



Federation of German Security and
Defence Industries

BDSV Position Paper on the European Commission's Defence Action Plan



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I. Executive Summary

This paper elucidates the position of the Federation of German Security and Defence Industries (BDSV) with regard to the European Action Plan on Defence (EDAP). We have taken the six most salient issues set forth by the European Commission (EC) and expanded on them illustrating the particular concerns and pertinent interests of the German security and defence industry concerning the soon to be published EDAP. To strengthen and further develop the competitiveness of the security and defence industries within the European Union and beyond we consider the following objectives to be of vital importance:

1. The Preparatory Action on Defence Research

The basis for a successful Preparatory Action and the following programme is a sufficient financial budget as well as the involvement of the industry in the conception and implementation process. The subject orientation of the programme needs to create EU-added value and should therefore be complementary to other national or international programmes. Ultimately, research programmes must lead to procurement programmes and industrial added value.

Readiness to more
cooperation

2. Implementation and Application of the Defence Procurement Directive 2009/81/EC

Veritable Level Playing
Field

For the adoption and application of the Defence Procurement Directive, a veritable Level Playing Field is the only practical way in order to establish a fair competition within the EU defence market. The inefficient usage of the Directive is not caused by the content itself, but rather owed to missing clarification in regard to the application of the Directive in Government to Government business, procurement by an agency or in subcontracts. Instead of undoing the Directive, it must be clarified and refined.

3. Implementation and Application of the Intra-EU Transfers Directive (ICT) 2009/43/EC

Clarification on the application of the certification and internal compliance standards is needed. A follow-on delivery and service support can only be guaranteed through a free circulation of defence and military goods for the end-use of Member States within the EU.

Harmonization among
Member States

The ICT Directive should be revised to ensure that European industry is not put at a competitive disadvantage vis-à-vis its worldwide competitors. Further, less sensitive parts and components from the Military List should become eligible for General Transfer Licences with no re-export restrictions and simplified rules for their incorporation into larger products. A reopening of the Directive 2009/43/EC is not expedient or appropriate.

4. Security of Supply

Free circulation of defence
services and supplies mandatory

A well functioning Security of Supply (SoS) is implemented, if a free circulation of defence supplies and services for the end use of Member States' armed forces is possible. Also an effective agreement between Member States needs to be established, which commits them to not block internal transfers for onward export, with the only exception of essential national security interests. Subsequently, the EDTIB needs adequate investments to maintain a viable defence industry as a foundation for SoS.

5. SMEs and Supply Chain Management

Any form of restriction concerning the supplier selection (subcontracting) or the Supply Chain Management of primes creates market disturbances. Both the Offset requirements and the restrictions to subcontracting are interfering with the optimized situation. Last but not least, the competitiveness of the Supply Chain is affected, as different requirements for further customers will be imposed on the product or service than considered by the prime for the previous contract. To minimize risks and costs and to keep up competitiveness, any restrictions or distortions should be avoided or at least reduced to a minimum.

Optimized Supply Chains

6. Financial Incentives

Prevent market
distortions

Many of the past's interventions into the market only caused market distortion, extra costs and no positive measurable effects. So any intervention has to be evaluated carefully, regarding the output and consequences for the security and defence industries among all Member States. We would strongly encourage the European Commission to enter into a structured dialogue with all relevant stakeholders to systematically assess all possible options before deciding on any concrete action.



Federation of German Security and
Defence Industries

In light of recent political developments the objectives for the establishment of a Common Security and Defence Policy as well as a competitive European Defence Technological and Industrial Base (EDTIB) examined above have become increasingly time critical.

II. Subjects

II. 1. The Preparatory Action on Defence Research

The Federation of German Security and Defence Industries (BDSV) appreciates the Preparatory Action (PA) as the starting point for a full-scale EU funded defence research programme and part of the next financial framework (2021-2027). Therefore we call for a Preparatory Action, which contains and tests all relevant features of the financial framework.

The main mission of the defence related EU research programme is to support the development and implementation of the Common Security and Defence Policy (CSDP) within the European Union. From an industry's perspective, this means enhancing the self-sufficiency of Europe in key strategic technologies and assisting SoS for key defence capabilities. The programme also has to strengthen the competitiveness of the European Defence Technological and Industrial Base (EDTIB) and foster European cooperation by contributing to the preparation of joint European development programmes. On this basis, more specific objectives can be defined to ensure the EU-added value of research activities.

Such objectives could be, for example, to foster and contribute to:

- Interoperability of technologies and systems and common standards for defence systems made in the EU
- Support for the full range of possible CSDP military missions
- Capability driven technology demonstrators
- Maintaining and strengthening the capabilities and competitiveness of the EDTIB
- Non-dependency and Security of Supply within Europe for critical technologies

In addition, EU funded research activities can only have an EU-added value when they do not duplicate existing efforts. Therefore both the PA and its follow-on programme are intended

to be clearly distinguishable from each other and have to be complementary to other research programmes, i.e.: national research programmes, intergovernmental cooperative research programmes or EU-funded civil and dual-use research programmes, which are already financed by national or EU-budgets.

Governance Structure and implementation

The existing governance structure for the current security programme, consisting of an Advisory Board (stakeholders), a Programme Committee (Member States) and independent expert groups for proposal evaluations, seems an appropriate model for defence research. However, the specificity of the defence sector, and the crucial role of industry for defence research, must be fully reflected in the Advisory Board. The BDSV strongly recommends the AeroSpace and Defence Industries Association of Europe (ASD) as an appropriate interlocutor for this purpose and promotes the following governance model for an EU-funded CSDP related Defence R&T-Programme developed by the ASD:

The main defence R&T-directions and orientations have to be derived from an overall EU-Defence Strategy on Common Foreign and Security Policy (CFSP) and CSDP. Therefore they have to be defined by the European External Action Service (EEAS), as well as the Defence Minister Steering Board. A Group of Personalities (GoP) shall provide political support to the European Commission and assist the EC. A focus in the different sectors: air, land, naval, cyber and space is mandatory in order to adjust the directions the CFSP and CSDP. The Commission shall draft, release and guide annual work programmes in close consultation with the Member States, which follow the high priority orientations defined by the GoP. The Commission shall be supported by the following bodies:

An Advisory Board, which derives the main R&T-goals from the R&T-orientation for each annual work programme. The Advisory Board proposes the budgetary share for each R&T-goal and evaluates a proper balance between innovation (low technological readiness level) and capability driven (high technological readiness level) R&T-goals. All R&T-goals must provide EU-added value and follow the Capability Development Plan (high technological readiness level) and the Strategic Research Agendas (low technological readiness level). The Advisory Board proposes the project evaluation criteria for each R&T-goal and involves representatives from EU-Member States and industry. The European Defence Agency (EDA) is supposed to send high level representatives from its working bodies.

Secondly, a Programme Committee is needed to confirm the main R&T-goals of each work programme. The Programme Committee assists the Commission during the programme

drafting process. R&T-topics from the Member States can be addressed to the Commission through the Programme Committee. Further, it proposes the implementation parameters, e.g. classification, individual budget and runtime for each R&T-topic. It approves the work programmes and the evaluation as well as it selects the industry consortia. The Programme Committee is composed of Member State representatives from the Ministries of Defence (MoDs) and chaired by the Commission. The Committee should be compiled in proper balance between capability and innovation experts. Following the high priority R&T-goals and the inputs of the Advisory Group, the Commission is expected to draft each work programme with the R&T-topics.

The Commission is assisted by the Programme Committee during the drafting process. After final approval of the Programme Committee the work programmes can be adopted.

A supporting and executing agency, such as EDA, implements the work programmes on an administrative level. It performs all calls and contractual processes on behalf of the Commission. In addition, it represents the administrative project management and reports to the Commission. Furthermore an independent expert group should evaluate the proposals and report the results to the Programme Committee. Administrative support to the expert groups is provided by the supporting agency. Members of expert groups are selected and nominated by national MoDs and industry associations (through ASD) by the commission. The industry needs to form competitive consortia taking into account the general terms and conditions of the work programme. A consortia agreement makes sure the prime contractor is authorized to represent the consortium vis-à-vis the contracting agency.

General views

It needs to be taken into account that the defence market is characterized by some specifics, for example the monopsonic nature, with only one public customer per member state, in which the national MoDs (as final customers and in charge to provide the necessary technologies to the final users) determine the capability requirements. Further, very long time scales are involved in the development and life cycle of complex defence systems. Defence activities are by nature sensitive and therefore subject to specific national rules for handling classified information and export control. Any EU defence research programme must take these characteristics into account. Consequently, the conditions of the current Framework Programme, as laid out in EU regulation 1290/2013, need to be modified for

CSDP related defence research. The funding level needs to be standardized to 100% of the complete expensed cost (direct plus related indirect cost) for the respective industry effort.

Due to the monopsonic nature of the defence market, the industry should not be expected to co-finance. For strategic and security reasons, EU-funding for defence research is likely to be reserved only for EU- States. However, participation of non-EU member states should only be possible, if their participation is financed by themselves and appropriate security arrangements (e.g. for the protection of classified information) are ensured. In order to assure the reliability of all participants, we recommend a pre-qualification process for the candidates based on inputs from national security authorities. Regulations have to be specified in order to take into account national practices of classification on sensitive issues among the Member States.

Furthermore, Intellectual Property Rights (IPR) are essential for defence industries. Consequently, detailed rules for the handling of IPRs should be agreed which include the interests of both, those who fund the project and those who receive funding. The ownership of results remains with the industrial participant generating them. The industrial participant retains a hundred percent ownership of its background IPR and the EC and EDA. Access rights are limited to non-commercial and non-competitive use. All Member States' national authorities enjoy access rights to a special report of a project that has received EU-funding in which the main technology results, findings and a synthesis of performances are described.

It is understood that funded defence research programmes are a first initial step towards potential defence procurements in line with the European defence strategies und public procurement rules.

Nevertheless, Member States should commit themselves to devote at least 10% of their defence investment budgets to R&T, and at least 20% of their national R&T budgets to collaborative R&T projects. They should combine this with a firm and renewed commitment to fulfil the NATO target of spending 2% of their GDP on defence.

II. 2. Implementation and Application of the Defence Procurement Directive 2009/81/EC

The BDSV appreciates the specific objective of the EU Defence Action Plan to continue to move forward to a more efficient EU internal market for defence and security while considering the specificities of this sector. For a functioning internal EU defence and security market a harmonized application of the Intra-EU-Transfer Directive (ICT) is crucial. Further, we acknowledge the necessity of cross border competition and therefore call for a veritable Level Playing Field for applying the Defence Procurement Directive in all Member States. The reason for the lack of efficiency of the Directive is not its content, but certain aspects have to be clarified. This should be done by revision of the EC Guidance Notes. A reopening of the Directive 2009/81/EC is not expedient or appropriate.

General views

The BDSV embraces the specific objective of the EDAP to improve the current internal defence and security market towards more efficiency. This also includes a harmonized application of the Directive 2009/81/EC among all Member States in order to follow the long-term goal of a Level Playing Field. Further, we welcome dialogue with Member States in order to facilitate a proper enforcement of the Directive.

The objectives of Directive 2009/81/EC are still relevant for all Member States in order to establish an open and competitive European Defence Equipment Market (EDEM) and to strengthen the European Defence and Technological Industrial Base (EDTIB). Currently, the Directive covers only certain areas of the national procurement. Further huge differences in publication rates among Member States can be detected. This demonstrates the needs for clarification in order to establish a fair and harmonized procurement process within the EU. The use of provisions of the Directive including derogations and exclusions seems to differ significantly among Member States. Ultimately, this leads to market imbalances and distortions.

The procedures and conditions for their use under Directive 2009/81/EC are appropriate to facilitate equal treatment and transparency but the assurance of these principles and the application of this Directive is pending on the individual behaviour of the Member States and

its authorities. Therefore guidance is needed to specify the current scope of application and to guarantee equal market conditions for all Member States.

Impact and Issues

Given the long product lifecycles of defence markets, it is difficult to measure the concrete impact of the Directive after only five years. From a more general perspective, the impact on cross-border access, on competitiveness of European defence industry and the EDTIB as well as on access of SMEs is only seen as moderately positive. The distinction between the scope of the Civil Procurement Directive and Directive 2009/81/EC is sufficiently clear. The Directive 2009/81/EC itself is adequate to reach its objectives, however clarifications for certain aspects are needed, e.g. Government to Government business; procurement by an agency or cross border subcontracting. These clarifications should be included in the existing EC Guidance Notes. A reopening of Directive 2009/81/EC should be avoided as past experiences have shown, since it will lead to transfer delays caused by uncertainties.

Therefore we strongly recommend undertaking following steps:

The exemptions / exclusions from application of Directive 2009/81/EC (Articles 12 and 13) are appropriate. However the wording is not always sufficiently clear and leaves room for interpretation (e.g. government to government business; procurement by an agency; subcontracting and non-discrimination versus factual Offset).

- The provisions on SoS are sufficient to limit the risks of supply disruptions and ensure operational autonomy, but the EU Directive on Intra Community Transfer has to be enforced in all Member States. Additionally, the rules for export outside the EU have to be harmonized EU-wide in order to avoid risks for SoS by specific national export regulations, which impact and hamper the intra EU transfer of defence goods or subsystem / parts. The Directive has reduced the former automatic use of the Art 346 TFEU, but governments continue to use this exemption with different intensity. Concerning the still existing practice of Offset requirements, a further clarification and clear guidance is needed by the EC.
- The industry was often confronted with industrial return or Offsets before the implementation of the Directive. This has continued after the implementation. There is still no sufficient confidence that a foreign authority would consider a bid for defence and security procurement from another EU country. Therefore, the Directive should also include the application of Offsets.

- The procurement rules should also be properly applied to the security market in order to enhance the effectiveness and limit the uncertainties related to the scope of application.

From our perspective, there is no difference among the applicable procurement rules concerning market access, fairness of procedures, and procedure duration. However concerning legal certainty and access to review procedures the situation has improved. The participation in procurement procedures under Directive 2009/81/EC is perceived as more resource intensive than before, especially in terms of legal advice to assure that no mistakes occur during the award process. It is similarly cost-intensive compared with civil public procurement, but the costs outweigh the possible benefits in defence procurements, particularly in regard to the inter alia regulated and not risk adequate profit margins. Ultimately, the clarification of the Directive 2009/81/EC must be considered as part of a credible enforcement policy and enhance the effectiveness. As stated before, complete reopening of the Directive does not represent an appropriate way to improve the application. The long-term goal should be a harmonized application, thereby eliminating uncertainties.

II. 3. Implementation and Application of the Intra-EU Transfers Directive 2009/43/EC

The BDSV shares the assessment and considerations of the ASD regarding the Intra-EU Transfers Directive (ICT) 2009/43/EC. We welcome the implementation of Directive 2009/43/EC, because an efficient intra-EU transfers system is crucial for the functioning of the internal market for defence. Up until now, the effectiveness of Directive 2009/43/EC has been undermined by a lack of visibility of the General Transfer Licences (GTL) available in Member States; huge differences in the use, coverage and conditions of GTLs between Member States, and a burdensome process of company certification. These shortcomings must be addressed to improve the application of the Directive. The further development of Directive 2009/43/EC must also be seen in the international context. Over the last few years, the U.S. Export Control Reform (ECR) considerably simplified the American licencing system which decreased the compliance burden on U.S. industry both as supplier to foreign integrators and as an exporter of complete systems. This has further strengthened the U.S. competitiveness on export markets, while Europe is still struggling with transfers in the internal market. In Europe, we urgently need to take action to ensure that our own transfer

and export control systems do not put us at a competitive disadvantage. We therefore encourage the EC to use its Defence Action Plan as a vehicle to drive, in close cooperation with Member States, reforms to Directive 2009/43/EC.

These reforms should be guided by three political objectives:

- Foster competitiveness and responsiveness of EU industry
- Establish a level playing field with the U.S.
- Improve the security of supply of Member States' armed forces

General views

These objectives can only be achieved with a more harmonized use of GTLs, following a common agreed format, including terms and conditions for use as well as for goods coverage. GTLs should work in harmony with the way the defence industry both develops and supplies defence products to our respective government's armed forces. It makes little sense to restrict certain items in one GTL for certified companies where they are ultimately for delivery to Member State's armed forces and allowed for armed forces under a GTL. Harmonization should include the following elements:

- A common EU definition of the term "specially designed" (for military purpose/use) should be developed to ensure a clear and harmonized distinction between items that are to be controlled (be they sensitive, less- or non-sensitive) and those to which export controls should not apply. This EU definition should be comparable in its effect to the US definition and apply to both the use of the Transfer Directive and the Common Position on Arms Exports to ensure consistency between the licencing systems for intra-community transfers and exports. Those parts and components that do not fall within the definition of "specially designed" would no longer require a transfer- or an export licence.
- In order to reach a similar level of facilitated transfers and exports as in the U.S. ECR, less or non-sensitive parts and components in the EU Military List should be clearly identified and benefit from free movement within the EU, under GTLs for end-use by the armed forces of Member States or by certified companies. Only where items are truly sensitive, or where general licensing is not permitted as a matter of multilateral commitments or obligations, should they be excluded from GTLs.

- Less or non-sensitive items should lose their export control identity when incorporated into main equipment. Consequently, no re-export provisions should generally apply to such items. At the very minimum re-export provisions should not be imposed as a matter of course on the supply of non-sensitive and less sensitive parts and components destined for a system integrator within the EU, particularly when the end-use of complete systems are located in other Member States, NATO partners or close allies.
- The Certified Company scheme should be reviewed, introducing standard minimum internal compliance programme requirements. Companies with a full AEO (Authorized Economic Operator) certification should qualify as a certified company in the context of the ICT Directive Certified Company Scheme. A more harmonized approach can only be developed together with Member States. However, we do believe that the EC can and should drive this process.

II. 4. Security of Supply

The BDSV appreciates the European approach to support and maintain a stronger Security of Supply (SoS).

The European Council in 2015 called on the Commission to develop a „Roadmap for a comprehensive EU-wide SoS regime“.

Such comprehensive and effective regime has to pursue three intertwined objectives:

- Free circulation of defence supplies and services for the end use of Member States' armed forces;
- an effective agreement established between Member States that commits them not to block internal transfers for onward export except where there are essential security interest concerned, and
- adequate investment in the EDTIB – in research, development and procurement of equipment and services in order to maintain a viable defence industrial base.

General views

The baseline for SoS is to ensure freedom of action and to provide an operational advantage to armed forces. They need to be able to procure reliably the equipment and services. Key industrial and technological capabilities have to be defined and maintained by the Member States. European strategic autonomy can only be safeguarded by developing SoS as an integral part of the Internal Market for Defence.

Since the SoS has to be developed as an integral part of the internal market for defence, three measures have to be taken: Firstly an industrial strategy needs to be developed. Thus SoS roadmap should propose as an action the preparation of a defence industrial strategy with related technology roadmaps. These should address existing and future key industrial and technological capabilities on a national and European level as well as in international supply chains. Secondly, research needs to be considered as an integral part of this strategy. Therefore the roadmap should include defence R&T as a priority for Europe's long-term SoS and suggest a common minimum level of R&T spending for all Member States. Thirdly, the procurement procedures are crucial for a successful SoS. For this reason the roadmap should highlight the link between R&T, procurement and strategic autonomy. The European Council should call on Member States to favour the development of European solutions for key strategic capabilities.

In many cases supply chains are organised pan-European (if not internationally) and rely on swift and efficient transfer of components and subsystems. In this context, we especially welcome any practical steps that would enhance confidence when procuring from or in another Member State. Therefore an envisaged SoS regime has to address not only industrial or contractual but also regulatory and political issues.

In a nutshell: An EU wide SoS regime is essential for pan European co-operation. If this cannot or can only be partially established, the whole concept of "better spending" cannot work if pan-European Defence Co-operation is impossible.

The BDSV, in line with ASD, proposes two initiatives:

- Free circulation of defence goods and services for the end-use by Member States' armed forces: a system based on a harmonized and generalised approach to the exemptions provided for in Directive 2009/43 and to General Transfer Licences should be incorporated in a European SoS regime. Member States should also commit themselves not to block such transfers, except when it is considered necessary for the protection of their essential security interests. Mutual recognition of national export control standards as equivalent should also be explored by the Member States.
- A prioritisation and allocation: In order to address and better manage possible shortages and bottlenecks, especially in times of crisis, the above mentioned system should be underpinned by a system of prioritisation and mutual support between Member States. In this context, EDA's voluntary framework should be strengthened and bilateral and NATO agreements taken into account.

The BDSV welcomes the European approach to maintain and enhance stable and reliable supply chains within the security and defence sector.

General views

Stable and reliable supply chains created according to optimal economic assessments are essential to the European defence industry. Therefore the minimization of risks is a crucial step in order to establish stable supply chains within the entire procurement process. This serves to ensure delivery in the guaranteed time and quality, but also avoid additional costs caused by un-qualified suppliers going through qualification/certification processes. In addition, building trustful relations and carrying out regular screenings will give long-term-suppliers and the prime contractor a possibility to react to any financial or business risks. Furthermore, keeping up a stable supply chains will also help to minimize the costs for transactions and processes in total. The less variety and customization in products the more possibilities for cost-effective supply chain management will open up. Fair competitiveness and flexibility can only be maintained through less adaption to specific requirements for the supply chain members of one contract. Through this, competitiveness for alternative markets and customers will allow the prime contractor to react flexible to the customer's requirements as well as to changes in the sales markets. Last but not least, stable and reliable supply chains will result in the best conditions for the customer and the prime. The optimization of European supply chains is only feasible, if the partners in the supply chain

can be chosen without any restrictions in subcontracting (this is also valid for requirements on involvement of SMEs).

Impacts and issues

The selection of partners and suppliers for the supply chain usually undergoes a process determined by strategic considerations of the prime contractor. In this context the qualifications, certificates and proven quality according to requirements as well as a competitive cost base including labour, industrial infrastructure for engineering, logistics and production as well as materials have to be considered in the conception and implementation of strategy in order to establish strong and sustainable supply chains. Further aspects are the engineering or production capabilities and capacities, related timing (fitting into delivery schedules), fit with technology standards (according to requirements), risk aspects (financial situation/dependencies), logistic aspects (geographical position/effects on delivery times), legal aspects (import/export), options for second sources as well as the access to innovation. These aspects should not only fit the current customer and his specific requirements, but also meet any future requirements and the long-term strategy of the prime contractor. However, the main task for primes is to make sure that the client receives a product, system or services according to the mutual contractual baseline.

Therefore, the requirements for the products or services in terms of quality, timing and quantity are accompanied by specific frame conditions such as: special quality requirements (defence and security), long-term development phases and product life cycles (decades), low number of units (often below 100 units), legal aspects (import/export conditions), obligations for industrial participation/local content/coproduction (per quota of contract value) and the involvement of SMEs (per quota of subcontracts). The area of conflict opening up here is arranging the optimized supply chain by following usual economic assessments. Every additional aspect that has to be considered apart from usual economic evaluations finally results in higher costs and risks and reduction of competitiveness.

Supply chains in defence programmes are very complex and sensitive, since the interaction with partners has been built on trust and long-term relations in order to ensure stability and reliability. Only long-term partnerships as described above can build the stable base for meeting the quality requirements set for defence procurements. Some relevant aspects are also mentioned in an assessment on the implementation of the Directive by the European Defence Agency (EDA). The EDA states why long-term partnerships are more efficient and reduce risks for primes and the subcontractors in supply chains, i.e.: securing confidentiality

of data and know-how. This is essential for primes when working with partners or regular assessments. Further it assures liability and stability concerning price and performance of partners. In addition, companies can use past performances as an indicator for future programmes. Furthermore, international market strategies may be disturbed by focussing mainly on the subcontracting provisions.

This is on the one hand caused by the insufficient definition of using Article 346 TFEU and the different interpretation and using of SoS among Member States. Moreover, the Guidance Note on Offsets explains why Offset requirements are violating the principles of primary EU law. However, using Article 346 allows Member States to ask for Offsets, specifically concerning the procurements defined as “necessary to protect its essential security interests”. If applicable, Member States should only ask for specific subcontracting when defined as security interests. Consequently, only direct Offsets (related to the procurement contract) should be required. Even if the Guidance Note gave clarification and a very precise definition on the issue itself, it is recommended that compliance of the tenders and Offset agreements in accordance with the Directive is monitored by the Commission.

Considering the aspects mentioned, the following recommendations for reducing the negative implications on subcontracting should be followed:

- Common defence procurement programmes and harmonized standards in the European Union to reduce costs, minimize risks, ensure stable quality and allow exchange of equipment between Member States
- More support of joint R&T programmes followed by joint procurements to involve partners from all over Europe into supply chains
- Erase any market disturbances such as offset requirements or strict subcontracting provisions
- Compliance procedures/risk assessments to be harmonized so they can be used as a standard benchmark for defence industry all over Europe

The Defence Procurement Directive was not supposed to offer an alternative to Offset requirements, but was indirectly referring to Offset requirements in Defence Procurements (specifying the issue in the Guidance Note on Offsets). This is clearly restricting competitiveness in the Supply Chain of Defence Procurements and presents a market

disturbance. Therefore, the Directive was aiming to erase Offsets rather than creating an alternative. This corresponds with the recommendation given above to eliminate Offset requirements completely. Consequently, primes should be able to choose their partners within the supply chain without external restrictions.

Even if SoS still leaves opportunities for Member States to ask for a “localization” in defence procurements, these options should be applicable to limited cases only.

To conclude, any form of restriction concerning the supplier selection (subcontracting) or the supply chain management of primes creates market disturbances. Offset requirements in procurement contracts create a discrepancy to the principle of economic assessment of supply chains and, in addition, represents a market distortion affecting the principle of competitive tenders in the EU. Exceptions justified under Article 346 TFEU, being relevant for SoS of a Member State, should be applicable on a case-by-case basis only and monitored carefully by the EC. Both the Offset requirements and the restrictions to subcontracting are interfering with the optimized situation given by supplier selection and supply chain management under economic assessment. Last but not least, the competitiveness of the supply chain is affected, if different requirements will be imposed on the product or service. To minimize risks and costs and to keep up competitiveness, any of the restrictions or distortions should be avoided or at least reduced to a minimum. Therefore, the effectiveness of the measures taken and implemented according to the Defence Procurement Directive should be further monitored.

II. 6. Financial Incentives

Europe's security environment changed dramatically over the past few years, with consequences that directly affect EU citizens. As recognised in the EU Global Strategy, none of the EU countries has the strength and resources to address these threats and seize the opportunities alone. Europe needs to take greater responsibility for its security collectively and act as a global security provider within and beyond its borders. This overall context highlights the need for Member States to sustain investments in defence. EU instruments could be mobilised to encourage defence cooperation and strive to create a solid European defence industry, which is critical for Europe's autonomy of decision making and action. Indeed, many of the past's interventions into the industry only caused market distortion, costs and efforts. As a result, any intervention has to be evaluated carefully regarding the output.

General views

Keeping this in mind, we support the EC's announcement for a European Defence Fund in general. As President Jean-Claude Juncker highlighted in his speech on the state of the union, *„for European defence to be strong, the European defence industry needs to innovate. That is why we will propose before the end of the year a European Defence Fund, to turbo boost research and innovation“* (Brussels, 14th of September 2016). We understand this fund as a catalyst for harmonized planning and more cooperation.

Given the fact that many European countries are still spending far below the NATO targets of 2% of GDP on defence and 20% on investment any steps taken to increase investment in defence development and procurement in Europe are welcome. This could arguably help reinforce the essential message that EU instruments are rightly able to support capabilities that are essential for European security and stability. We therefore encourage the European Commission to discuss this intention in the Defence Action Plan. However, although the industry would endorse this in general, we also have some concerns about the wider implications and utility of broadening the eligibility of the use of the European Fund for Strategic Investment (EFSI) for defence investments. One such wider implication concerns the debate currently taking place over whether some grant funding could be replaced with

loans for research. This would be a non-starter for the defence sector and we consider it vital to avoid any risk of dilution or confusion regarding this message.

Impact and Issues

Furthermore, there are some doubts that the EU guarantee provided by EFSI would fit to the unique risks of most defence projects. These unique risks would make them ill-suited for EFSI/ European Investment Bank (EIB) financing. The main reason for this is the monopsony of the defence market: The only end-customers for defence equipment are governments who initiate, specify, control and fund development and procurement. Defence development timescales often stretch to years or even decades, and by their very nature, new products must stretch the boundaries of technology. As a consequence, defence product development is sometimes extended, re-configured, or even stopped completely by the customer government. Since governments are the only end customers for defence equipment, and also control subsequent export sales, it is no surprise that the globally established business model is that governments fund the vast majority of the development and procurement costs of defence equipment. Private companies rarely take investment funding risks, with the exception of investment funding with a clear commercial spin-off perspective.

Keeping this in mind, we struggle to recognize the interest from defence industry in pursuing direct EIB/EFSI lending. There may be exceptions for SMEs, for which access to finance is a well-known issue. Conversely, we consider how governments themselves could be interested in accessing EFSI/EIB backed loans for defence spending; many EU governments are already facing challenging budget deficit reduction targets, which would presumably also apply to EIB lending.

Plus, we caution against a possible negative impact on the EDRP. Given the pressures on EU and Member States' budgets, the establishment of a fund supporting procurements may lead to a reduction of the envisaged EDRP. We feel that substantial progress has been made at establishing the case for the EDRP, and we would not want to undermine this or dilute the message that the EDRP alone needs a level of funding of ~€500m/year if it is to catalyze a change of current procedures.

A higher goal of the announced European Defence Fund is lacking; there is a persisting lack of clarity on possible models. It is not clear which instruments are planned and who might be qualified to benefit of the instruments of a European Defence Fund. This has to be clarified. We are promoting a CSDP, a real EDTIB, a EDRP, and a harmonized planning and joint

procurement. But we do not see benefits of e.g. collective funding of national defence policies. Therefore, we would strongly encourage the European Commission to enter into a structured dialogue with all relevant stakeholders to systematically assess all possible options before deciding on any concrete action.

III. Conclusion

There is no doubt that the BDSV welcomes and whole-heartedly supports all actions undertaken by the EU commission, the EU Parliament, and Member States to strengthen a CSDP. Past efforts such as the Council Conclusions of 2013 and 2015 have already paved the way towards a more unified and real CSDP, common capabilities, and an innovative and competitive European defence industry – essential cornerstones of European sovereignty. Furthermore, the provisions of the EU Global Strategy mark another important milestone towards these goals. Consequently, the expectations of the BDSV are high with respect to the EDAP, the Implementation Plan for the EU Global Strategy and the European Council meeting in December 2016.

With regard to the PADR we cannot stress enough how deeply we appreciate the involvement of EU institutions in establishing a credible EDRP. However, for the member companies of the BDSV it is of key importance that these programmes are sufficiently funded and fully complementary to national research, and that they truly strengthen European strategic autonomy. This strategic autonomy can only be achieved by a competitive and innovative European defence industry. Of course, a level-playing field, an even application of rules to all Member States, and common standards are pre-requisites that have to be fulfilled if a sovereign and autonomous European Defence industry – as an integral part of any CSDP – is to survive. In particular, this applies to the procurement of defence goods and the free transfer of those goods within the EU. Thus, we await the evaluation of the respective directives and very much expect the commission and the Member States to draw authoritative conclusions.

Naturally, the same issues of European autonomy and sovereignty arise when it comes to the principle that underpins all other topics of the EDAP, namely SoS. The importance of SoS flows from its vital importance to Member States and suppliers alike. Member States rely on industry for the secure, i.e. guaranteed delivery of defence goods; industry relies on its suppliers for the production of said goods, respectively. Thus, only the enforcement of the directives, together with their even application to all EU Member States, can allow for a proper SoS regime. As a consequence, we very much expect these insights to be reflected in the EDAP, the Implementation Plan for the EU Global Strategy and the Council conclusions.

Last but not least, we assume that the Commission and the Member States fully agree that stable and reliable supply chains are integral to a prosperous and functioning European security and defence industry. More concretely, robust supply chains form the very foundation of every defence procurement programme. In this vein, the Defence Procurement Directive has provided us with some rules for supply chain management, for example the sub-contracting and local content requirements. However, the current situation creates a mixed picture because it has also led to market distortion and a lack of transparency. For mitigating this negative outcome we recommend to line up more European defence programmes and to support joint R&T programmes followed by joint procurements. Furthermore, to tangibly reduce market distortions and create the aforementioned “level playing field”, we recommend that all European defence companies have a fair chance to enter the cross border supply chains with no insurmountable entry costs.

Most pundits agree that the Brexit has served as a warning shot to all Europeans who hoped for an ever deeper and wider European integration. From the BDSV’s point of view this remains a desirable goal, and hopefully the EDAP, the Implementation Plan for the EU Global Strategy and the conclusions of the European Council will further facilitate an integration in the defence and security realm. However - and this reflects our position of the past ten years - for these plans, programmes and reviews to work, a courageous and substantiated approach is necessary. In other words, we hope that the European institutions shy away from, what its critics call, perfunctoriness and instead embrace bold and meaningful steps towards a more integrated EU defence and security landscape.

Finally, we understand that balancing the interests of Member States on the one hand and the EU as a community on the other hand is walking a tight rope. With regard to implementing and following the EU institutions’ proposals and measures, Europe can surely rely on the support of the BDSV’s member companies. We strongly believe that the announced propositions serve the objectives of the EU and its Member States well. With the points presented in this paper we hope that we were able to provide valuable input concerning the future development of the CSDP, true European capabilities and a strong and sustainable EDTIB.



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