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**IMPLEMENTING EUROPEAN UNION STRATEGY  
ON DEFENCE-RELATED INDUSTRIES**

## IMPLEMENTING EUROPEAN UNION STRATEGY ON DEFENCE-RELATED INDUSTRIES

### SUMMARY

*The need to implement a European Union strategy to keep up with the major changes in the European defence-related industries is becoming more pressing every day. The industrial and technological base of defence are both precious in terms of economic development and indispensable for weapons capabilities. Despite the urgent warning and call for action issued by the Commission in its Communication of January 1996 on the defence-related industry, the situation in the sector has deteriorated since then. Employment in the industry fell by 13% between 1993 and 1995. In 1995 the value of European Union imports of defence-related products from the United States was six times the value of its exports of the same category, whereas in 1990 the ratio was five to one, and in 1985, four to one. In 1996 it took eight European defence undertakings to achieve sales worth \$60 billion, while the three biggest American undertakings alone achieved sales of \$90 billion. This trend is even more worrying when one considers how it compromises the political objectives formally enshrined in the Treaty on European Union concerning the "eventual framing of a common defence policy". The essential responsibility for restructuring the defence industry lies with the Member States. However, their cooperation within the framework of the Union is important and the purpose of the Commission's initiatives is to facilitate the development of such cooperation.*

*An integrated European market for defence products must be set up using a combination of all the instruments at the Union's disposal: Community and Common Foreign and Security Policy legislative and non-legislative instruments. The Commission proposes a global approach to implementing this strategy:*

- a proposal for a Common Position on drawing up a European armaments policy. The Commission calls on the Council to adopt the proposed CFSP Common Position in order to open up the debate on the major issues relating to such a policy and promote the Member States' commitment to its establishment. The areas specifically covered by the proposal are intracommunity transfers, public procurement and common customs arrangements.*
  
- an Action Plan for the defence-related industries. The Plan put forward by the Commission describes the areas in which immediate EU action seems necessary. The Commission will take appropriate steps to develop more detailed versions of the measures outlined in the Plan.*

*The speed and scale of current change make it imperative for the Union to initiate practical action on this matter in 1998.*

### 1. THE CONTEXT

In the last few years the European defence-related industry has been undergoing restructuring, shaped notably by the new security environment and international competition. The process involves, *inter alia*, shedding jobs and reducing production capacity. National frameworks no longer have the capacity to achieve the scale of restructuring needed. A European framework is now essential to provide adequate solutions, but it has not yet evolved into a source of rules governing a European market

for armaments. Similarly, the objective of gradually defining a European defence policy is accepted, but the first steps towards a common defence initiative have not yet produced any list of specific European needs regarding defence equipment.

The essential responsibility for the restructuring process lies with the Member States because of the nature of the sector. However, cooperation between them at European level seems important for the success of this process. The purpose of the Commission's initiatives is to facilitate the development of such cooperation.

The process of restructuring and consolidating the European defence-related industry, which should be carried out on a European scale, cannot progress satisfactorily unless market barriers are lifted and a clear, reliable political and institutional frame of reference is provided. The European Union must take the necessary steps to establish this regulatory framework. The urgent need for such action is still greater given the fact that the European industry's biggest competitor, the United States industry, has achieved a much greater level of consolidation with the open and practical support of the Administration. The US industry's success in exporting arms to international markets is closely linked to the size of the American undertakings and their special relationship with government. The Commission Communication on the aerospace industry<sup>1</sup>, which highlights the striking difference between the situations on either side of the Atlantic, calls for a reaction at Community level and contains some valuable suggestions on this matter which are equally applicable to other sections of the defence-related industry.

The Union accepted the need to adopt a strategy in this area as far back as the summer of 1995, when the Council established a working party on European arms policy with a mandate to put forward specific measures for areas within the Union's jurisdiction; these recommendations could be formulated as Community or CFSP measures. After two years of work, although the group has been unable to formulate any recommendations, it has made useful progress in defining the special characteristics of this sector and identifying areas in which action should be taken as a priority.

The Treaty of Amsterdam sets the course for the development of an armaments policy. Article J.7.1 stipulates that "The progressive framing of a common defence policy will be supported, as Member States consider appropriate, by cooperation between them in the field of armaments." The Declaration on Western European Union, which will be annexed to the Amsterdam Treaty and was adopted by the WEU Council of Ministers on 22 July 1997, provides for armaments cooperation between the EU and WEU "in the context of rationalisation of the European armaments market and the establishment of a European Armaments Agency."

The imminent establishment within the WEU of the Joint Organization for Armaments Cooperation (OCCAR), which will have important responsibilities in the management of joint armaments programmes, is an essential step towards setting up the European Armaments Agency. The latter body, which will have extensive responsibilities for all factors affecting the definition and organization of demand for armaments products, will facilitate the restructuring and consolidation of the European defence industry. Commission initiatives are also contributing to this process by helping to create a suitable environment for setting up the Agency sooner rather than later. In the interests of economic efficiency, the creation of a European market for defence products and the

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<sup>1</sup> COM(97) 466.

establishment of the Agency should not be treated as unconnected. Complementary rules of operation should be developed for the market and the Agency so that a homogeneous overall framework can be established. The establishment of OCCAR and the preparation for setting up the European Armaments Agency must take full account of EU *acquis*. This, together with the development of a European armaments policy, means that more effective links will have to be established between Union institutions and the Western European Armaments Group (WEAG).

As far back as January 1996 the Commission presented a Communication on the challenges facing the European defence-related industry in which it outlined the action the Union should take. The strategy indicated in this document was approved by Parliament which, in June 1997 adopted a detailed resolution on EU initiatives. The Economic and Social Committee also approved the communication. The Commission has built up close links with the defence-related industry and through meetings and discussions with its representatives it has identified the most important areas in which action should be taken in the short and medium term.

It has to be said that since the Communication was adopted in January 1996 the situation of the defence industry has deteriorated still further. The warning then issued by the Commission did not trigger action at Community level. According to BICC (Bonn International Center for Conversion) data for 1997, employment in the defence-related industry fell by 13% between 1993 and 1995. US Arms Control & Disarmament Agency statistics show that in 1995 the value of European Union imports of defence-related products from the United States was six times the value of its exports in the same category; in 1990 the ratio was five to one; in 1985 four to one. In 1996, thanks to consolidation, the three biggest American defence undertakings achieved sales of more than \$90 billion, while it took the eight biggest European undertakings to achieve a total of \$60 billion in sales. These figures should be considered in the light of the fact that there is a single internal market for American companies which is considerably bigger than all the Member States' markets put together. Since 1990 the market for defence products has fallen significantly in the Member States because of the end of the Cold War. The United States, faced with a similar decline, reacted to the new situation by restructuring its defence-related industry. The European market is still too fragmented and the level of intracommunity trade in defence equipment is astoundingly low compared to total procurement by the Member States.

This downward trend in the industrial base is all the more worrying if one considers how it compromises the objectives formally adopted by the Member States. The Amsterdam Treaty, which was finalised at the Amsterdam European Council in June 1997 and signed on 2 October, provides for the first time (in the first subparagraph of Article J.7.1) that "the common foreign and security policy shall include all questions relating to the security of the Union, including the progressive framing of a common defence policy ... which might lead to a common defence, should the European Council so decide." The Atlantic Alliance, at its ministerial meeting in June 1996 and at the Madrid Summit in July 1997, stressed the emergence within the Alliance of a European security and defence identity and set out a number of guidelines to further this process. But there can be no European defence policy or identity without a healthy and competitive European technological and industrial base.

## **2. EUROPEAN UNION STRATEGY**

The need to implement a European Union strategy to keep up with the major changes in the European defence-related industries is becoming more pressing every day. The most important undertakings in the sector and the association representing them at European level are calling for action by EU institutions. The defence-related industry and the context in which it operates are changing fast, although not so fast as its American counterpart. The factors driving this change are still at work. The Commission Communication on the European aerospace industry<sup>2</sup> stresses the importance of these changes in the United States and the need for drastic action in Europe. It is not possible for the aerospace industry of any single Member State alone to maintain adequate performance and competitiveness. It is vital to consolidate the industry's non-military and military activities at European level. The same applies other defence-related sectors. There, too, change within the industry must be accompanied by public measures at European level. The industry needs a reliable and transparent frame of political and legal reference and it needs it soon.

The Commission Communication of January 1996<sup>3</sup> gave rise to a widespread debate, a key product of which was the Parliament resolution adopted in May 1997 which strongly endorsed the Commission's ideas. The Council's working party on European armaments policy ("Polarm") has reviewed the positions of the Member States and found a number of points of convergence:

Firstly, the Union must maintain the industrial and technological base of its defence-related industry. This base, which increasingly involves dual-use products, is valuable for economic development and indispensable for a weapons capability. The reasons for maintaining it therefore relate to establishing a European defence identity and to competitiveness and jobs in crucial manufacturing sectors.

Secondly, the Union is one of the preferred frameworks for action in this area. It complements others such as the national frameworks and those of the defence organisations to which most Member States belong. The Community framework has proved its efficacy in setting up European markets for non-defence products; Union instruments can now also serve the same purpose for defence products. This kind of market would be of great benefit to the defence industry. The Union should therefore apply a combination of its legislative, non-legislative, first pillar and second pillar instruments.

Thirdly, the different strategies afforded by these instruments need to be combined because of the particular nature of the defence industry, namely that it is both a major means of production and essential to foreign and security policy. Any action by the European Union has to take this dual nature into account, if necessary by adapting the resources within the Community's jurisdiction.

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<sup>2</sup> Presented in September 1997.

<sup>3</sup> COM (96) 10: The challenges facing the European defence-related industry, a contribution for action at European level

In conclusion: Action should be taken at once, without waiting for a new institutional context to be established, in areas in which it is urgently needed to protect the defence sector's technological and industrial base.

### **3. COMMISSION INITIATIVES**

The Commission proposes a global approach to implementing EU strategy:

- **A proposal for a Common Position on drawing up a European armaments policy.** The Commission herewith sends to the Council a draft Common Position adopted under Article J.2 of the Treaty on European Union. This form of CFSP instrument has been used because of the foreign policy and defence dimensions of any European Union measures on arms. Following work done earlier by the Council, the Common Position proposed by the Commission sets out a number of principles and indicates where the first steps should be taken. The areas specifically covered by the proposal are intracommunity transfers, public procurement and common customs arrangements. The Council has already done work on them, specifically in connection with armaments. Furthermore, their advantage is that EU measures could be based on a substantial *acquis communautaire* in these areas. This proposal for a Common Position should open up the debate on the major issues relating to European armaments by directly involving policy-makers in the decision-making at the appropriate levels. It is intended to promote Member States' political commitment to the progressive establishment of a genuine European armaments policy.
- **An Action Plan for the defence-related industries.** The Commission has drawn up a list of areas in which it considers EU action necessary and specifies what measures should be taken at once to ensure progress towards a true European market for defence products. Some of these measures require legislation while others could be adopted under instruments already available to the Union. The Action Plan has been drafted for the attention of the EU institutions and the Member States, but also for the European defence industry. The Commission will take the necessary steps to develop more detailed versions of the measures outlined in the Plan.

In the Commission's view the Council should adopt a position on EU strategy on the defence-related industries as a matter of urgency. The proposed measures would provide a framework and a programme for initiatives at European level. The speed and scale of current change make it imperative for the Union to initiate practical action on this matter in 1998.

### **CONCLUSIONS**

- *The Council is asked to adopt the proposal set out in Annex I.*
- *The Commission calls on the Council to take note of the Action Plan attached as Annex II. The Commission will take the appropriate initiatives following the procedures provided for by the Treaty in close collaboration with the relevant authorities in the Member States.*
- *The Commission calls on the European defence-related industries and other parties concerned to cooperate in the implementation of the Action Plan.*

**DRAFT COMMON POSITION**

**ON FRAMING A EUROPEAN ARMAMENTS POLICY**

adopted on the basis of Article J.2 of the Treaty on  
European Union

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on European Union, and in particular  
Article J.2 thereof,

Whereas drawing up a European armaments policy based on the  
existence of a competitive technological and industrial base is  
an essential precondition for the development of a European  
defence identity within the framework of the Common Foreign and  
Security Policy;

Whereas specific measures, including measures on armaments, must  
be taken to follow up on the political commitment to the  
progressive framing of a defence identity which was reaffirmed by  
the Amsterdam European Council of 16 and 17 June 1997;

Whereas the Declaration by Western European Union on the role of  
WEU and its relations with the European Union, adopted on 22 July  
1997, and in particular paragraph 7 thereof, provides for greater  
cooperation between these two organisations;

Whereas Community policies and instruments can make an important  
contribution to developing a European armaments policy;

Whereas the Commission Communications of January 1996 on the  
defence-related industries and of September 1997 on the European  
aerospace industry, which focus on the urgent need to restructure  
the industries at European level and promote synergy between  
military and non-military production and trade, demonstrate the  
necessity of taking action at European level, in particular  
through the Community;

Whereas it is necessary to protect the industrial and technological defence base and promote the competitiveness of the European industry;

Whereas the defence industry is an important source of employment in some regions;

Whereas the Council has named intracommunity transfers and public procurement as priority areas for EU action;

Whereas it is in the interests of the European Union and the Community that certain imports of arms and equipment for the European armed forces should benefit from exemption from customs duties and a list of equipments suitable for exemption from such duties is therefore needed;

Whereas, in accordance with Article 223(2) of the Treaty the Council has drawn up a list of products to which the provisions of Article 223(1)(b) apply,

HAS ADOPTED THIS COMMON POSITION:

#### Article 1

For the purposes of this Common Position account shall be taken of the specific features of the armaments sector as defined in the annexed document.

#### Article 2

The Council considers that developing an effective European armaments policy entails using CFSP and Community instruments.

### Article 3

The Council notes that European armaments policy is linked to Community policies, in particular on industry, trade, customs, the regions, competition, innovation and research.

### Article 4

The Council notes that the Commission has presented an Action Plan for the defence-related industries calling for the application of a number of Community instruments and that the Commission will take the appropriate initiatives to ensure that it is implemented. The Council declares its intention of using the Plan to further develop a European armaments policy.

### Article 5

In accordance with Article M of the Treaty on European Union, the following measures will be adopted as soon as possible following the appropriate procedures:

#### 1. *Movement of goods*

- a simplified system applicable to intracommunity transfers including export and re-export guarantees, and monitoring and surveillance mechanisms;
- binding principles, rules and mechanisms on transparency and non-discrimination in respect of procurement, taking current Community public procurement rules as a guiding principle.

#### 2. *Customs*

The Council undertakes to draw up, before 31 December 1998, a list of products which could be exempt from the common customs tariff in the light of the defence needs of the Member States and the desirability of encouraging the development of a European armaments policy.

Taking account of this list Commission will, where appropriate, make appropriate proposals for exemptions based on the Treaty establishing the European Community.

#### Article 6

This Common Position shall be reviewed 18 months after its adoption.

#### Article 7

This Common Position shall enter into force on the day of its adoption.

This Common Position shall be published in the Official Journal of the European Communities.

**Definition of specific characteristics of the defence-related sector**

*(Text drafted by the working party on European armaments policy and approved by the Coreper on 10 December 1996)*

1. Any definition of the characteristics specific to the defence-related sector must begin with the current circumstances in which the sector finds itself. There are a number of political and economic factors which have specific relevance for this sector. On the political side, there is the impact of the end of the Cold War and the changes that have resulted in the international climate in which foreign, security and defence policy is formulated and conducted. There is also the development of the EU's Common Foreign and Security Policy (CFSP), which "shall include all questions related to the security of the Union, including the eventual framing of a common defence policy, which might in time lead to a common defence". The EU's Intergovernmental Conference is currently reviewing the CFSP provisions of the Treaty on European Union. At its meeting in Berlin in June 1996, the NATO Ministerial Council agreed to develop the European security and defence identity within NATO, and the WEU and NATO are currently working on the implementation of the inter-related aspects of the decisions taken in Berlin.
2. On the economic side, the domestic demand for European defence equipment has been falling since 1987 and the global arms market has practically halved in the last decade. This reduction in the national defence budgets of European countries has implications for the survival of an independent industrial and technological defence base. Employment in this sector has fallen by 37% since 1984 (from 1.6 million to 1 million). This has hit certain regions in particular and has implications for the manufacturing base and innovation capacity of European industry as a whole. The market remains fragmented - in the 1988-92 period, intra-European trade amounted to 3-4% of total procurement. The lack of competition and impossibility of fully exploiting economies of scale has worsened the competitive position of the European industry vis-à-vis the US since the 1980s. The consolidation of defence-related industry has advanced much more in the US than in Europe, due to, inter alia, less fragmented market conditions in the US, an insufficient degree of harmonisation of European operational requirements and the various security imperatives in Europe.
3. The specific characteristics of the armaments sector, which have been acknowledged since the foundation of the Community, are taken into account by the provisions of Article 223 of the Treaty.

4. The defence-related industry is a strategic industry, the products of which can be crucial to national defence. Unlike in other industries, where economic considerations are the determining factor, security and defence policy, to varying degrees, also dictates national armaments policy. Political, strategic and security considerations accordingly come into play in determining the conditions within which the industry operates and the demand for its products.
5. 90% of the production of EU defence equipment is concentrated in some Member States: France, UK, Germany, Italy and Sweden.
6. Since governments are the only customers, and in some cases a major owner of defence industries, the market differs from most other sectors of the economy. Also, relations between the government and defence-related companies differ considerably between Member States, for example the extent of State ownership, the extent of funding for R&D, etc. The role of governments explains many of the characteristics of this sector and has a major influence on the way it is built up and restructured. At the same time, the industry itself has a specific role and responsibilities in this regard.

The following considerations arise in the context of the role of governments :

- in the first place, the production and trade of armaments are subject to governmental authorisation ;
- secondly, governments being the sole customers, they are therefore alone in defining operational requirements and technical specifications. As sole customers, governments determine demand for the industry's products ;
- furthermore, long-term demand cannot be forecast with certainty, since it is dependent on the evolution of threats, which influences the assessment of needs and budget planning;
- in addition, the quality-price relationship is not the sole criterion which determines procurement policy. Offset (compensation), including industrial co-operation agreements, as well as strategic political, economic and security considerations can also be a factor ;
- finally, national defence interests require guaranteed sources of supply. The requirement for security of supply goes beyond the normal customer supplier relationship. In certain areas, some Member States consider an indigenous capability essential for their national interest. This should not, however, prevent governments from purchasing from an external supplier.

7. The long-term technological value of the industry is important. This includes the maintenance of both technological and industrial capabilities. Defence programmes can be spread out over 20-30 years, and, following lengthy development programmes, equipment can have an in-service life of as much as 30 years or more.
8. Confidentiality regarding sensitive military information is crucial to national interests. This can lead to constraints on competition and to relationships between customer and supplier which are more close-knit than usual.
9. Many products in the armament sector carry disproportionately high Research & Development costs. High standards are required, as technological advances are necessary to national defence. However, returns on this investment are uncertain. Mass production, which might offset high R+D costs, is rare in comparison with civil industry. The need for confidentiality can preclude the wide circulation of technological developments and the financial benefits of such a circulation. There will always be a need for one-off products, which it may be uneconomical to produce. Numbers of programmes are limited and R+D teams sometimes cannot be supported by purely commercial means during intervals between programmes. Commercial organisations driven by market-t forces could not be expected to make the necessary investment in R+D and government support could be therefore required.
10. Some defence-related technologies can have both civil and military applications. However, there is an increasing synergy between civil and military technologies in some areas and the above characteristics of purely military programmes may not apply to all defence-related or dual-use domains.
11. The exports of this sector are subject to government authorisation. Arms export policies, including export control policies of Member States, differ. The European Council has adopted Common Criteria to be applied to arms exports.

#### Conclusions and recommendations

12. It was concluded that the analyses contained in this paper of characteristics specific to the defence-related sector is a useful contribution to the ongoing consideration of items on the agenda of the Ad Hoc Working Party on European Armaments Policy, and will be taken into account as appropriate, inter alia, in the deepening discussions on "the simplification of controls governing intra-EU transfers of armaments and other defence related products" and "procurement policy". It is recommended that in accordance with its mandate the Ad Hoc Working Party should keep the item "definition of characteristics specific to the defence-related sector" on its agenda, with a view to further developing its analyses in the light of future developments.



EUROPEAN COMMISSION

/Annex II

## Action Plan for the defence-related industries

## **Action Plan for the defence-related industry**

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## **I. INTRODUCTION**

The Treaty on European Union as well as the new Amsterdam Treaty offer a context for action in the area of defence-related industries by calling for enhanced co-operation between the European Union and the Western European Union. For this co-operation, the European Commission could offer its experience and legal and administrative structures in support of this new relationship.

The necessary urgent restructuring of the defence industries in Europe, which are still nationally based, requires that a European dimension is provided to this industry and to the market, demand and supply sides, in which it operates.

As far as the demand side is concerned, the role of Member States, the WEU and other multilateral organisations is particularly important in areas such as the harmonisation in time and content of operational requirements and the creation of a European Armament Agency to run programmes with a European dimension.

- As far as the supply side is concerned, intense discussions, during the recent months, between the Commission and industry have been useful in identifying industry's requirements to establish a strong, integrated and competitive European Defence Technological and Industrial Base.

This Action Plan takes into account the issues raised by industry that fall within the competence of the European Union. It will be implemented according to the Timetable provided in chapter VI.

Some of these actions were also drawn up together with a Common Position, under Article J.2 of the Common and Foreign Security Policy (CFSP).

## **II. DEFENCE INDUSTRY RESTRUCTURING**

In response to declining demand and increasing competition a restructuring process has started among the European defence industries. So far the restructuring has mainly taken place on a national level, but the need to pursue these efforts at a European level is pressing.

The European industry must be allowed to carry out the necessary restructuring process, co-operate or merge activities where they are similar or complementary and improve its competitive position. Whilst industry must lead this process, the Member States and European Institutions and Organisations must strive to establish the necessary framework to allow for the proper functioning of the European defence-related equipment market. When creating this framework the European industry's position in the global arena must be taken into account.

### **III. THE EUROPEAN DEFENCE TECHNOLOGICAL AND INDUSTRIAL BASE**

The defence technological and industrial base, including technological know-how, R&D facilities, a skilled work-force, manufacturing facilities and a marketing and export capacity, is a vital strategic asset for Europe and needs therefore to be consolidated and preserved. Some very important reasons for this are:

- It is a pre-requisite for the establishment of a genuine European Security and Defence Identity;
- It is a necessity for the preservation and the development of an important technological and industrial base which is of importance both for military and civil purposes;
- It is an important factor for employment, particularly in specific European regions, and for many SME's.

The situation as it is today, with European companies fragmented into too many and too small national suppliers, is no longer sustainable. The consequences of the present structure are for example:

- Costly research and development of similar technologies and systems by national suppliers;
- Too small batches of systems and therefore inadequate economies of scale.

### **IV. OBJECTIVES FOR AN ACTION PLAN**

The main objectives of the Action Plan are therefore to establish the necessary conditions to:

- strengthen the competitiveness of the European defence industry;
- preserve the Defence Technological and Industrial Base;
- favour the integration of European Defence Technological and Industrial Base in the general economy to avoid duplication of efforts between the civil and the military areas;
- create the necessary preconditions for a European Security and Defence Identity.

### **V. ACTIONS**

A timetable for the actions proposed below can be found in chapter VI. The timetable shows that the Commission will work in parallel with actions to be implemented in the short term and actions that will be implemented in the medium term.

#### **V.1 Simplification of Intra-community transfers**

National procedures relating to intra-Community transfers of defence related products are burdensome and time consuming. A simplification of these procedures could increase the competitiveness of the European defence industry and lighten the administrative tasks and reduce costs.

The simplification objective cannot be obtained without a significant commitment by Member States. It also supposes the establishment of confidence mechanisms between the Member States. The Commission will therefore propose to put in place a simplified licensing system applicable to the shipment of defence related products within the European Community. This system shall comprise guaranties for exports and re-exports as well as mechanisms for control and surveillance.

## V.2 European Company Statute

The creation of a European Company Statute which would help the creation and management of companies with a European dimension will facilitate the necessary restructuring of this industry. The Commission will continue its efforts to create such a legal framework.

The report of the "Davignon Group" on the European Company Statute opens new perspectives for political agreement on employee involvement in the European Company in the months ahead. If this hurdle can be overcome it could lead the way to the adoption of the Statute as one of the priority measures foreseen in the Single Market Action Plan agreed at the Amsterdam European Council of the European Union. It is therefore important to obtain a favourable Council decision on this subject as soon as possible.

## V.3 Public procurement

The concrete system of rules that will apply to procurement of defence equipment will impact substantially on the way a competitive Defence Technological and Industrial Base will be set up.

This framework should make provision for competitive tendering whenever feasible.

Furthermore, it must favour the maintenance and development of the fundamental industrial capabilities and key technologies at European level. In addition, these rules must guarantee the security of the necessary supply, while enabling a progressive elimination of over-capacity.

To this end, taking into account the need to build broad support in this matter, it is necessary to establish an appropriate set of principles, rules and mechanisms on procurement by the defence sector. In order to take into account the specificities of the defence sector, and in particular the need for confidentiality and security of supplies, an appropriate level of flexibility should be envisaged where necessary.

For this purpose, materials for the defence sector could be divided into three categories:

- Products intended for the armed forces but not for military use therefore not covered by Article 223 EC nor by Article 2 of the directive 93/36 (markets declared secret, protection of vital interests, national security, etc). As these products are already subject to the Community public procurement rules, the Commission will specify, where appropriate, in the most suitable form the conditions for the application of these rules;
- Products intended for the armed forces and for military use, but not constituting "highly sensitive defence equipments". The Commission could work out a fairly flexible set of rules, while respecting the principles of transparency and non-discrimination, inspired by the existing Community public procurement rules;

- Highly sensitive equipments covered by the scope of Article 223 EC. These products could be exempted from the rules referred to above when safety or the protection of vital national interests of the country in question so require. A notification mechanism for this purpose should be foreseen in order to ensure a degree of control and transparency.

#### V.4 RTD (Research and Technological Development)

The level of research and development costs in relation to turnover is in general much higher in the military field than in the civil field. Technology plays a vital role for the competitiveness in these industries.

Increasing integration of civil and military research activities within company's is a reality in the United States, in particular in certain sectors of the defence-related industry such as aeronautics or space. The Commission, for example, highlighted this phenomenon in its analysis of the merger between Boeing and McDonnell Douglas.

It is therefore desirable that the European firms as well as Member States draw the conclusions from this development as regards the restructuring of these industries, the merging of research teams, and the impact of certain military purchases on the civil technological capacity.

The Community's Framework Programme for Research and Technological Development<sup>4</sup>, is aimed solely at civil objectives. Some of the technological areas covered (e.g. materials, Information and Communication Technologies - ICT) have a multiple use dimension: the development of these technologies can contribute to the improvement of the defence technological base and the competitiveness of this industry.

The Commission also considers that the complementarity between national and European research programmes should be reinforced to avoid a wasteful duplication of effort.

#### V.5 Standardisation

Setting up a European defence equipment market and consolidating Europe's defence industrial base will call for an effort to rationalise the sets of standards currently being used by the defence ministries of the Member States.

With increasing use being made of dual-use technologies in the military systems, the current trend is to make as much use as possible of civil standards.

The on-going replacement of military standards by civil standards in the US should be considered so as to avoid that the European industry finding itself at a disadvantage.

It is with the purpose of promoting the use of international industrial standards that the Commission is proposing to take into account the experience gathered in the field of standardisation by the Community.

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<sup>4</sup> The Commission adopted, on 9 April 1997, its proposal for the Fifth Framework Programme (COM(97)142).

Therefore, the Commission will pursue the following actions:

- inviting the industrial circles concerned to get together to draw up a work programme for identifying a homogeneous system of standards for defence equipment programmes;
- assessing different ways and means of setting up a system of regular exchange of information between NATO and the European standardisation bodies, so as to reduce as far as possible the risk of duplication of efforts in the future;
- providing support at Community level to the standardisation organisations concerned that have agreed on the need to act. For this support, careful consideration will be devoted to taking account of the particular characteristics of the industrial sectors concerned (aeronautics, space, electronics, mechanics...) and the “defence” specificity of the topics covered.

#### V.6 Customs duties

Common tariffs for imported products is a basic principle of the Customs Union and the Single Market.

Article 28 of the Treaty therefore constitutes the only permissible legal basis for granting autonomous suspensions. In this respect, the existence of differing national approaches for tariff arrangements for imports of military or dual-use equipment generates unequal treatment of operators and for this reason common rules on the tariff arrangements for such equipment need to be established.

Therefore:

- legislative initiatives should be taken to harmonise tariff arrangements with a view to achieve equal treatment of operators throughout the Community;
- the Commission proposal from 1988, for temporary suspension of import duties on certain weapons and military equipments, should be reviewed and adopted;

#### V.7 Innovation, transfer of technology and SME's

In the Commission's Green Paper on Innovation dated December 1995 the potential for civilian use of defence technologies is acknowledged. General policies to promote technology transfer can facilitate the civilian exploitation of defence technologies; and should also involve SMEs because of their interest and role in this process.

In this context, the Commission will support initiatives for the purpose of disseminating ideas, technologies and best practices. In particular, the Commission will continue to support the following activities:

- the organisation of partnering events between suppliers (e.g. INTERPRISE) and between suppliers and research institutes;
- the organisation of partnering events between main contractors and suppliers (e.g. IBEX).

## V.8 Competition policy

The emergence of a Community market for the defence industry, resulting from common programmes, from necessary restructuring and European alliances, and from common rules on public procurement requires that the Community's competition policy examines in an appropriate way all competition issues within the defence industry.

The process of restructuring the European industry, in particular the defence industry and related industries, has given rise and will continue to give rise to an increasing number of mergers and co-operations between companies within the European Union. Such a development must be welcomed as being in line with the requirements of dynamic competition and capable of increasing the competitiveness of the European industry, in particular the defence industry, insofar as it does not result in lasting damage to competition. This is why Community competition policy and in particular the Community Merger Control Regulation provides for a clear framework and quick decisions, so as to facilitate those concentrations and co-operations between companies which do not call into question effective competition. Moreover, Community control of State aids in all industrial sectors, including those of the defence sector, makes it possible to distinguish between those aids necessary for restructuring - to the extent they accelerate change, encourage research, development and innovation and reduce the social consequences of reorganisation - and for the preservation of adequate security of supply, and those aids granted for by Member States for the mere protection of their national companies which do not promote the overall competitiveness of the sector.

In this respect, it is important to recognise the specificity of the defence-related industry in the application of Community competition policy, in particular as regards the geographical scope of the market. Whilst this scope may be kept limited by public procurement rules and administrative procedures, competition may increasingly take place for certain products, at European or even world wide scale. In this context, the Commission will take into account the manner in which, in particular, governments of third countries which produce armaments formulate and apply competition law to their own industry.

## V.9 Exports

### *Dual-use goods and technologies*

A common regime for dual-use exports controls was adopted by the Council in December 1994, on a proposal from the Commission. It is based on two legal instruments, an article 113 Regulation (No 3381/94) and a Joint Action under the Common Foreign and Security Policy (94/942/CFSP) which together form an integrated system. This regime reflects the international arrangements to prevent proliferation of weapons of mass destruction.

For dual-use goods, industry and administrations are invited to provide evidence if they face disadvantages under European export control compared to US and Japanese controls. The Commission will work to balance the situation and create a level playing field in this area if such a need exists.

The Commission will draw a report on the application of the Dual-use regulation and possible proposals to strengthen and improve the current system particularly taking into account the ruling of the European Court of Justice in cases C-70/94 and C-83/94 that states that dual-use goods fall within the scope of the common commercial policy defined by Article 113.

#### *Conventional armaments*

Increasing industrial co-operation in the form of transnational co-operations and mergers is necessary to achieve an efficient industry structure. It is therefore urgent to eliminate limits to such co-operations arising from differing export policies.

In this respect it should be recalled that political guidelines already exist, notably in the form of 8 criteria adopted by the European Councils in Luxembourg (June 1991) and Lisbon (June 1992) to guide Member States in their decisions concerning arms exports.

Given the difficulties in developing a common basis for harmonisation of arms export policies, a gradual process should be pursued. First, the exchange of information on the application of the 8 criteria within the Council should be intensified.

Secondly, the adoption by Member States in the EU framework of a code of conduct concerning arms exports, which the incoming UK Presidency has indicated to be a priority, would be an important development.

The resolution adopted by the European Parliament in May 1997 in support of the Commission communication on defence industry invites the Commission to present a White Paper on the subject of arms export policy. The Commission intends to prepare such a White Paper formulating possible options for progress toward a common arms export policy, which could contribute to the establishment of an effective code of conduct.

In the case of co-operation programmes further progress could be achieved on the basis of some experiences, namely by following the principle whereby will apply the export rules of the country where the prime contractor is established or where the final assembly and the physical export takes place.

#### V.10 Structural funds

In Agenda 2000, (EU-Bulletin Supplement 5/97) the Commission proposes a reform for the Structural Funds in the light of the new financial perspective (period 2000-2006):

Three Objectives are foreseen under the new Structural Funds framework. In addition to Objective 1 which concerns the development and structural adjustment of regions lagging behind, a redefined Objective 2 will be created for other regions with structural problems. These are areas undergoing economic change (in industry or services), declining rural areas, crisis-hit areas dependent on the fishing industry or urban areas in difficulty. A limited number of significant areas should be identified in order to facilitate an integrated strategy for economic diversification. Objective 3 will concern the strategy for human resources outside these regions.

In Agenda 2000, the Commission does not foresee the continuation of a number of specific Community initiatives, including the one related to the reconversion of areas dependent on the defence, since these objectives could already be integrated in the aforementioned programmes as such.

Possible needs for diversification and conversion within the defence-related industry will therefore have to be properly considered when considering the new programmes for the next programming period. The new programmes supporting Objective 2 regions should focus on economic reconversion and diversification, including in regions heavily dependent on a single declining economic sector. For this reason specific attention should be given to SME's and innovation, professional education, local development, environmental protection and the fight against social exclusion. In this context, regional reconversion linked to the defence industry may also be the subject of actions aimed at the economic and social reconversion of regions covered by Objective 2. A similar approach may be followed in the regions covered by Objective 1. Further, Objective 3 could possibly contribute in the context of the adaptation of workers to industrial change.

## V.11 Taxation

### *Indirect taxation*

In July 1996 the Commission published its suggested programme for a "common system" of VAT for the European Community (EC), COM 328(96) Final. To achieve this, the new system's essential characteristics must ensure that:

- No distinction shall be made between domestic and intra-EC transactions;
- All transactions shall be taxed in the EC on the basis of the origin principle, and;
- A new mechanism to decide the place of supply of goods and services needs to be established;
- The VAT rates shall be simplified.

The Commission believes that the new system will benefit also to the defence industry. The Commission will in parallel secure a fuller implementation of the eighth directive.

### *Direct taxation*

As part of its new global approach to taxation, the Commission adopted in November 1997 a Communication outlining a tax package on which it invited Member states to reach a political agreement. Part of this package is a request to Member states to make a political commitment to work towards the early adoption of a Directive to eliminate withholding taxes on interest and royalty payments between companies. Such a directive would eliminate an important barrier to transfers of capital and technology between companies, as these withholding taxes create obstacles for economic operators: they can involve time consuming formalities, result in cash flow losses, and sometimes lead to double taxation.

The Commission's new proposal for a directive on interest and royalties can be expected in early 1998.

#### V.12 Principles for market access

Based on principles of comparable and effective access to markets, the Community should seek to remove obstacles to European exporters, including Customs duties.

In the case of the US (with which the EU trade balance is in the ratio of 1 to 6) the issue might be raised, if European and American industries so decide, in the Transatlantic Business Dialogue or in the context of the New Transatlantic Agenda (the chapter on the new Transatlantic Marketplace).

#### V.13 Benchmarking

In line with the Commission's industrial policy to promote benchmarking as a tool for increasing the competitiveness of European industry and spreading best practice, the Commission will consult industry and other relevant actors for a benchmarking exercise in certain areas of interest to the competitiveness of defence-related industries. Such an exercise could for example look at issues such as best practice for the utilisation of synergies between civil and military information technologies, best practice for the integration of civil and military standards or best practice concerning multilateral projects.

#### V.14 Enlargement

The Commission will launch a study in order to better assess the situation of defence industries in the CEEC. The outcome of this study together with other relevant informations should be used as a basis for further analysing and reflecting upon the following topics:

- the potential of the defence and industrial base of Central and Eastern European countries and its impact on European industry.
- the relevance for and the best ways of promoting industrial co-operation.

## VI. TIMETABLE FOR MAJOR ACTIONS PRESENTED IN THE ACTION PLAN (SUMMARY)

Area	Action	Timing
V.1 Intra-Community transfers	The Commission shall propose a simplified licensing regime	1998
V.2 European Company Statute	Council decision	1998
V.3 Public procurement	Proposal of rules for procurement in the defence sector	1998-1999
V.4 RTD	Establishment of complementarity between national and European research programmes	1998-1999
V.5 Standardisation	Finalisation of study. Draw up a work programme to identify homogeneous system of standards for defence equipment programming.	Second semester 1998 End 1998
V.6 Customs duties	Commission propose legislative initiatives to harmonise tariff arrangements within the Community Review and adopt Commission proposal from 1988 on temporary suspensions on import duties	End 1998  End 1998
V.7 Innovation, transfer of technology and SME's	Continue to support initiatives such as : INTERPRISE, IBEX	Ongoing
V.8 Competition policy	Take into account specificities of the defence-related industry in Competition assessments	Ongoing
V.9 Exports - Dual-use goods and technologies - Conventional armaments	- Report on the application of the Dual-use regulation - White paper - Proposal for a code of conduct	First semester 1998  First semester 1998 In accordance with White Paper
V.10 Structural funds	- Proposal for a general reform of cohesion policy according to Agenda 2000  - Negotiation of these proposals in the Council and in Parliament as well as consultation of the other institutions and bodies  - Implementation of the new regulation/framework	First semester 1998  2nd semester 1998  Between end of 1998 to end of 1999
V.11 Indirect Taxation Direct Taxation	Pursue Council discussions Propose directive on interest and royalties	Ongoing Early 1998
V.12 Principles for market access	Issue to be raised in the context of the the TABD if EU and US industries so decide or in the New Transatlantic Agenda	During 1998-1999
V.13 Benchmarking	The Commission will consult industry and other relevant actors on a benchmarking exercise in the defence-related industry.	1998-2000
V.14 Enlargement	- Finalisation of Study - Industrial impact assessment	End 1998 1998-2000

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