Improving the transfer of defence-related products within the EU

Addressing implementation challenges of Directive 2009/43/EC will promote the competitiveness of the European defence market

Executive summary

Directive 2009/43/EC on intra-EU transfers of defence-related products aims to simplify and harmonise the rules and conditions for transfers of defence-related products within the European Union (EU). However, there are indications that the benefits offered by the Directive have not yet been fully exploited by Member States and defence companies. The European Commission is to be commended for its ongoing effort to review the Directive in an all-inclusive manner, particularly as reflected in its Evaluation and Fitness Check Roadmap[i]. AmCham EU hopes that government-industry collaboration will lead to improvements that will make it possible for the Directive to achieve the goals and objectives under which it was established.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €2 trillion in 2015, directly supports more than 4.3 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

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POSITION PAPER

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Introduction

As the European Commission prepares its implementation report on Directive 2009/43/EC, which covers intra-EU transfers of defence-related products, the American Chamber of Commerce to the European Union (AmCham EU) welcomes the opportunity to provide its perspective on the discussions and looks forward to further engagement with the Commission on this important issue. AmCham EU has had the opportunity to review the Commission's Evaluation and Fitness Check Roadmap for the Directive and hopes that this paper will assist in informing the report.

1. Objectives and expectations

Directive 2009/43/EC of the European Parliament and of the European Council (May 6, 2009) was launched with the key objectives of rationalising, harmonising and streamlining the defence trade licensing systems of EU Member States in order to create standards that would better support defence export controls administration, enhance supply chain performance, and more globally promote the competitiveness of the European defence market.

Both EU industry and multinational companies operating in the EU welcomed the initiative, not only because of its strategic goals, but also because of meaningful improvements expected in practical areas such as licensing review times, collaboration on development projects, compliance requirements, and streamlined overall processes and tools.

Initial industry expectations regarding this initiative included (but were not limited to) the following:

- General licenses created under the Directive would be implemented in a harmonised manner across all Member States.
- Industry would be able to deliver products more speedily due to greater transparency of license options and usage.
- Member States would have a common approach for compliance oversight activities.
- Requirements for obtaining certification would be significantly easier than obtaining a license and the process the same within all Member States.
- Requirements for recipients of exports made under the Directive would be outweighed by the benefits resulting from conducting trade under the Directive.
- General licenses authorised under the Directive would be granted to any legal entity established in any of the Member States, including foreign-owned legal entities.
- Overall benefits achieved through use of the Directive would compare favorably from a competitiveness standpoint to the defense export control environment in the United States.

2. Assessment of implementation

While some of industry's expectations may have been realised to at least some extent, a number of key elements of the Directive remain a challenge both for EU and non-EU companies operating in the Union, therefore putting into question the success of this important initiative. Other contributing factors may be related to either limited opportunities for or efforts by industry as a whole – or both – to connect with the Commission and with the governments of Member States from a unified, integrated perspective.

Additionally, an important consideration with respect to the overarching objective of the Directive, i.e., to support and enhance the competitiveness of the European defence market, is that of changes in the export control system of the United States, which naturally were intended to achieve similar results for US industry. While export reform in the United States has its roots in previous administrations, it was President Barack Obama who launched an all-out effort to bring it to fruition in the period immediately following the establishment of Directive 2009/43/EC. The most prominent aspect of a transformational new US system is a revision of the United States Munitions List leading to the transfer of large numbers of defence items from the List, i.e., from the control of the U.S. Department of State to the less stringent controls of the U.S. Department of Commerce. Clearly, no assessment regarding use and efficacy of the Directive would be complete at this point without taking into consideration the potential impact of these sweeping changes on the Directive.

The following comments and recommendations address both the requirements embedded in the Directive and developments in the United States of particular interest:

- **Certification**

  The certified company scheme was the major innovative element of the Directive. It was introduced as a confidence building measure to assure another member state that the certified company would be in a position to comply with any re-export provisions that the other Member States choose to apply to parts and components authorised for transfer to the integrator. The certification process looks at whether the policies, procedures and resources in place are sufficient to enable the certified company to comply with transfer and export controls regulations applied by the relevant regulator.

  A certified company was supposed to be a systems integrator, but when compared to the number of companies in the supply chain, systems integrators represent a small percentage of the total. Achieving certification demonstrated that companies had sufficient policies, procedures and resources in place to be able to abide by the exporting states re-export provisions, but the process is burdensome on both companies, as well as on authorities who must assess whether a company has met required standards. Furthermore, there is no real incentive for a company to apply for and achieve certification if it has no visibility of the general licenses in place in other EU Member States where its suppliers may be located. If not all Member States published the newly available licenses, or if the licenses that have been issued do not include the parts and components they wish to import, then certification does not represent an advantage. Equally, if deliveries from suppliers are not significantly delayed by the requirement to obtain licenses currently available under the regulations, the general perception is that there is no need to consider the possibility of certification.

  The scheme, as it stands, assesses the robustness of a system integrator's internal compliance programme. It looks at whether the policies, procedures and resources in place are sufficient to enable it to comply with transfer and export controls regulations applied by its regulator. However that is not the real purpose of the exercise. The purpose is to provide assurances to another member state that the company would be in a position to comply with any re-export provisions that the other Member State chooses to apply to parts and components that it authorises for transfer to the integrator *while facilitating intra-EU defence trade*. While all concerned agree that defence companies should have robust compliance programs, EU industry wants to see the re-export burden reduced to mirror the benefits gained by US companies and their customers as a result of Export Control Regulation (ECR). Further, there is a perception within industry that the review of the EU Dual-Use ECR where consideration

is being given to introducing standard internal compliance program requirements for the export of dual-use items, should lead to similar approaches under the Directive. This way the certified company scheme would allow for the adoption of more standardised and therefore less burdensome and more widespread compliance requirements on companies transferring defence products within the EU.

The complexity of the certification process is a disincentive for the end user, which in turn has a negative impact on the original exporter's ability to broadly use the Directive. It does not make much difference to the end user whether a particular item is delivered under an individual license or a general license, particularly if re-exports are not contemplated. It does however, negatively affect the consumer if the condition for receiving the item under a general license is a burdensome certification process. Complying with conditions in an individual license therefore becomes a more attractive option. Likewise, if the exporter can only transfer products to an eligible end user and the number of eligible end users remain low, then the benefits of the general license may no longer seem like the best option, particularly if the conditions for using the general license are themselves seen as burdensome.

Recommendations:

- Consider the Authorised Economic Operator certification currently available within the European Union that covers both exports and security sufficient for operating under the Directive or, alternatively, harmonise the conditions for certification under both trusted trader programs to the maximum extent possible.

- Explore the option of not requiring the same type of certification requirement for both the exporter and the recipient of the defence items. Instead, consider a simple set of requirements, at least for recipients who do not intend to re-export or when less sensitive items are involved. These items could include those listed under the U.S. Export Control Reform Initiative to be the least sensitive of the items removed from the U.S. Munitions List.

- **General licenses**

A major stumbling block since the inception of the Directive has been the general lack of visibility on the General Transfer Licenses (GTLs) that are available in other Member States. While the introduction of a GTL database within the Register of the Certified Defence-related Enterprises (CERTIDER) has been a step forward, the system is only as good as the information that Member States provide on the licenses that they have issued. Additionally, the site is not well known, and therefore the publication of company names may not be immediately beneficial.

GTLs also vary markedly in coverage and conditions for use. While some Member States have issued all the GTLs foreseen in the Directive, others have only issued some. This may be because there is a lack of demand for such licenses, but lack of confidence on the part of government officials managing the Directive could be another factor.

There is no real incentive for a company to apply for and achieve certification if there is no visibility of the general licenses available in the EU Member States where its suppliers are located. If those Member States either have not published the general licenses available or if their licenses do not cover the relevant parts and component that a company wants to import, then certification is not an attractive option.

In many cases, companies that have engaged in legitimate defence trade within the EU, with the United States and other defence trading countries have not taken advantage of the general licenses for many decades. This is because they have been unable to justify the training, process changes and compliance requirements necessary to operate under the umbrella of the Directive. However, those same companies might be willing to use them under more favourable circumstances.

Another challenge is that fact that the military lists are not the same for all Member States. To change this status quo would be a longer-term project, and clearly national discretion cannot be overridden, but it is important to incorporate this element into the overall thinking about the use and efficiency of the Directive.

*Recommendation*s:

- Encourage Member States to be more proactive with respect to use of CERTIDER and make the database more visible to industry. There needs to be a harmonised approach to the use of the general licenses provided by the Directive. Ideally they should follow a commonly agreed format, including terms and conditions for use and goods coverage.

- Consideration should be given to adding two additional GTLs to cover:

    - Access to software and technology for personal use in other Member States, either via access to employers' systems or on hand carried electronic devices (such as laptops and tablets.).
    - Re-transfer after import for test, maintenance, repair, evaluation, exhibitions and demonstrations. This license could be applied for by the original exporting company, which should be a Certified Company, in order to remove the requirement of finding an importer of record and subsequently an exporter of record to return the equipment to the original exporting company.

- In order to further facilitate transfers and exports, less sensitive parts and components in the EU Common Military List should be clearly identified and benefit from free movement within the EU pursuant to General Transfer Licenses for end-use by either armed forces of all EU Member States or Certified Companies.

- All GTLs should include a list of less sensitive items to which no re-export provisions would apply.

- Re-export clauses should not be automatically imposed on the supply of parts and components destined for a system integrator within the EU, particularly when the end-users of complete systems are in other Member States, or with NATO partners or close allies. Given that all Member States consider license applications for export in accordance with the criteria established under Common Position 2008/944/CFSP defining common rules governing control of exports of military technology and equipment, the decision by the authorities in the exporting member state should normally be unfettered by re-export provisions placed on parts and components by another member state.

- **<u>Industry outreach</u>**

Prior to the Directive coming into force, most Member States have predominantly only used individual licenses (although some, such as the UK, have open licenses) and it has taken time for them to adapt to new ways of approaching controls and to have confidence that the use of global and general licenses to facilitate transfers did not equate to a loss of oversight and control. Most Member States have published legislation and some have published more detailed guidance and have entered into dialogue with major companies and trade associations. However, there remains a general lack of uniformity across the entire EU. Also, while it is difficult to determine whether the SME community has been an active participant, or has the financial means to do so, the issue of the different role, capacity, and ultimate access to information for SMEs continues to be a concern. However, it would be reasonable to assume that prime contractorsay have flowed down information to their supply chain, as appropriate.

The rather slow pace of adaptation to the new environment created by the Directive, coupled with challenges faced by industry with respect to certification requirements, conditions for use of the general licenses and generally interpretation of the provisions of the Directive may have contributed to a loss of momentum with respect to the government-industry engagement process that is needed to assist with interpretation and compliance, and to find solutions to practical problems.

Recommendations:

- Establish a structured and centralised outreach mechanism, i.e., a 'single window' type of access to ensure an extensive communications network that can support all concerned actors in the Member States.

- Engage industry associations on a regular basis to enhance outreach.

- Set up regular conference calls with industry to answer questions submitted in advance of the call.

- Post frequently asked questions to the EU and to Member States on the European Commission website. Review regularly to ensure consistency of responses.

- **Relevance of US Export Control Reform**

Many of the major competitors of EU industry, but also its partners, are in the United States, and generally European and US companies and their respective governments are looking to the same markets for potential sales. The US ECR Initiative was aimed at making US industry, whether as a supplier to foreign integrators or as an exporter of complete systems - but particularly suppliers - a more attractive proposition. Naturally, European industry wants to see in place in Europe export control measures that do not put them at a competitive disadvantage with respect to US industry, and this is particularly true in the world of defence trade.

Prominent among US initiatives in which AmCham EU is particularly interested are the following:

- 'Specially Designed' – While certain exemptions from licensing have always been available for defense exports, as part of the ECR, the United States has developed a definition for the term 'specially designed; for military use. This allows for certain parts, components, or software not enumerated on the U.S. Munitions List and not falling under the definition of not 'specially designed' to be released from the jurisdiction of the International Traffic in Arms Regulations (ITAR). Once transferred to the U.S. Department of Commerce and under certain

conditions, some of these items may be exported from the United States without a license whereas other items may be eligible for a license exemption. This step-by-step catch-and-release process has resulted in certain items transitioning from the US Munitions List (USML) to the jurisdiction of the Department of Commerce. In some cases it has also resulted in items transitioning from the '600 series' (list of transferred items) to the traditional Commerce Control List (CCL) or, in limited cases, to the basket of non-listed items. The latter is commonly known as 'EAR-99', which is still subject to the regulations, but typically not subject to a license requirement).

However, due to the absence of a similar common definition of 'specially designed' in Europe, when items received from the United States (that have transitioned from the USML to the CCL) enter the European Union, they become subject to traditional military controls under the EU Common Military List.

As a result, European companies are at a disadvantage vis-à-vis US companies. To date, Wassenaar Arrangement members have failed to agree on a definition of the term and thus all states, including in the EU, apply markedly different interpretations and understandings which in turn exacerbate the fact that an item may be deemed licensable in one EU country but not in another.

Recommendation:

To ensure that European industry is not increasingly disadvantaged by developments in US. ECR, Member States are encouraged to work quickly, including in the Wassenaar Arrangement, to agree on a common interpretation and application of the term 'specially designed' aimed at allowing for certain parts, components, or software to be designated as not 'specially designed' and thereby, released from traditional military export or re-export licensing requirement. In other words, the new definitions should apply equally to transfers within Europe and exports from Europe.

- *De Minimis* EU content in foreign platforms

Defense items in the United States are generally not eligible for application of what is commonly known as '*de minimis*' content, a concept that is used in the area of commercial and dual use exports under which the U.S. Government relinquishes export control jurisdiction of US origin items incorporated into foreign items if they are below a specified threshold. A limited number of items transferred from the jurisdiction of the Department of State to that of the Department of Commerce may be eligible for *de minimis* treatment. These include some of the least sensitive items falling under a particular export control classification number or those now listed on the traditional Commerce Control List.

Recommendation:

Explore the possibility of incorporating this concept into the Directive, as a means for eliminating re-export requirements considerations for the least sensitive items which in the United States may have become eligible for *de minimis*. This in turn could potentially eliminate the need for those companies that receive only these kinds of items to be subject to certification obligations.

- Level playing field

As Commission officials review the Directive, they are encouraged to ensure alignment of licensing requirements, e.g. that transfers of defense products within Europe are not subject to licensing provisions that are less favorable than those imposed by the US, for essentially identical exports to entities within the EU. This approach would be necessary, for purposes of implementing a definition of 'specially designed' or for determining the possibility of establishing some form of a *de minimis* concept for select items no longer subject to the ITAR in the United States.

Recommendations:

- The Commission should carefully compare the effects of US export reform on US defense trade to the provisions in the Directive and determine how the Directive could be reviewed for purposes of achieving beneficial commonalities, and ultimately to ensure a level playing field.

- Explore the option of establishing exemptions from licensing rather than maintaining a General License scheme which usually requires some engagement with the regulators prior to export. Exemptions from licenses are subject to specific conditions but generally do not require coordination with the administrating agency prior to export.

- Review the EU Military List with the goal of identifying common standards that can be agreed upon by all EU MS and introduce solutions to make less sensitive items subject to less restrictive controls

- Re-export controls imposed on licenses should also be reviewed within the context of US export reform, taking into consideration that through the application of a catch-and-release definition of 'specially designed' a significant number of items may have fallen outside of a military item designation and may therefore be treated as what is commonly referred as dual use items.

Conclusion

The Directive is a very important development in the area of defence trade, and a major step towards the alignment of controls throughout the European Union. However, the inconsistent execution of the Directive at the national level has not eased compliance measures or improved cost-efficiency for defence industry stakeholders. For that reason, AmCham EU fully supports a review of the Directive and commends the Commission for its Evaluation Roadmap exercise. The Roadmap includes elements that, while not directly related to the Directive, are important parameters to consider for purposes of ensuring its broad use and long-term enduring success.

In order to ensure that the Directive truly becomes the driver for the harmonisation of defence trade controls across the EU and ensures a level playing field, the Commission and Member States need to take a coordinated, holistic approach in their engagement with industry. It is also imperative that they take into consideration current implementation challenges.

[1] European Commission; *Evaluation of the Directive 2009/43/EC on the transfers of defence-related products within the Community ("the Transfers directive")*; February 2016 http://ec.europa.eu/smart-regulation/roadmaps/docs/2016_grow_049_evaluation_transfers_en.pdf