

Balance of Competences Review

Free Movement of Services – Defence Procurement

Discussion Events

London, 18 December 2013

NB: the following views were expressed by meeting attendees.

1. Article 346:

The use of Article 346 does not allow for a level playing field: UK 'slavishly' follows the rules and the rest of EU do not. UK SMEs are so disadvantaged that there is a feeling that preferential treatment is required to bring them into the market and enable a position of growth from the recession.

Furthermore, anything that gets out into the open is immediately copied by the Far East / India and UK SMEs quickly lose out in the competition because overheads are so great here by comparison.

2. Defence Directive:

UK was the first to transpose this directive into law and both foreign suppliers and governments are taking advantage of the guidance published on AOF. UK suppliers cannot access such information from other EU countries. Exclusive rights and technical exemption reasons are examples where EU suppliers can gain an advantage this way.

3. Amount of regulation:

On balance, there is the right amount of regulation in this area. However, the European Commission should look at how the legislation is applied in each country, and direct implementation.

4. Government planning:

UK Government is inconsistent with big decisions: a lack of strategy undermines the UK defence industry survivability. Failure by UK Government to invest in areas such as CBRN, means UK has lost its position as leader in this field and that current operations cannot be supported – the overseas suppliers having no incentive to place UK first.

The importance attached to 'value for money' can affect quality or lead to skills and knowledge being transferred out of the UK, which undermines the long-term prospects for the industry.

5. EU Member States and defence:

Only the five countries party to the LOI are serious about defence. There is an imbalance between those five and the remaining Member States who don't contribute.

The larger Member States who are more active also have extensive commitments beyond the EU. It is difficult to see how all Member States can agree on a single defence procurement policy when they cannot agree on a single defence and security policy.

6. Defence industry evolution:

There is a wider global trend toward countries wanting to acquire their own defence equipment. For example, all 28 Member States have their own armoured fighting vehicle, and so there are 28 different designs across the EU. Another example is the Swedish Gripen fighter plane, which is 85% British made, but the UK Defence Secretary Philip Hammond won't stand proudly to have his photo taken next to it because it has the 'wrong' flag painted on the side. At the same time, emerging countries are also increasingly likely to procure their own equipment instead of relying on second-hand technology from European suppliers.

Collaboration is the future shape of the market in Europe, but these issues have to be overcome, even if this involves bilateral or multilateral collaboration between small groups of Member States.

7. Changes to regulation

There is a perception that UK SMEs are left to fend for themselves: other Member States have a more competitive environment with a lower minimum wage and outside of the EU national governments can provide even more direct support.

Off set is not a bad thing – money can be made if it is done in the right way; SMEs get work from it; and export activities can result too.

Defence Procurement Reform: new pricing regulations can be avoided by sending prime contract overseas. This builds in costs, and risks the loss of skills, UK jobs and capability.

8. Potential for EU to do more:

More use could be made of the European Economic Interest Grouping structure: this allows groups to bid for work together via a contract rather than joint venture, provided that companies from at least two Member States participate, but this could usefully be expanded to allow the formation of EEIGs between UK companies.

The EU could have a role in contractual context for security of supply issues where a country asks for a supply to be brought forward from a supplier with other priorities. Previous attempts to negotiate rules meaning that countries requiring priority service paid the costs incurred by suppliers who had to delay orders for other customers failed, but this would be a useful option to re-examine.

A cautionary note that individuals acting at commission level can drive things through almost on a personal mission, rather than for the greater good. (Article 346 seen as example).

9. Additional costs caused by EU activity:

The whole procurement process is very cumbersome, and for a hypothetical £1 million contract, a week's delay can add £10, 000 to the total cost. In particular, the results of the *Alcatel* decision by the Court of Justice of the EU imposes a mandatory ten day 'cooling off period' between a decision to award a contract and its formal

signature, allowing unsuccessful bidders the opportunity to appeal. Unsuccessful companies make these appeals almost as a matter of course, but this rarely benefits UK companies because other Member States tend to refer to provisions of national legislation.

Also, EU is not a good market for UK SMEs generally – unless the industry is European-wide: UK SME's don't trade in the market.

10. Is European Defence feasible or not?

Countries prop up own companies to maintain jobs and sovereign choice. Split and share capabilities cannot be agreed upon as sovereign decisions such as who to go to war with are likely to remain a Member State competence. There is a clear connection with other policy areas such as foreign policy and the EU's Common Security and Defence Policy. At the same time, changes of government in individual Member States can change the direction of national policy.

Obstacles to creating a common European Defence market are political intention; national preferences; behaviour and the EU's inability to broker common ground.

However, industry collaboration works without government interference. It should also be possible to use a platform-based approach with an option for countries to add custom elements.

11. European Defence Agency:

Acting as agent or principal? Role is unclear.

UK has benefitted by gaining both prime and sub contract work from EDA, but current suggestions that it should take over the role of export licensing are not appropriate.

Instead, the EDA could act as honest broker between a group of Member States working together on a single procurement project, but you'll never get all EU Member States together for a single procurement.

Additionally, there could be a role for a European institution for carrying out 'soft issue' studies for defence e.g bringing cultural issues to attention of appropriate countries.

12. R&T / R&D:

The process of bidding for EU funding from the FP7 for R&D is very complex and pushes up the cost of research. In addition, no subsidy is available. Simplification is required to prevent research going else where for better funding. There is little evidence of research funded by FP7 actually leading to products that successfully make it to the market.