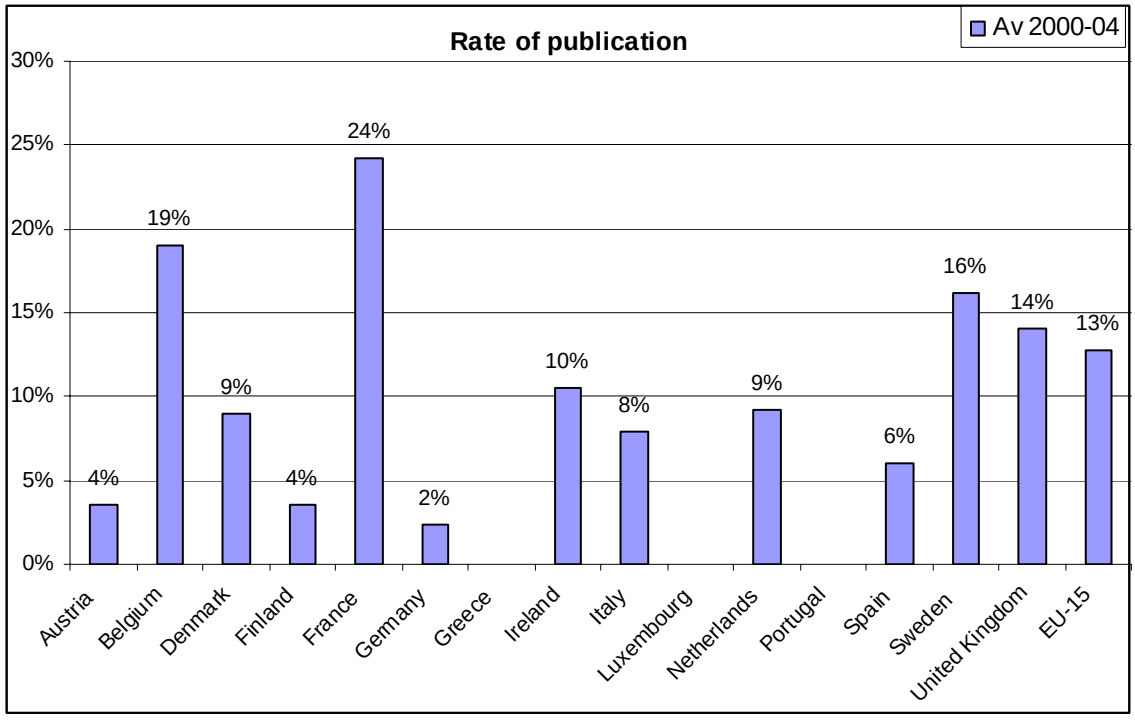
17. RATES OF PUBLICATION IN THE OJEU OF DEFENCE CONTRACTS

	2000	2001	2002	2003	2004	Av 2000-04
Austria	4%	5%	1%	5%	2%	4%
Belgium	14%	18%	13%	28%	24%	19%
Denmark	1%	24%	9%	0%	10%	9%
Finland	3%	6%	5%	4%	1%	4%
France	20%	39%	22%	21%	19%	24%
Germany	5%	4%	1%	2%	1%	2%
Greece	NR	NR	NR	NR	NR	NR
Ireland	5%	26%	7%	5%	3%	10%
Italy	6%	13%	6%	8%	7%	8%
Luxembourg	NR	NR	NR	NR	NR	NR
Netherlands	10%	14%	3%	6%	12%	9%
Portugal	5%	NR	NR	NR	8%	NR
Spain	8%	8%	11%	3%	3%	6%
Sweden	12%	13%	2%	52%	2%	16%
United Kingdom	25%	14%	15%	10%	7%	14%
EU-15	**16%**	**17%**	**11%**	**12%**	**8%**	**13%**

Definition: Publication rate = total value of contracts awarded by Awarding Authorities in the field of defence published in the OJEU / defence procurement expenditure

Methodology: the value of contract notices published in the OJEU is calculated by an extrapolation method based on the average value of published contract award notices (for Greece, Luxembourg and partly Portugal, this calculation has not been possible for lack of enough available data)

Source: OJEU (publication) and EUROSTAT (expenditure) and calculations by the Commission



18. AVERAGE AMOUNTS OF DEFENCE CONTRACTS PUBLISHED IN THE OJEU

Country	Av amount (€)
Austria	645.145
Belgium	1.164.972
Denmark	2.633.309
Finland	1.013.286
France	1.203.828
Germany	1.026.816
Greece	NR
Ireland	633.943
Italy	1.878.472
Luxembourg	NR
Netherlands	1.751.185
Portugal	652.625
Spain	1.069.581
Sweden	5.126.148
United Kingdon	8.115.255
EU-15	**1.939.202**

Source: OJEU and calculations by the Commission

Defence intra-community transfers and penetration rates

In 1998, the Council adopted a Code of Conduct on armament exports, establishing a set of common criteria to be applied by the Member States in their respective export policies. The Code of Conduct also provides that Member States report their arms exports, and an annual report (the 8th report was issued in December 2006) publishing armament exports (and refusals) per destination and by type (according to a common Military List), with three set of figures: the number of licences issued, the value of licences issued (authorized transfers), the value of arm exports (actual transfers).

18.1. Intra-community transfers (exports and imports)

	Export tr.	Import tr.	Net transfers
Austria	1.097.902	18.988.773	-17.890.871
Belgium	40.540.698	63.551.516	-23.010.818
Denmark	24.043.449	38.124.164	-14.080.715
Finland	97.918.142	153.130.415	-55.212.273
France	1.064.271.129	202.866.529	861.404.600
Germany	546.355.000	543.471.385	2.883.615
Greece	17.840.068	492.709.673	-474.869.605
Ireland	8.292.453	6.743.794	1.548.659
Italy	461.569.512	209.359.805	252.209.707
Luxembourg	485.700	7.591.078	-7.105.378
Netherlands	215.770.033	272.197.943	-56.427.910
Portugal	1.195.535	83.658.753	-82.463.218
Spain	251.019.987	387.703.789	-136.683.802
Sweden	423.660.000	101.640.302	322.019.698
United Kingdom	164.380.002	474.806.921	-310.426.919
EU-15	**3.318.439.610**	**3.056.544.840**	**261.894.770**
Cyprus	NR	23.198.390	NR
Czech rep.	33.838.000	21.565.894	12.272.106
Estonia	600	5.763.675	-5.763.075
Hungary	3.940.000	3.912.551	27.449
Latvia	1.084.510	1.461.421	-376.911
Lithuania	477.000	3.111.001	-2.634.001
Malta	251.059	18.771.955	-18.520.896
Poland	1.932.836	196.657.173	-194.724.337
Slovakia	8.204.989	27.760.609	-19.555.620
Slovenia	92.953	9.514.048	-9.421.095
EU-10	**49.821.947**	**311.716.717**	**-261.894.770**
EU-25	**3.368.261.557**	**3.368.261.557**	**0**

Definition: Intra-community export transfers are calculated on the value of actual transfers as declared by the reporting MS (some MS did not declare actual transfers but only authorized transfers. In these cases, the value of authorized transfers has been used instead)

Source: Code of Conduct on arms exports

18.2. Intra-community penetration rate

	2005
Austria	10%
Belgium	28%
Denmark	NR
Finland	28%
France	4%
Germany	16%
Greece	35%
Ireland	7%
Italy	10%
Luxembour	32%
Netherland	22%
Portugal	38%
Spain	18%
Sweden	8%
United Kingd	7%
EU-15	**12%**
Cyprus	48%
Czech rep.	10%
Estonia	29%
Hungary	4%
Latvia	10%
Lithuania	8%
Malta	NS
Poland	31%
Slovakia	29%
Slovenia	24%
EU-10	**26%**
EU-25	**13%**

Methodology: as the source (the annual report on the EU Code of Conduct on arms exports) refers only to defence equipment, the penetration rate will be calculated only for defence equipment

Definition: Penetration rate = intra-community imports (in value) / defence equipment expenditure (in value)

Classification of MS by Penetration rate and Equipment expenditure

Rate \ Equip		Low <1000 M€	Medium 1000<4000 M€	High >4000 M€
Low	**<=10%**	CZ AT HU IE LT LV	IT SE	UK FR
Medium	**10%<=20%**	∅	DE ES	∅
High	**20%<=40%**	PL FI BE PT SK SI LU EE	EL NL	∅
Very High	**>40%**	CY MT	∅	∅

Assessment of Member States' procurement practices

In order to characterize the procurement practices of the Member States, a survey was subcontracted to an external consultancy: Yellow Window (Belgium).

A classification of defence products was set up, consisting of:

- 5 main sectors (land, naval, aerospace, electronics, individual/support),

- 15 groups,

- 38 subgroups,

- 142 types.

A questionnaire was passed to Member States, asking them 3 questions:

- When procurement is done within this type, will the publication through Official Journal of the EC be the "normal" practice?

- If EU procurement rules are not used, is the normal procedure to approach a single supplier, or to have a competition?

- If competition is normally used, will this normally be restricted to national providers or open to other countries?

Then each type of defence product was classified according to 4 categories (see classification below), on the basis of the provided answers.

19 out of 25 Member States provided an answer (some types of products are not applicable to some Member States e.g. landlocked countries do not purchase naval equipment).

18.3. Classification of procurement practices

The following categories were identified:

C1	publication in the OJEU (indicating use of Directive 2004/18/EC);
C2	no publication in the OJEU and competition between international suppliers;
C3	no publication in the OJEU and competition between national suppliers;
C4	no publication in the OJEU and no competition (only a single national supplier approached).

Source: Yellow Window, survey to Member States

18.4. Identification of the most published defence product types

Number of product types for which at least half of responding MS normally publish contracts in the OJEU (i.e. Category 1)

	Goods	Services	Works	Total
1.Ground equipment	5 out of 26	1 out of 10	2 out of 6	8 out of 42
2.Naval equipment	0 out of 15	0 out of 6	1 out of 4	1 out of 25
3.Aerospace equipment	0 out of 37	1 out of 10	2 out of 8	3 out of 55
4.Electronic systems	0 out of 8	0 out of 2	0 out of 2	0 out of 12
5.Individual and support e	2 out of 4	2 out of 2	1 out of 2	5 out of 8
Total	**7 out of 90**	**4 out of 30**	**6 out of 22**	**17 out of 142**

Source: Yellow Window, Survey to Member States, calculations by the European Commission

List of product types for which at least half of responding MS normally publish contracts in the OJEU (i.e. Category 1)

1.Ground equipment
Bus & coach
All Terrain Personnel Transportation
Trucks < 15 Tons
Trucks > 15 Tons
Special Vehicles
Transportation Vehicle - Maintenance
Non Armoured Vehicle - Parking Areas
Armoured Military Vehicle - Parking Areas
2.Naval equipment
Warship - Parking areas / pier
3.Aerospace equipment
Helicopter - Maintenance
Aircraft - Parking Areas / Hangars
Aircraft - Installations for maintenance
5.Individual and support equipment
Service Uniforms
Field Uniforms
Services - Maintenance
Services - Distribution and Exchange
Storage / Stock

Source: Yellow Window, Survey to Member States

Assessment of Member States' publication practices

A study of the publication practices of Member States in their national bulletin was subcontracted to the College of Bruges. The aim of the study was to characterise the contracts by level of publication (see if the identified contracts are also published in the OJEU) and by awarding procedure. Contrary to annex n°11, contracts are counted by numbers.

By level of publication

	National &OJEU	**National only**
Total %	33%	67%

Source: College of Bruges, Review of national bulletins

By procedure

	Open	**Restr**	**Nego**	**Others**
Total %	71%	18%	9%	1%

Source: College of Bruges, Review of national bulletins

Assessment of the barriers to cross-border procurement in the EU

In order to characterize defence companies' behaviour, a survey was subcontracted to an external consultancy: Rambøll (Denmark).

A database of about 1200 companies in the field of defence was set up.

A questionnaire was passed to all companies, asking them several questions (the most relevant questions and their answers are detailed below).

The responses were made either through electronic means, or during face to face interviews (for a limited sample of 18 Large Enterprises and 2 organizations representative of Small and Medium Enterprises).

Between 150 and 180 (depending on the completeness of the response) companies provided an (at least partial) answer.

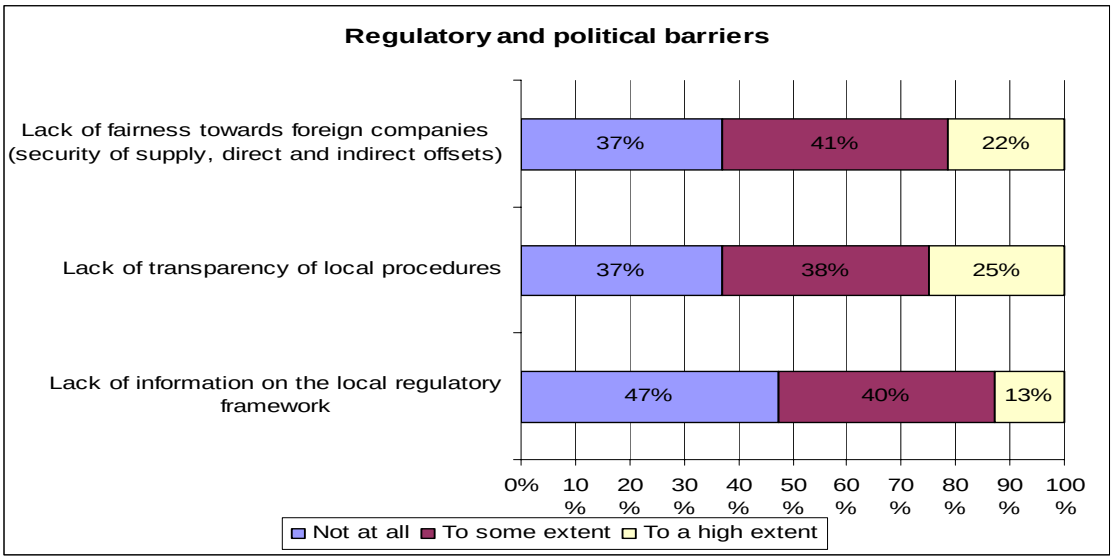
ASSESSMENT OF THE REGULATORY AND POLITICAL BARRIERS TO ENTER NEW MARKETS

Question: What are the main barriers which could limit the expansion of your sales beyond your current national markets in the EU?

All companies

Regulatory and political barriers	Not at all	To some extent	To a high extent
Lack of information on the local regulatory framework	47%	40%	13%
Lack of transparency of local procedures	37%	38%	25%
Lack of fairness towards foreign companies (security of supply, direct and indirect offsets)	37%	41%	22%

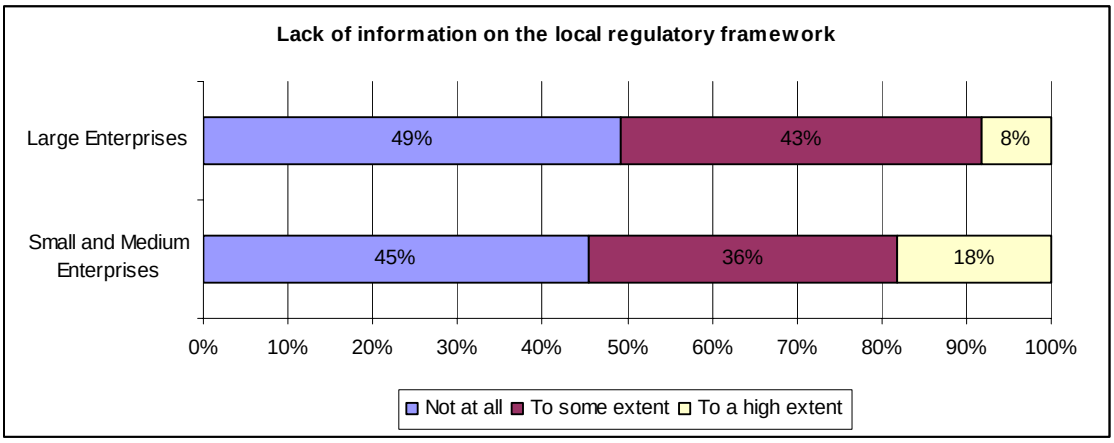
Source: Rambøll, survey to companies (116 responses)



By size of companies

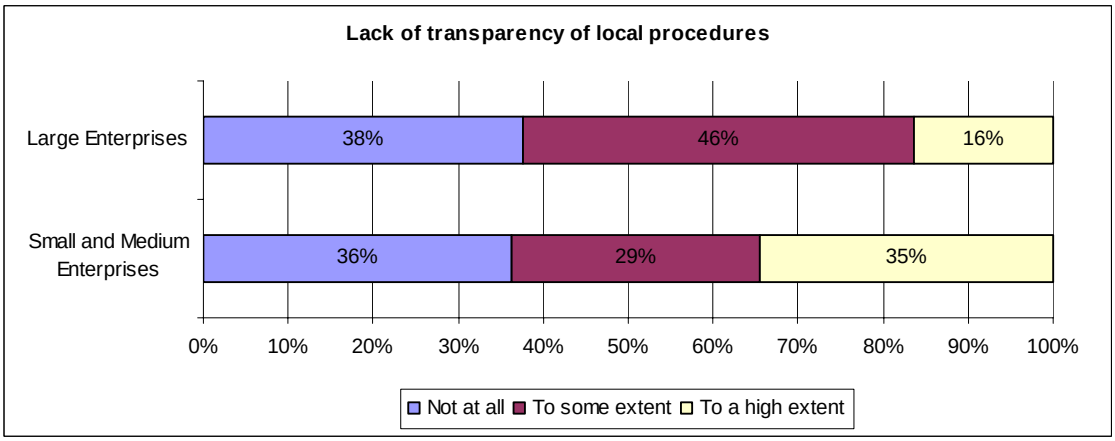
Lack of information on the local regulatory framework	Not at all	To some extent	To a high extent
Small and Medium Enterprises	45%	36%	18%
Large Enterprises	49%	43%	8%

Source: Rambøll, survey to companies (116 responses)



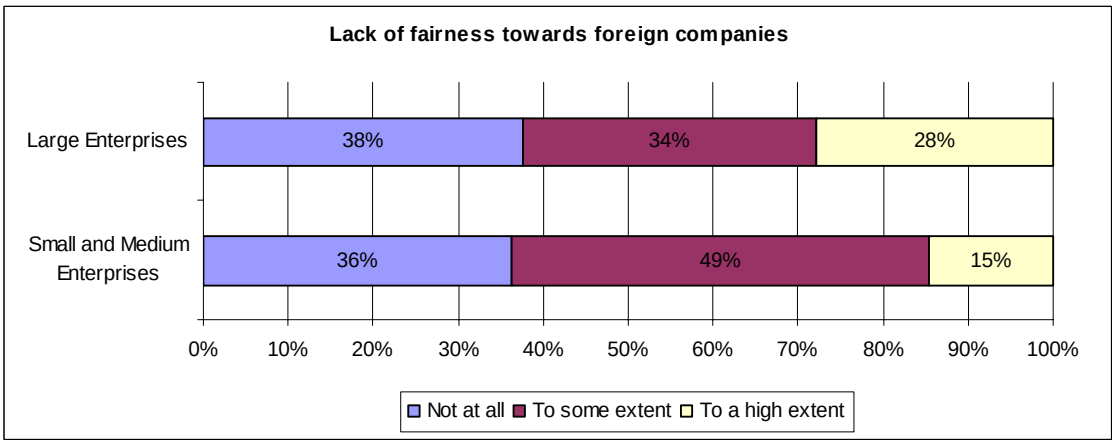
Lack of transparency of local procedures	Not at all	To some extent	To a high extent
Small and Medium Enterprises	36%	29%	35%
Large Enterprises	38%	46%	16%

Source: Rambøll, survey to companies (116 responses)



Lack of fairness towards foreign companies (security of supply, direct and indirect offsets)	Not at all	To some extent	To a high extent
Small and Medium Enterprises	36%	49%	15%
Large Enterprises	38%	34%	28%

Source: Rambøll, survey to companies (116 responses)



19. ASSESSMENT OF THE IMPACT ON ADMINISTRATIVE COSTS OF A DEFENCE-SPECIFIC DIRECTIVE

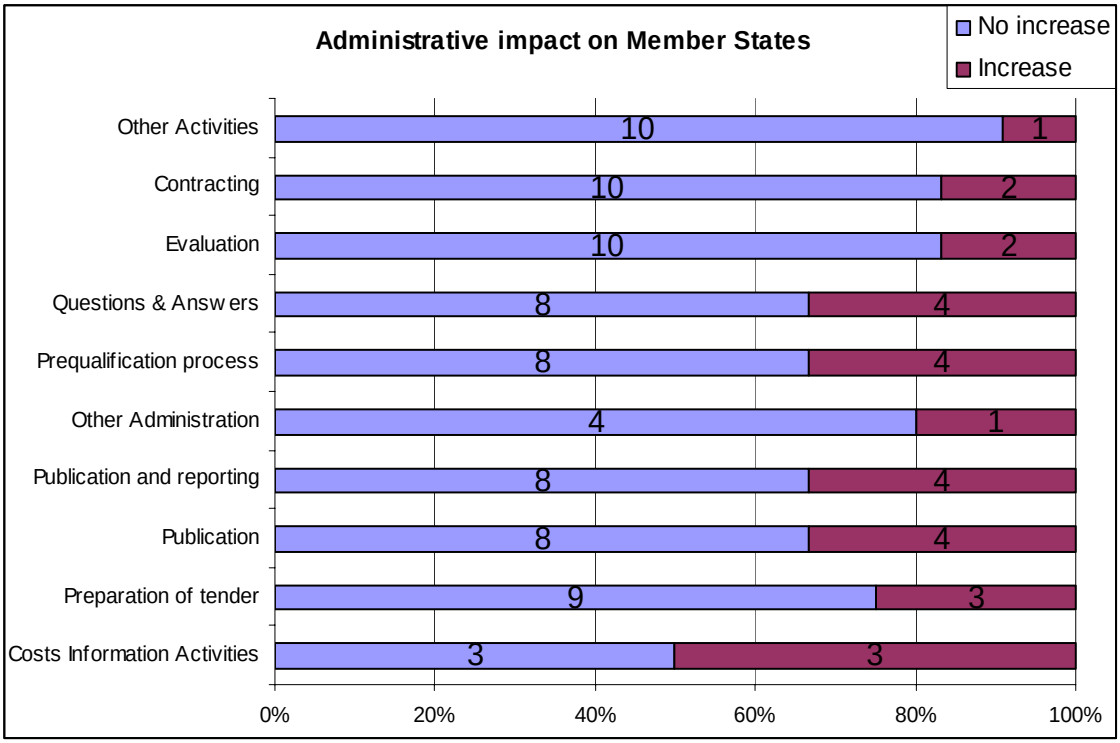
As part of the study subcontracted to Rambøll, a set of questions was asked, both to Member States and to companies, regarding the administrative impact of the adoption of a new specific Directive.

Administrative Impact on Member States

Question: If a new Directive on defence public procurement were to be adopted, would it lead to additional administrative impacts in your authority during the implementation phase?

Type of activity	No increase	Increase	% of increase
Costs Information Activities	3	3	40
Preparation of tender	9	3	50
Publication	8	4	23
Publication and reporting	8	4	50
Other Administration	4	1	50
Prequalification process	8	4	38
Questions & Answers	8	4	40
Evaluation	10	2	25
Contracting	10	2	15
Other Activities	10	1	10

Source: Rambøll, survey to Member States (12 responses)

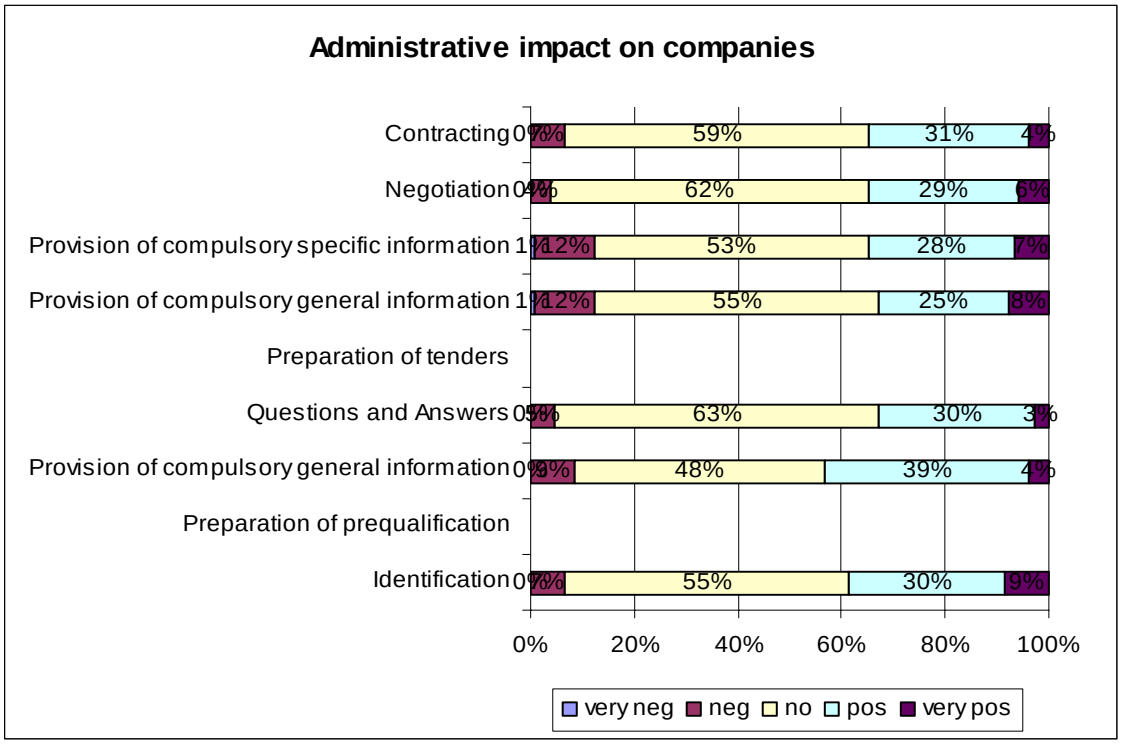


Administrative impact on companies

Question: the implementation of a specific Directive may have an administrative impact in your organisation in connection with your participation in tenders. Please assess the impact of such a Directive on the various actions needed in the awarding process.

	very neg	neg	no	pos	very pos
Identification	0%	7%	55%	30%	9%
Preparation of prequalification					
Provision of compulsory general information	0%	9%	48%	39%	4%
Questions and Answers	0%	5%	63%	30%	3%
Preparation of tenders					
Provision of compulsory general information	1%	12%	55%	25%	8%
Provision of compulsory specific information	1%	12%	53%	28%	7%
Negotiation	0%	4%	62%	29%	6%
Contracting	0%	7%	59%	31%	4%

Source: Rambøll, survey to companies (104 responses)



20. ASSESSMENT OF THE ECONOMIC IMPACT OF A DEFENCE-SPECIFIC DIRECTIVE

As part of the study subcontracted to Yellow Window (Belgium), a survey was carried-out to companies, regarding the possible economic impact of a specific directive, in terms of sales, production costs, prices, consolidation and competitiveness of the sector. A sample of 20 defence product types (supplies, services and works) was extracted from the classification of defence products. For each of these product types, a few products (from 1 to 5) available on the market were selected. For each of these products, the producing companies (30 market players) were interviewed.

The answers were classified according to the following scale:

+ : positive impact **-** : negative impact **=** : stable / no impact **A** : high impact **B** : medium impact **C** : low impact

	TYPE				**impact on sales**			**impact on production cost**			**impact on prices**			**impact on consolidation**			**impact EU competitiveness**		
		market size EU	**Nb of interviews**	**expected market evolution**	+	=	-	+	=	-	+	=	-	+	=	-	+	=	-
1	Light Wheel Vehicles	> 1 billion €/y	2	slight increase		X			X		C				X.			X	
2	Infantry Fighting Vehicle	global markt < 1 billion €/y	4	stable in the EU		X			X			X		C				X	
3	Maintenance of Armoured Military Vehicles	global market > 1 billion €/y	5	slight increase		X			X			X			X			X	
4	Hand Guns	small	2	increase	A			A			A				X		B		
5	Rifles	unknown	1	small	C			C			C				X		C		
6	Machine Guns	unknown	1	small	C			C			C				X		C		
7	Bullets	small	2	stable or decrease	B				X		B			B			B		

8	Grenades	small	3	increase	C				X			X			X			X	
9	Corvettes and Patrol Craft	unknown	3	stable	C				X			X			X				
10	Maintenance of Warships	small	3	stable		X			X			X			X			X	
11	Mine Hunter / Mine Sweeper	unknown, but small	3	stable or decrease	C				X			X			X			X	
12	Training Aircraft	15 billion € over 20 y	3	increase	C				X			X			X			X	
13	Maintenance of Fixed Wing Aircraft	1 billion € for 5 y	4	increase	A				X			X			X		B		
14	Transport Helicopter	unknown	2	increase (sh.t.)		X			X			X			X				B
15	Installations for Maintenance	1 billion € per year	1	stable	C				X			X			X			X	
16	Bombs and Rockets	unknown	2	increase	C			C			C				X		C		
17	Command, Control, Communications System	unknown	4	increase	B			B			C				X			X	
18	Communication Electronic Warfare System	100 mio €/y	2	increase	C			C			C				X			X	
19	Maintenance of Communication, Command & Control & Information systems	unknown	1	stable		X			X				C		X			X	
20	Military Clothing	1,5 billion €/y	3	increase	C				X		C			B			B		

Source: Yellow Window, survey to companies (30 market players)

21. SIMULATION OF THE IMPACT OF A DEFENCE-SPECIFIC DIRECTIVE ON THE VALUE OF CONTRACTS AWARDED WITH EC RULES

In this simulation, under the hypothesis that the rate of publication of defence is put at the same level as the rate of publication of central administration without defence, the variation of the value of contracts published in the OJEU is calculated.

This simulation of the impact of a defence specific directive on the value of contracts is done using 2002 figures.

2002	Defence procurement expenditure (1)	Defence procurement publication (2)	Defence rate of publication (3)=(2)/(1)	Rate of publication at central level (without defence) (4)	Gap between "civil" and defence rates (5)=(4)-(3)	Additional publication "Half gap" (6)=(1)x½(5)	Additional publication "Full gap" (7)=(1)x(5)
Austria	650,6	8,7	1,3%	11,4%	10,1%	32,7	65,5
Belgium	899,4	118,2	13,1%	51,0%	37,9%	170,2	340,5
Denmark	1.403,4	119,9	8,5%	22,5%	14,0%	97,9	195,8
Deutschland	11.450,0	112,0	1,0%	6,1%	5,1%	293,2	586,5
Finland	1.163,0	54,4	4,7%	11,8%	7,1%	41,4	82,8
France	14.099,0	3.129,1	22,2%	20,0%	-2,2%	-154,7	-309,3
Greece	3.727,0	n/a	n/a	n/a	n/a	n/a	n/a
Ireland	170,8	12,2	7,2%	18,9%	11,7%	10,0	20,1
Italy	6.082,0	340,0	5,6%	8,1%	2,5%	76,3	152,6
Luxembourg	17,9	n/a	n/a	n/a	n/a	n/a	n/a
Netherlands	3.027,0	94,2	3,1%	9,0%	5,9%	89,1	178,2
Portugal	419,9	n/a	n/a	n/a	n/a	n/a	n/a
Spain	3.419,0	362,7	10,6%	51,5%	40,9%	699,0	1.398,1
Sweden	3.545,2	61,4	1,7%	19,4%	17,7%	313,2	626,3
United Kingdom	25.914,8	3.777,9	14,6%	36,9%	22,3%	2.892,3	5.784,7
UE-15	**75.989,0**	**8.190,9**	**10,8%**	**24,8%**	**14,0%**	**5.327,2**	**10.654,4**

Source: OJEU (publication) and EUROSTAT (expenditure) and calculations by the Commission

Methodology: the rates of publication are calculated by extrapolation as explained in annex n°11

List of all consultations held with stakeholders on Defence Procurement

21.1. Consultations for the Green Paper (2003-2004)

Advisory Committee on Public Procurement (ACPP) meetings

- 9 October 2003

Sessions of the Working Group of Member States' experts

- "Identification of characteristics and economic dimensions of armament contracts", 30 January 2004
- "Defence procurement regulations at national, intergovernmental and Community level", 15 March 2004
- "The way forward for a Community instrument as regards defence procurement", 29 April 2004

Sessions of the Working Group of Industry experts

- "Identification of characteristics and economic dimensions of armament contracts", 25 January 2004
- "Defence procurement regulations at national, intergovernmental and Community level", 17 March 2004
- "The way forward for a Community instrument as regards defence procurement", 30 April 2004

Written contributions received from Member State in preparation of the Green Paper

	ACPP	**Working Group of Member States' experts**		
	9/10/2003	**1st session**	**2nd session**	**3rd session**
Austria		Received	Received	
Belgium	Received	Received	Received	Received
Denmark	Received	Received	Received	
Finland	Received	Received	Received	Received
France		Received	Received	
Germany		Received	Received	Received
Greece	Received			
Ireland	Received	Received	Received	
Italy		Received	Received	Received
Luxembourg	Received	Received	Received	
Netherlands	Received		Received	Received
Portugal		Received	Received	Received
Spain	Received	Received	Received	Received

Sweden	Received	Received	Received	Received
United King.	Received	Received	Received	Received
Cyprus	Received		Received	Received
Czech Rep.				
Estonia				
Hungary				
Latvia				
Lithuania		Received	Received	Received
Malta				
Poland		Received	Received	
Slovakia				
Slovenia		Received	Received	

Written Contributions to the Green Paper consultation (39 total)[75]

(1) Member states and third countries (19)

(2) Undertakings and professional organisations (13)

(3) Experts, think tanks and other organisations and individuals (3)

(4) European Parliament (1)

(5) Agencies of the Council (2)

(6) European Economic and Social Committee (1)

21.2. Consultations in Preparation of the interpretative Communication (2006)

Advisory Committee on Public Procurement (ACPP) meetings

- 15 June 2006

Written contributions received from Member State following the 15 June 2003 ACPP meeting

Austria	Received
Cyprus	Received
Czech Republic	Received
Finland	Received
France	Received
Italy	Received
Netherlands	Received

[75] All written contributions to the Green Paper on Defence Procurement are available online at: http://ec.europa.eu/internal_market/publicprocurement/dpp_en.htm.

Slovenia	Received
Spain	Received
Sweden	Received
United Kingdom	Received

Bilateral Meetings with Member States

- Austria (in Brussels), 27 September 2006
- Czech Republic (in Brussels), 1 December 2006
- Finland (in Brussels), 23 May 2006
- France (in Brussels), 21 September 2006
- Germany (in Bonn), 14 September 2006
- Germany (in Berlin), 25 September 2006
- Netherlands (in Brussels), 29 June 2006
- Netherlands (in Brussels), 14 November 2006
- Sweden (in Brussels), 6 December 2006
- United Kingdom (in Brussels), 22 September 2006
- United Kingdom (in Brussels), 5 October 2006

Meetings with Industry

- Dassault Aviation (in Brussels), 10 May 2006
- Textile industries (in Brussels), 31 May 2006
- SAAB (in Brussels), 6 June 2006
- Thalès (in Brussels), 29 June 2006
- Federation of German Industries (BDI) (in Brussels), 25 July 2006
- German SMEs (meeting organised by the Government of the State of Hesse, in Francfort), 20 September 2006
- BAE Systems (in Brussels), 3 October 2006
- EADS (in Paris), 9 November 2006
- Federation of German Industries (BDI), 18 December 2006

21.3. Consultations in preparation of Defence Directive (2006 - 2007)

Advisory Committee on Public Procurement (ACPP) meetings

- 19 December 2006
- 8 February 2007
- 24 April 2007

Written contributions received from Member State following ACPP meetings

	19 December	8 February 2006	24 April 2007
Austria			Received
Belgium			
Bulgaria	Received		
Cyprus	Received	Received	Received
Czech Rep.			Received
Denmark		Received	Received
Estonia	Received	Received	
Finland	Received	Received	Received
France	Received	Received	Received
Germany		Received	
Greece	Received	Received	
Hungary	Received	Received	Received
Ireland			
Italy	Received	Received	Received
Latvia	Received	Received	
Lithuania	Received	Received	Received
Luxembourg			
Malta		Received	
Netherlands	Received	Received	Received
Norway	Received		
Poland	Received	Received	Received
Portugal			
Romania		Received	
Slovakia	Received		Received
Slovenia			
Spain		Received	

Sweden		Received	Received
United King.	Received	Received	Received

Bilateral meetings with Member States

- France (in Brussels), 22 January 2007
- France (in Paris), 22 March 2007
- Germany (in Bonn), 12 February 2007
- Germany (representative from the Office of Defence technology and procurement (in Brussels), 1 March 2007
- Germany (in Bonn), 12 March 2007
- Germany (in Berlin), 3 April 2007
- Germany (in Berlin), 23 April 2007
- Finland (in Brussels), 20 March 2007
- Italy (in Rome), 29 January 2007
- Italy (in Brussels), 1 March 2007
- Netherlands (in Brussels), 27 March 2007
- Norway(in Brussels), 5 March 2007
- Sweden (in Brussels), 27 March 2007
- United Kingdom (in Brussels), 23 January 2007
- United Kingdom (in Brussels), 20 March 2007

Meetings with industry representatives

Swedish industries (in Brussels), 26 February 2007

European Association of Aerospace Industries (in Brussels), 8 March 2007

European Association of Aerospace Industries (in Brussels), 8 May 2007

21.4. Consultations with EDA

- Preparatory Committee, 4 July 2006
- Special Preparatory Committee, 7 July 2006
- EDA-DG MARKT bilateral meeting, 2 September 2006
- Preparatory Committee, 12 September 2006

- National Armaments Directors (NADs) Points of Contact (POCs) meeting, 11 October 2006
- EDA-DG MARKT bilateral meeting, 19 October 2006
- Preparatory Committee, 3 November 2006
- Preparatory Committee, 6 December
- NADs POCs meeting, 12 December
- Preparatory Committee, 21 March 2007
- NADs POCs meeting, 28 February
- Steering Board meeting in NADs formation, 29 March 2007
- Special Preparatory Committee meeting, 24 April

22. ASSESSMENT OF THE COMPLIANCE WITH THE MINIMUM STANDARDS OF CONSULTATION

Minimum standards for consultation	Compliance with standards
All communications relating to consultation should be clear and concise, and should include all necessary information to facilitate responses.	The Green Paper concluded with the opening of a consultation, and indicated both a postal address and an e-mail address for the sending of responses.
When defining the target group(s) in a consultation process, the Commission should ensure that relevant parties have an opportunity to express their	The responsible unit within the Commission has always carried out an "open door" policy (see the list of meetings in annex n°20)
The Commission should ensure adequate awareness-raising publicity and adapt its communication channels to meet the needs of all target audiences. Without excluding other communication tools, open public consultations should be published on the Internet and announced at the "single access point".	The consultation was prepared during three working parties with MS, and three working parties with the organization representative of the industries, and announced during the Advisory Committee for Public Procurement. Dedicated internet pages were opened in the DG MARKT web site, as was an e-mail box to receive answers. The consultation was announced on the "Your Voice" site in the header as an "open consultation". A press conference (leading to several papers) followed the adoption of the Green Paper.
The Commission should provide sufficient time for planning and responses to invitations and written contributions. The Commission should strive to allow at least 8 weeks for reception of responses to written public consultations and 20 working days notice for meetings.	The consultation was opened at the end of September 2004 for a duration of 4 months, and then extended to 6 months. Practically, responses were received until April 2005.
Receipt of contributions should be acknowledged. Results of open public consultation should be displayed on websites linked to the single access point on the Internet.	A acknowledgement of receipt was sent for every and each received response. From the "Your Voice" pages, a link was established to the dedicated internet pages in the DG MARKT web site. The responses to the consultation are accessible from those pages.

Source: Communication from the Commission "Towards a reinforced culture of consultation and dialogue - General principles and minimum standards for consultation of interested parties by the Commission", COM(2002) 704 final, 11.12.2002