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EU REGULATORY INCENTIVES FOR ARMAMENT COOPERATION:

Lessons from directive 2009/81/EC

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Comment

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ABSTRACT

Since the December 2013 European Council, armament cooperation is caught into a new impetus at EU level which focuses on incentives as decisive policy tools to foster such cooperation. Incentives are generally thought to be of fiscal (tax exemption) or budgetary (subvention) nature but they can also be comprehended from a regulatory perspective. For instance, article 13 (c) of directive 2009/81/EC which regulates defence procurements offers an incentive for cooperation by eliminating regulatory obligations for Member States procuring on a cooperative basis instead of nationally. Such incentivizing mechanisms should not be neglected given their low cost but their (actual and potential) effectiveness needs to be assessed.

The ambition of this comment is to offer some lines of thinking on the nature of regulatory incentives and the conditions for their effectiveness from the article 13 (c) example.

Keywords: procurement, regulatory incentives, directive 2009/81/EC, article 346 TFEU.

INTRODUCTION

In its conclusion of December 2013, the European Council "encouraged the further development of incentives for and innovative approaches to cooperation" in the area of military capability development (**European Council, 2013**). Since then, several incentivizing mechanisms to foster cooperation between Member States have been deployed (VAT exemption for EDA projects) or proposed (Preparatory Action for Defence R&D, European Defence Fund) (**De la Brosse, 2016**).

Contrary to what is generally admitted, incentives are not necessarily of a financial or a fiscal nature: they can stem from regulation itself. For instance, directive 2009/81/EC - which regulates public procurements in the fields of defence and security - provides an exception to its scope of application for procurements awarded in the framework of certain cooperative programmes (article 13 (c)). Therefore, these procurements benefit from a specific legal regime which can be considered *a priori* as more favourable compared to the "standard" regime applicable otherwise.

The ambition of this paper is to determine how and to what extent the use of regulatory incentives can contribute to the enhancement of armament cooperation between Member States. Such an objective implies, first, to define the concepts of 'incentives' and more specifically 'regulatory incentives' and, second, to determine the conditions of their effectiveness through the example of article 13 (c) of directive 2009/81/EC).

DEFINING REGULATORY INCENTIVES

For the purpose of this paper, we will consider that an incentive is composed of two main elements:

- First, an advantage that favours a certain behaviour;
- Second, the advantageous behaviour itself.

In the case of regulatory incentives, the advantage stems from a reduction of regulatory obligations and can be considered, from an economic point of view, as a lever to lower transaction costs (**Laffont and Tirole, 2009**). However, the advantage stemming from those regulatory incentives needs to be further discussed, as it can lead to some conceptual misunderstandings. Indeed, one could assert that any difference between legal regimes can be construed as a regulatory incentive. Surely a distinction shall be made between an incentive which aims at influencing a targeted behaviour and the difference of legislation applicable to objectively distinct situations. Where the incentive entails the existence of an alternative between at least two behaviours to be chosen by its (potential) beneficiary, different legal regimes imply that no such alternative exists because several objective criteria arrange those behaviours into two legally distinct

situations.

In the case of the article 13 (c) of directive 2009/81/EC, the conferred advantage stems from the reduction of obligations weighing on the public purchaser, when he decides to purchase on a cooperative basis rather than on a national basis. Within the framework of article 13 (c), the public purchaser does not have to comply, as for the procurement attribution, with obligations provided by directive 2009/81/EC such as obligations to use certain competitive procedures (articles 25 – 29) or to advertise the procurement (article 30 – 35). However, such cooperative procurements must comply with obligations stemming from EU primary law such as the prohibition of discrimination based on nationality or the obligation of transparency which consists in "ensuring, for the benefit of any potential tenderer, a [sufficient] degree of advertising" (**ECJ, 2000**).

In relation to the behaviour which is favoured, article 13 (c) applies only to cooperative behaviours which comply with the following three main criteria:

- First, concerned procurements shall be part of a cooperative programme "conducted jointly by at least two Member States". Such a criterion does not require the programme to be led at the level of EU institutions (*ad hoc* programmes are allowed). Moreover, it is still unclear whether a Member State can benefit from this advantage if it joins the programme only after the R&D phase. DG Internal Market (now DG GROW) indicated that, in its view, article 13 (c) implies a "genuinely cooperative concept" (**DG MRKT, 2011**), which goes necessarily beyond the only purchase of the equipment. Such a participation should therefore entail specific obligations for the joining State, which should reflect a certain level of burden-sharing.
- Second, the cooperative programme shall be "based on research and development", which excludes numerous forms of cooperative acquisitions. Concerned procurements have not to be related to the R&D phase and can concern any downstream phase of the concerned programme (including maintenance).
- Third, the programme shall aim at "the development of a new product". The incentive does not concern pure R&D programmes (which can be covered by other provisions, article 13 (j) for instance). However, article 13 (c) does not require neither the R&D phase to be fruitful nor a commitment from Member States to effectively acquire the developed product.

In addition, article 13 (c) requires programmes between Member States to be notified to the European Commission. It appears that recourse to article 13 (c) has never been notified yet, which calls its very interest into question.

CONDITIONS FOR THE EFFECTIVENESS OF REGULATORY INCENTIVES

In its Treaty on rewards, Bentham already pointed out the main drawback of rewarding mechanisms against punishments: their high cost (**Bentham, 1811**). Comparatively, regulatory incentives seem to have the advantage of carrying zero cost. In an EU context where financial resources are particularly constrained (the EU budget represents less than 1% of its Member States' aggregated GDP), this aspect is far from being negligible. However, given the specificity of the advantage they present, the question of the effectiveness of such incentives needs to be properly addressed.

In accordance with article 73 of directive 2009/81/EC, the Commission published in November 2016 a report on its implementation which was accompanied by an evaluation of the directive (**Commission, 2016a and b**). In these documents, the Commission does not make any reference to article 13 (c), which implies it has never or almost never (Lithuania's participation to the OCCAr-led BOXER programme could be considered as a recourse to article 13 (c) despite its absence of notification to the Commission) been used. It also raises the question of the causes of such non-application. One explanation may probably lay in the low effectiveness of the directive itself. In its report, the Commission stated that "a very significant share of defence procurement expenditure is still made outside the Directive" (i.e. around 90%) and pointed out that Member States may still use article 346 TFEU to dismiss the application of directive 2009/81/EC. Indeed, article 346 TFEU enables Member States not to apply certain provisions of EU (primary and secondary) law where it is *strictly* necessary to protect their essential security interests but, in reality, it has been used to systematically exclude armament from the scope of application of EU law (**European Commission, 2006**). In a context where public purchasers willing to have purely national procurements do not effectively comply with the provisions of directive 2009/81/EC, the article 13 (c) exemption is deprived from its advantageous character and therefore from any effectiveness.

This example shows that the effectiveness of a regulatory incentive is directly and deeply dependent on the effectiveness of the legal framework in which it is embedded. If a regulatory incentive bears no direct financial cost, it implies – just like any legal mechanism – the mobilization of resources (judicial, political, etc.) to ensure its effective implementation.

FROM STAND-ALONE MEASURES TO SYSTEMATIC APPROACH

So far, regulatory incentives – mainly article 13 (c) – did not prove to be that successful to promote cooperation in the field of armament. On the contrary, given the low effectiveness of directive 2009/81/EC, article 346 TFEU acts like an incentive for circumventing EU law and buying nationally instead of cooperatively. In its recent

European Defence Action Plan, announcements made by the Commission in favour of the enforcement of directive 2009/81/EC and article 346 TFEU are positive steps towards more effectiveness of regulatory incentives (**European Commission, 2016c**).
In the meantime, regulatory incentives do not appear as sufficient to initiate or foster armament cooperation, as buying cooperatively has a cost ('the cost of cooperating'; **Ford, 2015**) and can be a source of complexities or inefficiencies. Even though a precise evaluation of these issues remains to be done, they are all potential obstacles and disincentives to cooperation. If the EU wants to succeed in meaningfully enhancing the recourse to cooperation in the armament field, it should tackle those issues to make it attractive for Member States. In other words, the EU need to deploy a wide range of incentives such as: a flexible and light legal regime, fiscal exemptions in favour of cooperation, a favourable budgetary and accounting treatment, direct participation in the financing of projects, etc.

Although some measures already exist (e.g. VAT exemption for EDA projects) or are currently planned (e.g. the research and capability windows announced in the European Defence Action Plan), consistency is still lacking: for instance, their scopes of application are not similar. Furthermore, several central questions are still unsolved: what kind of capabilities projects should the EU promote? How should the current EDA capability development plan be considered? Are all forms of cooperation desirable from an EU perspective? As they are not, by themselves, attractive enough to make a Member State choose cooperation over going national, regulatory incentives can play a useful role only in a more systematic and integrated approach promoting and incentivizing cooperation.■

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Edouard Simon is finishing his PhD about "The role of EU law in the integration of arms acquisition policies".

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ARES GROUP

The Armament Industry European Research Group (Ares Group) was created in 2016 by The French Institute for International and Strategic Affairs (Iris), who coordinates the Group. The aim of the Ares Group, a high-level network of security and defence specialists across Europe, is to provide a forum to the European armament community, bringing together top defence industrial policy specialists, to encourage fresh strategic thinking in the field, develop innovative policy proposals and conduct studies for public and private actors.

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