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## European Commission Proposes Expanding the European Defence Fund—A Major Potential Barrier to Transatlantic Defense Procurement

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### FEATURE COMMENT: European Commission Proposes Expanding The European Defence Fund—A Major Potential Barrier To Transatlantic Defense Procurement

The European Commission (EC) has proposed expanding the European Defence Fund, an initiative to fund defense technology developed in Europe. As a general matter, only European firms would have access to the fund for development, and participating European nations would need to commit themselves to purchasing the defense materiel developed under the fund.

In effect, this could lock U.S. firms out of billions of euros worth of European defense procurement over the coming years—despite long-standing reciprocal agreements under which the U.S. and its European allies agreed to open their defense markets. The fund was announced quietly last year and now, in the shadow of a trade war launched by the Trump administration, has evolved into a substantial potential barrier in the transatlantic defense market, and potentially another brick in a rising wall of protectionism between the U.S. and Europe.

**European Union's Efforts to Open Procurement Markets**—The European Defence Fund arose against the backdrop of long-standing efforts by the EU to pressure other nations, including the U.S., to expand access to their procurement markets. The EU “International Procurement Instrument,” for example, was first proposed in 2012 as a regulation that would allow European governments to discriminate against nations which refuse to cooperate in negotiations on opening procurement

markets. See “Commission Amended Proposal for a Regulation of the European Parliament and of the Council on the Access of Third-Party Goods and Services to the Union’s Internal Market in Public Procurement and Procedures Supporting Negotiations on Access of Union Goods and Services to the Public Procurement Markets of Third Countries,” COM (2016) 34 final (Jan. 1, 2016), available at [www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2012/0060\(COD\)&l=en](http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2012/0060(COD)&l=en); Harte, European Parliamentary Research Service, “Briefing: International Procurement Instrument” (December 2017), available at [www.europarl.europa.eu/RegData/etudes/BRIE/2017/614610/EPRS\\_BRI\(2017\)614610\\_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/614610/EPRS_BRI(2017)614610_EN.pdf); Grier, “EU: Penalizing Closed Procurement Markets” (Feb. 16, 2016), available at [trade.djaghe.com/?tag=international-procurement-instrument&paged=2](http://trade.djaghe.com/?tag=international-procurement-instrument&paged=2).

Some of the likeliest targets of discrimination under the proposed regulation would be China (which has been stuck in limbo for years in its negotiations to accede to the World Trade Organization Government Procurement Agreement), and the U.S. (the Europeans are intent on gaining greater access to U.S. state and local procurement markets). See generally Grier, “Do Open Markets Decrease China’s Incentive to Join GPA” (Nov. 2, 2017), available at [trade.djaghe.com/?tag=international-procurement-instrument](http://trade.djaghe.com/?tag=international-procurement-instrument).

The proposed International Procurement Instrument has shuttled for years between the European Parliament and committee, and was to be considered by committee on June 21—like the European Defence Fund, possibly another step towards an open fight over procurement between the EU and the U.S. See generally European Parliament, Legislative Observatory, available at [www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2012/0060\(COD\)&l=en](http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2012/0060(COD)&l=en) (procedure file); Dawar, “The 2016 EU International Procurement Instrument’s Amendments to the 2012 Buy European Proposal: A Retrospective Assessment of Its Prospects,” 50 J. World Trade 845 (2016)

(tracing the European initiative to U.S. protectionist models), available at [sro.sussex.ac.uk/60062/1/K%20Dawar%20JWT%20submission%202016%20IPI%20Amended%20Proposal.pdf](http://sro.sussex.ac.uk/60062/1/K%20Dawar%20JWT%20submission%202016%20IPI%20Amended%20Proposal.pdf).

#### **Emergence of the European Defence Fund—**

Although the concept for the European Defence Fund emerged in late 2016, see “EU Proposes Common Defence Fund,” 58 GC ¶ 435(a), President Trump accelerated the initiative when in May 2017 he scolded European leaders for not spending enough on their own defense, see, e.g., Emmott, “Trump Effect? Europe’s Defense Spending to Rise Faster in 2017,” Reuters, June 28, 2017, available at [www.reuters.com/article/us-nato-defence-idUSKBN19J0ZW](http://www.reuters.com/article/us-nato-defence-idUSKBN19J0ZW). Shortly thereafter, in June 2017, the EU announced specific plans for the European Defence Fund, see EC, Press Release: A European Defence Fund: \$5.5 Billion Per Year to Boost Europe’s Defence Capabilities (Brussels, June 7, 2017), an initiative lauded by some for fostering investment and development in the European defense sector, see, e.g., Brattberg and Fly, “Two Cheers for European Defense Cooperation,” Foreign Policy March 9, 2018, available at [foreignpolicy.com/2018/03/09/two-cheers-for-european-defense-cooperation/](http://foreignpolicy.com/2018/03/09/two-cheers-for-european-defense-cooperation/).

Although last year’s proposal already contemplated a focused effort to nurture the European defense industry, this year’s announcement marked a broader effort to fund European defense innovations from within—and to keep non-European firms from sharing in the fruits of that investment. See EC, Press Release: EU Budget: Stepping Up the EU’s Role as a Security and Defence Provider (Strasbourg, June 13, 2018), available at [europa.eu/rapid/press-release\\_IP-18-4121\\_en.htm](http://europa.eu/rapid/press-release_IP-18-4121_en.htm).

In its most recent announcement on June 13, the European Commission proposed a budget of €13 billion for 2021–2027 for the European Defence Fund, see, e.g., EC, Fact Sheet: European Defence Fund, available at [ec.europa.eu/commission/sites/beta-political/files/budget-may2018-eu-defence-fund\\_en.pdf](http://ec.europa.eu/commission/sites/beta-political/files/budget-may2018-eu-defence-fund_en.pdf), substantially more than the funding initially proposed last year. The new fund will be used to support innovation and development in defense across Europe. The EC stressed the fragmentation and inefficiencies that can cripple the European defense industry, and the need to foster cooperation among European firms to encourage a strong, coordinated defense industrial base in Europe. See, e.g., EC, Commission Staff Working Document: Impact Assessment, SWD (2018) 345 (June 13, 2018), avail-

able at [ec.europa.eu/commission/sites/beta-political/files/budget-may2018-eu-defence-fund-swd\\_en.pdf](http://ec.europa.eu/commission/sites/beta-political/files/budget-may2018-eu-defence-fund-swd_en.pdf).

The expanded European Defence Fund would be available only to defense initiatives spanning three or more European member states, and the fund could be used only to develop (not purchase) new defense systems; member states would have to commit in advance to purchasing the new systems, using the member states’ own funds. The regulation proposed to implement the initiative made clear that the proposed fund is as much about industrial policy as it is about defense: the fund would be used to foster small- and mid-sized companies in the European member states, with an eye to economic development as well as defense security. See EC, Proposal for a Regulation of the European Parliament and of the Council Establishing the European Defence Fund, COM (2018) 476 (Brussels, June 13, 2018), available at [ec.europa.eu/commission/sites/beta-political/files/budget-may2018-eu-defence-fund-regulation\\_en.pdf](http://ec.europa.eu/commission/sites/beta-political/files/budget-may2018-eu-defence-fund-regulation_en.pdf). By the terms of the proposed regulation (discussed further below), presumptively the European Defence Fund would be used exclusively to support European firms.

#### **U.S.-EU Trade Disputes and the New Fund—**

The European Defence Fund’s expansion did not, of course, happen in isolation. Although European policymakers were careful to stress that the fund was not a “reaction” to the Trump administration, see, e.g., Remarks by High Representative/Vice-President Federica Mogherini (June 13, 2018), available at [eeas.europa.eu/headquarters/headquarters-homepage/46450/remarks-hrvp-mogherini-press-conference-european-defence-fund-european-peace-facility-and\\_en](http://eeas.europa.eu/headquarters/headquarters-homepage/46450/remarks-hrvp-mogherini-press-conference-european-defence-fund-european-peace-facility-and_en), these latest steps were taken against the backdrop of a gathering trade war and ongoing uncertainties about the U.S. commitment to the North Atlantic Treaty Organization, see, e.g., Taylor, “Trump’s Next Target: NATO,” Politico, June 14, 2018, available at [www.politico.eu/article/will-donald-trump-wreck-nato-summit-too-g7/](http://www.politico.eu/article/will-donald-trump-wreck-nato-summit-too-g7/). The Trump administration has announced that it will impose steep tariffs against European steel and aluminum, and the EU has said that it will respond in kind against goods and services from the U.S. See, e.g., Petroff, “Trump Is Starting a Global Trade War,” CNN Money (June 1, 2018), available at [money.cnn.com/2018/05/31/investing/us-steel-aluminum-tariffs-response/index.html](http://money.cnn.com/2018/05/31/investing/us-steel-aluminum-tariffs-response/index.html).

The European initiative also came in the wake of the Trump administration’s own efforts to boost foreign military sales by U.S. firms, see National

Security Presidential Memorandum Regarding U.S. Conventional Arms Transfer Policy (April 19, 2018); “White House Rolls Out Arms Transfer Policy, Drone Sales Priorities,” 60 GC ¶ 146, and concern among some U.S. policymakers that President Trump is squandering the U.S.’ goodwill with its allies.

**Will the New Fund Violate Reciprocal Defense Procurement Agreements?**—From a U.S. perspective, the unanswered question is whether the European Defence Fund will, in fact, be a barrier to U.S. firms in the European defense market. Though one senior EU policymaker argued that “the United States understand[s] perfectly well that European money goes to support European projects,” see Remarks by High Representative/Vice-President Federica Mogherini, *supra*, and a number of observers read the new initiative to mean that U.S. firms will be locked out, see “EU to Block UK, US from €13 Billion ‘European Defence Fund’; Programme Bid to Guarantee Member States’ Security,” World Agence France-Presse, June 13, 2018, available at [www.firstpost.com/world/eu-to-block-uk-and-us-from-e13-billion-european-defence-fund-programme-a-bid-to-guarantee-member-states-security-4508597.html](http://www.firstpost.com/world/eu-to-block-uk-and-us-from-e13-billion-european-defence-fund-programme-a-bid-to-guarantee-member-states-security-4508597.html), the proposed implementing regulation was less than clear on this important point.

On one hand, the EC’s proposed regulation was explicitly protectionist. The EC noted that because the fund “aims at enhancing the competitiveness, efficiency and autonomy of the Union’s defence industry,” only entities “established in the Union or associated countries and not subject to control by non-associated third countries or non-associated third country entities” (such as U.S.-based firms) “should in principle be eligible for support.” Furthermore, the proposed regulation warned, “in order to ensure the protection of essential security and defence interests” of the EU and its member states—a phrase that normally signals a derogation from open-market obligations under trade agreements—“the infrastructure, facilities, assets and resources used by the recipients and their subcontractors in actions supported by the Fund should not be located on the territory of non-associated third countries.” Taken on their face, these provisions would seem to mean that no part of the work supported by the fund could be done in the U.S., or by a U.S.-based or -controlled contractor or subcontractor.

At the same time, however, the proposed regulation seemed to leave the door open to possible involvement by U.S. firms. “In certain circumstances,”

said the proposed regulation, “if this is necessary for achieving the objectives of the action, it should be possible to derogate from the principle that recipients and their subcontractors should not be subject to control by non-associated third countries or non-associated third country entities.” To involve a non-European firm, applicants would have to show that “relevant and strict conditions relating to the security and defence interests of the Union and its Member States are fulfilled,” and the “participation of such entities should not contravene the objectives of the Fund.” The proposed regulation did not explain, however, what the “strict conditions” are; nor did it explain when, exactly, participation by a non-European firm might “contravene the objectives of the fund.”

Nor—and critically—did the proposed regulation squarely address many European states’ standing obligations to keep their defense markets open to U.S.-based firms, under the reciprocal defense procurement agreements that the U.S. has entered into with the majority of its European allies. Of the 28 EU member states and four European Free Trade Association nations (which also may participate in the fund, under appropriate circumstances), 21 nations have entered into these reciprocal agreements with the U.S., and so generally have agreed not to discriminate in their purchases of defense materiel and services. See Department of Defense, Defense Procurement and Acquisition Policy, Reciprocal Defense Procurement and Acquisition Policy Memoranda of Understanding, available at [www.acq.osd.mil/dpap/cpic/ic/reciprocal\\_procurement\\_memoranda\\_of\\_understanding.html](http://www.acq.osd.mil/dpap/cpic/ic/reciprocal_procurement_memoranda_of_understanding.html).

The U.S. commitments under the reciprocal agreements are written into the Defense Federal Acquisition Regulation Supplement, see DFARS 226.872, and those commitments to open DOD purchases to vendors from “qualifying” (signatory) countries are a recognized part of U.S. defense procurement. See, e.g., Yukins and Ramish, Feature Comment, “Section 809 And ‘e-Portal’ Proposals, By Cutting Bid Protests In Federal Procurement, Could Breach International Agreements And Raise New Risks Of Corruption,” 60 GC ¶ 138 (discussing agreements).

The EC’s proposal does not explain whether the reciprocal defense procurement agreements with the U.S. will be honored—and so leaves open the possibility that the European Defence Fund will become a new battleground in the ongoing trade wars between the U.S. and Europe.

**Potential Impact of a Trade War in the Transatlantic Defense Market**—A trade war in defense would not be good news for the U.S., for both economic and security reasons. The U.S. enjoys a large and long-standing trade surplus with Europe in defense equipment, see, e.g., “The Nature and Impacts of Barriers to Trade with the United States for European Defence Industries” (No. ENTR 08/040) (EC December 2009), available at [ec.europa.eu/growth/sectors/defence/industrial-policy\\_en](http://ec.europa.eu/growth/sectors/defence/industrial-policy_en), and U.S. defense firms could be hurt if a “European preference” took hold in the EU’s defense markets. See generally Butler, *Transatlantic Defence Procurement* (Cambridge U. Press 2017).

The loss to the U.S. would go beyond lost exports. As a matter of policy, the U.S. has long worked to open foreign defense markets, on a reciprocal basis, partly to share the cost burdens of weapons development, but also to foster closer military cooperation between the U.S. and its allies. See, e.g., Miller, “Is

It Time To Reform Reciprocal Defense Procurement Agreements?,” 39 *Pub. Cont. L.J.* 93, 96 (2009); Bialos, Fisher and Koehl, “Fortresses and Icebergs: The Evolution of the Transatlantic Defense Market and Its Implications for U.S. National Security Policy” (Brookings 2009). In doing so, DOD has sought to enhance a common defense with its allies by encouraging interoperability between U.S. and allied defense systems. If the European Defence Fund ultimately locks out U.S. defense firms from new European defense initiatives, although interoperability among European defense systems may improve, ready interoperability—and a coordinated defense—between the U.S. and its European allies may well suffer.



*This Feature Comment was written for THE GOVERNMENT CONTRACTOR by Christopher R. Yukins, Lynn David Research Professor in Government Procurement Law, George Washington University Law School.*