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CONSULTATION PAPER ON THE INTRA-COMMUNITY CIRCULATION OF PRODUCTS FOR THE DEFENCE OF MEMBER STATES

1. INTRODUCTION

Through a series of complementary actions, the European Commission intends to contribute to the gradual construction of a more open and more transparent "European Defence Equipment Market" (EDEM) between Member States which, while respecting the specificities of the sector, would make it economically more efficient and technologically more competitive.

This document is the result of commitments made by the Commission in the context of its Communication on an EU Defence Equipment Policy[1] and the study "Intra-Community Transfers of Defence Products"[2]. It is intended to lay the groundwork for a Community initiative facilitating the movement of defence-related products within the Community. Today the circulation of such products is subject to varying national administrative procedures in the Member States. These are costly to the point of being prohibitive for European defence industries, and particularly small and medium-sized enterprises, which produce sub-systems and components.

1.1. Political Background

Achieving the objectives of the European Union's European Security and Defence Policy (ESDP) depends, among other things, on the ability of Member States to meet military needs under proper security conditions and at an appropriate cost. This implies giving the defence industry a European dimension, thus increasing the competitiveness of the technological and industrial base of European defence and in particular of European defence companies. This industrial objective requires that the transfer of defence-related products be simplified at Community level.

Groups of Member States and the European Union have tried to take up the new challenges by concluding ad hoc or partial arrangements.

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1 COM (2003) 113 final, 11.3.2003.

2 http://europa.eu.int/comm/enterprise/regulation/inst_sp/defense_en.htm

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– As early as 1998, the defence ministers of six Member States[3] signed a **Letter of Intent (LoI)** which aimed to facilitate the restructuring of the European defence industry via, among other things, common measures with regard to export procedures The agreement committed the signatory nations to applying simplified export procedures to transfers. Since then, no other Member State has signed the Letter of Intent or the **Farnborough Framework Agreement** of 2000 which consolidated the participating nations' cooperation.

– In 1998, with regard to the common foreign and security policy, the Council adopted a **European Union Code of Conduct on arms exports** in order to strengthen cooperation between the Member States and to promote convergence with regard to exports of conventional weapons. The preamble includes an explicit reference to industrial aspects by emphasising the intention of the Member States to maintain a defence industry as part of their industrial base and their defence. What is more, the Council is preparing a common position based on Article 15 of the EU Treaty which aims to update and make compulsory the principles of the code and the common list of military equipment covered by the attached EU code of conduct[4], which determines its scope. Nothing in the code prevents it from being applied on an intra-Community basis, i.e., to the exports of products included in the lists intended for other EU Member States.

– In 2003, the Council Working Party on Armaments Policy (**POLARM**) received a German proposal for a **common position** on the procedures for the intra-Community transfer of military equipment which aimed in particular to get commitments to reducing their scope and to grant recognition by any other Member State of export authorisations to a given Member State granted by an EU Member State.

– Recently, the Member States created a **European Defence Agency**[5] whose goals include:

> "supporting the creation in liaison with Commission, as appropriate, of an internationally competitive European Defence Equipment market, providing further impulse and input to the development and harmonisation of rules and regulations affecting the European defence market, particularly by an EU wide application of rule and procedures adapted from those negotiated in the Letter of Intent (LoI) Framework Agreement process".[6]

The Agency's Steering Board made up of the Defence Ministers adopted a regime for a **Code of Conduct** applicable from July 2006 on defence procurement under Article 296 TEC which aims, among other things, to get subscribing Member States to undertake to support efforts to simplify intra-Community transfers and transits amongst them of defence goods and technologies. The Code will only apply to

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[3] Germany, Spain, France, Italy, United Kingdom, Sweden.

[4] Amended on 25 April 2005, OJ C 127, 25.05.2005, p. 1.

[5] COUNCIL JOINT ACTION 2004/551/CFSP of 12 July 2004 on the establishment of the European Defence Agency. OJ L 245, p.17.

[6] External Relations Council, 17 November 2003, Doc. 14500/03, page 13.

Member States who choose to subscribe to it, and these remain free to cancel their participation at any time.

1.2. Community legal framework

According to the case-law of the Court of Justice of the European Communities, **Community law applies** to defence-related products, as it does to all other products. In particular, the principle of free movement of goods and services and commercial policy (Articles 28, 49, 133 TEC) are applicable. By their very nature, export authorisations are one of the measures which create quantitative restrictions or measures having equivalent effect (ECJ, Case C-70/94, Werner GmbH v Federal Republic of Germany concerning the prohibition of exports to non-member countries, covered by Article 133 (ex 113)) which Community law aims to eliminate with regard to intra-Community trade.

Nonetheless, Articles 30 or 296 TEC allow Member States to justify restrictive measures by demonstrating on a case-by-case basis that they are needed and proportional to protect national security. However, it is not possible to infer from these articles that there is inherent in the Treaty a general proviso covering all measures taken by Member States for reasons of national security (Opinion of Mr Advocate General La Pergola, Case C-273/97, Angela Maria Sirdar v The Army Board and Secretary of State for Defence, point 11). Thus Articles 30 or 296 have no effect on the Community's **legislative** power to lay down measures concerning the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market (Article 95(1)).

2. WAYS TO IMPROVE EXPORT AUTHORISATION SYSTEMS

2.1. Continue intergovernmental cooperation

The Letter of Intent which aimed to facilitate the restructuring of the European defence industry, signed on 6 July 1998, and, to an even greater extent, the Farnborough Framework Agreement of 27 July 2000, set up a framework for cooperation among six EU Member States. This included an undertaking by the signatory nations to apply simplified export procedures to transfers carried out as part of joint developments and production programmes, and as part of purchases by a signatory nation's military forces of the system produced, and of its components. In 2004, the work programme of the group entrusted with preparing the implementation of this undertaking drew up a transposal agreement asking the signatory nations to grant national manufacturers (or the lead manufacturer of a group) with **global authorisations** for any transfers needed to implement an cooperative armaments programme, and to recognise the global authorisations granted by the competent authorities of the other signatory nations. The conditions (e.g. duration, quantity, value) of the global authorisation would be laid down by the competent authority, and exports to countries other than those taking part in the cooperative armaments programme would be restricted to the countries included on a "white list" drawn up by common agreement for each project.

A recent attempt by a major arms-producing country to establish a free-trade area for defence equipment, technology, information and personnel (a Schengen-like defence area)

did not attract the support needed at this stage for the constructive, in-depth work which would allow the idea to be pursued within the framework of the LoI.

During the consultation carried out by the Commission, certain Member States which were taking part in this intergovernmental cooperation, suggested to the other 19 Member States that they should participate in this cooperation in order to extend its benefits to the Community as a whole and, at the same time, eliminate the discrimination that currently resulted from the limited participation. This would without a doubt have the advantage of making use of an instrument which was already available, thus saving resources and time.

On the other hand, it would require some sort of unanimity from the group of 19 Member States. Their reaction left no hope that this option would be successful, not even over the long term. It seems that these countries feel that the rules decided on by the current participants should be negotiated anew as a condition for them to join. Moreover, the Member States prefer cooperation through the European Defence Agency. If this impression is correct, the argument in favour of extending an existing instrument would become irrelevant.

2.2. Reinforcing the European Security and Defence Policy

In 2002, the Council Working Party on Armaments Policy (POLARM) received a German proposal for a common position of the Council which, in order to simplify cooperation between Member States' defence industries, aimed to:

- apply mutual recognition to export authorisations and
- abolish the principle of export authorisations itself with regard to intra-Community transfers or to
- significantly reduce their scope at national level.

Exceptions would be possible where transfers posed a risk to public order or security, or to the defence interests of Member States. This proposal did not cover products which could be exported outside the European Union, or the export of which was prohibited or limited by international treaties, systems or conventions, as stated in the first criterion of the European Union Code of Conduct on arms exports.

This work was not successful, despite the fact that it had enjoyed majority support in the Council. Among the reasons put forward were the difficulty of organising export controls on the basis of unharmonised documents, the connection with the fight against terrorism requiring national control to be maintained, and issues regarding the preservation of sovereignty against the interference of the European Union with regard to the regulations which applied to trade and the circulation of war material. Moreover, at that stage, certain Member States were still hoping that the future Constitution might redefine the EU's legal framework and the distinction between the three pillars. The consultation carried out by the Commission did not give any indication that support for this initiative had considerably increased.

2.3. Proposing a Community instrument

This is the reason why thought should continue to be given to an instrument at Community level.

2.3.1. Objectives

Article 95 TEC gives the Community the right to approximate national provisions regarding export authorisation systems for the purpose of eliminating barriers to intra-Community trade. The Commission is the only player who would be able to pave the way for this by putting forward a proposal for a specific legislative instrument for defence markets. This instrument would have to lay down measures which were sufficient for ensuring the national security of Member States. In this way, it would create the indispensable guarantees which would allow the Member States to come to an agreement to weaken, or even abolish, the principle of prior authorisation with regard to the circulation of all defence-related products within the Community. For example, it could establish transparency of transfers at Community level and the criteria according to which Member States could certify any companies which desired such certification.

This instrument should therefore pursue a number of main objectives. It should:

- uphold the principle of free movement of defence-related products between EU Member States while providing **guarantees for the protection of national security**, particularly by organising checks at external borders;

- make a significant contribution in this way to a reassuring Member States or other purchasers of defence-related products of the **security of supply** by defence industries established in other Member States with regard to the delivery of military equipment, spare parts and accessories (e.g. ammunition) in a timely manner and independent of any crises or military action;

- replace the authorisation of each intra-Community transfer with a procedure and simplified common criteria which would make it possible to guarantee national security through general transparency and specific controls on transfers which pose a serious risk to national security;

- organise the traceability of transfers within the Community;

- confirm that it is possible for Member States to exempt themselves from these principles under certain conditions which are better suited to the specificities of this sector by taking all measures needed to protect essential interests of national security.

2.3.2. Content

a) The **scope** should cover all products which are currently covered in a Member State by a requirement for an export, import or transit authorisation, without prejudice to the possibility of justifying such a restriction, in particular on the basis of Article 296 TEC. It is, after all, justified measures especially that need to be harmonised in order to remove their restrictive effects, while measures which cannot be justified are already subject to the direct application of the principles in the Treaty. It is very clear that only if the scope is broad is the instrument likely to ensure that all obstacles detected are removed in order to gain maximum added value from industrial cooperation at European level.

- The products covered could be included on a list drawn up on the basis of the existing lists (Common list of military goods covered by the EU Code of

Conduct[7], Wassenaar Arrangement) and included in the instrument. These lists have the advantage of already existing and being regularly updated.

- Instead of a list of the products covered, the instrument could cover all defence-related products and define them in broad terms. The definition would have to be as specific as possible to provide operators with legal certainty.

- Using the common criteria of transfer risk, the Member States could themselves determine which products were covered (subsidiarity). This would involve setting up mechanisms to guarantee mutual confidence between Member States with regard to the management of the various lists.

b) The consultation carried out by the Commission revealed that the main justification for applying export control systems to the transfer of defence-related products to other Member States was the **risk of re-exportation** outside the Community after the transfer to another Member State.

Although the instrument's primary objective is to facilitate intra-Community transfers, its creation seems to be dependent on a number of compensatory measures intended to define and guarantee the converging implementation of the common export policy. Any Community system should therefore provide Member States with the **guarantees** that are both required for their national security and other important considerations of general interest, and appropriate for the risk arising with each transfer.

The instrument should define the principles of an export policy on the basis, in particular, of the European Union Code of Conduct. Experience of applying these principles suggests that there is sufficient consistency among arms export policies to make this approach worth exploring. This could, if necessary, be completed by a list of the third countries to which exports would be authorised (a white list based on the "dual-use" approach.) Work under the LoI has led to a solution which applies only to cooperative programmes and aims to limit exports to non-signatory nations via a white list of authorised countries for each cooperative programme. Each Member State should therefore explicitly authorise any export to any third country of any product freely transferred within the Community.

c) What guarantees are there regarding the converging implementation in all the Member States of this export policy which would compensate for the abolition of individual authorisations for transfers between Member States? These must build up confidence in each Member State in the way in which the recipients of these products, and the competent administrations grant the authorisations needed for re-export to a third country, while at the same time setting up checks on the actual movements of defence-related products to make it possible to verify compliance with the rules and the final destination of a product. Several ways of doing this have been recommended in the UNISYS study: transparency and traceability of products and certification of companies.

Carrying out **checks** on the basis of the **transparency** and the **traceability** of all transfers: A reference number would be assigned to each transfer of a defence-related product on the basis of a declaration by the company which would include certain information on the details of the consignments, without requiring the final destination to

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[7] Amended on 25 April 2005, OJ C 127, 25.05.2005, p. 1.

be declared under the conditions. At the heart of the system lies the assignment of a Movement Reference Number (MRN) which is normally granted by the national administrations within a very short time – a few hours – and is actually a simplified electronic licence. In addition, to enable the competent authorities to trace products during transport, this information on the consignment would be stored in the computerised transfer recording system for defence-related products which could be run by the Commission a similar way to the existing system monitoring excise duties. Under the control of the governments of the Member States, the Commission has already created a system regarding transactions between companies called EMCS (Excise Movement and Control System), the purpose of which is to replace the "all paper" system with intra-Community monitoring of each transfer of products which are subject to controls.

Creating confidence by certifying companies:

- Member States would have to be sure that companies established on their territory would be able to ask for certification of compliance with certain criteria which the Community instrument would have to define. This certification would be valid for a predetermined period, for example, three years. Only certified companies could continue to trade in defence-related products at Community level without prior authorisation of individual transfers. Certification would have effects similar to a global authorisation without limits of quantity or value, but would be based on an overall undertaking by a company and would not be limited to a single cooperative project. Member States would recognise and grant the same effect to certifications of companies established in other Member States.

- In cases where producers or recipients are not certified, Member States would continue to grant individual export or import authorisations at the request of the companies.

d) The purpose of **certification**, for which each Member State would designate a certification authority, would be to ensure that certified companies had actually built into their internal organisation procedures for complying with all specific restrictions on exports of certain defence-related products or technologies laid down in the Community instrument or in the national law of the Member State in which the certified company was established. Certification would generally comprise a regular audit and be subject to a number of criteria (establishment in the Member State granting certification, experience in international activities, implementation of technical and administrative structures and procedures for assessing and storing the relevant documents, designation of an internal security administrator with supervisory power, submission to appropriate penalties for offences, absence of previous serious offences, financial health, etc.). Certification would be withdrawn if serious offences were substantiated.

How can the requirements of certification be reconciled with the specific situation of SMEs? The conditions of certification must not introduce disproportionate constraints for SMEs as compared to the current situation. Would it be possible to adapt these conditions according to the sensitivity of the products being transferred?

Transparency would also have to be ensured: a list of certified companies, and possibly of products identified, could promote legal certainty for companies planning to make transfers, while transparency of individual authorisations should inform companies on the

situations, products, or categories of products which require authorisation according to the Member States in question.

e) A **safeguard** clause would, under certain conditions, allow Member States to limit the circulation of defence-related products to Member States which would not guarantee that their companies complied with the guarantees set out in the Community instrument. This would allow a Member State to temporarily interrupt transfers to another Member State if, for example, it became aware that the companies certified by the Member State seriously and repeatedly violated the conditions of certification, and in particular the limits on re-exporting transferred products.

2.3.3. Means

Of the Community legal instruments provided for in the Treaty to ensure proper functioning of the internal market, only directives and regulations are binding.

Under the policy of "better regulation"[8], the Commission continues, on a case-by-case basis, to pursue the potential simplification offered by opting for regulations rather than directives because of the speed of entry into force and the legal certainty that they provide throughout the Community.

Specific questions:

General

Under what conditions could a Community measure add value to the current systems of checks on transfers from the point of view of the security of commercial transactions, the protection and safeguarding of the public interest and the simplification of procedures for businesses?

Is defining a common export policy a pre-requisite for abolishing intra-Community controls or would it be possible to set up a transitional system until such a policy was defined?

Scope

Could the common list of military goods covered by the EU Code of Conduct serve as a reference for applying the arrangements governing the movement of defence-related products? Are all the products on the list authorised to circulate on the national market?

Should sensitive transfers at Community level be identified through a positive list of products, or would it be sufficient to determine common criteria (e.g. conventional weapons, nuclear weapons, cryptographic products) with several examples and leave the details of individual cases up to Member States? Taking another approach, would it be

[8] Communication from the Commission to the Council and the European Parliament - Better Regulation for Growth and Jobs in the European Union, COM(2005) 97 final, 16.03.2005; Commission communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions — "Implementing the Community Lisbon programme: A strategy for the simplification of the regulatory environment", COM(2005)535 final, 26.10.2005.

possible to consider transfers which are a government purchase by an EU Member State as transfers which are, in general, not sensitive?

Arrangements for checks

On businesses:

Do the arrangements governing movement need to make the businesses which would like to take advantage of it subject to conditions which would give the public authorities guarantees? What guarantees would be necessary insofar as security, confidentiality, etc. requirements are concerned? Can certification systems (ISO 9000) provide these guarantees?

In such a situation, how could account be taken of the situation of SMEs? Is it possible to have specific arrangements for SMEs without affecting the confidence between Member States?

On transfers:

Should a product monitoring system for the exporting Member State be paper or computer-based? Is the common list enough to ensure that Member States of transit will ensure compliance with the Member State of origin's export policy?

Arrangements for export

Could the Member States of transit be required to check the agreement of the Member State of origin in the file which the exporting company must submit?

Could the arrangements be simplified by introducing a white list of authorised exporting countries ?

Is it possible to move towards arrangements similar to those for dual-use products?

Arrangements for management

Managing the instrument will call for specific expertise and confidentiality requirements (updating lists, dealing with unusual cases, etc.). What role should the European Defence Agency play?

The legal instrument

Do the specific constraints justify drawing up a directive or regulation?

The Consultation document is available on the Internet at:
http://europa.eu.int/comm/enterprise/regulation/inst_sp/defense_en.htm

Interested parties may submit their comments in writing to the Commission by e-mail
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