

**Between cooperation
and competition:
the transatlantic
defence market**

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**Institute for Security Studies
Western European Union**

Paris - January 2001

CHAILLOT PAPER 44

(A French version of this paper is also available from the Institute)

The Institute for Security Studies of Western European Union

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ISSN 1017-7566

Published by the Institute for Security Studies of Western European Union and printed in Alençon, France, by the Imprimerie Alençonnaise.

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Preface

A few months ago, the Institute published a *Chaillot Paper* by Burkard Schmitt dealing specifically with the new industrial integration strategies of the big European armaments groups (*Chaillot Paper* 40, 'From cooperation to integration: defence and aerospace industries in Europe', July 2000). This *Chaillot Paper*, edited by the same author as an essential complement to the earlier one, examines the prospects for transatlantic cooperation in this field, and also the constraints on it.

An old debate if ever there was one. How can European companies gain access to the American defence market, one of the most protected in the world? How can industrial partnerships be arranged in such a way that they do not result in either the dilution of the European groups or US monopoly in the most strategic sectors? To what extent, moreover, are these Euro-American partnerships essential for the survival and competitiveness of European defence industries? Recent political developments on both sides of the Atlantic now justify new approaches and perhaps answers: in the Union, the CESDP has an almost irreversible momentum; in the United States, the arrival in office of a new presidential team is traditionally the occasion for new directives and initiatives.

What is important in Euro-American programmes is not only to fill the technological and strategic gap that is alleged to exist between American and European armed forces: most European countries do not share the Americans' obsession with the RMA, and are not really inclined to adhere to the strategies defined by Washington for future wars. It would therefore be quite illusory to bank on transatlantic industrial cooperation as a way of making the Europeans fall in with American military strategy, even if certain Americans do so. In the same way, while transatlantic armaments cooperation may well bring benefits for Euro-American political relations as a whole, it is obvious that its true merit lies elsewhere: in the commercial advantages that could result from it for all the companies concerned. Indeed, it is very much in the interest of the major European groups to be able to penetrate the American market, which is still far and away the most important. Conversely, the American groups wish to increase the share they already have of certain national markets in Europe and

consolidate their positions so as to meet the challenge of a future European armaments market.

But it will take a long time to overcome the contradictions that are inherent in the concept of a balanced transatlantic armaments partnership. Two tensions are particularly obvious. The first is between defence companies, whose commercial logic is increasingly 'normalised', and an armaments market that is still largely captive and protected by numerous different national regulations, in both Europe and the United States. The second tension is between differing principles, whether in the political or armaments aspects of European defence: the defence industry is an area where competition and duplication, which are a priori taboo in relations between the Union and NATO, are both legitimate and necessary when it comes to relations between European and American industrial partners.

European companies are, it would seem, the more heavily penalised, possibly doubly so. American protectionism, on the one hand, is so powerful that the quantity of formalities and procedures that have to be gone through in attempting to form a partnership in the United States, given the benefits that these may bring, act as a deterrent. On the other hand, the absence of a truly European market, that is to say a minimum of harmonisation of requirements and military doctrines among EU member countries, handicaps European companies while at the same time reducing member countries' room to negotiate with suppliers that are already highly integrated at the European level.

Which just shows how fundamental politics is here: the true problem is not the impenetrability of the American 'fortress', even if it is very real, but the slowness of European politics. It would be logical for the creation of a European industrial base that is already happening to be accompanied by a minimum of joint military equipment planning and a common armaments market, as essential steps towards successful Euro-American industrial cooperation. European integration is an essential condition for true transatlantic partnership, and here, as in other areas, timing will be paramount.

Nicole Gnesotto
Paris, December 2000

Introduction

Burkard Schmitt

The driving forces underlying Euro-American relations in the field of armaments are changing, with far-reaching implications. Major political, strategic, technological and financial developments have already considerably modified this sector in both the United States and Europe. Today, they extend to the transatlantic level, calling into question the relationship between the two most important defence markets and industries in the world.

The present situation is one of contradictions: commercial and technological logic is driving the major defence groups towards closer transatlantic links, but there are formidable obstacles to be overcome. Very likely, Euro-American relations in this field will continue to be characterised by both competition and cooperation, but what the dominant trend will be is less obvious. Will governments dare take a quantum leap in the matter of cooperation so as to create a truly transatlantic market, or will they rather use their power to keep their markets closed and protect their industries? What are the true interests of the main political, military and industrial actors? How will the Europeans react if the United States refuses to play its part in establishing a fair balance between the two sides? Is the 'fortress' concept itself obsolete, given the new economic and technological realities? If the present political framework does not change, what strategy will the major industrial groups adopt? Can they go ahead with globalisation on their own initiative? To what extent can they do this despite constraints imposed by governments?

These are big issues. If, for example, armaments cooperation intensifies and leads to a balanced partnership, this will both strengthen the Atlantic Alliance and benefit industries' competitiveness. If, on the other hand, 'fortress America' persists, and if Europe develops a common armaments policy 'in opposition' to the United States, there is a risk of confrontation between two closed systems, with damaging consequences for relations within industry in particular, but also for transatlantic relations in general. In reality, the way relations develop will probably not be so clear-cut, but the possible spillover effects between armaments and politics are obvious.

Given the importance of the subject, the Institute invited three well-known experts to give their views on the present situation and the future of transatlantic armaments cooperation.

In Chapter One, Gordon Adams firstly analyses the many factors that affect the relationship between Europe and the United States in this field. This allows a better understanding of the complexity of the issue, and gives an insight into possible ways to improve cooperation. In the second part of his analysis, he examines 'Fortress America' in detail and assesses recent efforts by the Pentagon to facilitate international cooperation.

Christophe Cornu covers the situation in Europe in Chapter Two. He evaluates budgetary and legal realities as well as European countries' procurement policies in order to gauge just how far 'Fortress Europe' is a reality. He then looks at the various initiatives in hand and their consequences for future transatlantic cooperation.

In Chapter Three, Andrew James examines cooperation from the standpoint of industry, reviewing the historical development and the driving forces behind industrial cooperation. He then analyses companies' transatlantic strategies and suggests short and medium-term prospects.

While complete in themselves, these three contributions are also complementary. This combination of approaches will hopefully result in as wide a survey of the question as possible.

Chapter One

FORTRESS AMERICA IN A CHANGING TRANSATLANTIC DEFENCE MARKET

Gordon Adams

The transatlantic defence relationship is changing dramatically, but the future remains uncertain: greater integration and cooperation across the ocean or the emergence of two ‘fortresses’? Whether at the level of defence cooperation and interoperability of forces or at the level of industrial collaboration and transatlantic trade, there are substantial reasons for the transatlantic defence relationship to grow stronger and more interdependent. From a strategic and military point of view, there is a clear need for enhanced interoperability between American and European military forces. From a budgetary point of view, greater transatlantic industrial integration could help conserve scarce resources and focus on priority defence objectives. From a technological point of view, the industrial and technology base meeting defence needs is increasingly commercial and global in nature, making more open defence industrial cooperation attractive, even inevitable.

At the same time, transatlantic rhetoric, policy and political developments are putting increased interdependence at risk. The Europeans are moving towards a defence capability that they will be able to use within or outside of NATO – as expressed in the Common European Security and Defence Policy (CESDP). In support of that goal, many European policy-makers argue for a ‘buy-European’ bias in defence procurement and resist what some, particularly the French, have described as a unilateralist American security policy. Combined with defence industry consolidation in Europe, institutional changes in the European Union and the emergence of a common defence procurement organisation, there is a pronounced ‘fortress Europe’ trend emerging in Europe, which is America’s most important security partner and the most important international market for US defence products and technology.

Equally important, the evolution of American defence policy and industrial consolidation is pushing towards greater transatlantic integration and a stronger 'fortress America' at the same time. There are clear economic, technological and operational advantages in having closer defence ties and a more open and flexible regime for transatlantic defence industry cooperation. These are counterbalanced by strong political and bureaucratic opposition to any weakening of American rules and regulations that constrain direct foreign investment in the American defence market or the transfer of critical defence technologies to potentially hostile countries via exports to allies and friends.

The logic of coalition-building and military interoperability, and the forces of economic and technological rationality, confront the logic of politics and bureaucracy in the struggle over the future of the transatlantic defence industrial relationship. The issue has some urgency, as Europe gathers together both its defence industry and its defence capabilities, and as a new Administration comes into office in Washington. This article briefly describes the contradictory character of the forces operating in the transatlantic relationship and examines, in greater depth, the evolution of the American defence industry 'fortress'. It proposes a near-term agenda of issues that policy-makers must face if a more open and flexible transatlantic industrial regime is to emerge.

I.1 Contradictory transatlantic trends

Strategic and military planning

From a strategic and military perspective, European and American visions have clearly diverged since the end of the Cold War, reinforcing fortress tendencies on both sides. At the same time, the crisis in the Balkans has revealed an increasingly urgent need for greater interoperability within the Atlantic Alliance, strengthening the logic of convergence across the Atlantic.

With the evaporation of the Soviet threat, the unity of vision that characterised NATO for more than 40 years disappeared. For most of the 1990s, the United States and its European allies have struggled, with some difficulty, to define a successor vision. The differing European and

American views about their strategic goals, interests and required military capabilities reinforce the arguments of those who would strengthen industrial fortresses to ensure that each side can pursue its own strategic agenda.

The difference in strategic vision is significant. With the end of the Cold War, the American strategic vision has become decidedly more global. Where once that vision focused on the defence of Europe, making the transatlantic relationship central to US strategic thinking and military planning, today European security is less central.¹ With the Base Force (1991) and Bottom-Up Review (1993), the shift away from Europe became evident. The core force-planning algorithm for the Pentagon was no longer defending the Fulda Gap in Germany; it was the requirements of two Major Regional Contingencies (MRC) or Major Theater Wars (MTW) with the Gulf and Korea as the proxies for defence planning purposes.²

Consistent with a global security mission, US forces moved towards a high-intensity, forward-deployed expeditionary capability capable of a full spectrum of military operations.³ The Gulf War, the crisis with North Korea in 1994 and the tensions in the Taiwan Straits in 1996 suggested that the two MRC scenario had roots in geostrategic reality. American military deployments in the 1990s were clearly expeditionary in character: to Somalia, Rwanda, Haiti, and, especially, the Balkans. Despite the inertial weight of Cold War force planning in the Pentagon and the heavy investment in current generation equipment, the American military became substantially more mobile, agile and flexible. Moreover, all of the Services are incorporating the technologies of modern warfare into their doctrine and operations: precision-guided munitions, sophisticated interoperable communications, satellite and UAV-generated intelligence, data linkages and the information systems that tie operations and equipment together.

¹ In the early 1990s, American forces deployed in Europe quickly fell from over 300,000 to roughly 100,000. Military forces that were once based in Germany and deployed in the Gulf War in 1990-91 returned to the United States after the war.

² See Secretary of Defense Les Aspin, *Report of the Bottom-Up Review* (Washington, DC: Department of Defense, Office of the Secretary of Defense, October, 1993), and Secretary of Defense William Cohen, *Report of the Quadrennial Defense Review* (Washington, DC: Department of Defense, Office of the Secretary of Defense, 1997).

³ See Joint Chiefs of Staff, *Joint Vision 2020* (Washington, DC: Department of Defense, 1998), and *Joint Vision 2020* (Washington, DC: Department of Defense, 2000).

Europe's view of its global relationships has a pronounced economic flavour; trade and investment drive European policy outside of the region. Europeans play essentially no role in military security beyond the Gulf region. Even there, the Europeans have played a markedly secondary military role.⁴ While most European countries supported the 1991 Gulf campaign, only the British and the French had a significant military presence.⁵ Today, the Europeans make little direct military contribution to Gulf security arrangements and have shown minimal concern about a potential ballistic missile threat to the European continent from the Middle East/Gulf region.⁶ The difference in strategic focus affected preparations for the April 1999 NATO Washington summit, with the Europeans strongly resisting American proposals to extend NATO's mission beyond the territory of the Alliance.⁷

⁴ See Philip Gordon, 'The Transatlantic Allies and the Changing Middle East', *Adelphi Paper* 332, September 1998.

⁵ In military terms, the Europeans contribution in the Gulf War was comparatively small. The United States supplied 1,376 aircraft and 532,000 ground troops, while the British contributed 69 aircraft and 35,000 ground troops and the French 42 aircraft and 13,500 troops. The British deployed these forces slowly, using largely their own transport. The French relied heavily on US transport and were so lightly armoured that they were put on the left flank and supplied with American artillery support. See David C. Gompert, Richard L. Kugler and Martin C. Libicki, *Mind the Gap: Promoting a Transatlantic Revolution in Military Affairs* (Washington, DC: NDU Press, 1999), p. 18. See also James D. Thomas, 'The Military Challenges of Transatlantic Coalitions', *Adelphi Paper* 333, Chapter 2.

⁶ For the American perspective on the ballistic missile threat, see Commission to Assess the Ballistic Missile Threat to the US, *Executive Summary of the Report of the Commission to Assess the Ballistic Missile Threat to the United States* (Rumsfeld Report), 15 July 1998.

⁷ It is not that the Europeans lack interests elsewhere; simply that they do not see force as an instrument for achieving those interests. This makes the solution proposed by Gompert, et al. hard to achieve. As they put it: 'Interests reflect the underlying vulnerabilities and opportunities of a society, and its economic vitality, relative to developments elsewhere in the world. In this sense, Europeans do have global interests – indeed interests quite similar to those of the United States.' They point to concern with Russian stability, African developments, oil reserves, the spread of WMD, the reality of world economic integration, as well as transnational problems like terrorism, drugs and information warfare, and note that 'the transatlantic disparity in strategic outlook is not really about interests: it is about whether and how to protect them.' (p. 20.) It is not clear the Europeans are persuaded that military force is part of this equation, however.

European strategic and force planning in the 1990s followed a different logic, as well. The regional threat was low and European force planners were ‘prisoners of inertia,’ locked largely in a Cold War military paradigm.⁸ While European NATO spent significant resources – 60 per cent of the US total – on defence, they were not buying technologically advanced or expeditionary capabilities. The result has been, by and large, a personnel-heavy military with aging equipment that has increasing difficulty operating in coalition with the Americans.⁹

Two critical developments in the late 1990s began to change this divergence in strategy and force planning. The first began with the December 1998 Franco-British summit in St-Malo, when Tony Blair and Jacques Chirac agreed on the goal of providing Europe with ‘the capacity for *autonomous* [emphasis added] action, backed up by credible military forces, the means to decide to use them, and a readiness to do so, in order to respond to international crises.’ This was a watershed in Britain’s European policy: for the first time ever, the United Kingdom accepted the idea that European defence actions could be decided on and executed outside the NATO framework. For France, St-Malo was a step away from the traditional French requirement to retain its own *national* autonomy in defence, and a commitment to joint action at the European level.

The other turning point was the Kosovo air war. It had already become clear during the Gulf War and the Bosnian deployments that there were considerable gaps between European and American military capabilities.¹⁰ The Kosovo air campaign demonstrated how wide this gap had become.¹¹ In

⁸ Gompert et al., op. cit. in note 5, p. 10.

⁹ The European allies have more than 1.8 million soldiers under arms. Of these, 1.3 million (or two-thirds) are British, French, German and Italian. This excludes Greek and Turkish personnel, and includes the new members in Central Europe. NATO, ‘Financial and Economic Data Relating to NATO Defence,’ Press Release M-DPC-2 (1999) 152, Table 6.

¹⁰ James Thomas, *Adelphi Paper* 333.

¹¹ Of the 35 satellites positioned over Kosovo during the conflict, two were European (overall the Europeans possess only five such assets, to the Americans’ 65). As a result, the United States supplied the bulk of the military intelligence. The Europeans lacked the ability to communicate easily or securely with each other or with the Americans; of the communications capability in theatre, 90 per cent was American. They had virtually no inventories of precision-guided munitions (except for the British *Tomahawks*) and little capability (aside from some French) for all-weather or night fighter operations. As

the American view, European shortfalls in precision-guided weapons, lift, and interoperable command, control and communications 'were real and had the effect of impeding our ability to operate at optimal effectiveness with our NATO allies'.¹² The British, French and Germans also realised that they lacked the flexible, agile and technically capable forces they would need, either for autonomous action or to play an influential part in NATO coalition operations.¹³

St-Malo and Kosovo together had a major impact on European defence planning. At its June 1999 summit in Cologne, the EU subscribed to the Franco-British agreement from St-Malo to develop the capacity for autonomous European military action.¹⁴ The Fifteen decided to absorb the Western European Union into the EU, and to set up their own politico-military decision-making machinery: European defence ministers would begin to meet regularly at 15, the EU would create a Political and Security Committee, a Military Committee and a European Military Staff. In addition, the EU members named former NATO Secretary-General Javier Solana as the first High Representative for the CFSP.¹⁵

a result, 80 per cent of the strike missions in theater (and two thirds of the total aircraft sorties) were flown by Americans. The Europeans depended on American support aircraft for their sorties, especially for battle control, refuelling and for jamming and destroying Serbian radar. At the mundane but critical level of transportation and logistics, European force projection capabilities included only two roll-on, roll-off sealift ships, on lease, as compared to 12 for the United States, no fast sealift capability (8 for the United States); and no large airlift capability (compared to 254 aircraft for the United States). See International Institute for Strategic Studies, 'A Common European Military Policy,' *Strategic Comments*, vol. 5, no. 6, July 1999, p. 2; J. A. C. Lewis, 'Building a European Force,' *Jane's Defense Weekly*, 23 June 1999, p. 22; Carla Anne Robbins, 'Display of US Might Makes Allies, Adversaries Doubt Their Relevance,' *Wall Street Journal*, 6 July 1999, p. 1. See also James Thomas, *Adelphi Paper* 333.

¹² Secretary of Defense William S. Cohen and Gen. Henry H. Shelton, 'Joint Statement on the Kosovo After Action Review,' 14 October 1999, p. 8.

¹³ See Roger Cohen, 'Uncomfortable with Dependence on US, Europe Aims for New Parity,' *The New York Times*, 15 June 1999, and William Drozdiak, 'War Showed US-Allied Inequality,' *Washington Post*, 28 June 1999, p. 1. See also, Department of Defense, *Kosovo/Operation Allied Force After-Action Report* (Washington, DC: Department of Defense, 31 January 2000).

¹⁴ European Union website, 'The Council of the European Union and the Common Foreign and Security Policy,' p. 2.

¹⁵ See David Buchan, 'Solana Hoped to Add Value to EU Foreign Policy-Making,' *Financial Times*, 15 September 1999, p. 2. To facilitate the integration of the WEU, Solana was also named Secretary-General of WEU in November 1999.

The Helsinki summit in December 1999 reinforced this plan. The EU endorsed a Franco-British proposal to create a European rapid reaction force of up to 60,000 troops by 2003, designed to carry out the full range of 'Petersberg tasks', rapidly deployable within 60 days and sustainable for a year, with appropriate back-up rotation capability.¹⁶ The EU partners underscored the European commitment to 'develop rapidly collective capability goals in the fields of command and control, intelligence and strategic transport', and welcomed decisions some members had already made to coordinate early warning systems, open joint headquarters, reinforce the rapid reaction capabilities of existing forces and prepare for a joint European air transport command.¹⁷

These European moves towards what is now referred to as a Common European Defence and Security Policy (CESDP) have been greeted in Washington with a mixed response. On the one hand, the NATO Washington summit of April 1999 welcomed the development as a 'further impetus . . . to the strengthening of European defence capabilities to enable the European Allies to act more effectively together, thus reinforcing the transatlantic partnership . . .'¹⁸ On the other, there has been concern that this European identity might grow away from NATO into a separate organisation with a separate strategy.¹⁹

The April 1999 NATO discussions pushed decisively in a transatlantic direction, committing the Alliance to connecting the CESDP more closely to NATO and coalition operations. The Alliance undertook to 'define and adopt the necessary arrangements for ready access by the European Union to the collective assets and capabilities of the Alliance, for operations in which the Alliance as a whole is not engaged militarily.'²⁰ NATO also made it clear, however, that there would be careful procedural constraints on the ability of the Europeans to act autonomously, noting that ESDI would

¹⁶ See 'Presidency Progress Report to the Helsinki European Council on Strengthening the Common European Policy on Security and Defence,' 10-11 December 1999. The Petersberg tasks include humanitarian and rescue operations, peacekeeping tasks, and the use of combat forces in crisis management, including peace-making.

¹⁷ Ibid.

¹⁸ NATO Summit Declaration, S(99)63, 23 April 1999, para. 6.

¹⁹ See speech by Deputy Secretary of State Strobe Talbott, 'America's State in a Strong Europe,' remarks at the Royal Institute of International Affairs (Chatham House), 7 October 1999, p. 3.

²⁰ Ibid., para. 10.

'continue to be developed within NATO', and providing that the Alliance would 'assist the European Allies to act by themselves . . . on a case-by-case basis and by consensus'.²¹

Moreover, NATO created a parallel effort to address the capabilities gap exposed in the Kosovo war: the Defence Capabilities Initiative (DCI). The goal of the DCI is to improve NATO capabilities in several key areas: the deployability and mobility of Alliance forces, their sustainability and logistics, their survivability and effective engagement capability, and command and control and information systems.²²

As the NATO agenda is implemented, it substantially reinforces the importance of greater transatlantic defence industrial cooperation. The underlying tension remains, however. On the one hand, the improvement of European defence capabilities substantially increases the attractiveness and the potential for coalition operations between Europe and the United States. On the other hand, closer European defence cooperation reinforces the tendency towards two defence fortresses, one on each side of the Atlantic. EU operations to carry out the Petersberg tasks, if conducted independently, could open a gap in transatlantic force planning. DCI planning in NATO could produce the forces appropriate to these tasks, but it is not clear that the EU effort will succeed, which undermines this intended capability. Coordination between the two efforts, a process only established in spring 2000, will be critical.²³ Failure to establish a close relationship between these efforts at both the policy and military planning level could undermine the logic of interoperability exposed by the Kosovo air war, and exacerbate political tendencies in Washington to reinforce fortress America.

Budgets

The considerable gap between European and American defence spending, particularly for procurement and research and development, suggests the

²¹ NATO, 'The Alliance's Strategic Concept,' Press Release NAC-S(99)65, 24 April 1999, para. 30.

²² Ibid., p. 3. To address these problems, NATO created a Multinational Joint Logistics Center as of the end of 1999 and plans for a C3 system architecture by 2002.

²³ See European Union Council, *Presidency Conclusions*, Santa Maria da Feira, 19 and 20 June, 2000, Section C.9.

importance of greater cooperation across the Atlantic, if only to achieve more efficient use of scarce resources. On the other hand, while the US defence budget is projected to grow in real terms, starting in 2001, European defence budgets are not. Since the Europeans are promising a greater military capability that they may find it difficult to pay for, the promise/performance gap could exacerbate the feeling in the United States that the European allies are not holding up their side of the bargain. This outcome could, in turn, strengthen fortress tendencies in the United States.

Based on current projections, US budgets for procurement and research and development are virtually certain to exceed \$100 billion a year in the next five years, more than twice the level of spending by all the European NATO allies combined. There is growing recognition in Washington, moreover, that a US acquisition budget of this size may still fall short of the funds needed to meet the Defense Department's projected hardware acquisition plans.²⁴

The Europeans face an even more stringent budgetary dilemma. Failure to augment European defence investment would mean relying even more on the American military. Ultimately, this could exacerbate transatlantic tensions over burden-sharing, since the Americans would see an unmodernised European military as a potential liability in coalition operations.

However, the costs of a significant European investment in command, control, communications, intelligence, surveillance and reconnaissance, for much of which the Europeans currently depend on the United States, will be high. In addition, European plans for enhanced logistics, sea and airlift, meaningful inventories of precision-guided munitions, all-weather/day-night aircraft, in-flight refueling and search and rescue aircraft will add to the costs. While the total price tag cannot be easily estimated, it could add billions annually to current European defence budgets.

If past performance is any guide, European defence budgets will not meet this challenge. Overall, these budgets, especially those of the largest allies,

²⁴ See Steven Kosiak and Elizabeth Heeter, 'Cost of Defense Plan Could Exceed Available Funding by \$26 Billion a Year Over Long Run' (Washington, DC: Center for Strategic and Budgetary Assessment, March 1998), and General Accounting Office, *Future Years Defense Program: Funding Increase and Planned Savings in Fiscal Year 2000 Program Are at Risk*, NSIAD-00-11 (Washington, DC: GAO, November 1999).

have declined sharply since 1985: in Britain by 34.5 per cent, Germany by 28.4 per cent and France by 16.1 per cent.²⁵ Spending on procurement, a key CESDP goal, is a small share of defence spending in a number of European countries: 13.6 per cent in Germany (1999), 12.2 per cent in Italy, and 16 per cent in the Netherlands. Only France, at roughly 25 per cent, and the United Kingdom at 28 per cent, rise close to the US level of more than 30 per cent. Moreover, equipment budgets have been heading down, not up. From 1994 to 1998, French equipment expenditures declined 24.7 per cent in constant dollars; German equipment spending fell 7.5 per cent; only Britain went the other direction, increasing equipment spending by 15.5 per cent.²⁶

Spending on research and development, which is critical to the next generation of defence technology, shows an even wider gap: by 1998, the combined R&D spending of the European NATO allies was \$9.7 billion (in 1997 dollars), 90 per cent of which was accounted for by Britain, Germany and France. The US investment was \$35.9 billion. Moreover, the European R&D investment is duplicative, given the lack of sustained R&D coordination among the European allies.

This trend is unlikely to change. No major European ally, with the exception of the United Kingdom, is proposing defence budget increases in real

²⁵ These calculations use NATO definitions and data and are made in constant local currency to avoid the problem of changes in currency values. Only Denmark, Norway and Portugal have increased defence budgets over this period. Greece and Turkey have both increased their defence budgets over this period, but much of this is driven by their local rivalry, not by NATO requirements. For comparison, US defence budgets declined 27.8 per cent over the same period. NATO, *Financial and Economic Data*, op. cit. in note 9, author's calculations. According to IISS data, the average decline in NATO Europe defence budgets has been 26 per cent since 1986. The new NATO allies do not change this trend; according to IISS data, their budgets have declined since 1990 at twice the average rate for the western European NATO allies; *The Military Balance, 1998/99* (Oxford: Oxford University Press for the IISS, 1998).

²⁶ Author's calculations, based on IISS data. For comparison, US equipment spending declined 6.1 per cent over this period. Italy also increased its spending 41.4 per cent, while the new Allies, preparing for NATO entry, increased it significantly, albeit from a low starting point: the Czech Republic by 115.9 per cent, Hungary by 30.7 per cent and Poland by 89.8 per cent.

terms.²⁷ The House of Commons, having noted that inadequate resources were leading to 'cancelled exercises, delayed equipment programmes and resources apparently insufficient to reverse the problems of overstretch and undermanning',²⁸ prompted Defence Minister Geoff Hoon to announce in July 2000 an increase in the equipment budget of £1.25 billion over three years. Overall, the annual rise in the UK defence budget, in real terms, will be from 0.1 per cent to 0.7 per cent between 2001 and 2004.

France and Germany are both squeezed by non-defence needs. Unemployment rates remain high and both governments remain committed to high levels of social spending. In France, the 2000 defence budget was below that of the preceding year, while procurement spending had fallen 3.5 per cent.²⁹ In Germany, where the continuing costs of absorbing the former East Germany add to budgetary pressures, the Finance ministry is insisting on reductions of \$1.7 to 2.4 billion a year in defence budgets over the next five years from a base of \$23.2 billion.³⁰ These reductions could have an especially hard impact on German procurement plans.³¹

American leaders have urged the Europeans to reverse this spending trend,³² but resource considerations suggest the Europeans will have a hard time shaping common programmes and equipment plans, especially plans that could lead to greater autonomy from the United States. The combination of a shortage of European resources and growing American investment budgets could create greater transatlantic tension. These trends also suggest, however, that greater transatlantic cooperation in defence equipment would be a cost-effective way for the Europeans to acquire the advanced technical capability needed for modern contingency operations. This would be an

²⁷ See Colin Clark, 'Lack of European Spending Threatens DCI,' *Defense News*, 13 December 1999, p. 4 (26); Douglas Barrie, 'Defense Budgets Remain Tight Throughout Europe,' *Defense News*, 20 December 1999, p. 26.

²⁸ As reported in Reuters, BBC Online, 10 February 2000.

²⁹ Douglas Barrie, 'Defense Budgets Remain Tight Throughout Europe,' *Defense News*, 20 December 1999, p. 26.

³⁰ Based on July 2000 exchange rates.

³¹ Barrie, *Defense News*, 20 December 1999.

³² See Secretary of Defense William S. Cohen, '[I]n the final analysis, allies will have to spend more on defense, if they are to measure up to NATO's military requirement and establish a European Security and Defence Identity that is separable but not separate from NATO,' in 'Europe Must Spend More on Defense,' *Washington Post*, 6 December 1999, p. 27.

important signal to industry about the advantages of greater transatlantic cooperation and integration. Here, again, political considerations could preclude a more efficient allocation of resources, but leave the Europeans unable to afford the autonomous capability they seek.

Technologies

Although a clear gap in defence technological performance was revealed in the Kosovo air campaign, there is every reason to think that a transatlantic market for defence technology is virtually inevitable. The technologies displayed in the Gulf and Kosovo exemplify to a growing extent what has been called the Revolution in Military Affairs (RMA): sophisticated command, control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR), data links, and precision-guided munitions. This package of technological capabilities is one of the great force multipliers of the twenty-first century and its impact on military operations will only increase.

The technology base from which these twenty-first century military capabilities grow is increasingly global and commercial in character. The application of commercial, global technology to military requirements constitutes one of the most fundamental changes ever to strike the defence industrial base. In every advanced economy that base is changing beyond recognition. It is no longer composed largely of companies that provide technologies and equipment exclusively to the military as their primary business. For the sources of RMA technology, defence is a small, even invisible, share of total business, just another market for a product or technology that companies sell commercially, in a global market.³³

³³ Gompert et al., 'Advanced military systems are chock-full of information technology. Yet *non*-military market segments dominate the information technology market. Defense contracts account for a mere 2 per cent share of today's purchases of information technology.' (pp. 68-9.) Reference is to an Institute for Defense Analysis study, IDA, *Research Summary*, vol. 3, no. 2, 1996.

This technological base draws Europeans and Americans together into a common, global market.³⁴ As this commercialising, globalising trend continues, it will be increasingly difficult for any government, including that of the United States, to maintain exclusive control or create a technology 'gap'.

The discriminator between the United States and the Europeans has been the existence of defence contracting firms and defence investments that allow governments to exploit commercial technologies in military platforms and capabilities. This is where the real gap between Europe and the United States lies. The lag in the appearance of large, system-integrating defence contractors in Europe, combined with low defence R&D investment and a lack of defence R&D coordination among the Europeans has created the RMA gap.³⁵

The commercial origins of the RMA offer an opportunity for greater intra-European and transatlantic cooperation. As larger European systems integrators emerge, they can take greater advantage of those technologies. Moreover, given the American defence investment and the global character of the technology market, European firms are inevitably driven to transatlantic technical cooperation. This process is already clear at the level below prime contractors, since a sub-contractor component and supplier market of roughly \$12 billion is already said to exist across the Atlantic, roughly equal in each direction.³⁶ The missing ingredient in Europe is

³⁴ Indeed, examinations of technologies by the US Department of Defense in the 1990s suggest that significant technical capabilities exist in Europe, from which the US military might benefit.

³⁵ The opposite argument is made by John Deutch, Arnold Kanter and Brent Scowcroft, 'Saving NATO's Foundation,' *Foreign Affairs*, vol. 78, no. 6, November/December 1999, pp. 54-67. These authors consider that advances in communications, computers, software are areas where 'the United States has a considerable advantage (but by no means a monopoly) over Europe.' (p. 61) Gompert et al., make a similar argument in more detail (pp. 74-7). They argue that US commercial firms, such as Motorola and Oracle, are far ahead of Europe and there are significant barriers to commercial exchanges across the Atlantic that re-enforce this advantage. It is not clear, however, that these firms operate exclusively in the American market; all of them research, produce or market on a global basis. The know-how in these businesses is widely disseminated and available in Europe and European firms are not backwards, as the experiences of Ericsson and Nokia suggest. See, for example, *Financial Times*, 'FT Telecoms: Financial Times Survey,' 8 October 1999, pp. I-L.

³⁶ IISS, *The Military Balance, 1998-99*, p. 273.

funding. A stronger and more coordinated European investment in defence R&D would go a good distance towards closing the gap and strengthening transatlantic defence industrial cooperation, as well as improving interoperability in the Alliance. Here, too, the political will to increase or reallocate resources will determine whether there is transatlantic industry convergence.

Industries

The defence industry on both sides of the Atlantic has been undergoing a profound transformation over the past decade, driven in part by sharp declines in defence budgets and changes in government policy, and in part by trends towards more global and commercially based defence technology. The result has been a quite radically transformed defence industrial and technology base, unlike the days of the Cold War, when dedicated defence suppliers and platform makers served a unique defence market. The defence industry has also taken an increasingly independent course in determining its future shape as the trend towards globalisation has begun to make itself felt in the defence sector.³⁷

The consolidation of the industry, combined with greater reliance on commercial technologies and suppliers, has pushed the defence market in a more fluid, flexible, transparent and transatlantic direction. The growth of a transatlantic industry should be welcome for the efficiencies it could bring

³⁷ There is a growing body of research and writing focusing on this trend in the defence sector. See, among others, Gordon Adams, Alex Ashbourne, et al., *Europe's Defence Industry: A Transatlantic Future?* (London: Centre for European Reform, 1999); Gordon Adams, 'Revolution in the Arms Trade: The Emergence of a Transnational Arms Industry,' paper for the Defense Budget Project, Washington, DC, May 1992. Richard A. Bitzinger, *The Globalization of Arms Production: Defense Markets in Transition* (Washington, DC: The Defense Budget Project, December 1993); Bitzinger, 'Globalization in the Post-Cold War Defense Industry: Challenges and Opportunities,' in Ann R. Markusen and Sean S. Costigan, *Arming the Future: A Defense Industry for the 21st Century* (N.Y.: Council on Foreign Relations, 1999), pp. 305-33; Robert P. Grant, 'Transatlantic Armament Relations Under Strain,' *Survival*, vol. 39, no.1, Spring 1997, pp. 111-37; International Institute for Strategic Studies, 'Transatlantic Defence Industry: Fortresses or Integration?', in *Strategic Survey, 1998/99* (Oxford: Oxford University Press for the IISS, 1998); and Andrew D. James, *Post-Merger Strategies of the Leading US Defence Aerospace Companies* (Stockholm: Defense Research Establishment, Division of Defence Analysis, December 1998).

to defence procurement, increased competition for acquisition programmes, and the opportunity to fully exploit critical emerging technologies. Government policies have both promoted this consolidation and sought to constrain its independent actions, fearing a loss of national control over technologies, the dispersion of the resultant capabilities to potential adversaries outside of NATO, and the loss of economic benefit in particular regions. These contradictory pressures clearly affect the degree to which the American market remains a fortress and the European market becomes one.

In the United States, the Defense Department communicated in 1993 a clear message that the American industry should consolidate after the end of the Cold War. The result was the fairly rapid emergence of four major aerospace firms: Northrop Grumman, Lockheed Martin, Boeing, and Raytheon. The aerospace/defence activities of the more diversified companies – General Electric, Ford, Texas Instruments and Hughes, among others – disappeared into these four firms. The American government played a role in this process, easing the enforcement of anti-trust laws and subsidising contractors for the costs of consolidation in proportion to the savings that would result to the Government.³⁸

The Government also constrained this consolidation process. In 1998, the Defense and Justice departments blocked Lockheed Martin from acquiring Northrop Grumman, arguing that the merger would create a vertically integrated company that would frustrate competition.³⁹ It also denied an attempt to combine Newport News Shipbuilding and General Dynamics, which would have created a single nuclear submarine/carrier manufacturer.

European defence industry consolidation actually preceded that of the United States, with ‘national champions’ emerging in the 1980s and reaching a zenith by the late 1990s: British Aerospace (BAe) and General Electric-Marconi in the United Kingdom, Dasa in Germany, Saab in Sweden, Aerospatiale-Matra and Thomson-CSF in France, CASA in Spain and the various holdings of Finmeccanica in Italy.

³⁸ The US General Accounting Office concluded that consolidations had saved \$2.1 billion, or 64 per cent of DoD’s expected savings. See GAO, *Defense Industry: Restructuring Costs Paid, Savings Realized and Means to Ensure Benefits*, NSIAD-99-22 (Washington, DC: GAO, 1 December 1998).

³⁹ See Deputy Secretary of Defense John J. Hamre, ‘Remarks to the American Institute of Aeronautics and Astronautics,’ 5 May 1999, p. 2.

A key difference between the American and European consolidation processes has been the degree to which the European firms have already become transnational. Parallel to the consolidation and privatisations of the 1980s and 1990s, European governments had encouraged a process of cross-border joint ventures and cooperative projects in a wide variety of areas, including civil and military aircraft, missiles, and helicopters. By the 1990s, a network of industry collaboration through partnerships and joint ventures already existed in Europe and some European firms were even further along, having acquired firms or shares in firms in other countries.

The most critical European consolidations took place in 1999, with the merger of BAe and GEC-Marconi in the United Kingdom and of Aerospatiale-Matra, Dasa, and CASA on the Continent, creating BAE Systems and the European Aeronautic, Defense and Space Company (EADS). A rich tapestry of joint ventures links the two European giants to each other (Airbus, Eurofighter, Astrium, MBD)⁴⁰

As a result of the American and European consolidations, the market is poised at a crossroads. On the one hand, the American market is large and the merged companies could do well in what may be rising US budgets for aerospace procurement. With European budgets flat, the market opportunities in Europe may not appear as attractive to American firms but they clearly exist, and access to technological cooperation across the Atlantic is an attractive option. From the European perspective, the consolidated companies provide a solid base for European defence procurement and governments have a clear incentive to protect that base as they move towards a more clearly European defence capability.⁴¹

Transatlantic industrial ties have emerged more slowly than the process of consolidation within Europe and the United States. In the past, transatlantic collaboration was largely the result of government-driven collaborative

⁴⁰ For a detailed survey of European consolidation activity see Burkard Schmitt, 'From cooperation to integration: defence and aerospace industries in Europe', *Chaillot Papers* 40 (Paris: Institute for Security Studies of WEU, July 2000).

⁴¹ 'The Aerospatiale Matra/Dasa merger agreement has a strong political meaning. In the wake of the BAe/Marconi merger, [it] could advance the political environment required to forge a unified European defence.' Philippe Grasset, Brussels defence analyst, quoted in John D. Morrocco and Pierre Sparaco, 'Franco-German Merger Will Spur Airbus Overhaul,' *Aviation Week and Space Technology*, 18 October 1999, p. 26.

programmes that involved the licensing and co-production of US defence hardware in Europe. While such programmes enhanced Alliance interoperability, European governments became increasingly concerned about the absence of a 'two-way street', given American reluctance to purchase European systems.⁴²

Government-to-government collaboration across the Atlantic has dwindled to a handful of joint programmes, all with uncertain futures. The British-American land vehicle known in the United Kingdom as *Tracer* may still die as a result of the restructuring of the US Army into a lighter force. The joint US-German-Italian MEADS terminal air defence system narrowly escaped cancellation and is not a high US Army priority. There is active European participation (especially by Turkey and the United Kingdom) in the Joint Strike Fighter (JSF) project, but it is still in the research and development phase and has an unclear future, with deployment some years off. NATO is exploring a common air/ground surveillance (AGS) system, but it is not clear that the chosen technology will forge a transatlantic industrial collaboration.⁴³

The decline of joint programmes created at government direction has not meant the end of transatlantic industrial ties, however. Gradually, companies in the defence industry have begun to move ahead of government policies, exploring transatlantic ties based on mutual corporate interest and market access. British companies have been particularly aggressive in seeking entry into the US market. Thanks to the acquisition of local companies, some of them have penetrated the American market successfully. BAE Systems in particular has become one of the Pentagon's main suppliers and is further extending its position. Continental European defence groups have also

⁴² Joel Johnson, 'The United States: Partnership with Europe,' in Ethan B. Kapstein (ed.), *Global Arms Production: Policy Dilemmas for the 1990s* (Lanham, MD: University Press of America), p. 122.

⁴³ On *Tracer*, see Douglas Barrie, 'U.K. Deals Bog Down,' *Defense News*, 25 October 1999, p. 1; Andrew Koch, 'FSCS/*Tracer* still 'on course' despite cuts,' *Jane's Defence Weekly*, 2 February 2000, p. 8. On MEADS, see Colin Clark and George I. Seffers, 'US Security Restrictions Hinder MEADS Cooperation,' *Defense News*, 18 October 1999, p. 1; Gopal Ratnam, 'Technology-Sharing Plan Beset by Skepticism,' *Defense News*, 15 May 2000, p. 3; Colin Clark, 'Germany, US Resolve MEADS Tech Dispute,' *Defense News*, 29 May 2000, p. 1. On AGS, see David A. Fulghum, 'Pentagon Demands Radar Upgrade Accord,' *Aviation Week and Space Technology*, 7 August 2000, pp. 41-2.

shown a growing interest in the US market, but so far negotiations have not led to any arrangements.

American defence industry has moved more cautiously with respect to the European market, though the pace picked up in 2000. Although there has not as yet been a major acquisition of European defence assets by American firms, there are active partnership or joint venture discussions under way at Lockheed Martin (with EADS and Airbus), Northrop Grumman (Dasa/EADS), Boeing (BAE Systems) and Raytheon (Thomson-CSF, renamed Thales in December 2000).⁴⁴ The Raytheon/Thales joint venture on ground-based air defence radar systems announced in December 2000 constitutes an important first step towards actual transatlantic partnership in a broad area of defence technology. In general, however, US firms have preferred to partner on a specific programme, as was the case with Raytheon's winning bid for the British ASTOR ground surveillance radar system, which has substantial subcontracting in Britain.⁴⁵

It is not clear how long American firms will continue to have access to the European market for the sale of American hardware or partnering, given European industrial consolidation and the desire to build a European defence capability. The British government, long a supporter of transatlantic programme cooperation, sent a decidedly ambiguous signal in its May 2000 \$7.5 billion package of decisions on missiles for the Eurofighter programme and the future European military transport aircraft. Consistent with the Blair government's efforts to strengthen defence cooperation within the European Union, the Government rejected a Raytheon bid for the missile programme, which had strong support and an offer of technology sharing from the US government, choosing instead to opt for the *Meteor* ramjet missile being developed by the transeuropean missile company Matra-BAE-Dynamics (MBD). Moreover, while announcing the intention to lease four Boeing C-17 transport aircraft, the British made a long-term commitment to a

⁴⁴ Other examples are US General Electric Co. joint venture with the French firm SNECMA (manufacturing and marketing the CFM-56 engine) or Boeing's purchase of the Czech aircraft firm Aero Vodochody (in anticipation of expanding aircraft purchases by the new NATO members). For more details on the industrial ties see Andrew James's chapter.

⁴⁵ Nick Cook, 'Raytheon's "best balance" ASTOR bid wins the day,' *Jane's Defense Weekly*, 23 June 1999, p. 3.

European airlifter, the A400M, being developed through Airbus, a consortium in which BAE Systems is a 20 per cent participant.⁴⁶

US industry has begun to recognise that market presence will be increasingly necessary to ensure access to European defence acquisitions, even if that market grows slowly. The recently announced creation of a joint Raytheon-Thales company is the first indication that transatlantic discussions could lead to joint ventures or full strategic partnership. Such an arrangement ensures market presence for American firms, which could in turn give US industry a voice in emerging European defence and procurement policies at the multilateral levels of the European Union and OCCAR, the Organisation for Joint Armaments Cooperation.⁴⁷ With the European consolidation virtually complete at the prime contractor level, partnerships are now a necessary ingredient of access and presence, hence the accelerating pace of negotiations between firms across the Atlantic.

I.2 The American fortress: reinforced or disappearing?

Decisions in the United States about the extent to which the American defence market will be open to European industry are a critical signal for the future of transatlantic defence industry collaboration and integration. 'Fortress America' has long been a major obstacle to a more open transatlantic defence market. The US military services and the Defense Department leadership, while aware of the Allies' needs and concerns, tend to give them second place, resist the acquisition of European defence material, discount the capabilities of European military forces and as a result resist the notion of incorporating European views into the US military strategy planning process.

⁴⁶ UK House of Commons, Geoffrey Hoon, UK Secretary of State for Defence, 'Transcript of Oral Statement on Defence Procurement to the House of Commons,' *Hansard*, Column 149, 16 May 2000; John D. Morrocco, 'U.K.'s Tilt Toward Europe Poses Multiple Challenges,' *Aviation Week and Space Technology*, 22 May 2000, pp. 24-6. There was a small transatlantic element in the winning bid for the *Meteor* missile, as Boeing was a small participant on the Matra BAe Dynamics team. The Boeing contribution would be in with respect to systems and aircraft integration and lean manufacturing techniques, not actual manufacturing. John D. Morrocco, 'Boeing Adds Clout to Meteor Team,' *Aviation Week and Space Technology*, 25 October 1999, p. 33.

⁴⁷ On OCCAR, see Cristophe Cornu's Chapter.

At the bureaucratic level, service programme managers and export licence processors have resisted the idea of more flexible export regimes, fearing negative political reaction to the loss of American technological superiority and having little desire to face American technology in an adversary's hands on the battlefield. The export licence bureaucracy in the State Department resists any loss of control over this area of policy, and wants to retain the leverage that licence decisions can provide for broader foreign policy objectives. In the American political process, especially in the US Congress, defence technology export issues and the question of non-American direct investment in the American defence economy have been political 'hot potatoes'.

These bureaucratic and political obstacles are not rigid or unchangeable. Indeed, the evolution of the global defence marketplace and the compelling need for greater interoperability have posed the greatest challenge the American defence fortress has ever faced. The American political process debated export control issues and the question of direct foreign investment repeatedly throughout the 1990s. Moreover, traditional Pentagon views on technology controls were challenged and, to a large extent, reversed, in the late 1990s. The result has been the first significant reform of American export controls – a major problem in the transatlantic defence business – in decades. Given the political debate on these issues, however, it is not entirely clear how much will change, nor how quickly.

Defense Department autonomy

The US orientation towards a global vision, as contrasted with Europe's more regional focus, has meant that American strategic and force planning have been conducted largely without European involvement. The underlying assumption of the 1997 Quadrennial Defense Review (1997) was that the US military would carry out its major combat missions – two major theatre wars – unilaterally.

The next American QDR, due in 2001, will confront this issue once again, especially given NATO's new emphasis on the Defence Capabilities Initiative. Strong pressures to confront the problem of interoperability will clash with the inclination among defence planners to think first about how US forces can perform missions unilaterally before considering potential

Allied contributions. There is some indication, already, that early QDR planning has included debate on this issue, but the outcome will not be determined before mid-2001.⁴⁸

Some of the DoD's resistance to a more integrated transatlantic defence industry regime stems from a reluctance in the military services to consider European solutions to US military requirements or to develop joint programmes across the Atlantic. To achieve interoperability, the American military services would prefer the Europeans to buy American equipment, such as the JSTARS aircraft for airborne ground surveillance, rather than create new joint programmes or buy European equipment. As force and hardware requirements are set in the Pentagon it is generally difficult for the European Allies to penetrate this planning process or for European hardware manufacturers to qualify as potential bidders for contracts. As a result, transatlantic cooperation on hardware or industry relations is hard to achieve, and sales volumes from Europe to America are consistently low.⁴⁹

Obstacles to direct foreign investment

An obvious way for European equipment to become more attractive to the DoD would be for European firms to establish a presence in the American market through direct investment, a trend clearly under way with respect to British firms. 'Fortress America' is reinforced, however, by a long-standing resistance in the United States to direct foreign investment in the US defence industry.

Historically, this concern stems from the fear that foreign-owned firms may not be available to the military in wartime or may even constitute a 'fifth column' inside a country at war. American law dealt with this risk through

⁴⁸ This issue became sensitive with a preliminary report that the Joint Chiefs of Staff had rejected greater reliance on European forces in coalition operations, arguing that coalitions actually cost the US resources because of the reliance of the allies on US transport and logistical support. The report was a false alarm: no such conclusion had been reached. It suggests, however, that proposals that would increase interoperability and role-sharing with the Europeans would be controversial in the US planning process. See Robert Holzer, 'Report: Allies No Substitute for US Troops', *Defense News* 28 August 2000, p. 1.

⁴⁹ See Joel Johnson, op. cit. in note 42, and *The Military Balance, 1998-99*, p. 273.

such legislation as the Trading with the Enemy Act and the 1976 International Emergency Economic Powers Act (IEEPA), which permit the President to block foreign transactions or seize foreign-owned assets in time of national emergency or war.⁵⁰

Corporate investments linked to an adversary present a fairly clear case for action. Investments in the US defence industry by firms based in friendly or clearly Allied countries such as Britain and France present a more complex problem. The issue is not preventing foreign ownership per se, but setting the conditions under which such investments are scrutinised and approved and the security arrangements for such investments that protect sensitive technologies.

Current American rules and procedures governing direct foreign investment pose major political and administrative hurdles to foreign firms seeking to establish geographic presence in the United States through merger with or acquisition of US defence industries.⁵¹ The obstacles are both political and bureaucratic. At the political level, there has been persistent concern about and resistance to non-US, and especially non-British firms establishing a direct, local presence, marketing to the Defense Department. For years, this concern reflected a broad concern in the United States about protecting American business from foreign competition or foreign takeover, with a particular focus on the activities in the United States of Japanese investors and businesses.⁵² As applied to defence firms, this political concern also reflected worries about the risks that technological secrets and the American

⁵⁰ See Edward M. Graham and Paul R. Krugman, *Foreign Direct Investment in the United States*, Third Edition (Washington, DC: Institute for International Economics, January 1995), pp. 98-110, and Robert T. Kudrle and Davis Bobrow, 'Foreign Acquisition of Defense-Related US Firms: Concentration, Competition, and Reality,' in Douglas Woodward and Douglas Night (eds.), *Foreign Ownership and the Consequences of Direct Investment in the United States* (Westport, CT: Quorum Books, 1997), pp. 303-25.

⁵¹ See Graham and Krugman, esp. Chapters 5 and 6, and Patrick Norton, 'United States Foreign Investment: Restrictions and Reporting Requirements,' *Lex Mundi World Reports*, Supplement No. 17, May 1992. It is worth noting that US rules and procedures, while different in detail, are not different in kind from those practiced in other friendly and allied countries such as Japan, Britain or France. Graham and Krugman, pp. 144-6.

⁵² For a broader discussion from this perspective, see Martin Tolchin and Susan J. Tolchin, *Buying Into America: How Foreign Money is Changing the Face of Our Nation* (NY: Crown Publishing Company, 1998).

technological lead would be lost, both to competitors abroad and, through them, to hostile countries, with negative consequences for US national security.⁵³

The US government has gradually recognised that there is a downside to blocking direct investment in the US defence sector. As technology becomes more global and more 'dual-use' in nature, opposing such investments could cut the United States off from potentially useful technologies, including those that emerge in commercial markets. There is both an in-flow and an out-flow of technology, both of which need to be accommodated in the interests of national security, lest the American technological lead be lost through an over-restrictive investment regime. In addition, as the technology base becomes more commercial in nature, it is becoming increasingly difficult to distinguish the implications of direct foreign investment in the commercial sector from the security impact of such investment in defence.⁵⁴

As a result, the United States government has developed complex procedures for reviewing and approving direct foreign investment in the United States, both in general and with respect to the defence sector in particular. The American procedures were defined in statute in 1988, and gave the President authority to prevent mergers, acquisitions or takeovers by non-American interests if:

The President finds that (1) there is credible evidence that leads the President to believe that the foreign interest exercising control might take action that threatens to impair the national security, and (2) provisions of the law other than [this provision or the International Emergency Economic Powers Act] do not in the President's judgement provide

⁵³ Concern about foreign penetration of American secrets has a long history, most recently major worry about possible Chinese industrial and military espionage in the US nuclear labs and the space launch industry. See US House of Representatives, Report of the Select Committee Select Committee on US National Security and Military/Commercial Concerns with the People's Republic of China, *US National Security and Military/Commercial Concerns with the People's Republic of China* (Washington, DC: House of Representatives), 3 January 1999.

⁵⁴ See Kudrle and Bobrow, op. cit. in note 50, p. 308.

adequate and appropriate authority for the President to protect the national security . . .⁵⁵

Using this provision, a pre-existing inter-agency body, created in 1975, the Committee on Foreign Investment in the United States (CFIUS) was empowered to review and make recommendations on foreign takeovers. The CFIUS is chaired by the Secretary of the Treasury, and includes most agencies that might be concerned with foreign takeovers, including Defense, State, Commerce and Justice.⁵⁶ Under regulations set down in 1991, the CFIUS can receive notification of a proposed takeover from any agency or any party to the acquisition, or it may itself choose to review a transaction. Once formally notified, at least three members of the CFIUS must decide within 30 days that there should be a review of the case. Within another 45 days, the review must be conducted and a recommendation made to the President, who has another 15 days to make a decision on whether to block the transaction or allow it to go ahead.⁵⁷

The CFIUS review requirement is, in and of itself, a deterrent to direct foreign investment in the US defence sector. While there is no formal requirement to notify CFIUS of a merger or acquisition, the presumption is that notification is desirable. Within the CFIUS context, moreover, there is no clear definition of the meaning of ‘national security’ or ‘foreign control’, which also leads to caution and a bias towards notification, just in case.

The prospect of a CFIUS review itself, combined with a charged political atmosphere, can make some transactions impossible. This was the case, most prominently, with the 1992 effort by government-owned, French

⁵⁵ Section 5021 of the Omnibus Trade and Competitiveness Act of 1988, amending Section 721 of the Defense Production Act. This provision is also known as the Exon-Florio amendment, for its sponsors, Sen. J. James Exon (D-NE) and Rep. James J. Florio (D-NJ). This temporary amendment to the Defense Production Act was made permanent in 1991.

⁵⁶ It also includes several offices within the Executive Office of the President: the Office of Management and Budget, the Office of the US Trade Representative, the Council of Economic Advisers, the Office of Science and Technology Policy, the National Security Council and the National Economic Council.

⁵⁷ As of 1999, CFIUS had received over 1,300 notifications, had conducted 18 investigations, and had made 11 recommendations to the President, only one of which recommended that a transaction be denied. Interview with the Office of the Assistant Secretary of Treasury for International Affairs, August 2000.

defence electronics firm Thomson-CSF (now Thales) to buy the Vought Aerospace subsidiary of the LTV Corporation. The debate over this proposed acquisition was acrimonious, focusing both on the competitive implications of introducing another defence electronics firm into the US market and on the risks of third-country transfer of American technology via the parent French company and its French government owner. Thomson was, in the end, deterred from pursuing its acquisition effort, shortly before it faced the CFIUS review, in the expectation that the review was likely to lead to a negative recommendation.⁵⁸

The Thomson/LTV case led to a strengthening of the CFIUS process, creating a stronger deterrent to acquisitions in the defence sector by non-US firms. As a result of these changes, buyers owned by a foreign government cannot acquire US firms doing significant business with the Pentagon, and are prohibited access to contracts containing Top Secret information. In addition, a CFIUS investigation became mandatory in any case of an attempt by a foreign government-owned entity to acquire a US defence firm. These changes both strengthen the presumption against mergers and acquisitions with businesses controlled or owned by foreign governments and add some specificity to the meaning of 'national security' in the statute.⁵⁹

Partly as an outcome of the Thomson case, and the strong domestic US political reaction, the only significant acquisitions of US defence industry assets since 1992 have been by British-based firms. Even in these cases, the businesses involved have carefully sounded out US government agencies and the Congress in advance of announcing the transactions, to prepare the ground for a successful CFIUS review and to lower the risks of political reaction.⁶⁰ In the BAe-Marconi case, both companies operated in the US defence market and both are involved in the Joint Strike Fighter and the

⁵⁸ See Graham and Krugman, *op. cit.* in note 50, pp. 112-13, 130-1.

⁵⁹ The amendments also expanded CFIUS membership, require detailed reports to Congress of CFIUS reviews, mandated that technology diversion and the potential loss of US technological leadership be part of a CFIUS review, and strengthened government data-gathering on foreign government ownership in the defence sector. Graham and Krugman, pp. 131-2.

⁶⁰ Author's personal interviews. Graham and Krugman (p. 132) noted in 1995 that strengthening CFIUS could have the effect of stimulating efforts to pre-clear or negotiate the terms of their acquisitions in advance of any CFIUS notification.

Tracer programme to build a new armoured reconnaissance vehicle. Nevertheless, the CFIUS review delayed conclusion of the merger.⁶¹ In general, the prospect of a CFIUS review can be enough to slow or change the terms of a proposed transaction, including spinning off part of the deal to avoid a review or restructuring of the internal terms of an acquisition.⁶²

The CFIUS process is not the only deterrent to foreign investment in the US market. In addition, firms pursuing such an acquisition must be prepared to create a corporate entity in the United States which is partially or significantly shielded from the view or detailed management by the parent firm. Defense Department procedures have required the creation of a separate subsidiary for US operations, which must have an agreement with DoD either to create special security rules (a special security arrangement or SSA) or to place the equity of the parent firm in a separate, non-voting trust. In the former case, the parent firm might not have any members from overseas on the board of directors of the subsidiary and might be blocked from access to operating or financial data. In the latter case, which is quite common, the parent company is simply the fiscal beneficiary of the activities of the US subsidiary and has no role in its management.

SSA's and non-voting trusts can make investments in the US defence market unattractive to overseas investors by significantly limiting technological synergies between the non-US parent and the US subsidiary. Further, they necessarily introduce administrative inefficiencies into the management of the relationship in order to ensure that the security membrane is not penetrated. Efficiencies that might normally emerge from such a merger are, in part, lost, making the transaction less financially and technologically attractive.

Export controls

One of the principle barriers in the American fortress is the complex US process of export controls and technology transfer regulations. Export controls and technology transfer rules have been the central target of

⁶¹ Although both companies were British, their merger needed CFIUS approval because it involved Marconi's US subsidiary Tracor. See Douglas Barrie, 'U.K. Deals Bog Down,' *Defense News*, 25 October 1999, p. 1(28).

⁶² Norton, *op. cit.* in note 51, p. 9.

European criticism of the American fortress and of the emerging struggle within the American government to redefine the transatlantic defence industrial relationship.

The American export control and technology transfer regime for defence items was shaped during the Cold War and played a central role in the transatlantic COCOM technology control agreement, designed to prevent the flow of technology to the Soviet Union and the other members of the Warsaw Pact. International agreement on export controls dissipated quickly, however, with the end of the Cold War. COCOM was replaced in 1995 by the relatively weak 'Wassenaar Arrangement' covering exports of conventional arms and dual-use goods and technologies.⁶³ Parties to the Wassenaar agreement exchange arms transfer information regularly on a voluntary basis and notify each other on approvals and denials of export licence requests with respect to an agreed list of goods and technologies. However, each country retains the right to exercise its own sovereign control over these decisions, which leaves export control decisions entirely in the hands of each national government's processes and regulations.

National export control rules inhibit the ability of a firm producing in a given country from exporting its goods, services, technology and know-how to firms or foreign governments which might pose a threat to the exporting country, either directly or through the re-export (transfer) of that technology to a third party. In principle, the constraints apply to firms within a single country. However, export control regulations and processes in the United States have proven to be a growing obstacle to defence cooperation with allies across the Atlantic and to the increasing interest in closer inter-firm cooperation and ownership.

The American rules and processes necessitate a licence each time an American firm wants to export a commodity or know-how to a non-American buyer, but also each time an American firm wishes to engage in a negotiation or discussion with a potential foreign partner. They also apply to discussions between US subsidiaries of foreign businesses and the parent company, as well as to discussions over potential cooperation, joint ventures, mergers or acquisitions across boundaries. American law also

⁶³ 'The Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies: Initial Elements', adopted 11-12 June 1996, Part I(1).

provides explicit protective measures against the transfer of knowledge, products or technologies to third parties. Finally, the processes in the United States are lengthy and complex, making such discussions and exchanges awkward and time-consuming.

The Department of State has responsibility for administering the export control regime under the statutory authority of the Arms Export Control Act (AECA). The AECA makes the Secretary of State responsible for the 'continuous supervision and general direction of sales, leases, financing, cooperation projects and exports' of defence articles and services.⁶⁴ This authority covers both transactions with the countries receiving the articles or services and the retransfer of those articles or services to third countries. Section 39 of the AECA provides details on the implementation of this authority, stating that the President can determine what items constitute 'defence articles and defence services' and promulgate regulations covering these items. Together, the items so designated constitute the United States Munitions List, and no item on this list 'may be exported or imported without a licence'.⁶⁵

This relatively brief statutory text was implemented through Executive Order 11958 in the 1970s, giving the Secretary of State responsibility to create regulations on defence exports. The resulting International Traffic in Arms Regulations (ITAR) and the Munitions List are the responsibility of the Office of Defense Trade Controls (ODTC) in the State Department's Bureau of Politico-Military Affairs, which has sole authority to decide if a particular article or service is covered by this authority.⁶⁶

The ODTC range of authority is quite broad, covering not only major items of defence equipment but also technical data related to the 'design, development, production, manufacture, assembly, operation, repair, testing,

⁶⁴ The Arms Export Control Act (22 USC. 2778-80) was first passed in 1968 and has been frequently amended since that date. The Secretary's authority is contained in Ch. 1, Sec. 2b, 'Coordination with Foreign Policy.' See US Senate/US House of Representatives, Committee on Foreign Relations/Committee on Foreign Affairs, *Legislation on Foreign Relations Through 1990*, vol. 1, 'Current Legislation and Related Executive Orders' (Washington, DC: Joint Committee Print, February 1991), pp. 274-347.

⁶⁵ Section 39(a)(1) and (b)(2) of the AECA statute.

⁶⁶ ITAR is found at 22CFR 120-130. The ODTC authority to designate articles is at section 120.4.

maintenance or modification' of defence articles, as well as defence services, including military training, involving defence articles, for any foreign persons.⁶⁷ Moreover, the range of activities covered is also quite extensive, since 'exports' include sending articles, transferring ownership, disclosing technical data or performing a defence service, and includes a requirement that classified visits by foreigners to US defence plants be licensed in advance.⁶⁸ Any person or corporation who seeks to export an item on the Munitions List must seek the prior approval of ODTC before making such an export. The licence covers only the country where the product will be used, and prohibits trans-shipment to any other country (outside NATO, Japan or Australia) without ODTC approval.⁶⁹ As a consequence, the State Department's Office of Defense Trade Controls considers roughly 50,000 licence requests a year, registers all US manufacturers and exporters of defence articles, and provides regular guidance to the agencies and industries involved in export policy issues.⁷⁰

The State Department retains exclusive authority over the granting of licences for defence articles and services on the Munitions List. There is an inter-agency process for considering a licence application, however, including referral for views to the Defense Department's Defense Threat Reduction Agency (which reviews over 21,000 licence applications annually), the Commerce Department's Bureau of Export Administration and, for certain items, the Department of Energy. These referrals provide the opportunity for other views on the request, but also add layers of processing and extend the time during which a licence is under consideration. The complexity of this referral process has added to the deterrent effect of the US licensing process and has been a focus of recent reform efforts.

In addition to the ITAR/Munitions List process, moreover, there is a separate US licensing process for dual-use technologies that are not on the munitions list, but have both military and commercial potential. The Department of Commerce oversees the 'Commerce Control List', which covers these dual-use items and has, in the past, exercised the licensing authority under the Export Administration Act (EAA) of 1979, as amended. The EAA expired in 1994, but the President extended Commerce's authority

⁶⁷ Section 120.6-120.10.

⁶⁸ Section 120.17 and 125.5.

⁶⁹ Section 123.9.

⁷⁰ Office of Defense Trade Controls description on Department of State website.

to designate items as dual-use and process export licences under the International Emergency Economic Powers Act. The Bureau of Export Administration at Commerce administers the Export Administration Regulations, sets the timetable for agency review and resolves disputes. Since, broadly speaking, the Commerce Department has an export promotion orientation, the process is somewhat less restrictive than the ODTIC process in the State Department. However, that same policy orientation has been a major obstacle to congressional reauthorisation of the Export Administration Act, which has been debated in Congress without any outcome since 1994.⁷¹

The US process is made more complex by the frequent recourse made to economic sanctions and embargoes. Other governments and non-US firms frequently do business with countries and companies in countries with which the United States maintains an embargo or has legislated sanctions, including Cuba, Iran, Iraq and China but extending to more than 25 countries around the world.⁷² The State and Commerce departments, as well as the Treasury, are involved in the administration of sanctions, and the US Congress is frequently the source of legislation creating them.

The Congressional role underscores an important element in the US export control process: it is highly political in nature. Not only must the Congress authorise agency responsibilities through action on statutes, but the members and committees of the Congress become deeply involved in arms sales and export decisions. Amendments to the Arms Export Control Act have brought Congress further into the process, requiring that the State Department notify Congress, particularly the Committees on International Relations (House) and Foreign Relations (Senate), of the intent to license the sale of major defence equipment or services above certain dollar thresholds. The Congress has 30 days after such notification to react with a resolution of prohibition, an authority virtually never exercised. Instead, rather like the CFIUS process, in order to avoid such resolutions arms sales

⁷¹ For the latest draft bill re-authorising the Export Administration Act, see 106th Congress, 1st session, S1712, Report no.106-80, 'A Bill to provide authority to control exports, and for other purposes,' sponsored by Sen. Phil Gramm (R-TX), Chairman of the Senate Banking, Housing and Urban Affairs Committee, which has jurisdiction over the EAA.

⁷² For a complete list, see the Department of State, Office of Defense Trade Controls website, 'State Department Embargo Reference Chart.'

above the threshold are generally informally discussed with the Congress beforehand, and withdrawn if the congressional reaction is likely to be negative. The Congressional stake in export controls brings additional complications to the process of considering licences or seeking changes in the overall process.

The politics of the US fortress: reforms and constraints

The foreign investment and export control/technology transfer rules and processes in the United States are major obstacles to a more flexible transatlantic regime for defence trade, industrial cooperation and investment. European criticism of this regime has been matched in recent years by growing internal recognition that the US process inhibits flexibility and may discourage military interoperability, security-enhancing technology transfers and closer industrial ties.

Within the Defense Department, there has been growing recognition, at the policy level, of the need for a more flexible transatlantic regime for trade, cooperation and investment. The DoD bureaucracy responsible for protecting military technologies, however, has resisted policy change. Moreover, within the executive branch, while the Defense Department has given voice to a reform agenda, the State Department has resisted any reduction in its authority to process licences or maintain the US Munitions List. Finally, there has been frequent tension between the Democratic executive branch and the Republican-controlled Congress over sanctions, trade with China and export control reform, with the latter pushing for a more protectionist agenda.

Although Defense Department officials have become gradually more aware of the impact of global change on military capability, it was not until 1998 that there was explicit recognition that existing rules and processes were posing a substantial obstacle to transatlantic industrial relations and interoperability within NATO.⁷³ Moreover, as Europe moved towards

⁷³ See 'Technology, Future Warfare, and Transatlantic Cooperation,' Remarks by Jacques S. Gansler, Under-Secretary of Defense, to NATO Workshop, Norfolk, Virginia, 12 November 1998: Another, unnamed defence official warned about the risks of 'fortress Europe': '[DoD] favors an evolution toward a competitive transatlantic model of defense industry linkages of multiple forms . . . In contrast, a 'Fortress Europe'

greater defence integration and industrial consolidation, the resulting fortress across the Atlantic would exacerbate the interoperability problem.⁷⁴

Under Deputy Secretary Hamre's leadership, the Defense Department began an intensive effort to change both internal DoD policies on investment, technology transfer and export controls, and to spearhead broader US government reform in these areas. Hamre gave a much noticed talk to the Aerospace Industries Association in November 1998, in which he suggested that the DoD wanted to look well beyond the CFIUS process in developing policy towards transatlantic partnerships, and suggested that the DoD might look favourably on closer partnership with industries in closely allied countries such as the United Kingdom, Norway, the Netherlands, Canada and Australia. Defense officials suggested that these countries were good potential partners, since they had strong export control regimes and law enforcement and intelligence cooperation with the United States.⁷⁵

In this same speech, Hamre argued that the United States might rank other countries as 'A', 'B' or 'C' countries with respect to the transatlantic relationship, A being those with which a presumption of greater flexibility and openness was clear, B being those which posed more uncertainty, and C those with which relations would not become more flexible in any circumstances. This ranking proposal caused some consternation among allied countries, some of which were uncertain as to where they would rank. It reinforced the sense that the United Kingdom and Australia might enjoy enhanced access, while others would face greater obstacles. While this concept has not become US policy, the speech did signal greater openness to change in the DoD.

model could result in a separate evolution in US and European military technology and therefore undermine interoperability with our NATO partners.' Unnamed official quoted in Sparaco, 25 October 1999, p. 32.

⁷⁴ As Deputy Secretary of Defense John Hamre put it in May 1999, 'I very much fear that we are seeing the emergence of a Fortress Europe in the consolidation that's under way in Europe right now and by the negative forces of paranoia about America's defense industry . . . Even worse in my mind is that European defense establishments seem to be prepared to accept second best in terms of modernization in order to retain these defense entities.' Hamre speech, 5 May 1999, p. 3.

⁷⁵ Douglas Barrie and Philip Finnegan, 'DoD Scrambles to Shape Merger Approval Policies,' *Defense News*, 14-20 December 1998, p. 1.

DoD's encouragement of change continued in 1999, with wide-ranging meetings between DoD officials and European industry and government representatives.⁷⁶ In addition, the Department created a task force of its Defense Science Board to study how DoD could change policies to deal with the reality of a globalised and more commercial defence establishment. The DSB report, published in December 1999, urged the Defense Department to focus on protecting critical military capabilities, as opposed to a long list of specific defence-related technologies, and to put higher priority on acquiring commercial technologies. It noted that 'transatlantic defence-industrial integration could potentially yield tremendous benefit to the United States and its allies'. It called for greater clarity in DoD policy towards defence industrial mergers, and a relaxation of the regulatory burdens on direct foreign investment and on the transfer of defence technologies.⁷⁷

Defense Under-Secretary John Hamre made the reciprocity argument for Defense's changed position abundantly clear in early 2000:

'While some barriers to our defence market are based in law, others are based on an obsolete paradigm that the United States must be prepared to fight by itself and to be prepared to supply itself during any conflict from within the domestic industrial base. If we expect companies producing equipment in the United States to have access to the defence markets of our allies in the future, we must show a greater willingness to rely on companies located in allied countries for satisfying our defence equipment needs.'⁷⁸

Up until mid-2000, Defense Department urgings led to only small changes in transatlantic merger and joint venture activity. Only British firms moved into the American market to any extent, as noted. This slow progress was due, in part, to the accelerated pace of European consolidation and DoD

⁷⁶ Thomas E. Ricks, Anne Marie Squeo and Jeff Cole, 'Pentagon is Encouraging More Mergers Between European, US Defense Firms,' *Wall Street Journal*, 7 July 1989.

⁷⁷ See, Office of the Under-Secretary of Defense for Acquisition and Technology, *Final Report of the Defense Science Board Task Force on Globalization and Security* (Washington, DC: Defense Science Board, December 1999), and Colin Clark, 'Hamre to Reveal Strategy for Globalization,' *Defense News*, 1 November 1999, pp. 1, 27.

⁷⁸ 'Testimony of Deputy Secretary of Defense John Hamre before the Senate Armed Services Committee, 28 February 2000, p. 9.

recognition that this European process was leading away from transatlantic bargains, at least temporarily.⁷⁹ It also reflected caution in the DoD about the potential internal congressional reaction to changes in investment and merger policy.

Political resistance to a more open transatlantic regime was an offshoot of a highly political debate over the Cox Commission report on US-China relations, condemning American satellite manufacturers Hughes and Loral for allegedly allowing the Chinese to obtain American satellite and launch technology.⁸⁰ Although the Cox Commission issue was not focused on transatlantic activities or on the defence industry, it did have a substantial chilling effect on broader efforts to bring more flexibility to the transatlantic relationship.⁸¹ The DoD made it clear to American and European defence executives, in October 1999, that its earlier enthusiasm for transatlantic mergers and acquisitions had cooled, in favour of a more restrained encouragement for joint ventures and partnerships among the major system integrators.⁸²

Nevertheless, the DoD continued to push for changes in the way trusted foreign companies might be allowed to operate inside the United States. In January 2000, after a year-long review, the Pentagon lifted the proxy board requirement for Rolls Royce's Allison Advanced Development Company, an Arlington, VA company. Instead, the Pentagon negotiated a less strict Special Security Arrangement with Rolls Royce North America, which would simplify visits between the parent company in the United Kingdom and the American subsidiary and allow parent company officials to sit on the subsidiary's board of directors. It was clear that the DoD was sending a signal about greater flexibility with this decision, but it was cautious about the breadth of the precedent, saying 'decisions on foreign ownership . . . are

⁷⁹ Author's interviews.

⁸⁰ *US National Security and Military/Commercial Concerns With the People's Republic of China*, Report of the Select Committee on US National Security and Military/Commercial Concerns with the People's Republic of China (Washington, D.C.: House of Representatives, January 1999).

⁸¹ For example, a Defense Department report on the commercialising trends in defence technology was not released and did not deal with globalising trends, in part because of concern about the strong Congressional reaction to allegations of the loss of launch technology secrets to China in the spring of 1999. Author's interviews.

⁸² Robert Wall, 'New Strategy Emerging for Transatlantic Linkups,' *Aviation Week and Space Technology*, 1 November 1999, p. 27; and private interviews.

made on a case-by-case basis so there is no reason to assume that other proxy requirements will be lifted just because this one was.’⁸³ Deputy Secretary Hamre made it clear, however, that a similar approach was being taken to the security requirements negotiated with BAE Systems’ Marconi North American subsidiary as well.⁸⁴

As the Department began to show careful flexibility about transatlantic mergers and partnerships, it also began to tackle the other significant obstacle to transatlantic cooperation, the US export control regime. The initial focus was on the Pentagon’s own process. Throughout 1999, an internal DoD effort, led by Under-Secretary Gansler’s principal deputy, David Oliver, worked to reshape and streamline DoD export licence review processes by standardising the processing of export licence requests, reducing the number of reviews at lower bureaucratic levels and accelerating its timetable for responding to the State Department with DoD views. As a result of these reforms, the DoD reduced the backlog of licence requests that were taking more than 60 days to process from nearly 600, in January 1999, to zero in April 2000, and reduced the average processing time from 46 days in 1999 to 12 days in April 2000.⁸⁵

It was clear, however, that reforming the Defense Department’s process was not enough to lower this barrier to a more flexible transatlantic industry relationship, given the State Department responsibility for the ITAR, the Munitions List and final licensing decisions. The State Department has been notoriously reluctant to streamline its own process, modify the Munitions List or expand exemptions from the export licensing requirement. As one State Department official said, ‘It continues to be in our national interest to keep a comprehensive system. It is in our national security interests, and it is also a foreign policy tool.’⁸⁶

⁸³ The Pentagon statement did note that the decision should ‘suggest to foreign investors that we are willing to be flexible within the general framework of our security regulations.’ Colin Clark, ‘DoD Smooths Path for Rolls-Royce Operations,’ *Defense News*, 10 January 2000, p. 1.

⁸⁴ ‘Testimony of Deputy Secretary of Defense John Hamre before the Senate Armed Services Committee, 28 February 2000, p. 9.

⁸⁵ Department of Defense, ‘Changes in DoD Munitions Export License Control Performance,’ April 2000. See also Colin Clark, ‘Pentagon Marches Ahead with Export Reform,’ *Defense News*, 6 December 1999, p. 3.

⁸⁶ See Colin Clark, ‘State Dept. Calls for Arms Export Control Review,’ *Defense News*, 8 November 1999, pp. 1, 26.

Moreover, the State Department was also responsive to Congressional concern over alleged inadequate enforcement of existing export control requirements, such as the requirement to monitor and receive reports on the negotiations involved in the Chinese discussions on satellites with Hughes and Loral. In reaction to the Chinese case, moreover, the Congress had returned jurisdiction over satellite and satellite component exports licences to the State Department, removing it from what Congress saw as an excessively permissive dual-use control regime in the Commerce Department.

Concerned about the State Department's general unwillingness to loosen export control restrictions for trusted allies, the Defense Department initiated a series of regular inter-agency meetings with the former to force a process of change. In addition, Defense officials became rather outspoken about the problems that controls aimed at dealing with the actions of less friendly countries were creating for US defence relationships with NATO Allies.⁸⁷

The Pentagon's heightened concern about the impact of export controls was driven, in part, by an increasingly vocal European reaction to US actions. In the autumn of 1999, the European defence industry and European governments began to weigh in heavily against the existing regime. In October 1999 German defence contractor Dasa sent a memo to its programme managers discouraging them from using American suppliers, especially for satellite components. According to the memo, delays in receiving export licences for US components were holding up Dasa programmes: 'Because of this uncertain export-licence situation, the use of US goods, especially US defence goods, should be avoided at all costs. Wherever US goods are being used, they should be substituted as quickly as possible with non-US goods.' A Dasa official explained that this order applied only if a US export licence and US delivery could not be guaranteed within a specified time, but the broader message was clear.⁸⁸

⁸⁷ Joseph C. Anselmo, 'Hamre: Export Delays Hurting US Alliances,' *Aviation Week and Space Technology*, 8 November 1999, p. 34.

⁸⁸ *Bloomberg News*, 28 October 1999 and author's interview, October 1999. As Manfred Von Nordheim, President of Dasa North America put it, 'We don't want to be caught with our pants down, so to speak, because we cannot meet customer demands or contractual obligations if a license is denied or not acted on.' Joseph C. Anselmo, *Aviation Week*, 8 November 1999, p. 34. In the same article the managing director of

European pressure for changes in the United States accelerated in December 1999. Dasa Chairman Manfred Bischoff wrote to US Secretary of State Madeleine Albright expressing industry's concern:

'I respectfully urge you to review current export control policies and procedures with a view towards promoting cooperation among NATO allies and laying the groundwork for possible future transatlantic industrial mergers . . . [T]he current system of export and technology control as practiced by the United States and especially by the Department of State serves to discourage rather than encourage, such cooperation.'⁸⁹

By the end of 1999, the executive branch disagreement over export control reform was out in the open.⁹⁰ State and Defense were working towards a common view on some reforms to the existing process, including providing a single licence for an entire project or programme, speeding licensing for programmes linked to the Defense Cooperation Initiative, and investing in computer links between the export licensing data bases in Defense, Commerce and State. The discussions were not moving quickly, however, as State viewed Defense's aggressive push for reform as an intrusion into its authorities, and was concerned to protect the policy advantages of retaining flexibility over the approval of licences.⁹¹

Asia Pacific Aerospace Consultants was quoted as saying: 'Frankly, America is no longer seen as a reliable supplier or partner . . . American companies can neither guarantee export permission nor estimate how long getting that permission might take.'

⁸⁹ Letter from Dasa Chief Executive Officer Manfred Bischoff to Secretary Albright, 9 December 1999, as quoted in Vago Muradian, 'Allies Call On Albright to Reform Export Controls,' *Defense Daily*, 6 January 2000, p. 2. A week later, all of the EU ambassadors to the United States jointly expressed their joint concern to Secretary Albright, that 'the lengthy and dated process of export controls is increasingly developing into a serious impediment to defense cooperation.' Letter from Joris Vos, Ambassador of the Netherlands, to Secretary of State Albright, 16 December 1999. Europeans also strongly criticised the American export control process at a symposium attended by US officials in Toulouse, France, 6-8 December 1999. Richard Smith, 'US Export Rule Under Fire at Symposium,' *Defense News* 10 January 2000, p. 18.

⁹⁰ See Colin Clark, 'Pentagon Unilaterally Moves to Speed Export Reviews,' *Defense News*, 25 October 1999, pp. 3, 28; Clark, 'Eased Export Controls Stalls,' *Defense News*, 22 November 1999, p. 3; Clark, 'Pentagon Marches Ahead With Export Reform,' *Defense News*, 6 December 1999; Vago Muradian, 'White House Help May Be Needed to Fix Export Control Squabble,' *Defense Daily*, 15 December 1999, p. 1.

⁹¹ Author's interviews, spring 2000.

The problem of executive branch authorities was exacerbated by the Pentagon's announcement in February 2000 that Secretary of Defense William Cohen and British Secretary of State for Defence Geoff Hoon had signed a 'Declaration of Principles for Defence Equipment and Industrial Cooperation' (see Annexe A), laying out a roadmap for negotiations towards a joint defence agency agreement that could bring fundamental change to the defence industry and trade relationship between the two countries. The DoD pursuit of this declaration had been under way for some time and, although State had been informed of the discussions, it did not participate in them.

The Defense Department had deliberately chosen to negotiate with the British because US-UK relations most closely met what the Pentagon had laid out as the 'five pillars of cooperation' which could lead to a licence-free relationship with another country:

- congruent and reciprocal industrial security policies and procedures;
- congruent and reciprocal export control processes;
- excellent cooperative relationships in law enforcement;
- close cooperation in intelligence sharing on matters of counter-intelligence, economic espionage, and industrial security and export control violations; and
- willingness to enter into binding agreements establishing reciprocal access to each other's markets.⁹²

These five pillars form the bedrock on which the DoD would build closer industry ties with allied countries. Through negotiations, the DoD would seek to ensure that industries in both countries share rules and processes that protect classified technologies and ensure proper clearance of company employees. Export control licensing regulations and processes should be similar, control technology exports in a parallel way and be responsive to each party's decisions. Law enforcement agencies should in general share a view on what violations of law should be pursued and cooperate with each other in pursuing those violations. The same principles should apply to cooperation between the intelligence agencies of the two countries. Finally,

⁹² 'Testimony of Deputy Secretary of Defense John Hamre before the Senate Armed Services Committee, 28 February 2000, p. 4. See also, Colin Clark, 'Britain, Australia Tighten US Defense Ties, *Defense News*, 14 February 2000, p. 1.

because both countries would be concerned that they could receive necessary defence items in a time of crisis, reciprocal access to each other's markets would be a necessary concomitant of allowing greater defence interdependence.

The Declaration of Principles also set out a process that would lead to greater harmonisation of military requirements between the two countries. It would identify, at an early stage, projects for cooperative R&D and production and would explore the harmonisation of acquisition processes. Finally, the parties would explore greater transparency and efficiency in export control procedures, including ways to simplify the process, especially for jointly produced goods that might be exported to third parties. They agreed to establish a 'high-level council' on export controls to work towards these goals.⁹³

This ambitious Defense Department initiative was intended to expand to other countries, starting with Australia, but continuing with the Netherlands, France, Germany, Norway and Sweden, among others. From the Pentagon's perspective, the relationship with other countries should evolve towards the regime that had existed with Canada. Canada was treated as a part of the North American defence industrial base and benefited, until 1998, from an exemption from the licensing requirement for transfers of unclassified technology, provided Canada was the end-point in the transfer.⁹⁴ While the limitation to unclassified exports would appear to limit the application of this exemption, it actually covers a broad range of technologies and

⁹³ Secretary of Defense William S. Cohen and Secretary of State for Defence Geoffrey Hoon, 'Declaration of Principles for Defense Equipment and Industrial Cooperation between the Department of Defense of the United States of America and the Ministry of Defence of the United Kingdom of Great Britain and Northern Ireland,' including the Annex, 5 February 2000 (See Annexe A). See also Ann Marie Squeo, 'US, Britain Set Defense Agreement Boosting Trans-Atlantic Business Ties,' *Wall Street Journal*, 8 February 2000.

⁹⁴ Colin Clark, 'Britain, Australia Tighten US Defense Ties,' *Defense News*, 14 February 2000, p. 1. In July 2000, a similar declaration was signed between the Defense Department and the Australian Ministry of Defense. See Neil Baumgardner, 'United States, Australia Sign Agreement to Lower Defense Trade Barriers,' *Defense Daily*, 18 July 2000, p. 8. The Canadian exemption from the ITAR had been suspended in April 1999, following several incidents which revealed laxity in export controls in Canada. It was restored, after negotiations tightened these procedures, in the summer of 2000.

information on the US Munitions List and would, in particular, permit a substantial cross-border interchange on technological cooperation and potential partnerships. Most such exchanges and discussions are unclassified, though they are generally carefully protected by the firms as proprietary and sensitive.

The State Department reacted sharply to the US/UK defence declaration, making it clear that the Pentagon had negotiated an agreement on a matter within State's jurisdiction and quickly asserted its position in the continuing turf war over export controls:

'This is an agreement in principle between ministries of defence, and does not impose any legal obligations . . . While the Department of Defense has advertised the declaration as being non-binding, it is clear the document prefigures efforts by DoD and the Ministry of Defence to secure a legally binding agreement to modify the defence export controls of both countries. [This] . . . would require amending existing law and regulation and hence involve State's oversight committees [in the Congress].'⁹⁵

The difficult negotiations on reform between the two US agencies continued through spring 2000. While they could agree on a substantial list of export control reforms, the sticking point was the DoD proposal seeking a Canada-like exemption for any country which successfully met the 'five pillars' tests as the result of a negotiated agreement, such as that under way with the United Kingdom. From the Pentagon's point of view, the reforms that would result from such an agreement would achieve two goals simultaneously. They would create a more open, flexible and transparent defence trade regime with allied countries, ensuring that the Pentagon benefited from global and commercial technologies, and that Alliance interoperability was strengthened. At the same time, such agreements would be achieved only if the other country 'levelled up' its export control, law enforcement, industrial security and intelligence sharing, which would provide the United States with greater assurance against the risk of technology transfer to hostile countries. In the end, the US export control

⁹⁵ Industry welcomed the Declaration, but British diplomats made it clear that they recognised State would need to be at the table for any final agreement: 'We know we have to deal with State.' Colin Clark, 'US Critics Assail Export Pact with British,' *Defense News*, 21 February 2000, p. 3.

process would no longer have to spend time on the secure cases with friends and Allies, and could focus on the more risky transfers.⁹⁶

The DoD proposal met with strong State Department resistance. It also attracted hostile fire from the Congress, where it tapped into the broader concern about the leakage of American technological secrets. Representative Benjamin Gilman (R-NY), Chair of the House Committee on International Relations, opposed the concept: ‘What I don’t support is utilizing exemptions to waive licensing requirement for our allies.’⁹⁷ Gilman was joined by Senate Foreign Relations Committee Chair Senator Jessie Helms (R-NC) and the ranking minority members of the two committees, Representative Sam Gejdenson (D-CT) and Senator Joseph Biden (R-DE) in a joint letter to Secretary of State Madeleine Albright on 16 March 2000 warning against the DoD’s proposed ITAR exemption. They defended the current framework for export controls and warned that the Canada-style exemption would leave 80 per cent of defence trade among companies unlicensed. They urged that no changes be made in current rules unless the beneficiary country had ‘in place an export control system comparable to that in the US’, and their committees had been fully consulted.⁹⁸

By April 2000 it was clear that the two agencies could not resolve their disagreement over the ITAR exemption. Members of Congress were concerned about the proposal and their jurisdiction. The defence industry, which had been calling for reform, was uncertain about pushing hard for a Canada-like exemption.⁹⁹ The Pentagon was anxious to have a package

⁹⁶ See Colin Clark, ‘DoD Urges Smoother Licensing for Allies,’ *Defense News*, 20 March 2000, p. 4. The United Kingdom and Australia are the destination for 30 per cent of the export licences requested from State. Stan Crock, ‘Reining In Out-of-Control Tech Export Controls,’ *Business Week*, 23 March 2000.

⁹⁷ Colin Clark, ‘State Department Splits on Export Reform,’ *Defense News*, 13 March 2000, p. 1.

⁹⁸ Chuck McCutcheon, ‘Industry Seeks Fresh Approach to Rewriting Export Controls,’ *Congressional Quarterly Weekly*, 1 April 2000, p. 781. Concern about the committee’s jurisdiction may have been a key motivation for this letter. It reflected the State Department’s concern about the Pentagon negotiating in an area of State’s authority and could have been more likely to engage the attention of the Democratic ranking members than the policy issue, itself. The State Department may have encouraged this letter, moreover. Author’s interviews.

⁹⁹ Gansler’s Deputy, David Oliver, weighed in with industry about its lukewarm support for the exemption in an e-mail on 17 April 2000. He noted that State representatives had been saying that industry was happy with the list of reforms State and Defense had

completed in advance of the May 2000 NATO ministerial meeting in Rome, where it could be announced. The National Security Council had stepped in to coordinate the inter-agency discussion, and the decision would have to be made by the President, given the State Department's firm opposition.¹⁰⁰

The final list of 17 reforms was announced as the Defense Trade Security Initiative (DTSI) at the NATO ministerial meeting on 24 May 2000. Most significantly, the President decided in favour of proposing an ITAR exemption for 'countries that share with the United States congruent and reciprocal policies in export controls, industrial security, intelligence, law enforcement, and reciprocity in market access.' As in the case of Canada, the exemption would cover unclassified exports. Moreover, it would depend on establishing 'appropriate international agreements on end use and retransfer of defence items, services and technical data and on close conformation of essential export control principles.' The Pentagon proposal had also been modified so that companies, as well as countries, would have to be 'identified as reliable by the US government' in order to benefit from the exemption. The United Kingdom and Australia were explicitly identified as 'the two countries most ready to take advantage of this exemption'.

The reforms also included other changes to US export controls that could streamline the process and facilitate closer transatlantic industrial relationships. They provided for a pilot programme 'major programme licence,' where a single, comprehensive eight-year licence would be provided for an entire project, where the US firm was the prime contractor, rather than seeking a licence for each transaction in that programme. They provided, as well, for a 'major project licence,' for a major commercial sale

agreed to already, but that these statements were coming from industry representatives who had to work with the State bureaucracy, not industry leadership. He expressed the view that the agreed reforms 'do not go anywhere near far enough to facilitate defense trade relationships with our closest allies' and urged the industry to contact presidential Chief of Staff John Podesta in support of the Canada-like ITAR exemption. A 12 April 2000 letter from AIA President John Douglass had appeared only mildly enthusiastic about the proposal, supporting it 'when such a move supports US foreign policy and national security interests' and noting that 'it would certainly seem possible to develop' an exemption system.

¹⁰⁰ As David Oliver put it: 'This is going to be a presidential decision because one of the agencies involved is not in complete agreement.' Neil Baumgardner, 'Oliver Expect Presidential Decision on ITAR Exemptions for Britain, Australia,' *Defense Daily*, 13 April 2000, p. 4.

of defence articles to NATO members, Japan or Australia, covering all parts of a proposed export. A 'global project licence' would cover all exports planned under a government-to-government agreement for a cooperative project. Of importance to the transatlantic industry dialogue, the reforms would allow a single comprehensive authorisation permitting companies 'to exchange technical data necessary for teaming arrangements, joint ventures, mergers, acquisitions, or similar arrangements', with companies in NATO, Japan and Australia. To encourage the NATO Defence Capabilities Initiative, the reforms would 'expedite US Government review of export licences for DCI projects or programmes.' Two reforms could ultimately create greater speed and efficiency in State Department administration of the ITAR licensing process. One provided for enhanced computer connectivity between the licensing activities at State and Defense (for which Defense had budgeted \$30 million), and the other called for a rolling review of the Munitions List, at a rate of one quarter of the list per year.

The May 2000 changes in US export controls are only the beginning of a process. The negotiations over agreements that would open up the ITAR exemption opportunity are not likely to be easy, given the levelling-up required by the beneficiary country to ensure that intellectual property rights are protected, export control rules are legally enforceable, and technology transfer regimes are tight. European industry representatives warned that this levelling-up issue made it appear that the reforms were of greater benefit to American than to European industry.¹⁰¹ The American industry, on the other hand, was concerned that the reforms may not have gone far enough, and that implementation could be a problem.¹⁰²

Moreover, the US Congress could still inhibit the proposed ITAR exemption. The Republican-controlled Congress reacted somewhat negatively to the exemption proposal, suggesting there might be a need for

¹⁰¹ Manfred Von Nordheim of Dasa stated: 'If . . . the carrot of an exemption is little more than an attempt to unilaterally impose US standards, values and criteria, the fault lines between Europe and the US will widen.' Statement, June 2000.

¹⁰² AIA President John Douglas was cautious: 'Even if these initiatives are implemented as well as everyone wants, we will have done no more than streamline a system devised for an age that no longer exists.' Douglas called for a commission to consider a more drastic overhaul of the export control system. Robert Wall, 'US Issues New Export Regulations,' *Aviation Week and Space Technology*, 29 May 2000, pp. 38-9; Greg Schneider, 'US Will Relax Arms-Sale Curbs,' *Washington Post*, 24 May 2000, p. E1.

legislation to prevent the granting of licence-exempt status to other countries, or for notification and review by the Congress before such an exemption were granted.¹⁰³ One congressional staffer put it even more strongly: 'We will stop it. This will not come to pass. This notion of going licence-free on weapons sales to various countries is an unsupportable step. It was opposed by the Secretary of State . . . and we oppose it for the same reasons.' There was also concern in Congress about the extent to which the Pentagon had intruded into State's territory on the issue: 'State let itself, in many ways, get run around. The Department of Defense in this regard was effectively usurping prerogatives of the State Department. And we were concerned about that.'¹⁰⁴

The reforms in the US export control process are an important first step in creating greater flexibility in the American fortress. However, they remain to be implemented, which is the only true test of the extent to which they will bring significant change. As the Office of Defense Trade Controls will be in charge of that implementation, the process of negotiation and reform could be slow. Moreover, agreements with other allied countries on the 'five pillars', which will be conducted by the Defense Department, are at an early stage and raise controversial issues of law and bureaucratic practice that will not be easily solved. The congressional politics regarding these reforms remain to be played out.

Finally, the new Administration will shape its own views on transatlantic defence industrial relations. Broadly speaking, it seems likely that the new Administration will be inclined to advance the process of reform, recognising the urgency of greater interoperability and the changing nature of the global and more commercial market in defence technology.¹⁰⁵ The key issue will be how quickly new appointments are made and how much

¹⁰³ See Colin Clark, 'Export Reform Advocates Feel Stymied by US Congress,' *Defense News*, 10 July 2000, p. 6. For a time, the Senate was considering an amendment to a separate bill that would have prevented the President from granting such an exemption but this language seemed unlikely to move forward. It was possible, however, that Congress would seek greater specification of the criteria that would be used to grant such an exemption. Colin Clark, 'Senate Targets White House Exemption Power,' *Defense News*, 26 June 2000, p. 4. See also, Robert Wall, 'Congress Tweaks Export Reforms,' *Aviation Week and Space Technology*, 10 July 2000, p. 57.

¹⁰⁴ Jay Hancock and Tom Bowman, 'US Set to Ease Weapons Exports,' *Baltimore Sun*, 12 June 2000.

¹⁰⁵ Author's interviews, 2000.

priority the new teams at Defense, State and Commerce give to the question of export control reform. The American fortress remains largely in place, however, though some of its ramparts are clearly weakening in the face of interoperability requirements and technology flows.

I.3 The transatlantic defence industrial agenda

Trends in the European, American and transatlantic defence markets point in contradictory directions for the future of transatlantic industrial collaboration and integration. A divergence over global strategy could drive the United States and its NATO partners apart, while a common concern about interoperability in NATO could drive them closer together. The future of the CESDP will be a critical ingredient in the outcome of this tension. The effort to carve out a distinct and autonomous European defence capability, along with a European defence procurement agency, could reinforce divergent tendencies in the transatlantic defence market. Shrinking budgets, which could serve as an incentive for transatlantic efficiencies in spending, could also push the Europeans to combine procurement on a continental basis and, through joint acquisitions, protect a smaller European industrial base. Technological trends – globalisation and the increased importance of commercial technology for defence capabilities – should be an integrating element across the Atlantic, but a shortfall of European investment could mitigate that trend and perpetuate US technological superiority. Finally, industry itself may be torn between the attractiveness of the larger transatlantic market (particularly in the United States) and the protection provided by more instances of fortress-like common European procurement.

The contradictory tendencies at play in the transatlantic defence market could easily lead to the emergence of two fortresses, each protecting its companies and its technologies. Alliance interoperability would suffer as a result, technological advantages would be missed and a more efficient research and procurement programme for all of the Alliance partners would be foregone.

If this outcome is to be avoided, the Americans and Europeans need to shape an agenda for the future. The year 2001 will be a crucial one, given the changes taking place on both sides of the Atlantic. The Europeans will

have shaped forces and budgetary goals for defence (CESDP) and the new US administration will be in its first year, with reforms to be implemented and a new team in office. The following points in particular deserve attention:

- American and European defence planners need to send a clear message to industry by focusing on success in the DCI and CESDP and on the connection between the two. Involving Americans in European discussions, ensuring the NATO-EU dialogue continues, and, above all, incorporating the Europeans in a meaningful way in the forthcoming US Quadrennial Defense Review (QDR) will be critical. If the two discussions (CESDP and QDR) are conducted in isolation, there is a real risk of increased transatlantic political tension, which could drive reform of US defence trade policy off the rails.
- Serious attention needs to be paid on both sides of the Atlantic to the health of current and pending joint programmes and defence acquisitions. A more integrated strategy and force planning dialogue will help, but both sides need to look for opportunities to shape programmes for which companies on both sides of the Atlantic can bid. The *Meteor* decision carries some risk of derailing this approach to transatlantic cooperation; the fate of the Joint Strike Fighter will send an even stronger signal from the American side.
- A transatlantic dialogue on defence trade and investment rules and practices is badly needed, at both the bilateral and multilateral levels. This should include the entire range of issues: export controls, foreign investment rules, technology transfer protection, industrial security, intellectual property rights and acquisition laws, rules and procedures. Greater harmonisation in all these areas will encourage industry to work on a cooperative transatlantic basis and relieve anxiety in the American political system about European policies and practices. The dialogue should be carried out in both the public and private sectors, and include legislative actors, particularly from the Congress.
- This dialogue needs to incorporate multilateral players, including NATO, the European Union and OCCAR. Bilateral rules will prove inadequate in what will be an increasingly multilateral rule-making process.
- Defence budgets will need more resources on both sides of the Atlantic, especially for procurement and R&D. A failure to invest in and coordinate European defence R&D could be fatal to the CESDP, and to transatlantic cooperation.

- Industry on both sides of the Atlantic faces a challenge. In the European case, the consolidated firms need to combine a desire to enter the American market with clear support for more open reciprocal access to the European market, lest the American political process react to European defence protectionism by rebuilding the American fortress. On the American side, industry needs to remain open to European cooperation in the American market, but also give careful consideration to how it operates in Europe. The challenge is to become more global; to operate as a 'European firm' in Europe, not as the leading edge for the sales of American products to the Europeans.

The transatlantic defence market is at a sensitive and critical moment. Fortresses could emerge on both sides, but, at the same time, the forces of interoperability, limited resources, technology flow and industrial cooperation could expand the market space across the Atlantic, while retaining and even reinforcing protection against the dissemination of critical technology. Much will depend on the will of policy-makers to overcome the obstacles to a more flexible transatlantic trade and industry regime in the next few years.

Chapter Two

FORTRESS EUROPE – REAL OR VIRTUAL?

Christophe Cornu

Although dictionaries and encyclopedias on strategy give various definitions of the word ‘fortress’, they all have two common denominators. A fortress is on the one hand a particularly important position which, in order to be impregnable, is protected by various defensive and offensive deterrent devices. On the other hand, a fortress is one of the components of a sphere of influence, which it helps to control and reinforce by various means, including its ability to project forces beyond that zone. Fortification is not therefore an aim in itself but rather a tool that facilitates a wider operation. It is merely one means among others that are available in implementation of a strategy, which in turn flows from a general policy.¹

This military imagery, which can easily be transposed to transatlantic relations in the field of armaments, allows one to gauge the dynamics of balances and tensions, in this very sensitive area, between a dominant constituted power and a group of European countries on the path to integration.² If, therefore, the Europeans wished to create a ‘Fortress Europe’ comparable to that which the United States has methodically built up,³ a certain number of instruments would have to be put in place, including:

¹ See Gérard Chaliand, *Anthologie mondiale de la stratégie* (Paris: Lafond, 1991).

² See Yves Boyer ‘Technologies, défense et relations transatlantiques’, *Politique Etrangère*, no. 4/94, pp. 1005-15. For a more general treatment, see Paul Kennedy, *The Rise and Fall of the Great Powers* (London: Unwin Hyman Ltd, 1988); Zbigniew Brzezinski, *Le grand échiquier. L’Amérique et le reste du monde* (Paris: Bayard, 1997); Nicole Gnesotto, *La puissance et l’Europe* (Paris: Presses de Sciences Po, 1998); Joseph S. Nye Jr., ‘The US and Europe: continental drift?’, *International Affairs*, vol. 76, no. 1, January 2000, pp. 51-9.

³ See European Defence Industries Group, ‘Study paper on Main US Discriminatory Measures and Practices in the Defence Field’, EDIG-EPP/93/04 Revision 4, Brussels, 20 June 2000; edig@skynet.be.

- decompartmentalised defence markets (as concerns production, transfers of equipments and subsystems, as well as acquisitions and competition) within a European space that has a unified legal system;
- customs barriers to armaments imports as a tool for a European Union type of customs system;
- a single authority responsible for armaments and acting initially within the framework of a common defence policy and then as the instrument of a single defence policy with an adequate budget of its own;
- European preference in procurement, and consequently an increase in the proportion of European equipment in service with European armed forces.

In the continuing debate over transatlantic relations in the field of armaments, the 'Fortress Europe' paradigm still strongly influences discussions, either pervading the accusations levelled by Europe's American partners or, for the Europeans, embodying a hope or, conversely, something to be rejected.⁴

Evolving at different speeds, depending on the actor or sector, the European armaments community presents a complex, multifaceted picture,⁵ in which 'Fortress Europe' is still virtual, whereas corresponding national 'citadels' are an undeniable reality (section II.1). However, recent attempts at convergence on the part of European countries, in certain parts of the armaments sector, introduce new terms into the transatlantic equation (section II.2).

⁴ See in particular Robert P. Grant, 'Transatlantic Armament Relations Under Strain', *Survival*, vol. 39, no. 1, Spring 1997, pp. 111-37; 'Lockheed Chief Warns of Risks of a Fortress Europe', *Financial Times*, 30 October 1998; Emma Bonino, 'A single European Army', *Financial Times*, 3 February 1999; Heinz Schulte, 'Euro mergers spark fear of Fortress Europe', *Jane's Defence weekly*, 20 October 1999, and the European Policy Centre of Brussels seminar 'Defence industry & weapons cooperation: still Fortress Europe against Fortress America', *Atlantic News*, 7 April 2000.

⁵ See Jean-Paul Hébert, 'Armement: le choc de l'Europe', in *RAMSES 1999* (Paris: Dunod for IFRI, 1999), pp. 229-54.

II.1 Fortress Europe and national ‘citadels’

An examination of European defence equipment budgets and markets, legislation relevant to this sector, the structure of European industry and the discussions on European preference, leads to the conclusion that the expression ‘Fortress Europe’ does not yet correspond to anything more than an eventuality. The reality today is of a juxtaposition of national citadels kept in being by government practice.

Limited, fragmented budgets

The most recent military operations involving Americans and Europeans (the Gulf conflict and crises in the Balkans) showed that, compared with the United States, the ‘yield’ from European defence budgets was very much lower, in particular because of their different budget priorities (operating costs versus capital investment) and a lack of pooling of equipment, leading to considerable duplication.⁶

Furthermore, the Europeans devote less money than the United States to defence. The following table shows that this gap is widening, in particular in the case of R&D budgets, which determine Europe’s capacity to design future weapons systems.

Year	United States		Europe (15 EU countries)			Europe (17 NATO countries)		
	Defence budget	R&D budget (1)	Defence budget	R&D budget (2)	Ratio (1):(2)	Defence budget	R&D budget (3)	Ratio (1):(3)
1995	274.6	36.6	168.9	12.1	3	172.7	12	3
1998	253.4	36.4	143.5	9.5	3.8	150.2	9.5	3.8
1999	252.3	35.3	131.6	9	3.9	140.1	9	3.9

All figures are in constant 1997 \$ billion. Source: ‘Defence Spending’, *The Military Balance 1999-2000* (Oxford: Oxford University Press for the IISS, 1999), p. 37.

⁶ See François Heisbourg’s analysis ‘L’Europe de la défense dans l’Alliance atlantique’ (in particular his innovative thoughts on a convergence of European countries’ defence policies to compensate for their various shortcomings), *Politique Etrangère*, no. 2/99, pp. 219-32.

One of the necessary (although not sufficient) conditions for constructing a 'Fortress Europe' would be the prior existence of a policy of state support for defence industries. Yet European countries' budgets are less oriented than that of the United States towards support for their national industries, whether for research, where European investment is inadequate, or procurement, where Europeans sometimes buy directly from the United States. Indeed, for missiles, combat aircraft and military satellites, as well as for R&D in these sectors, US budgets are around three times those of the EU countries. Overall, US industry receives 70 per cent more support than its European counterparts.⁷ There is a clear link between the drop in European defence aerospace industrial activity (from €24.5 billion in 1980 to €20.6 billion in 1999) and the reduction in EU states' orders (from 53 per cent in 1980 to 25 per cent of industries' total turnover in 1999), a reduction that has not been offset by a rise in defence exports.⁸ The same analysis can be extended to equipment for land forces and navies, even if their procurement and R&D budgets are lower.

These figures are of course averages that cover a range of situations: certain countries that do not have a national defence industry capable of designing and producing equipment buy from third countries, whereas others that do have this capability practice national preference.⁹ The overall gap between the United States and Europe does, however, show that there is no real European aim in this area.

In Europe, the shortage of funding for R&D is aggravated by the fragmentation of financing. Budgetary support for land and naval armaments seems to favour the retention of national 'citadels', at least in countries that have a domestic design, production and sales capability. As long as companies in these sectors remain national, the corresponding budgets will scarcely contribute to the construction of a 'Fortress Europe' as

⁷ AECMA (European Association of Aerospace Industries), 'Government Funding for Aerospace Industries', Brussels, May 2000, pp. 41 and 58 ; www.aecma.org.

⁸ AECMA, '1999 Statistical Survey', 5 July 2000.

⁹ See, in the next subsection, the graph showing the turnover of 14 European defence companies and the amount of equipment of US origin in service in the armed forces of the countries concerned.

such.¹⁰ Only the aerospace and electronics sectors follow the opposite logic, primarily because of the impact of transeuropean restructuring.¹¹

The uneven openness of European defence markets

Another factor to consider when assessing whether there is a 'Fortress Europe' is the extent of American penetration, in terms of both direct sales and investment, of the various European markets.

US sales in Europe

Experts estimate that, overall, nearly 40 per cent of the equipment of European armed forces is American in origin.¹² This figure hides wide disparities, and the graph on the next page, which shows the relationship between the turnover of 14 European national defence industries and the (estimated) percentage of equipment of US origin in service with the armed forces of the countries concerned, indicates that there are four distinct groups:¹³

- group A (France and the United Kingdom): countries capable of producing the complete range of weapons systems, and importers of very little US equipment;
- group B (Germany): a country with the capacity to manufacture complete systems, and importer of very little US equipment;
- group C: countries with considerable (Italy, Spain and Sweden), specialist (Finland, the Netherlands) or more limited (Belgium) industrial capabilities, and purchasers of a medium amount of US equipment;

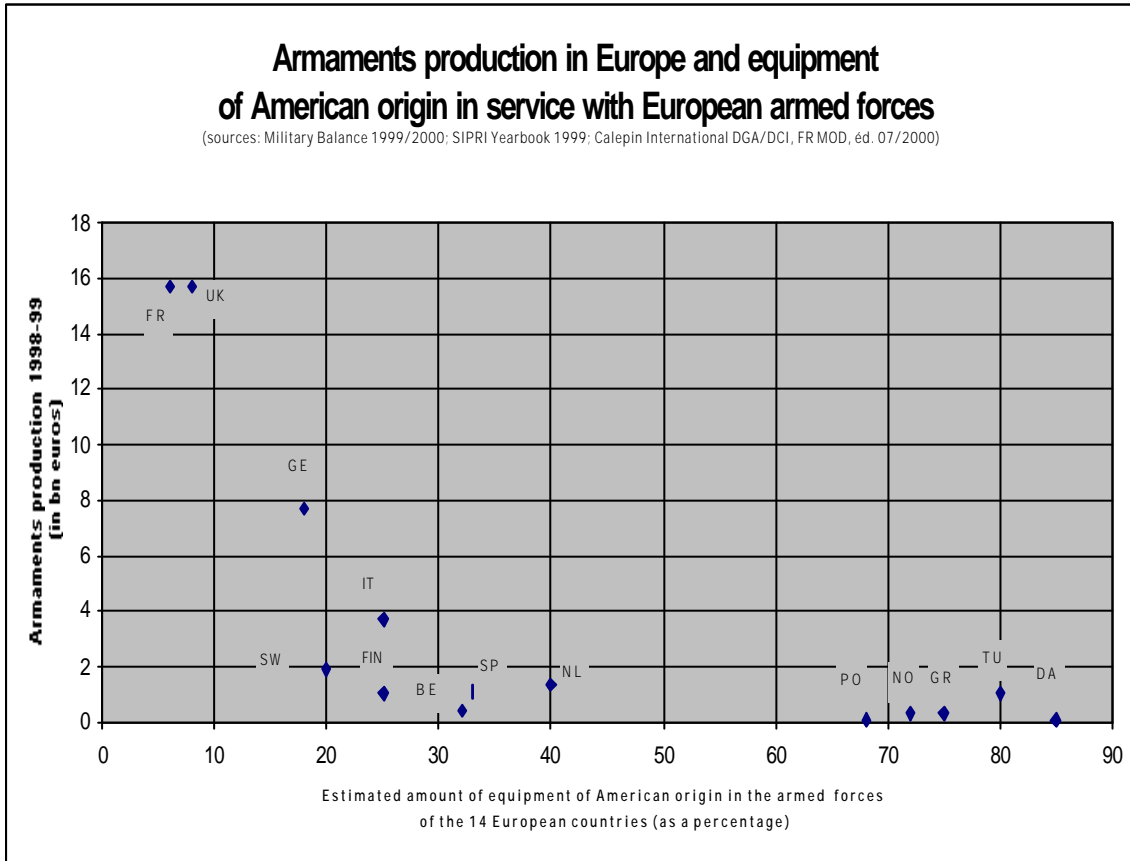
¹⁰ See Jacques Isnard, 'Les forteresses nationales de l'industrie d'armement', *Le Monde*, 2 juin 1999.

¹¹ See, below, an analysis by sector.

¹² See report by Burkard Schmitt of a defence industries task force meeting, held at the Institute for Security Studies of WEU, Paris, 31 March 2000, 5th session (Transatlantic armaments cooperation).

¹³ The author wishes to emphasise that the figures quoted should be treated with a certain amount of caution, mainly because of the scarcity of reliable data on EU member countries (AECMA data concerns only the aerospace sector, EDIG figures are non-existent and those of the EU incomplete).

- group D: countries with little industrial capacity, and purchasers of a high percentage of US equipment (Denmark, Greece, Norway, Portugal and Turkey).



In the light of these estimates it is easy to see that a European defence industry does not really exist, nor a homogeneous European market, but rather a number of actors who adopt their own particular approach to their American partner.¹⁴

The countries in group A have a fairly large degree of autonomy in defence technology. They have the technologies necessary to design and produce the complete range of weapons systems but sometimes lack the funding necessary to develop them (for its nuclear weapons, London has chosen in part the United States as its source of supply). The official British policy is to consider American offers along with others in accordance with the 'best value for money' principle. While, however, British procurement policy ostensibly gives priority to competition, one notes that the British armed forces have very little US equipment.¹⁵ For the French, purchases from the United States, which are in fact very limited, are made either because it is not possible to find a European designed/manufactured equipment, or because it is more economical to buy equipment that has already been developed (such as the AWACS, *Hawkeye* or C-130 aircraft).¹⁶

In the case of Germany (Group B), industrial links with the United States are limited to the field of missiles. In other aerospace sectors, Germany has traditionally participated in European collaborative programmes. It is only in land armaments and naval shipbuilding (which until now have largely remained national) that German industry has acquired a full prime contractor capability. As a result of these characteristics, Germany buys little from the United States, and devotes around 70 per cent of its equipment budget to European programmes.¹⁷

¹⁴ See William Walker & Philip Gummett, 'Nationalism, internationalism and the European defence market', *Chaillot Papers* 9 (Paris: Institute for Security Studies of WEU, September 1993), pp. 23-30.

¹⁵ See 'Smart procurement', in *The Strategic Defence Review*, Cm 3999 (London: The Stationery Office, 1998), pp. 41-4; and 'Breaking the Bank', *Jane's Defence Weekly*, 26 January 2000, pp. 25-8.

¹⁶ See Jean-Paul Hébert, *Stratégie française & industrie d'armement* (Paris: FEDN, 1991); the special edition devoted to France of *Jane's Defence Weekly*, 26 April 2000; and Robert Graham 'Government faces a financial squeeze', *Financial Times*, 14 June 2000.

¹⁷ See in particular Joachim Rohde, 'French-German Arms Cooperation' in Hans Stark (ed.), 'Les relations Franco-allemandes', *Les cahiers de l'IFRI* 25 (Paris: IFRI, 1998); the special edition on Germany of *Jane's Defence Weekly*, 7 July 1999; Dr Hans

The countries in Group C have significant, more or less specialised design and production capabilities on their national territory, and give preference to national or European suppliers (the Netherlands to a lesser extent). Italy is involved in many European collaborative projects and has a sizeable technological and industrial capacity. Sweden, which is fairly dependent on the United States in aerospace for subsystems (engines, missiles, etc.), equips its army and navy mainly with equipment manufactured on its soil. Spain cannot produce the complete range of equipments but is capable of producing nationally the major armaments with which its forces are mainly equipped.¹⁸

For the countries in these three groups, which carry significant weight in European policy, the debate on transatlantic armaments relations takes less account of the aim of a big 'Fortress Europe' than considerations to do with retaining existing national 'citadels'. Nevertheless, in certain cases the idea of a national 'citadel' tends to come down to simply preserving jobs, without attaching any great importance to technological capacity or national ownership of companies. Thus, one has seen for instance the purchase of Bofors's artillery activity by United Defense (US), the takeover of the Swiss company Mowag by GMC Canada and the Spanish government's offer to sell the armoured vehicle manufacturer Santa Barbara.

Lastly, the countries in Group D have little industrial capacity and (except for Norway) a lower technological level. Their policies of buying from the United States are based on a combination of factors: the purchase of high-technology equipment at the best price (countries, except for Turkey, with a fairly limited equipment budget), the request for technology transfers in an attempt to acquire a certain autonomy (Turkey) and above all privileged diplomatic relations with the United States.¹⁹

Eberhard Birke, 'L'industrie aérospatiale en Allemagne: puissante et prête à coopérer', *Défense Nationale*, no. 6, juillet 1999, pp. 38-46.

¹⁸ See General Alberto Zignani, 'L'Italie et l'Europe de l'Armement', *l'Armement*, no. 61, mars 1998, pp. 114-20, as well as individual country sections (Belgium, Finland, Italy, the Netherlands, Spain and Sweden) of *Calepin International* (Paris: DGA/DCI, Ministère de la Défense), édition 07/2000; and *The Military Balance 1999-2000* (Oxford: Oxford University Press for the IISS, 1999), pp. 30 ff.

¹⁹ See individual country sections of *Calepin International* (Paris: DGA/DCI, Ministère de la Défense), édition 07/2000; and *The Military Balance 1999-2000* (Oxford: Oxford University Press for the IISS, 1999), pp. 30 ff.

The European countries' different situations and choices explain why the 'two-way street' as such has remained at the level of declarations of intent. Indeed, the volume of US exports to Europe is very much greater than those from Europe to the United States (which are penalised by the closed American market).²⁰ The ratio of exports in the two directions is becoming increasingly favourable to the United States, as the following table shows.

	Exports United States to Europe	Exports Europe to United States	Ratio
1987	\$6.1 billion	\$1.4 billion	4.36:1
1994	\$4.1 billion	\$0.7 billion	5.86:1
1997	\$4.3 billion	\$0.7 billion	6.14:1

Sources: for 1987 and 1994, *The Military Balance 1996-1997*; for 1997, ACDA, quoted in *Revue Aérospatiale*, no. 166, mars 2000.

However, it must be noted that these American exports to Europe are in general concentrated in a few traditional importing countries (Group D) and usually concern electronic and aerospace equipment. Thus, sales to four countries (Denmark, Greece, Norway and Turkey) each year represent between 45 and 60 per cent of these exports.²¹

US investments in Europe

Concerning investment, American industrial strategy in recent years has essentially been to increase the number of agreements so that American interests become a part of the fabric of European industry, and thus retain access to European markets in all sectors.²²

²⁰ See 'Making Transatlantic Defense Cooperation work', Findings and Recommendations of the CSIS Atlantic Partnership Project, Center for Strategic & International Studies, Washington DC, May 1996.

²¹ Figures are taken from Foreign Military Sales added to commercial sales (arms exports control regime); see DSCA (Facts Book) published by Deputy for Financial Management Comptroller, 'Foreign Military Sales, Foreign Military Construction Sales and Military Assistance Facts', Washington, 30 September 1998. This percentage of exports to the four countries is only markedly lower when a big contract is signed (for instance the purchase of F-18 aircraft in 1994 by Finland or *Apache* helicopters by the Netherlands and the United Kingdom in 1995).

²² See Jean-Paul Hébert, 'Dimensions économiques de la compétition euro-américaine', in *Europe/Etats-Unis: coopérations et compétitions dans le domaine des systèmes de*

Agreements can take the form of joint production. Thus, Lockheed-Martin and BAe have collaborated in the design of a reconnaissance vehicle, Loral and Alcatel joined forces for the *Skybridge* and *Cyberstar* satellite systems, and so on. It can also involve subcontracting agreements (McDonnell Douglas orders parts from Fokker Aviation, Helicopter Aviation Services (Bell group) buys SFIM automatic pilots, etc.), transfer of licences or taking a share in or acquiring companies (acquisition of the French company Ratier-Figeac by the UTC group, the sale currently being negotiated by Spain of its armoured vehicle manufacturer Santa Barbara Blindados to the American firm General Dynamics, which has also become the principal shareholder in the Austrian light armoured vehicle manufacturer Daimler Puch, etc.).²³

The United States has had to content itself with this strategy of adaptation. Certain actors recommended a policy of hegemony,²⁴ but it would have been politically too costly within the Atlantic Alliance. Others supported the idea of establishing a true 'two-way street' between the two sides of the Atlantic, but this was finally abandoned, in particular because it would have been detrimental to the US balance of trade.²⁵

Disparate legislation

Within the European Union two forms of regulation of the armaments sector are superposed: on the one hand there are the legal systems of the 15

défense et des hautes technologies (Paris: La Documentation française, 1998), pp. 107-20

²³ See Jean-Paul Hébert and Laurence Nardon, 'Concentration des industries d'armement américaines : modèle ou menace ?', *Cahiers d'Etudes Stratégiques*, CIRPES/EHESS, Paris, no. 23, 1999 (chapitre 6: 'le renforcement ambigu des liens entre industries d'armement américaines et européennes'); Jacques Isnard, 'L'OPA américaine sur la défense européenne', *Le Monde*, 31 octobre-1 novembre 1999; Leslie Crawford, 'Spain to go ahead with sale of arms maker to US', *Financial Times*, 11 July 2000; and Nicole Beauclair & Jean Dupont, 'Industrie américaine : partenaire et concurrente', *Air & Cosmos*, no. 1706, 13 octobre 2000.

²⁴ See Ethan B. Kapstein, 'America's Arms Trade Monopoly. Lagging Sales Will Starve Lessers Suppliers', *Foreign Affairs*, May-June 1994, vol. 73, no. 3, pp. 13-19.

²⁵ See in particular Pamela Pohling-Brown, 'Fear of transatlantic trade war as market contracts', *Jane's Defence Contracts*, March 1997, pp. 5-7; and Jacques S. Gansler, 'Technology, Future Warfare and Transatlantic Cooperation', NATO workshop, Norfolk, VA, 12 November 1998.

member states, which contribute to the continued existence of national fortresses, notably through the laws on public sector contracts, and on the other legislation enacted by the European Union in its areas of competence.

National regulations

In both its impact and scope or its specificity compared with ordinary law, the heterogeneousness of national regulations in the field of defence became particularly clear during the work done by the four partners in the Airbus consortium (Aerospatiale, BAe, CASA and Dasa) on the setting up of a European Aerospace and Defence Company (EADC). Following the declaration of 9 December 1997 on the restructuring of the European defence aerospace and electronics industry,²⁶ the companies drew up a first report. The report criticised in particular the disparity of regulations in European countries in three areas (general provisions, the 'golden share' and export regulations), as the main obstacle to industrial restructuring in Europe.

Concerning *restrictions on foreign investments*, two separate groups of countries can be distinguished. In the first category, Germany does not impose any specific legal constraints on foreign acquisitions of national companies, and Italy has no special arrangements for controlling defence industrial agreements. The United Kingdom has no specific regulations concerning this issue, which comes under ordinary law. However, practice in these countries is still interventionist. Thus, the Italian government can invoke the protection of secrets touching on national security in order to prevent any takeover that is considered 'unfriendly' or inappropriate. In Germany, when BAe wanted to buy STN Atlas in 1998, the authorities discreetly pointed out the possible negative consequences regarding access to the German market in the event of a foreign majority holding in STN.²⁷

Industrial restructuring at the European level is complex to analyse, because it is a process that takes into account both the interests of shareholders and governments' objectives, which may differ. Thus, BAe's acquisition of

²⁶ Joint declaration by the heads of state and government of France, Germany and the United Kingdom of 9 December 1997. See Annexe B.

²⁷ In the end, BAe only acquired a 49 per cent share in STN Atlas (Author's interviews).

GEC in January 1999 could be interpreted as either the forming of a 'Fortress United Kingdom', refusal of an alliance with another European company (Dasa or Thomson-CSF), simply a way of looking after the interests of GEC's shareholders, rejection of an alliance with an American company, or all four at once.²⁸

A second group of countries makes use of a specific body of rules. Thus, French law is very restrictive in requiring prior authorisation (from the Ministry of Economy and Finances) for any foreign investment, which is to be limited to 20 per cent of a company's capital (it is however possible to obtain dispensations).²⁹ In Sweden, overall government permission is necessary for any armaments manufacturer, and in Spain the government must approve any foreign investment in a Spanish defence company.

Concerning *golden shares*, which involve rights going far beyond the normal business regime, another division appears. In Germany and Sweden, there is no golden shares mechanism. On the other hand such a tool is used in Spain, France (in particular in the processes of privatisation of companies such as Aerospatiale and Thomson-CSF), Italy (again in the case of privatisation, under law 474/94) and in the United Kingdom (where golden shares are subject to four conditions: the presence, on the board, of a non-executive director representing the government; a ceiling of 49.5 per cent on overall foreign ownership of a company's capital; a limit of 15 per cent on individual foreign holdings of the company's shares; and government approval of any modification of these provisions). In the United Kingdom, this ceiling of 49.5 per cent was initially fixed at 29.5 per cent but was raised following pressure from BAe and Rolls-Royce. The latter argued successfully that the figure of 29.5 per cent prevented alliances with foreign

²⁸ See Jean-Pierre Maulny, 'Industries et ventes d'armes', in *l'Année Stratégique 2000* (Paris: éditions Michalon, 1999), pp. 649-71; Marc Roche, 'La puissance du nouveau BAe pèsera sur l'avenir de l'Europe', *Le Monde*, 21 janvier 1999; Hugh Dixon and Alexander Nicoll, 'How Project Super Bowl Won the Day' (Publicly, Blair welcomed the deal, but privately, ministers and officials were seething), *Financial Times*, 23-24 January 1999; Ralph Atkins, 'DASA head gloomy over pan-European defence' (Bischoff warning follows BAe acquisition of Marconi), *Financial Times*, 25 January 1999.

²⁹ See, on these regulations, ICA Jean Hamiot, 'La Base Industrielle et Technologique de Défense', *l'Armement*, no. 61, mars 1998, pp. 44-52. The new European industrial realities are causing the French authorities to be more flexible (see the analyses of IGA Bessero and ICA Coq in *Info DGA*, no. 121, mars 2000, pp. 34-5).

companies and could have a negative effect on the value of shares, and that a ceiling of 49.5 per cent would still protect them from hostile takeover.³⁰

As far as *export regulations* are concerned, each European country has its own cumbersome legislation. This requires companies to obtain approval, either for a geographical area, for exploring external markets, for obtaining permission to export weapons systems at the time the equipment is exported (in the case of the United Kingdom) or at each phase of the export process (in the case of France, Germany and Spain). These regulations are in general applied by interministerial committees or at the highest level (in France, Germany, Italy, Spain and Sweden) and are sometimes based on specific lists of products (contained, in Italy, in law 474/94, in France in decree 95-589 of 6 May 1995 and in Germany KWKG of 20 April 1961).³¹

This multitude of heterogeneous regulations prevents the free circulation of defence products within the European Union and stirs up competition between Europeans in third markets. In this area, the 15 EU member states are just as foreign with respect to each other as is, say, the Netherlands *vis-à-vis* Russia or Argentina. The practical application of these procedures by states seems to be flexible, and their observance by defence companies is relative: in particular it seems to depend on the political context and competition in third markets.³² Nevertheless, in this area two sets of common rules have recently been under development in the EU and in the Letter of Intent (LoI – see below).

In the field of *competition*, one notes a difference between declared intentions and reality: the European countries declare a policy of openness of their internal markets but in practice still continue to think in terms of national capabilities.

³⁰ *Financial Times*, 26 June 1997 and 13 March 1998.

³¹ See, on these complex regulations, the exhaustive parliamentary report by MM. Jean-Claude Sandrier, Christian Martin and Alain Veyret, 'Le contrôle des exportations d'armement', Rapport d'information no. 2334, *Assemblée Nationale*, Paris, 25 avril 2000 (www.assemblee-nationale.fr).

³² See the analysis by Jean-Louis Scaringella, 'Les Industries de Défense en Europe', *Economica*, Paris, 1998, pp. 67-100; *Les Nouvelles du GRIP*, no. 4/99 (www.grip.org); and the special feature in *Le Monde* of 22 January 2000 (Patrice Claude, 'Tony Blair a du mal à concilier l'éthique diplomatique et ventes d'armes'; Christophe Jakubyszyn, 'En France, un outil à la discrétion du gouvernement'; and Arnaud Leparmentier, 'En Allemagne, les verts obtiennent un durcissement des règles').

Thus, the Coherent Policy Document (CPD) signed in 1990 by the 13 members of the Independent European Programme Group (IEPG) was aimed at creating an open European armaments market.³³ Even though some progress has been made, measures to open up markets and make them transparent remain just words, and have no effect on national preference.³⁴

Again, in the United Kingdom in the period 1996-97, of 730 contracts awarded (56 per cent of which were open invitations to tender) in the framework of the WEAG CPD, 95 per cent were won by British companies. In Italy, of 341 contracts published in the WEAG bulletin during the same period, 74 per cent were subject to limited competition and only 26 per cent to open competition. In the first case, 86 per cent of the contracts went to Italian companies (and the remainder to European or American companies), and in the second case 68 per cent of the contracts stayed in Italy (the rest going to European or American companies). In France, in 1997, out of 16,992 transactions (worth FF62.9 bn) done by the Ministry of Defence, 10,218 (i.e. 63 per cent, amounting to FF55 bn) were subject to restricted invitations to tender or not open to competition.³⁵ Moreover, the new version of the CPD agreed in 1999 by the 13 WEAG defence ministers is no more precise or binding regarding the openness of markets than was the 1990 document, whose limitations have been seen.³⁶

EU rules

Alongside all this national legislation, the EU has created a second body of rules, and here one finds a complete paradox: although the treaties provide that matters affecting national security can be excluded by states from the

³³ Entitled *Independent European Programme group – European Defence Equipment Market*, it developed all aspects of a European armaments policy; IEPG/PermSec/D-12 of 30 October 1990.

³⁴ See Sandra Mezzadri, 'L'ouverture des marchés de la défense: enjeux et modalités', *Occasional Papers* 12 (Paris: Institute for Security Studies of WEU, February 2000), pp. 6-11.

³⁵ See French Ministry of Defence, 'Annuaire statistique de la Défense', Collection Analyses et Références (Paris: *La Documentation Française*, juin 2000), p. 115.

³⁶ 'Coherent Policy Document', WEAG (99) 2, Brussels, 22 November 1999 (www.weu.int/weag).

field of application of community law,³⁷ the latter have allowed the European Union (the Commission and the Council) to make rules that apply to certain activities related to armaments. In particular, the Commission may intervene through competition regulations and in mergers/acquisitions of defence-related companies, the control of exports of dual-use goods and technologies and to some extent in Common Customs Tariff (CCT) questions. Moreover, it has tried continuously to address other issues in three Communications.³⁸ The Council for its part may intervene in the field of armaments, notably in connection with CFSP rules (see II.2 below).

This new stratum of regulations for the moment constitutes an extra level of legal complication. We are at present in a transitional phase, at the end of which these disparate regulations should necessarily be unified at EU level.

A dispersed industrial system

The situation in the European industry is the result of several factors, the main ones being the legacy of history and the varying degrees (depending on the sector) of American competitive pressure. The consequences of the restructuring of the defence industry in the United States are very important, in terms of the reduction in the number of both companies³⁹ and employees (which fell from 2.7 m in 1993 to 2.1 m in 1998). Europe is making slow progress in certain sectors, hardly going beyond the stage of national fortresses.⁴⁰

³⁷ A confidential list of defence equipments (the so-called list of 1958) is attached to Article 223 of the Treaty of Rome (now Article 296 of the Treaty on European Union).

³⁸ The three Communications are: 'The challenges facing the European defence-related industry, a contribution for action at European level', Brussels, COM (96) 10 final of 24 January 1996; 'The European aerospace industry – Meeting the challenge', Brussels, COM (97) 466 final of 24 September 1997; and 'Implementing EU strategy in defence-related industries', Brussels, COM (97) 583 final of 12 November 1997.

³⁹ The major US aerospace companies (Lockheed Martin, Boeing, Raytheon and Northrop Grumman) are the outcome of a process of concentration that began in 1990 among 22 firms. As a result, three of them (Lockheed, Boeing and Raytheon) amassed contracts worth \$30 bn with the US Department of Defense in 1999. However, if, in the United States, the electronic and aerospace sectors appear to have restructured, the process has not yet really begun in the land and naval equipment sectors (see below).

⁴⁰ See 'Restructuring in the USA and Western Europe', *SIPRI Yearbook 1999* (Oxford: Oxford University Press for SIPRI, 1999), p. 396.

Lagging behind the United States, the race to restructure in Europe has up till now mainly concerned the aircraft, space and electronics sectors, which restructured first at the national (in 1992-95) and then transnational (1998-2000) level. To meet the new competition from the United States, three large groups (EADS, BAE Systems and Thales – the former Thomson-CSF) formed through four processes: concentration, portfolio reshaping, rationalisation and internationalisation.⁴¹ However, it remains to internally reorganise the merged elements and in particular to decide whether all the industrial facilities spread among several European states will be kept in being. In addition, a European culture and spirit will have to be created in transnational companies, and the restructuring movement will continue for second and third-level equipment manufacturers.⁴²

As far as traditional equipment for land forces is concerned, this sector is not yet greatly affected by transnational restructuring. Several factors account for this:

- in the United States the internal market, which is dominated by American companies, is still split between a number of companies (General Dynamics, Textron, United Defense and Rock Island), even if certain rapprochements are under way. Until now, European companies have not, at least not in Europe itself, suffered from competitive pressures, even if competition is very strong for certain third markets;
- in Europe, the age of this industry (several centuries) and a strong State presence (in various forms) have created cultures that do not easily lend themselves to transnational restructuring;
- the range of products is very wide (from the soldier's personal equipment, engineer vehicles and medical equipment to the main battle tank) and their costs vary considerably;
- companies in the sector are often highly specialised and have widely spread shareholder structures. They are rarely associated with commercial

⁴¹ For a thorough analysis of these major trends, see Burkard Schmitt, 'From cooperation to integration: defence and aerospace industries in Europe', *Chaillot Papers* 40 (Paris: Institute for Security Studies of WEU, July 2000), pp. 11 ff. In 1999, the turnover in the aerospace sector was €145.7 bn for the United States and €65.6 bn for Europe (AECMA figures).

⁴² See Douglas Barrie and Theresa Hitchens, 'Europe's Merger Wave Rolls Toward Sectors', *Defense News*, 20 December 1999.

groups (except in Germany) and there is little diversification in their activities (even into related sectors);

- a large number of companies are relatively small and can survive with small contracts and in niche markets;
- some governments fear the social effects that industrial restructuring can cause when they concern regions that are historically very dependent on land armaments;
- the number of collaborative programmes is very small, in particular as a result of the slow progress towards harmonisation of operational requirements made within multilateral bodies such as NATO, WEU (EUROLONGTERM working group) or FINABEL.

To date, there are still around 37 major land systems companies in the 17 European NATO countries.⁴³ For certain managers in the sector, the restructuring movement must be launched as quickly as possible: ‘there will have to be something like the [EADS] in Europe’s land armaments sector’.⁴⁴ There have already been a series of operations in the light armoured vehicle sector (the takeover of small and medium-sized companies by those in a stronger financial position: the acquisition of GKN (UK) and Hägglunds (Sweden) by Alvis (UK), and the Thyssen Henschel-Kuka operations are two examples. But neither the dominant tank sector (which has three main actors: Krauss Maffei-Wegmann (Germany), Vickers (United Kingdom) and GIAT Industries (France)), nor the artillery sector (where there are 20 companies of all sizes in Europe), nor munitions (30 firms of very varied size) have begun the process of restructuring.⁴⁵ On the other hand, land forces equipment is very diverse. Only Krauss Maffei’s *Leopard* main battle tank, which has been bought by 12 armies, can be considered a European standard.

⁴³ See Douglas Barrie and Jack Hoschauer, ‘Armour May Not Yield to Europe Consolidation’, *Defense News*, 31 August-6 September 1998.

⁴⁴ Jacques Loppion (Chairman and Managing Director of GIAT Industries), in Douglas Barrie and Christina MacKenzie, ‘European Land Armor Consolidation Looms’, *Defense News*, 26 June 2000.

⁴⁵ See Bernard Chabassière and Frédéric Fossé, ‘L’industrie européenne des armements terrestres – panorama et perspectives’, *Revue l’Armement*, no. 70, juin 2000, pp. 114-22.

Finding themselves in a precarious financial situation, and with reduced workloads,⁴⁶ many companies in this sector are under threat. Their future is all the more uncertain since American companies are developing a dynamic takeover strategy in Europe: General Dynamics has become the principal shareholder in the Austrian company Daimler Puch and is in the process of acquiring Spain's Santa Barbara, GMC Canada has taken control of Mowag in Switzerland, and Bofors artillery of Sweden has been taken over by United Defense.⁴⁷ The situation in the land armaments sector thus clearly invalidates the theory that there is a 'Fortress Europe'.

The situation is quite different when it comes to naval shipbuilding, where the sector is in general structured around a national 'leader' that dominates its market (BAE Systems in the United Kingdom, Fincantieri in Italy, Bazan in Spain, DCN in France, Kockums in Sweden, etc.) and shipbuilders specialising in smaller niches. In this sector, there is little intervention in Europe by American companies. The American scene is dominated by five shipbuilders⁴⁸ that design very specific products to meet the Navy's needs (80,000-tonne aircraft carriers, nuclear submarines, etc.) that are unlikely to find an export market. Moreover, due to their lack of competitiveness, civil shipyards have been abandoned by the United States.

European manufacturers thus dominate not only their domestic markets but also export markets, while being barred from access to the American market.⁴⁹ The current major tendencies are the development of civil-military

⁴⁶ The launch of the MRV programme has assured the future of light armoured vehicle manufacturers, but the situation is worrying for MBT producers: Vickers (Rolls-Royce group) has a very reduced workload following delivery of 38 *Challenger II* tanks to the Sultanate of Oman (*Jane's defence Weekly*, 16 August 2000); GIAT Industries has little work and has over the last five years accumulated losses of €2.5 bn; Krauss Maffei has difficulty in deciding a strategy: after the acquisition of Mannesmann by Vodafone, Krauss-Maffei was sold to a Siemens/Bosch consortium. However, this seems to be an interim solution. The future may well be a merger between Krauss-Maffei and Rheinmetall.

⁴⁷ See the review article on this sector by the Chairman of GICAT, Jacques Texier, 'L'Europe de la défense et de l'armement: mythe ou réalité?', *Défense Nationale*, juin 2000, pp. 24-40.

⁴⁸ Newport News Shipbuilding Incorporated (an independent firm) and two shipbuilders owned by General Dynamics and two by Litton; in 1999, the Pentagon blocked the takeover of NNS par General Dynamics.

⁴⁹ It is estimated that in the next decade the world naval equipment market will be worth €24 bn a year, divided up as follows: Europe 34 per cent, United States 32 per cent,

synergies and the beginnings of industrial rapprochements.⁵⁰ The only transeuropean operation of any size is the merger of the German conventional submarine builder HDW and Sweden's Kockums.

Demand in the sector is still structured around national markets for two types of navy: blue-water navies that have a complete range of ships (France and the United Kingdom) and navies with more modest ambitions (Germany, Italy, the Netherlands, Spain and Sweden). Moreover, European navies rarely have common equipments.⁵¹ The supply side is dominated by BAE Systems and DCN Thomson-CSF/Thales, which have turnovers of, respectively, €2 and 1.6 billion. German companies have smaller turnovers (New HDN: €0.7 bn; Thyssen: €0.7 bn; STN Atlas: €0.5 bn) but have larger profit margins and are very competitive in certain areas (above all conventional submarines).⁵²

The emergence of transnational European companies, as a result of the combination of greater cooperation and restructuring, has thus followed different paths, depending on the sector.⁵³ In the naval and land equipment sectors, the 'Fortress Europe' issue is more a question of confrontation between the different European industries than a struggle against American industry. On the other hand, concerning aerospace and electronics, sectors in which the technological and industrial stakes are higher, competition with American industry is all-important.

Asia-Pacific 27 per cent and the rest of the world 7 per cent (*Le Monde*, 24 Octobre 2000).

⁵⁰ See Fernand Maillet's analysis, 'L'industrie de la construction navale en Europe et dans le monde', *l'Armement*, no. 63, octobre 1998, pp. 113-20.

⁵¹ The only examples of any significance are the tripartite (Belgium, France and the Netherlands) minesweeper, the MU 90 torpedo (France, Germany and Italy) and the future PAAMS-equipped frigate (France and Italy).

⁵² See the analysis by Gilles Bessero and Benjamin Gallezot, 'L'industrie navale de défense en Europe', *Défense Nationale*, no. 5, mai 2000, pp. 103-15.

⁵³ The various parameters in the process are given in Pierre Dussauge and Christophe Cornu, 'L'Industrie Française de l'Armement – coopérations, restructurations et intégration européenne', *Economica*, Paris, 1998, pp. 166-73.

The failure of European preference

The concept of European preference could have been a political catalyst for the construction of a 'Fortress Europe' in the armaments sector. In this debate, in which France played a leading role,⁵⁴ it was a matter of establishing an equivalent to the 'Buy American' Act, and of limiting purchases from the United States as far as possible.

The debate was launched in the context of the signing of the Maastricht Treaty,⁵⁵ and came to life during the first discussions about a European armaments policy and a European Armaments Agency.⁵⁶ At an informal seminar on 23 March 1995 held by the French presidency of WEAG, sticking points came out into the open. Arguing clearly for European preference, the French defence minister stated during the press conference that it '... must not be a diktat but a patient process of construction. It must not exclude the idea of economic and trade relations with the United States.' The British Secretary of State for Procurement for his part hoped that European preference would not lead to equipments that were more expensive than the market offered elsewhere: 'We don't believe in a strict European preference. We must reserve the right to deal with the United States or with the Asian countries. But we believe in the reciprocity principle: if our market is open, we expect the American market to be open.'⁵⁷ The concept of European preference received the support of a few European industrialists and politicians,⁵⁸ but it remained a subject of debate

⁵⁴ In *Le Livre Blanc sur la Défense - 1994* (Paris: SIRPA, 1994), which sets out France's official defence doctrine, it is stated that 'This policy also implies that European states show their solidarity through European preference . . .' (chapitre 7: 'Politique d'armement et stratégie industrielle', section 2: 'La dimension européenne').

⁵⁵ The Maastricht Treaty of 1992 gave new impetus to European armaments policy (see Declaration no. 30 on Western European Union annexed to the Treaty).

⁵⁶ See Giovanni de Briganti, 'France: Buy from Europe or Be Left Out – France, Germany Issue Ultimatum on European Preference', *Defence News*, 26 June-2 July, 1995; on the EAA, see below.

⁵⁷ See 'Europe: débat de Ministres de la Défense autour de la préférence européenne', AFP dispatch, 23 mars 1995.

⁵⁸ The chairman of Dasa, Manfred Bischoff, speaking at the European Parliament, declared his support for a 'European preference', saying that he was in favour of a European purchasing office, *Air & Cosmos*, 19 mai 1995, p. 13. See also Dominique Baudis, 'Pour une préférence européenne', *le Figaro*, 16 juin 1995 (he signs the article as a Member of the European Parliament and chairman of the 'intergroup' European Sky and Space).

on which there was no consensus and was seen by some as quite simply a French preference.

As a result, the idea of European preference is not included in either the OCCAR Convention of 9 September 1998 or the Letter of Intent of 27 July 2000. However, discussion of the subject served to draw attention to a lack of European solidarity.⁵⁹ It will also have enhanced the Defence Industrial and Technological Base (DITB) concept by adding to it the notion of the necessary competitiveness of the industry.⁶⁰

Nevertheless, the discussion on European preference looks like a non-debate. Ultimately, the procurement policies of European countries do not vary greatly: for industrial, strategic and social reasons, they always prefer their own companies when inviting tenders. The emergence of transnational companies changes nothing in this respect. As long as they have subsidiaries on their territory (and as long as these subsidiaries obtain a significant share of the work), governments look on them as 'national' companies. States thus always apply national preference; in relation to American competition, European preference is applied above all to systems that are manufactured as European collaborative projects *and* with the participation of local firms. If that is not the case, the 'European argument' *can* play a role, but it certainly carries less weight (compared with the criteria of cost, performance, budgets, etc.).

British policy illustrates well the complexity of procurement decisions and the importance of involving national industry in programmes. In 1995, London opted to buy the American *Apache* helicopter rather than its Franco-German competitor, the *Tiger*; as British industry was not participating in the European programme, other factors (the Conservative government's Euro-scepticism, the 'maturity' of the *Apache* compared with the *Tiger*, costs, etc.) counted in favour of the American product. On the other hand,

⁵⁹ See the declaration signed on 21 June 1994 by 11 European land defence industrial associations on the occasion of the defence exhibition Eurosatory 1994 in 'Vers une industrie européenne de défense terrestre', *GICAT*, Paris, 1994, p. 155.

⁶⁰ The DITB concept is officially recognised by the European Commission in the introduction to the Communication 'The challenges facing the European defence-related industry, a contribution for action at European level', COM (96) 10 final of 24 January 1996), by OCCAR (preamble to the 1998 Convention) and by the LoI (preamble to the framework Agreement of 2000).

when decisions were taken on the FLA and BVRAAM in May 2000, the situation was completely different. The British government chose the A400M made by Airbus rather than the American C-130 or C-17, and the *Meteor* (the Matra-BAe candidate) rather than Raytheon's AMRAAM.⁶¹ Despite strong American political pressure, London chose to combine the operational advantage of having an equipment that was in service in several armed forces in Europe, industrial considerations (British companies being closely involved in the consortiums producing the equipments chosen) and the diplomatic dimension (putting into practice in the field of armaments the new British policy of involvement in European defence since the Franco-British St-Malo summit of December 1998).

II.2 The beginnings of convergence in Europe

Under the constraints of both the situation of European companies (new competition as a result of the scale of American industrial restructuring) and growing budgetary pressures, European governments have embarked on an increasing number of initiatives in a significant number of aspects of armaments policy.⁶² These have included principally discussions in international forums (NATO, WEU/WEAG), the work that resulted in the OCCAR and the Letter of Intent, and finally European Union projects. At this stage these seem to be empirical, fragmented reactions rather than forming part of a coherent, structured plan that could lead to a 'Fortress Europe'.

The complexity of work in multilateral bodies (NATO, WEU/WEAG)

Work within these institutions, which allows members to tackle issues together and look for areas of convergence, highlights the complexity of

⁶¹ See Tom Buerkle, 'Europe's Air Industry Racks Up a Gala Day – Defence Industry in US is Snubbed', *International Herald Tribune*, 17 May 2000; Alexander Nicoll, 'Fight for \$7.5 bn defence orders was not a transatlantic battle', *Financial Times*, 17 May 2000; Jacques Duplouch, 'Missiles et avion de transport: les raisons du choix britannique', *le Figaro*, 17 mai 2000; and Jacques Isnard, 'Le Royaume-Uni en pointe sur l'Europe de l'Armement', *Le Monde*, 23 mai 2000.

⁶² See 'Government initiatives', *SIPRI Yearbook 1999* (Oxford: Oxford University Press for SIPRI, 1999), pp. 404-5.

armaments questions at the multilateral level and their effect on transatlantic relations.

NATO: a mixed record

Within NATO, responsibility for armaments questions is shared among several bodies, including the Conference of National Armaments Directors (CNAD), the NATO Consultation, Command and Control Organisation (NC3O), the NATO Air Defence Committee (NADC) and the Senior NATO Logisticians' Conference (SNLC).⁶³ These report separately to the North Atlantic Council. The conclusions of NATO's last armaments review, launched in 1997,⁶⁴ led to the creation of a NATO Committee for Armaments Cooperation (NCAC), which, chaired by a CNAD representative, brings together representatives from the bodies concerned.

The CNAD is important in this context, since it is this body (and its 132 subordinate specialist groups) that is responsible for cooperation, planning and standardisation in the field of armaments. The Conference is a reflection of variable-geometry alliances that form depending on the context and subject. Thus, before each six-monthly meeting of the 19 Armaments Directors, a group of four countries (France, Germany, Italy and the United Kingdom – the G4) meet to coordinate their positions and work on issues bilaterally. In reaction to this unofficial but well established practice, temporary alliances form between European non-members of the G4 and the United States. This does not, however, and again before meetings of the CNAD, prevent the G4 from turning into a G5 (the four plus the United States).

As far as industrial cooperation is concerned, the CNAD's discussions are at present focused on examination of the NATO Industrial Advisory Group (NIAG) document 'Ways to improve cooperation amongst defence industries within NATO – phase 2'.⁶⁵ This uncompromising report notes the

⁶³ See *NATO Handbook* (Brussels: NATO Office of Information and Press, 1998), Chapters 8, 13; www.nato.int.

⁶⁴ 'NATO Armaments Review', Press Communiqué (97) 43 of 17 April 1997.

⁶⁵ NATO Document AC/259 (INV) D (98) 7 (2nd revise) / NIAG (INV) D (98) 4 (2nd revise) of 11 January 1999.

blockages in this area.⁶⁶ It is difficult to follow up this report, mainly because of the great reluctance of certain countries to draw up a list of obstacles to the flow of goods between the two sides of the Atlantic.

NATO also provides an international legal framework for armaments programme management and logistic support.⁶⁷ Assistance in industrial matters is provided by the NIAG, which brings together representatives of industry from 17 countries of the Alliance.

The results of the Alliance's activities in the field of armaments is mixed. If programme management is a productive area, armaments planning and standardisation have not been successes, essentially because these subjects are still the responsibility of states. NATO forces in Kosovo or Bosnia (KFOR and SFOR) therefore have equipment that is very different from one national contingent to another, making support more costly and complicated. Agreed, standards have been defined, but the armed forces have difficulty meeting them. US forces may use a new-generation norm that has not yet been agreed by the Alliance, or certain European forces may not yet have applied a standard painfully worked out by the relevant NATO committee.⁶⁸ Moreover, within NATO there is no working group for the harmonisation of the operational requirements of the various armed forces, but simply studies carried out by the different committees in their respective spheres of competence (air defence, communications systems, etc.).

NATO has great difficulty in giving substance to the transatlantic link in the field of armaments. There are in fact few collaborative programmes

⁶⁶ One of the report's recommendations (para. 29) is that 'This paper has highlighted differences among the nations with regard to their views on the way in which transatlantic cooperation should be conducted and, indeed, the objectives of doing so. Previous attempts to generate agreement on these issues have failed since their basic requirement has been for a generic solution which did not recognize all aspects of the problem'.

⁶⁷ In, for instance, the NATO EF 2000 and Tornado Development, Production & Logistics Management Agency (NETMA), NATO Helicopter for the 1990s Design and Development, Production and Logistics Management Agency (NAHEMA), NATO Hawk Management Office (NHMO), and NATO Maintenance and Supply Organisation (NAMSU).

⁶⁸ See Ed Foster, 'Imbalance of Power', *Jane's Defence Weekly*, 5 January 2000, and Damian Kemp, 'Industry cooperation vital for interoperability', *Jane's Defence Weekly*, 2 February 2000.

involving both sides of the Atlantic. On the other hand, the organisation appears to be particularly favourable to initiatives between Europeans (examples are the EF 2000 fighter aircraft, which involves Germany, Italy, Spain and the United Kingdom, and the NH 90 helicopter programme, which brings together France, Germany, Italy and the Netherlands). It remains to be seen whether the Defence Capabilities Initiative (DCI) can really improve these very mixed results.⁶⁹

WEU/WEAG: a laboratory of cooperation

Following the Maastricht Treaty, an armaments function was created within WEU in the shape of the Western European Armaments Group, which took over the work of the Independent European Programmes Group, which had been created within NATO in 1976. During the same period (1993-94), the transfer of Eurogroups from NATO gave WEU in particular a study group on long-term military planning and armed forces' operational requirements (EUROLONGTERM).

EUROLONGTERM has done groundwork on many subjects (multinational task-sharing, work on the Petersberg missions, etc.), including with the WEAG's specialist committees. But no practical answer has been found by WEU to the question of harmonisation of future military requirements, either within EUROLONGTERM (discussions at present are about redefining the group's mandate) or at the Council's political discussions, where the states concerned cannot agree on implementation of EUROLONGTERM's proposals.⁷⁰

⁶⁹ See NATO Press Communiqué NAC-S (99) 69 of 25 April 1999; 'Strategic Policy Issues', *Strategic Survey 1998/1999* (Oxford: Oxford University Press for the IISS, 1999), pp. 21-31; Brooks Tigner, 'Europe's Military Capabilities Will Fall Behind US In Next Decade, say Experts', *Defense News*, 21 February 2000, and the special article on DCI 'Bridging the Gap, Will the DCI Succeed ? A Bridge too Far?', *Jane's Defence Weekly*, 14 June 2000.

⁷⁰ See the very full report WEU Assembly Document 1671, 'Armaments cooperation in the future construction of defence in Europe – reply to the annual report of the Council', Report submitted on behalf of the Technological and Aerospace Committee by Mr O'Hara, Rapporteur, 10 November 1999, and 'Harmonisation of future operational requirements', CM(99)18, WEU Council of Ministers, Bremen, 10 May 1999.

WEAG is an intergovernmental forum designed to develop more effective European armaments cooperation. It is the only European body in this field that meets at the level of defence ministers. With 19 members at present,⁷¹ WEAG works on three aspects of European armaments policy: harmonisation of programmes and operational requirements, cooperation in research and technology, and the opening up of markets. Its results are as yet modest, and it is rather a forum for discussion and a laboratory for testing procedures. A victim of its own decision-making mechanism (consensus, without binding regulations) and the lack of determination of its members, WEAG has not been able to give decisive impetus to European cooperation.⁷²

The work of the European Armaments Agency (EAA), which was entrusted to WEAG after signature of the Maastricht Treaty, has also been disappointing.⁷³ The states participating in the ad hoc group on the EAA, created in 1994, quickly disagreed on the ultimate objective and responsibilities of the future Agency. Those in favour of a pragmatic, loose arrangement were opposed by those with a more global vision.⁷⁴ As discussions were bogged down, in December 1995 France and Germany launched a bilateral project outside WEAG: the Franco-German armaments structure. Working in accordance with new principles of cooperation (the five so-called 'Baden-Baden principles'⁷⁵), it was to give birth, a year later, to the OCCAR (see below).

⁷¹ Since 13 November 2000 (WEU ministerial meeting), 6 further countries have become members of WEAG (Austria, the Czech Republic, Finland, Hungary, Poland and Sweden).

⁷² See the conclusions in the report by the Chairman of the National Armaments Directors, 'Improving the Operation of WEAG', Brussels, 23 September 1996; discussed by the 13 WEAO defence ministers at their meeting in Ostend, there has been no follow-up to this report.

⁷³ See declaration no. 30, on WEU, annexed to the Treaty (§ 5: '- enhanced cooperation in the field of armaments with the aim of creating a European armaments agency;'), www.weu.int/weag.

⁷⁴ See 'Shopkeepers versus strategists', *The Economist*, 8 April 1995, p. 74; Olivier Provost, 'Europe de l'Armement: le projet est menacé', *La Tribune Desfossés*, 19 juillet 1995; IGA Emile Blanc, 'Le GAEO, un outil pour construire l'Europe de l'Armement', *l'Armement*, no. 50, décembre 1995-janvier 1996, pp. 74-81; and 'L'Europe de l'armement, hier, aujourd'hui et demain', *l'Armement*, no. 61, mars 1998, pp. 121-7.

⁷⁵ The five principles are: best cost-effectiveness in programmes; coordination of long-term military requirements; competition in procurement; industrial cooperation based

In parallel with this, on 19 November 1996, at the WEU ministerial meeting in Ostend, the WEAO countries adopted the most modest proposal in the report by the ad hoc group on the EAA, and created the Western European Armaments Organisation (WEAO). The latter deals only with multilateral defence R&D projects.⁷⁶ To date WEAO has managed several programmes,⁷⁷ which represent, since 1990, a total budget of €400 million (or 3 per cent of European R&D), including €75 million in 2000. Future development of WEAO will depend on the outcome of the present discussions, which concern in particular the possibility of launching 'closed projects' and of devolving states' R&D budgets to the Organisation.

In the meantime, the EAA's work continues laboriously through discussions on a 'Master Plan for a European Armaments Agency'.⁷⁸

OCCAR: towards better programme management

Building on the Franco-German armaments structure of 1995, the Organisation for Joint Armaments Cooperation was created on 12 November 1996 with the inclusion of Italy and the United Kingdom. OCCAR is the first European armaments programme management organisation, but its missions are broader than managing programmes.⁷⁹ It has a legal personality (which is essential in order to be able to award contracts), and its working principles are designed to achieve:

on a multi-programme, multi-year overall balance; participation by other countries provided they accept the foregoing principles (declaration on the new Franco-German cooperative organisation, Baden-Baden, 7 December 1995).

⁷⁶ In theory the WEAO can in time become a European Armaments Agency. According to para. 12 of its Charter, 'When WEAG Ministers decide that conditions to move to a full European Armaments Agency are met . . . '.

⁷⁷ EUCLID (since 1990), EUROFINDER (1996), THALES (1996) and SOCRATES (1998).

⁷⁸ This plan was adopted by the WEAG defence ministers and confirmed in the WEU Ministerial Council *Rome Declaration* of 17 November 1998; www.weu.int/weag.

⁷⁹ Article 7 of the 1998 Convention states: 'OCCAR shall coordinate, control and implement those armament programmes that are assigned to it by Member States, and coordinate and promote joint activities for the future, thereby improving the effectiveness of project management in collaborative projects, in terms of cost, schedule and performance'. See 'L'OCCAR', *Etudes Juridiques*, no. 19, janvier 2000 (Paris: Direction des Affaires Juridiques / Secrétariat Général pour l'Administration, Ministère de la Défense, janvier 2000), pp. 57 ff.

- true industrial and technological complementarity among the four countries;
- common procurement principles (competition governed by common rules yet to be worked out);
- renunciation of the detailed calculation of industrial *juste retour* programme by programme, in favour of an overall balance across several programmes and over several years;
- integrated transnational teams (both governmental and industrial).

Countries joining OCCAR in the future will have to accept these principles and participate in at least one major collaborative project.⁸⁰

These principles are innovative compared with the mechanisms for cooperation used up till now. They do not include any special provisions aimed at creating a closed group, even if priority is given to the four OCCAR countries. Granted, Article 6 of the 1998 Convention mentions preference for equipments developed within OCCAR, but it would be difficult to reproach these countries for buying equipment in which they have made such a heavy financial investment. Rather than a protectionist measure, Article 6 acts as a stabilising factor for collaborative projects, which are often weakened when one of the partners withdraws. Paragraph 3 of Article 24 even states that competition can be extended to include countries outside WEAG (on condition that there is reciprocity).

The OCCAR structure represents one of the paths being explored towards the creation of a real European Armaments Agency. Indeed, Article 8 of the Convention provides that OCCAR may be given other functions than programme management, such as R&D and the study of operational requirements. The potential of OCCAR, which is still under-exploited, opens up many possibilities for European countries.

Nevertheless, the institutionalisation of the structure raises a number of new issues. On the one hand, it will be necessary to transfer to the new organisation all the work and responsibilities of the various national administrations that were formerly in charge of programmes. On the other, it must be determined whether the system of rules applied by OCCAR in its

⁸⁰ See IGA Jean Fournet, 'Vers une Europe de l'Armement solidaire et efficace: l'OCCAR', *Armées d'Aujourd'hui*, no. 219, avril 1997, p. 47.

programme management (awarding of contracts, etc.) is compatible with Community Law, which can be invoked in the event of litigation. As yet, the answer is not clear.⁸¹

OCCAR's existence will be fully justified if it is given broader functions, its internal mode of operation is modified and, above all, it is given new programmes to manage. At present these conditions have not been met, and a certain number of limits resulting from its design have become apparent. Management of budgets is still national and financial control is kept by programme managers, preventing the general management from having an overall view of the organisation's financial flow and calculating a true multi-programme *juste retour*. Moreover, the four founder-members of the organisation do not entrust all their programmes to it (not even those that meet the OCCAR criteria, such as the *Horizon* frigate and satellites), and OCCAR is restricted to managing programmes without having any involvement in their initial stages (choice of prime contractor, competition among subcontractors, etc.). In short, OCCAR today is still an incomplete actor on the European armaments stage.⁸²

However, the OCCAR's creation could have dual effects on transatlantic relations. In Europe, OCCAR represents a way to manage budgetary resources better and generate economies for its members. OCCAR is also attractive to other countries. Belgium and the Netherlands have asked to become members and Sweden has also shown an interest. Wider membership would mean potentially greater cooperation. However, for OCCAR to remain attractive, certain principles will have to be made more flexible. For countries that cannot or do not wish to participate in several programmes, the mechanism of Article 5 of the Convention will have to be modified. The intention of this article is to create a mechanism for involving the countries in several programmes but it seems rather rigid for medium-sized armaments producing countries. One way of achieving greater flexibility would be to apply the principle of *juste retour* to a single programme, but throughout all its life-cycle. (According to this model, country A, for example, would have a greater share of the work during the development phase, while country B would have more of the in-service

⁸¹ See, *Etudes Juridiques*, op. cit. in note 80, p. 25.

⁸² See report by Burkard Schmitt of a Defence Industries Task Force meeting held at the WEU Institute for Security Studies in Paris on 10 December 1999 ('Towards a common European demand for defence goods').

support work.) This limited version of *juste retour* is envisaged for the A400M transport aircraft so as to reconcile the participation of Belgium and Turkey with OCCAR's management of the programme. This would be less ideal than the original idea but more flexible, and would make it possible to combine wider participation (and therefore in the end a larger number of orders) with a distribution of work that is in accordance with participants' industrial capacity.

For the United States, this grouping of European countries could have three consequences. The first is that countries that traditionally import US equipment would reduce their purchases from the United States. Following its participation in the A400M programme, Belgium and Turkey, for example, are no longer likely to be buyers of the US C-130. By becoming members of OCCAR or being associated with it, they may even be less inclined to buy other US equipments, since they are encouraged, by Article 5 of the Convention, to participate in other OCCAR programmes, unless the detailed arrangements of *juste retour* are modified. The second, more long-term consequence would be that US industry would have a single point of entry into Europe. This would make it possible to simplify the dialogue mechanisms, but compel the United States to negotiate with a stronger partner (rather than with several different administrations). OCCAR would then have become the European Armaments Agency with a full range of competencies. Finally, the various US procurement agencies could subsequently establish a dialogue with OCCAR with the prospect of a situation in which 'opposition' existed, not between the United States and Europe, but between industry and government on both sides of the Atlantic.

The LoI: measures to accompany industrial restructuring

Following their joint declaration of 20 April 1998,⁸³ the defence ministers of six countries – France, Germany, Italy, Spain, Sweden and the United Kingdom – signed a letter of intent (LoI) on 6 July 1998, with the object of defining a framework for the measures to be taken by these states to accompany restructuring in the defence industry. Experts from the six countries worked on a report presented on 30 June 1999, as a result of which

⁸³ See Annexe C (this position is a consequence of the declaration by France, Germany and the United Kingdom of 9 December 1997).

ministers decided to seek a legally binding agreement covering six specific areas.⁸⁴

This process represents the first overall attempt to rationalise the internal regulations of the six countries that account for around 80 per cent of procurement budgets in Europe and 90 per cent of European industrial capacity. The initiative is an ambitious one. In the same spirit as that underlying the OCCAR mechanisms for programme management, the LoI is intended to bring about convergence of the legal systems of the six countries, and could in time stimulate work in the European Union.⁸⁵

The stakes are high: clearly, the new transnational companies can only fully exploit their advantages if Europe creates a homogeneous defence economic environment. The LoI is therefore without doubt a significant step forward. The agreement's weaknesses are nevertheless obvious: in the field of exports, for example, the six states have established a management mechanism but are not even trying to overcome their traditional divergences over exports policy.⁸⁶ It also remains to be seen to what extent this agreement will be able to take forward European cooperation in fields where progress is usually very laborious (in particular R&T and the harmonisation of requirements).

None the less, the LoI's credibility cannot be denied. Reactions of unease and nervousness on the part of Europe's American partners at the time of the official signature of the document at the Farnborough Air Show 2000 were a revealing indication of its potential.⁸⁷ Seen from the United States it

⁸⁴ See Annexe D. These six areas are: (1) security of supply; (2) simplification of procedures and adoption of common regulations for exports control; (3) harmonisation and simplification of procedures for protecting classified information; (4) coordination of research and technology programmes and financing; (5) harmonisation of military requirements (the process of planning and procuring defence equipment); (6) easier access to technical information in the event of transnational restructuring, and legislation relating to intellectual property rights. See Douglas Barrie, 'European Giants to Unify Industrial Policies', *Defence News*, 17 April 2000.

⁸⁵ For an in-depth analysis, see Burkard Schmitt, *op. cit.* in note 41.

⁸⁶ See Douglas Barrie, 'European Giants to Unify Industrial Policies', *Defense News*, 17 April 2000; Douglas Barrie and Colin Clark, 'European Industry Calls Export policy floated', *Defense News*, 31 July 2000.

⁸⁷ Alexander Nicoll, 'European Countries Set to Sign Security Pact', *Financial Times*, 24 July 2000.

appears that arrangements in Europe are evolving and call for a new approach in transatlantic relations.⁸⁸ In response to the LoI initiative, the United States is developing counter-strategies (for example by dividing its adversaries and choosing a privileged partner – the United Kingdom – or by proposing comprehensive offers with new cooperative arrangements).

Thus, the declaration on the principles of industrial cooperation between the United States and the United Kingdom signed in Munich on 5 February 2000⁸⁹ could lead to numerous problems, both political (as a divisive factor among the six LoI countries), industrial (if the US administration gives British companies privileged treatment) and legal (in the form of a conflict between the legal provisions of the LoI and any future UK-US arrangements). The DTSI initiative (17 measures) announced in May 2000 is similar in nature.⁹⁰ But these measures, which are very general and aimed rather at improving internal US procedures,⁹¹ are slow in coming into effect.

The mechanisms set up by the LoI are innovative and are similar to enhanced cooperation (as are those of OCCAR), but this approach may be too complex and heavy. Indeed, the six countries will in particular have to modify their internal legal systems (and it is difficult to foresee how long that will take) whereas the EU has tools that are immediately available.⁹²

The European Union: a reference forum, a forum for coherence and a forum of implementation?

Paradoxically, if armaments questions have been left out of the European integration process, (Article 296 of the TEU) and are not the subject of any overall Union strategy, many elements that go towards making up a real

⁸⁸ See Joseph Fitchett, 'US seeks more Defence Technology cooperation with European', *International Herald Tribune*, 14 June 1999; Thierry Gadault, 'Les Etats-Unis autorisent les alliances transatlantiques dans la défense', *La Tribune*, 8 juillet 1999.

⁸⁹ See David Buchan and Alexander Nicoll, 'Pentagon deal could help defence group', *Financial Times*, 7 February 2000; see also Annexe A.

⁹⁰ See the declaration by the US Secretary of State at a meeting of the North Atlantic Council on 24-25 May 2000, p. 6; www.nato.int/docu/speech/2000.

⁹¹ See the chapter by Gordon Adams.

⁹² See discussions at the defence industries task force meeting 'The LoI negotiations – a first assessment', Institute for Security Studies of WEU, Paris, 27 September 1999.

strategy exist: theoretical models, budgets and certain areas of competence.⁹³ It should therefore be noted that, despite certain states' reservations, only the EU, which offers a binding legal system, can provide a framework for coherence and action.

Theoretical models

In 1978 a report by Egon Klepsch, a Member of the European Parliament, proposed a model that included *inter alia* the creation of a European Armaments Agency, the promotion of competition for government defence contracts, harmonisation of regulations on exports outside the European Community and support to defence industries (R&D projects, structural funds, etc.).⁹⁴ In addition, the European Commission suggested a comprehensive system in its Communication of 1997 entitled 'Implementing EU strategy in defence-related industries', with proposals for 14 areas of armaments policy.⁹⁵ Finally, the Council has at its disposal an overall view of the subject in the very comprehensive report submitted in 1995 by an informal group of EU/WEU-WEAG experts, which has three chapters: European armaments policy, European armaments export policy and common measures in the field of procurement.⁹⁶

⁹³ Hervé Dumez and Alain Jeunemaître, 'Le cadre institutionnel de la restructuration des industries d'armement – une comparaison Etats-Unis/Europe', *Revue Gérer et Comprendre*, Annales des Mines, septembre 1999.

⁹⁴ Egon Klepsch, 'Report on European Armaments Procurement Cooperation', European Parliament Working Document, no. 83/78, 8 May 1978.

⁹⁵ The 14 areas are: inter-community transfers, the status of European company, public contracts, R&D, normalisation, customs duties, innovation, technology transfer and small and medium-sized companies, competition, exports, structural funds, direct and indirect taxation, principles of access to markets, standardisation of performance and enlargement. See 'Implementing EU strategy in defence-related industries', Brussels, COM (97) 583 final of 12 November 1997.

⁹⁶ EU/WEU-WEAG informal group of experts charged with studying 'options for a European armaments policy', Brussels, WEAG (95) 05 of 3 July 1995, or Annexe II of the European Council document no. 9458/95.

Budgets

In total, the European Union devotes between €1.5 and 2 billion per year to armaments-related issues, most of it for Structural Funds financing social and economic aid to industrial areas affected by restructuring ('Objective 2'), and also part of the budget for research and technology in the Framework Programme for Research and Technological Development (FP – for example, the 'aerospace' chapters of the 5th FP).⁹⁷

Treaty-based competencies

Within the Union, there are three main actors (the Parliament, Commission and Council) that can intervene in accordance with their treaty-based competencies.

The *Parliament* acts as the sounding board of European public opinion on armaments and defence. Through hearings or reports, members of parliament intervene in this field, but up till now without any major practical results.⁹⁸ However, the Parliament is fully involved in the Union's budget process, in particular through the co-decision process, including for subjects related to CFSP.

The *Commission* has wider powers than the Parliament and, since the armaments industry, despite its specificity, is also an industry, intervenes increasingly in areas falling within its competence (especially concerning mergers and acquisitions, control of exports of dual-use goods and technologies and the Common Customs Tariff). Its latest Communication suggests a comprehensive approach to this armaments question with, in particular, a proposal for a 'Common Position on drawing up a European

⁹⁷ See European Commission, 'General Report on the Activities of the European Union 1999', Brussels, first semester (www.europa.eu.int), in particular § 318 (for Structural Funds) and § 253 et seq. (for the 5th Framework Programme).

⁹⁸ There has, however, been a report by Gary Titley on the Commission's Communication on challenges facing European defence-related industries (EP no. 219.812 of 6 March 1997) and the Leo Tindemans report on the gradual establishment of a European Union Common Defence Policy (EP no. 224.862 of 30 April 1998).

armaments policy' supported by an action plan.⁹⁹ Because only the Commission can initiate EU regulations, its role will be fundamental.

Moreover, the Commission is fully involved (as financial contributor, project leader, etc.) in the management of programmes that may have consequences in the field of armaments. It thus acts as a driving force in defining a European space policy, and through the support it gives to important projects, notably in liaison with the European Space Agency (*Galileo* navigation satellite, earth observation, etc.).¹⁰⁰

Yet this role is deliberately restricted by states and depends on the balance of the Commission's relationships with the Council and the Parliament.¹⁰¹ Two examples illustrate this.¹⁰² The EU's Common Customs Tariff (CCT) in theory provides for application of customs duties for dual-use goods or defence equipment. In fact, exemption from CCT customs duties is granted unilaterally by member states. For the Commission, this practice therefore runs counter to community regulations. Unable to prevent states from granting such exemption, it has chosen, in order to regain the initiative on this subject and bring the law into line with reality, to submit to the Council a draft regulation aimed at temporarily suspending customs duties on certain military equipment.¹⁰³ The Council not having replied to the Commission, member states continue to grant exemption from the CCT unilaterally.

Conversely, in the area of exports of dual-use goods and technologies, the Commission cannot be bypassed. The regulation of 1995 on this point already functioned on a 'trans-pillar' basis (cooperation between the first and second pillars): regulations of the Commission (first pillar) laid down

⁹⁹ Op. cit. in note 95.

¹⁰⁰ See European Commission, 'Towards a Coherent European Approach for Space', Brussels, SEC(1999)789, final of 7 June 1999; this document follows three Communications on space questions (1988, 1992 and 1996); <http://europa.eu.int/comm/jrc/space>.

¹⁰¹ See Luke Hill and Brooks Tigner, 'EU Armaments Reforms Stalled', *Defense News*, 20 December 1999.

¹⁰² For interventions by the Commission on mergers and takeovers in the field of armaments and aerospace, see information from the Commission's Directorate-General for competition (<http://europa.eu.int/comm>).

¹⁰³ COM (88) 502 final (JOCE no. C 265 of 12 October 1988, p. 9).

principles, whereas the Joint Actions of the Council (second pillar)¹⁰⁴ drew up the lists of equipments and recipient countries. A new regime was adopted in June 2000, based on a different philosophy: principles and lists come under the Commission alone. From now on, a company needing to use this regulation may invoke it before the European Court of Justice in the event of a dispute. Only the granting of export licences is devolved to states in so far as the Commission has no agency with competence in this technical area (application of the principle of subsidiarity).

The *Council* remains the forum for the drawing up of a European policy, in two main working groups: POLARM (European Armaments Policy Council Working Group) and COARM (Working Group on Exports of Conventional Arms). Chaired by the country holding the EU presidency, these Council working groups include representatives of the 15 member states and the Commission.

Set up in 1995 following a report by an informal EU/WEU-WEAG group of experts, POLARM has examined many topics (intra-Community transfers, the specificity of the armaments sector, exports, security of supply, etc.), but its overall results are meagre. For example, in this group the 15 member states could have adopted for the first time a common position on a European armaments policy at the suggestion of the Commission (see above),¹⁰⁵ but this project gradually became devoid of any content. The 15 member states had many differences of view: the proposal was considered premature; the political expediency of having an EU position on this question was contested, as was the necessity to define in advance a common defence policy; there were disagreements on competence between the Council and the Commission, etc. The General Affairs Council of 15 November 1999 therefore restricted itself to taking note of the group's work, underlining the importance of this question for the CESDP and asking POLARM to continue its work without giving it any precise objectives.¹⁰⁶

¹⁰⁴ On the basis of Article J of the Maastricht Treaty (now Article 14 of the Treaty on European Union).

¹⁰⁵ On the basis of Article J.2 of the Maastricht Treaty (or Article 12 of the TEU) in its Communication 'Implementing EU strategy in defence-related industries', Brussels, COM (97) 583 final of 12 November 1997.

¹⁰⁶ Since then, the frequency of the group's meetings has fallen considerably.

The creation in 1993 of the COARM group shows the interest of the various European actors in armaments exports. Its activities, which are for the most part technical, essentially concern exports to third countries, and are based in particular on the eight export criteria defined by the Councils in Luxembourg (29 June 1991) and Lisbon (26 and 27 June 1992),¹⁰⁷ which served as a basis for the Code of Conduct adopted by the Council in June 1998. This Code of Conduct, which regulates sales to third countries, is the first sign of the Council's engagement in this sensitive area.¹⁰⁸ It rests on two main elements: a series of criteria for defining cases where such exports are to be avoided, and a political commitment by member states not to replace another in a sale that the first has refused. It publishes an annual report on European exports (point 8 of the Code). To complete this arrangement, on 13 June 2000 the 15 member states agreed a list of reference defence equipments to which the Code should be applied.¹⁰⁹ This list could, moreover, serve as a precedent for other aspects of the armaments issue within the European Union.¹¹⁰

However, with this Code, the Council has restricted itself to a political commitment only. It has declined to make use of the more restrictive instruments put at its disposal by the CFSP: Common Strategies (objectives, duration and means to be supplied by the Union under Article 13 of the TEU), Joint Actions (Article 14 of the TEU) or Common Positions (Article 15 of the TEU).

¹⁰⁷ 1. Respect for international commitments of the EU Member States. 2. The respect of human rights in the country of final destination. 3. The internal situation in the country of final destination. 4. Preservation of regional peace, security and stability. 5. The national security of the Member States. 6. The behaviour of the buyer country with regard to the international community. 7. The existence of a risk that the equipment will be diverted within the buyer country. 8. The compatibility of the arms exports with the technological and economic capacity of the recipient country.

¹⁰⁸ See Europe Documents no. 2092 / Atlantic Document no. 104 of 12 June 1998, and Jacques Isnard, 'Vers un contrôle européen des exportations d'armes', *Le Monde*, 4 mai 2000.

¹⁰⁹ Council Declaration 2000/C 191/1 of 8 July 2000.

¹¹⁰ Another list of defence equipments (dating from 1958 and confidential) is annexed to Article 296 of the TEU. In the perspective of updating, states could directly use that adopted in June 2000. The Council, acting unanimously at the invitation of the Commission, may modify that list.

With the competencies of the three main actors (the European Parliament, the Commission and the Council) and their recent actions, a first mechanism for implementing a European armaments policy is in place. It is, however, only at the embryo stage. European armaments policy is still clearly directed by governments. Only political impetus would make it possible to develop these disparate elements towards structured objectives.

New fields of action for the Union

In the conclusions of the EU summits in Cologne (June 1999), Helsinki (December 1999), Feira (June 2000) and Nice (December 2000), the EU acquired new politico-military instruments in the framework of the CESDP.¹¹¹ Although these decisions do not constitute a sufficient legal basis to allow the development of a comprehensive armaments policy, they have changed the framework for this cooperation profoundly: the 15 defence ministers may now meet in Council, and the Union has made a political undertaking on concrete military capabilities (the Headline Goal of 2003).¹¹²

Within the coherent framework of the EU these two innovations may have several consequences in the field of armaments:

- the possibility to use fully the complete range of EU mechanisms (definition of political priorities in the second pillar, binding provisions in the first pillar) making it possible to avoid the shortcomings and inadequacies evident in other organisations (NATO, WEU-WEAG, etc.);
- implications of the Headline Goal of 2003 for the armaments sector; this goal will require additional commitments to equip the forces (armaments planning, R&D projects, standardisation, etc.);¹¹³

¹¹¹ These new instruments are: a Political and Security Committee (PSC), a Military Committee (MC) and a European Military Staff (EMS). See the comprehensive study by François Heisbourg (with numerous contributions), 'European defence: making it work', *Chaillot Papers* 42 (Paris: Institute for Security Studies of WEU, September 2000).

¹¹² For all of the Petersberg missions (Article 17, para. 2 of the TEU), the force must be capable of projecting 50,000 to 60,000 troops, within 60 days, a distance of several thousand kilometres, with the necessary naval and air protection, and be sustainable for a year (conclusions of the EU Helsinki summit, press communiqué no. 300/99).

¹¹³ See the conclusions of the French Defence Minister at a hearing before the Defence Committee of the National Assembly on 20 September 2000, including the suggestion

- in the long term, within the EU armaments could become a routine topic just like any other subject.

Several alternative scenarios can be envisaged:

- the gradual development within the EU of an armaments policy in support of the Headline Goal;
- the creation, independently of the Headline Goal but based on the new CESDP framework, of a fully-fledged European armaments policy that would coordinate and develop existing EU instruments;
- the continuation and development, in the margins of the EU, of OCCAR-type instruments or agencies that could, when appropriate, be incorporated into the EU.

In budgetary terms, and whatever scenario materialises, the development of a European armaments policy could happen through major voluntary political commitments by states (the stabilisation of defence budgets, a commitment not to produce equipment on a purely national basis, the fixing of a minimal level of research expenditure, etc.).

Consideration could also be given to using the EU framework for the funding of certain military or humanitarian operations or certain armaments programmes,¹¹⁴ which would result in:

- either the transfer of a part of the national budgets concerned to the EU (and the creation of a specific budget); or
- an increase in the EU's own resources; or
- a redistribution of credits within a constant EU budget.

In the latter two cases, domestic margins for budgetary manoeuvre would be made available to member states, facilitating the adapting of national structures both in the military domain (to meet the cost of profession-

that the Headline Goal could lead to the beginnings of a European equipment programme. At this stage, around 10 per cent of the equipment expenditure of the various European countries could be concerned.

¹¹⁴ It would then be necessary to amend the financial regulations of the CFSP (Article 28 of the TEU).

alisation, etc.) and in the armaments sector (to meet the social costs of industrial restructuring, rationalisation of European test centres, etc.).

These mechanisms would benefit from being included in national, 'Europeanised' programming or even being worked out in collaboration among willing European partners. From this perspective, and going beyond the stage of 'limited convergence' or 'enhanced cooperation' (see the examples of OCCAR and the LoI), what could be truly revolutionary within the EU would be the creation of a 'defence' line in the EU budget that could be used for armaments programmes.

The European Union can provide the framework for coherence in European armaments policy, in particular through its capacity to make regulations, but at this stage there is a lack of agreement by nations on the ultimate objective (creation of a European Armaments Agency, management of armaments questions by the first or the second pillar, budgetary implications for the European Parliament, and so on), and in particular agreement on an architect to carry out the project.

II. 3 Conclusion

The beginnings of convergence noted in several areas of the field of armaments do not yet amount to a coherent arrangement that can be compared to 'Fortress America'. Convergence is still hesitant, and the concept requires both deepening and better presentation to European public opinion, given its consequences for national budgets.¹¹⁵ Moreover, senior officials prefer the term 'coherence criteria' because of the greater flexibility that it implies. This means in fact rationalising the available resources rather than raising defence budgets.¹¹⁶

¹¹⁵ See Alyson J. K. Bailes, 'European defence: what are the convergence criteria?', *RUSI Journal*, June 1999, pp. 60-5; see also on this subject the contribution by André Dumoulin, 'Le concept de convergence, les ambitions', Seminar '*Défense européenne : le concept de convergence*', organised by the Belgian defence ministry with the Ecole Royale Militaire and the Institut Royal Supérieur de Défense, Palais d'Egmont, Brussels, 28-29 March 2000; and Pierre Lefèvre, 'Le prix de la défense commune', *Le Soir*, 31 March 2000.

¹¹⁶ See 'Strategic Policy Issues', *Strategic Survey 1998/99* (Oxford: Oxford University Press for the IISS, 1999), pp. 21-31, and John Dowdy, 'Of Arms and the Men Who

Two types of development are under way: industrial restructuring made necessary by American competition, and government initiatives to strengthen European security and defence policy. European countries cannot, however, collectively and openly embrace a 'Fortress Europe' project, which would be politically difficult to proclaim within the Atlantic Alliance. Even if armaments constitutes a particularly sensitive sector, the idea of a 'fortress', with its protectionist connotations, is also in stark contradiction with the economic ideal of free competition. Moreover, industrialists oppose the idea.¹¹⁷

It might even be that the idea of a fortress would be counterproductive: in such a context, companies would scarcely be inclined to adopt policies of R&D innovation and fund them. They would not be able to remain competitive internationally. Today, a transatlantic equilibrium could be found through the establishment of a European armaments market functioning along the same lines as the 'Buy American' Act: if an American manufacturer wishes to sell a system in Europe, part of the production should be in Europe, either by the location of a subsidiary of the company in the country or countries in question, or else by using a local company ('second source') under conditions to be determined.

And yet in practice trends in recent years are likely to lead to the emergence, if not of a 'fortress', then at least of a 'Forceful Europe' that is more integrated. Political and industrial developments are leading towards that outcome. What is more, one can expect industrial restructuring to have the effect of accelerating European political integration. Restructuring should indeed lead to the formation, in all sectors, of powerful transeuropean groups. There is therefore a risk that European states will find themselves faced with situations of industrial monopoly over which they have little control. European governments must therefore at the same time manage the process of European integration, which has its own dynamic, and also define the national armaments production capacity that is really necessary for their security.

Budget for them (Europe won't raise its defence budget. But it can spend the budget more wisely)', *The Wall Street Journal Europe*, 27 July 2000.

¹¹⁷ 'Our wish is not to erect a Franco-German fortress, nor to suggest such an idea, much less to set up a European fortress in opposition to an American fortress . . .' See Philippe Camus & Rainer Hertrich, 'EADS ou l'ambition de faire gagner l'Europe', *Le Monde*, 8 June 2000.

To avert the risks of industrial monopoly and to be consistent with their previous political decisions, states will have no other *rational* choice but to hasten the process of political integration. Although inadequate, the decisions taken at recent EU summits point in that direction.

Chapter Three

THE PROSPECTS FOR A TRANSATLANTIC DEFENCE INDUSTRY

Andrew D. James¹

Debate has grown in recent years about the prospects for a significant transatlantic dimension to defence industry consolidation. Advocates of closer transatlantic linkages have warned about the dangers of a ‘fortress’ mentality on either side of the Atlantic, and have argued that a true transatlantic defence industry would strengthen political relations within NATO, improve military interoperability and reduce the cost of equipment procurement.² However, irrespective of these strategic and political pressures for deeper transatlantic relationships, the shape of any future transatlantic defence industry will ultimately be governed by the commercial decisions of defence companies. Governments may be able to set the political tone and regulatory conditions but it will be defence contractors – now almost exclusively in the private sector – who will determine the specifics of transatlantic developments.

¹ I would like to thank the following people for their useful comments on earlier drafts of this paper: Alexandra Ashbourne (Centre for European Reform, London), Jeffrey Roncka (Global Technology Partners, Washington DC) and Stefan Tornqvist (FOA, Stockholm).

² See, amongst others, Alexandra Ashbourne, ‘Trans-atlantic defense alliances best idea for Europe’, *Defense News*, 23 August 1999, p. 15; John Deutch, Arnold Kanter and Brent Scowcroft ‘Saving NATO’s foundation’, *Foreign Affairs* vol. 78, no. 6, 1999, pp. 54-67; Charles Grant ‘Transatlantic alliances and the revolution in military affairs’ in Gordon Adams et al., *Europe’s Defence Industry: A Transatlantic Future?* (London: Centre for European Reform, 1999); Joseph S. Nye, ‘The US and Europe: continental drift?’, *International Affairs* no. 76, vol. 1, 2000, pp. 51-9. Such arguments have also been made by many figures in the US government. See for instance, Felix Rohatyn ‘European defense restructuring and transatlantic cooperation’, remarks by Ambassador Felix Rohatyn, Les Echos Defense Industry Conference, Paris, 15 April 1999, and Jacques S. Gansler ‘Globalization and National Defense: Challenges and Opportunities’, speech by the Under-Secretary of Defense (Acquisition, Technology & Logistics), NDIA Globalization Conference, Washington DC, 1 May 2000.

This chapter will emphasise that there are signs that transatlantic industrial relationships are gathering pace and it will note that these relationships are primarily industry-led and are often building on existing links established through previous cooperative programmes. Nevertheless, it will also be argued that the history of transatlantic defence industrial relationships suggests that such developments face significant political, regulatory and business challenges. Given these challenges, transatlantic relationship building will almost certainly be a cautious process and – in the short term – we are most likely to see a broadening and deepening of transatlantic industrial linkages through programme-specific teaming, strategic alliances and joint ventures as well as some small and medium-sized acquisitions. However, the periodic speculation by some industry commentators about mergers between the largest US and European companies appears unrealistic under current conditions.

III.1 The evolution of transatlantic defence industrial relationships

The last fifty years have seen the evolution of transatlantic defence industrial relationships from predominantly government-led arrangements driven by Cold War concerns about Western European military capabilities towards increasingly industry-led relationships driven by commercial concerns about market access. However, throughout the period the common features of the transatlantic relationship have been the dominant position of the United States and European anxiety about the threat of US hegemony.

Government-led programmes

Transatlantic defence industrial relationships have a long history. In the first decades after the end of the Second World War, the United States maintained an almost unchallenged position in advanced military technology and industry. Europe was struggling to re-build its war-torn economy, most of its military industry was exhausted or destroyed and the former Axis powers were prohibited by treaty from rebuilding an independent defence industrial base. In response, the United States gave or sold military equipment to its allies in Europe to support the NATO Alliance and maintain a coordinated conventional deterrent against the threat of

Warsaw Pact invasion of Western Europe.³ Thus, the 1950s and 1960s saw the United States license the production of a number of weapons systems to Europe. These included the F-104 fighter to Belgium, Germany, Italy and the Netherlands, the F-4 fighter to the United Kingdom, the M-60 tank to Italy and the *Sidewinder* and *Hawk* missiles to a number of European NATO countries.⁴

The 1970s saw the emergence of new forms of transatlantic collaboration in response to growing NATO concerns about the standardisation, rationalisation and interoperability of defence equipment and a desire on the part of European countries to create more of a 'two-way street' in the transatlantic relationship. Thus, under a co-production agreement, the US-developed F-16 fighter aircraft was produced in two European countries (Belgium and the Netherlands) for a number of European partner countries that initially included Denmark and Norway and later also Greece and Turkey. These partners were guaranteed a work share in sub-assemblies for the entire European and US production.⁵ The next three decades also saw a series of other government-to-government initiatives to promote arms cooperation within NATO, all of which were to meet with rather limited success and often conspicuous failure. The 'family of weapons' concept emerged, under which a group of NATO countries would develop and produce a range of similar weapons systems. In 1978, NATO agreed that the United States would lead the development of one family member (AMRAAM – Advanced Medium-Range Air-to-Air Missile) and the Europeans would lead the development of another (ASRAAM – short-range). Both sides were to buy the equipment from each other but the programmes were to eventually collapse as a result of cost overruns and programme delays.⁶

³ Jeffrey Becker, 'The future of Atlantic defense procurement', *Defense Analysis*, vol. 16, no. 1, 2000, pp. 9-32. William W. Keller, *Arm in Arm – The Political Economy of the Global Arms Trade* (New York: BasicBooks, 1995).

⁴ Richard A. Bitzinger, 'The globalization of the arms industry', *International Security*, vol. 19, no.2, Fall 1994, pp. 170-98; Elisabeth Sköns 'Western Europe: internationalization of the arms industry' in H. Wulf ed., *Arms Industry Limited* (Oxford: Oxford University Press for SIPRI, 1993).

⁵ See Richard A. Bitzinger; Elisabeth Sköns, op. cit. in note 4.

⁶ Trevor Taylor, 'Transatlanticism versus regional consolidation', in David G. Haglund and S. Neil MacFarlane (eds.), *Security, Strategy and the Global Economics of Defence Production* (Montreal & Kingston: McGill-Queen's University Press, 1999). Also see Richard A. Bitzinger op. cit. in note 4.

Similarly, in the late 1980s, the US government engaged in a number of government-to-government joint weapons development programmes with NATO European allies. Several of these so-called 'Nunn amendment' programmes were abandoned at an early stage, including the NATO Frigate Replacement (NFR 90), the Autonomous Precision-Guided Munitions (APGM) programme and the Modular Stand-Off Weapon (MSOW). Their failure reflected the difficulty of harmonising military requirements, as well as limited political commitment on the part of the governments involved in the programmes.⁷

Undaunted by this troubled history, the Clinton administration also gave high-level political support to the goal of NATO armaments cooperation, not least through cooperative initiatives on three particular programmes. The US Joint Strike Fighter (JSF) programme was the largest and most significant programme that the United States opened to cooperative development with participation by Canada, Denmark, the Netherlands, Norway and the United Kingdom, among others. The United States also entered the Multifunction Information Distribution Systems (MIDS) programme – a digital-information-distribution system to provide integrated battlefield communications, navigation and identification – with European participation by France, Germany, Italy and Spain.⁸ The Medium Extended Air Defence System (MEADS) was the other government-to-government programme launched under the first-term of the Clinton administration, and it provides a good illustration of some of the challenges that have so often dogged these types of transatlantic industrial relationships.

MEADS began in the late-1980s as the joint US Army and US Marine Corps CORPSAM effort to replace the *Hawk* air defence system. In February 1995, France, Germany, Italy and the United States signed a statement of intent for cooperation on the programme, which was then renamed MEADS.⁹ However, the programme was soon to run into difficulties. From the beginning, the US Congress viewed MEADS as overlapping with other, higher priority US ballistic missile defence programmes, and it required vigorous lobbying by the Pentagon to get

⁷ William W. Keller, op. cit. in note 3.

⁸ Robert P. Grant 'Transatlantic Armament Relations Under Strain', *Survival*, vol. 39, no. 1, 1997, pp. 111-37.

⁹ Scott Gourley, 'USA may withdraw from joint MEADS programme', *Jane's Defence Weekly*, 14 October 1998, p. 8.

funding for the programme – albeit at a much reduced level.¹⁰ At the same time, a defence procurement budget crisis meant that France dropped out of the programme before the signing of the memorandum of understanding in April 1996.¹¹ Thus, the programme was restructured as a trilateral project between the United States, Germany and Italy, and under the MoU work shares and development costs were split in the ratio 60:25:15.

More problems were to follow. In September 1998, the US Congress halted funding for the MEADS programme. A number of factors influenced the decision but – in important respects – Congress was merely reflecting the scepticism towards the programme that was felt within parts of the Pentagon. Whilst Pentagon officials may have been expressing their support for the programme in public they had not lobbied vigorously for its continued funding – citing the cost of the system and the fact that it duplicated capabilities that the United States already possessed.¹² Uncertainty over US funding for the project was to continue throughout the next year. In May 1999, it was announced that MEADS International – a joint venture between Lockheed Martin, Dasa and Alenia Marconi Systems – had been selected as the US contractor, but the Department of Defense and Congress continued to be embroiled in a row over spending on the project.¹³

Funding cuts were also to provoke a major dispute over the specification of the system. Thus, the US Army decided that the original plan to develop a new interceptor missile for the programme would be too expensive and opted instead for the use of the PAC-3 *Patriot* missile. This raised new tensions, with the German and Italian partners arguing that Europe was yet again being forced to buy US technology. Eventually, they accepted the US option – not least because the Pentagon threatened that otherwise it would withhold programme funding.¹⁴ In turn, the use of PAC-3 triggered another dispute – this time over technology transfer. The United States insisted on having the right to conduct on-site security inspections of German and

¹⁰ Robert P. Grant, op. cit. in note 8.

¹¹ Ibid.; Scott Gourley op. cit. in note 9.

¹² Lisa Burgess and Colin Clark, 'US MEADS cutback shocks Germany, Italy', *Defense News*, 5-11 October 1998, p. 4.

¹³ Greg Seigle, 'US spending row puts MEADS in jeopardy', *Jane's Defence Weekly*, 25 August 1999, p. 3.

¹⁴ Colin Clark and George Seffers 'US security restrictions hinder MEADS cooperation', *Defense News*, 18 October 1999, pp. 1-98.

Italian facilities, and at the same time proposed the use of ‘black boxes’ to protect US technology. Such proposals were rejected by the German government, which saw MEADS as a test case for US willingness to share technology with its allies. A stalemate ensued which was only broken after eight months of sometimes tense negotiations.¹⁵ All in all, the history of MEADS highlights the sensitivity of technology transfer issues in transatlantic industrial relationships and the often limited political commitment to these kinds of government-to-government collaborative programmes.

Industry-led collaboration

Whilst government-to-government relationships have been dogged by problems, industry-to-industry collaborative arrangements became increasingly common in the 1990s. Thus, a number of transatlantic strategic alliances have been established over the last decade. For example, General Dynamics Corp. and British Aerospace entered into a relationship in the early 1990s to explore cooperation on armoured vehicles.¹⁶ The US-Italian Lockheed Martin-Alenia Tactical Transport Systems joint venture was established to develop the C-27J medium transport aircraft¹⁷ and – in April 2000 – Dasa/EADS and Northrop Grumman signed a memorandum of understanding to explore opportunities in the defence market.¹⁸ At the same time, European acquisitions of US defence companies grew in number. Between 1988 and 1992, according to one estimate, sixty US defence companies were sold – mostly to European companies – for some \$10 billion. These included the 1988 acquisition of Singer Electronic Systems division by Plessey of the United Kingdom and the 1989 sale of Fairchild Space & Defense to Matra of France.¹⁹

¹⁵ Colin Clark ‘Germany, US resolve MEADS tech dispute’, *Defense News*, 29 May 2000, pp. 1-35.

¹⁶ See Richard A. Bitzinger; Elisabeth Sköns, op. cit. in note 4.

¹⁷ Pierre Sparaco, ‘US, Europe explore transatlantic partnerships’, *Aviation Week & Space Technology*, 13 September 1999, pp. 37-8.

¹⁸ John D. Morrocco, ‘EADS, Northrop Grumman broaden cooperative links’, *Aviation Week & Space Technology*, 12 June 2000, pp. 35-6.

¹⁹ Figures cited in William W. Keller, op. cit. in note 3.

However, the development of such transatlantic relationships has not always been without controversy: Matra, for example, resold Fairchild in 1996, complaining that US government security regulations constrained freedom of management action.²⁰ Thomson-CSF, renamed Thales in December 2000, had an even worse experience when it sought to acquire the Missiles Division of the LTV Aerospace and Defense Company in the early 1990s. The French company – in a consortium with the Hughes Aircraft Company – successfully outbid Martin Marietta and Lockheed to take control of the US missile house only to see the deal become the object of a concerted lobbying campaign in Congress by Martin Marietta and others. Congressional hearings followed and opposition from leading US politicians eventually caused Thomson to withdraw its bid.²¹ The LTV Missile debacle may have been an unusually public case but it does serve to emphasise the political sensitivities that can be stirred up by foreign participation in a country's defence industrial base – especially where it threatens the business interests of powerful domestic rivals.

Certainly, the experience soured Franco-US relations and only served to heighten French suspicions about 'Fortress America'. However, it did not put an end to European acquisition activity in the United States, and the 1990s were to see UK companies in particular take control of a number of important and sensitive US defence industrial assets. Thus, in 1994, Rolls-Royce acquired Allison Engine Company – a major manufacturer of military aircraft engines.²² More significant still was the US government's decision in 1998 to allow GEC Marconi to acquire the defence electronics company Tracor. Many industry observers saw this at the time as a path-breaking acquisition, not least because of the nature of many of the technologies developed by Tracor and the role of the company in a number of highly sensitive US government programmes in the defence and intelligence fields.

In addition, other modes of transatlantic industrial cooperation became increasingly important during the 1990s, not least the continued growth of the transatlantic sourcing of subsystems and components by prime

²⁰ See Richard A. Bitzinger, *op. cit.* in note 4.

²¹ *Ibid.*

²² Rolls-Royce was the 31st ranking contractor to the Pentagon in 1998, with \$345m. in contract awards. It sells jet engines for the two joint US/UK aircraft AV-8 *Harrier* and T-45 trainer.

contractors.²³ The transatlantic market in this area was estimated to be worth over \$11 billion in 1997, with European sales of components and subsystems to the United States worth \$6.1 billion.²⁴ Offset arrangements associated with major US equipment sales accounted for an important share of this figure and – according to one estimate – European components represented some 10 per cent of the value of F-16 aircraft bought by the United States Air Force.²⁵ US components and subsystems also play an important part in European systems. Thus, Litton Industries estimates that each *Eurofighter* aircraft contains Litton avionics worth \$1 million supplied from either direct transatlantic sales or Litton's European subsidiaries.²⁶ Similarly, Sweden's JAS-39 *Gripen* fighter aircraft depends on more than a dozen foreign suppliers of key subsystems and components, including US companies Lockheed Martin, Sundstrand, Honeywell and General Electric.²⁷

The new transatlantic environment

For the last fifty years, the United States has almost always been the dominant partner in the transatlantic defence industrial relationship. The spectre of US hegemony has long haunted Europe, and much of European thinking in the second half of the 1990s was dominated by the size of the companies that had emerged from the US consolidation process. In 1998, the failure of Lockheed Martin's proposed merger with Northrop Grumman signalled the end of the main phase of top-tier consolidation in the United States and attention began to turn towards the prospects for a transatlantic dimension to restructuring. The expectation on both sides of the Atlantic was that the newly consolidated US companies would lead this process, and a number of European commentators sounded shrill warnings about the coming threat of US dominance. The immediate focus of speculation was the Marconi Electronic Systems defence business owned by the UK

²³ Andrew D. James, *Medium Sized Defence Electronics Companies and US Defence Industry Restructuring* (Stockholm: FOA Defence Research Establishment, April 2000).

²⁴ International Institute for Strategic Studies, *The Military Balance 1998/99* (Oxford: Oxford University Press for The International Institute for Strategic Studies, 1999).

²⁵ William W. Keller, op. cit. in note 3.

²⁶ Andrew D. James op. cit. in note 23.

²⁷ Maria Andersson and Johan Lilliecreutz, *Supply Chain Strategies and Sub-Tier Structures*, FOA User Report, FOA Defence Research Establishment, Stockholm, March 2000.

company GEC, and rumours grew about the possibility of a joint venture or outright acquisition or merger with either Northrop Grumman or Lockheed Martin.²⁸ The Pentagon – and in particular Deputy Secretary of Defense John Hamre – indicated support for closer transatlantic industrial relationships, and the US government began a review of its regulatory frameworks to deal with the anticipated growth in transatlantic acquisitions and other industrial relationships.²⁹

In the end, Marconi Electronic Systems was acquired by British Aerospace in a deal that provoked dismay in certain quarters on both sides of the Atlantic. Senior US Department of Defense officials expressed the view that it had put back the cause of transatlantic cooperation and represented another step towards a Fortress Europe³⁰. In Europe, it provoked a fierce reaction from Dasa – which had been courting British Aerospace – and only sought to strengthen the belief of some continental European observers that the United Kingdom was more interested in transatlantic relationships than European cooperation.³¹ In response, negotiations began between Aerospatiale-Matra of France, Dasa of Germany and CASA of Spain that were eventually to lead to the formation of EADS.³² There is little doubt that these developments in Europe have changed the terms of the debate on the transatlantic defence industry relationship. Consolidation in Europe has created two companies – BAE Systems and EADS – that match the leading US defence contractors in terms of the size of their turnover and breadth of their activities. Together with Thales (the former Thomson-CSF), they represent the three poles of the new European defence industry structure and will be major players in any future transatlantic developments.

²⁸ Alexander Nicoll, 'Gunning for top spot in defence's complicated game', *Financial Times*, 5/6 December 1998, p. 21; Daniel Bogler, 'Transatlantic target comes within range of GEC', *Financial Times*, 9 December 1998, p. 26; 'Locking on to Lockheed', *Financial Times*, 31 December 1998, p. 20.

²⁹ Bryan Bender, 'USA moves to pave way for easier Europe links', *Jane's Defence Weekly*, 23 December 1998, p. 19.

³⁰ See comments by the US Deputy Defense Secretary John Hamre reported by Thomas E. Ricks and Anne Marie Squeo, 'Pentagon urges caution involving trans-atlantic mergers', *Wall Street Journal*, 27 October 1999, and similar comments by Jacques Gansler the US Undersecretary of Defense for Acquisition and Technology.

³¹ See Alexandra Ashbourne 'Introduction' in Adams et al., op. cit. in note 2.

³² Burkard Schmitt, 'From Cooperation to Integration: Defence and Aerospace Industries in Europe', *Chaillot Papers* 40 (Paris: Institute for Security Studies of WEU, July 2000).

III.2 Business pressures for closer transatlantic relationships

Inevitably, there has been considerable speculation about the implications of such changes for transatlantic defence industrial relationships. What is clear is that the companies in the newly consolidated European defence industry and their US counterparts face significant business pressures to expand their international activities, and transatlantic relationships are likely to be an important dimension of their strategies.

Limited defence spending

Both US and European defence companies are facing growing pressures to internationalise their activities, not least because their home markets do not offer sufficient prospects to sustain them in the future. Since the end of the Cold War, European countries have made considerable cuts in their defence budgets. Between 1989 and 1998, France, Germany and the United Kingdom – which together accounted for 58 per cent of the Western European total in 1998 – reduced their defence expenditure by 12, 28 and 24 per cent respectively.³³ Even sustaining defence budgets at their reduced levels is likely to represent a political challenge for the majority of NATO European governments, especially as they seek to meet the Maastricht Treaty criteria for government debt. At the same time, many governments are faced with the management of competing priorities such as the professionalisation of their armed forces and equipment modernisation within static or shrinking defence budgets.³⁴ Certainly, there is little sign that any European country shares the US intention to increase defence spending (particularly on procurement) during the next five years. Indeed, even in the United States – where the Clinton administration's budget for 2000 contained the first sustained and long-term increase in US defence spending since the end of the Cold War – companies will continue to struggle to meet the financial expectations of their investors. The end of merger-driven opportunities for expansion has left US defence contractors struggling to raise growth rates in their defence businesses, and Wall Street remains

³³ Stockholm International Peace Research Institute, *SIPRI Yearbook 1999* (Oxford: Oxford University Press for SIPRI, 1999).

³⁴ International Institute for Strategic Studies, op. cit. in note 24; Douglas Barrie, 'Defense budgets remain tight throughout Europe', *Defense News*, 20 December 1999, p. 26; 'The European way of defence', *The Economist*, 24 June 2000, p. 23.

sceptical about their ability to utilise defence-related technologies to diversify into civil markets. Thus, US companies are increasingly seeking new defence contracts by expanding their international presence.³⁵

Access to markets and programmes

Ultimately, budget trends mean that – for the foreseeable future – there will be few new weapons programmes, and existing programmes face the prospect of being scaled-down or even cancelled. Thus, the challenge for defence companies is to ensure that they are able to participate in as many new programmes as possible and that they reduce their dependence on any one particular contract or national government customer. This emphasises the importance to companies of having a presence in both the US and European markets, and of capturing an increasing share of markets elsewhere in the world.³⁶

Accordingly, defence firms in both the United States and Europe have aggressively pursued arms exports as a way of making up for some of the post-Cold War decline in their home markets, and this has brought US and European companies into often intense and sometimes acrimonious head-to-head competition in third countries.³⁷ Nevertheless, the size of the US and European markets is such that it is inevitable that they are becoming the focus for new transatlantic business strategies, and the nature of the defence market means that a local presence is vital for any company that wishes to participate in major programmes. In the US market, barriers to direct sales by foreign companies mean that European companies have often concluded that the only way to gain access to US programmes has been to acquire a US company. In contrast, US defence contractors have long had access to European markets, prompting the long-running European complaint about a ‘one-way street’ in arms procurement. However, there appears to be a

³⁵ See Andrew D. James, *Post-Merger Strategies of the Leading US Defence Aerospace Companies* (Stockholm: FOA Defence Research Establishment, December 1998), and Andrew D. James *op. cit.* in note 23.

³⁶ Keith Hayward ‘The globalisation of the defence business’ in Gordon Adams et al., *op. cit.* in note 2.

³⁷ Jens Van Scherpenberg, ‘Transatlantic competition and European defence industries: a new look at the trade-defence linkage’, *International Affairs*, vol. 73, no. 1, 1997, pp. 99-122.

growing recognition amongst US companies that they need to do more than offer offsets if they are to secure European contracts in the future. Thus, building strong European programme teams, supported by significant technology transfer from the United States, is seen as increasingly important by US companies if they are to meet increasing European demands for greater technology transfer and industrial participation in major programmes.³⁸

Sharing costs and risks

At the same time, companies are increasingly looking to share the costs and risks of new programmes in the face of the growing cost and technological complexity of designing and developing advanced weapons systems.³⁹ In practical terms, these pressures mean that it is increasingly difficult for any single company – whether in the United States or Europe – to find the investment funds and technological capabilities needed to develop such programmes alone. Thus, internationalisation is also being driven by a desire on the part of even the largest US contractors to share programme costs, access specific non-US technologies and seek new sources of capital. For European companies, transatlantic industrial relationships promise opportunities to access US technology that will enable them to meet European programme requirements.

III.3 Influences on strategic options

Nevertheless, companies will not operate with a free hand as they seek to develop business strategies to address this new defence industry environment. Instead, their strategic options will be influenced by a number of interrelated factors that are likely to have an impact on both the extent to which they will enter into transatlantic relationships and the mode of collaboration that they will choose for the implementation of their strategies.

³⁸ See Andrew D. James, *op. cit.* in note 23. The UK ASTOR and BVRAAM programmes are good illustrations of these new bid strategies.

³⁹ See 'Linking Arms: A Survey of the Global Defence Industry', *The Economist*, 14 June 1997, and Burkard Schmitt, *op. cit.* in note 32.

Political will

The willingness of policy-makers and politicians to support the development of a transatlantic defence industry will have a critical impact on company decision-making. The nature of the defence industry is such that contractors will always be highly sensitive to the political context in which they are operating, and they are unlikely to move forward without a strong sense that they have backing from key policy-makers in national legislatures, defence ministries and the military.

In many respects, it is the US government that has taken the lead in this area with the Department of Defense giving high-profile support to greater transatlantic defence industrial cooperation. Three factors have driven its policy initiatives: first, a view that opening up the US market to European competition may be one way to increase competition and provide a counterbalance to the dominance of certain sectors by Boeing, Lockheed Martin and Raytheon; second, a wish to prevent the emergence of a 'Fortress Europe' in which US companies are excluded from European procurement programmes; finally, a belief that transatlantic defence industrial cooperation may provide a means of promoting greater interoperability between NATO forces.

There has, however, been some criticism of the Department of Defense for sending what some in the industry feel are mixed signals on policy towards globalisation. Thus, in July 1999, Jacques Gansler stated that the Department of Defense was open to the prospect of a European defence company merging with or purchasing all or part of some of the leading US defence companies. Gansler indicated that second tier companies such as Northrop Grumman, TRW and General Dynamics could become targets for teaming, joint ventures and mergers.⁴⁰ However, comments by John Hamre in October 1999 seemed to signal a change in attitude. Hamre argued that it was premature to expect any large transatlantic mergers soon, and his message was said to be 'Cooperation now, possible consolidation later'. The proposed merger of Dasa and Aerospatiale Matra was felt to have erected a second pillar of a new 'Fortress Europe', making it unlikely that a US defence firm would merge or be taken over by a European company.

⁴⁰ Bryan Bender 'USA seeking solutions to globalisation trend', *Jane's Defence Weekly*, 31 March 1999, p. 20.

Instead, Hamre emphasised that joint ventures, partnerships and other alliances would be the way forward.⁴¹

Nevertheless, foreign participation in a nation's defence market remains an area of great political sensitivity and – even if senior policy-makers are increasingly supportive of the case for a transatlantic defence industry – it is unclear whether politicians, mid-level officials and the military will necessarily share this commitment. Thus, when BAE Systems announced its plan to acquire Lockheed Martin's aerospace electronics business it was seen by many commentators as a test of the preparedness of the US government to allow the globalisation of key parts of its defence industrial base. The acquisition meant that BAE Systems would own more than half of the advanced electronic warfare technology programmes in the United States and the prospect of significant foreign participation in such a key sector prompted speculation that senior figures in the US military might oppose such a deal. In November 2000, the US government gave the go-ahead for the deal in what has been hailed as a landmark for transatlantic industrial cooperation. Nevertheless, it was reported that the decision was made against a background of State Department concerns about the security implications of allowing a European company into the inner circle of advanced US military electronics technology.⁴² In Europe, Germany applied intense political pressure on the Spanish government in a bid to prevent the planned sale of Empresa Santa Barbara de Industrias Militares (ENSB), the Spanish combat vehicle and munitions manufacturer, to General Dynamics of the United States.⁴³ The German government cited intellectual property concerns as the reason for its opposition but it seems clear that broader political issues about Germany's role in the consolidation of the European armoured vehicle industry were at the heart of the dispute. The example shows – once again – that governments are more than willing to raise political objections when cross-border deals do not favour their own national companies.

⁴¹ See Thomas E. Ricks and Anne Marie Squeo, *op. cit.* in note 30.

⁴² Anthony L. Velocci and Philip J. Klass, 'BAE Systems bid unsettling to many', *Aviation Week & Space Technology*, 29 May 2000, pp. 37-8; 'BAE Systems opens door for European defence companies in US', *Defence Systems Daily*, 27 November 2000, <http://www.defence-data.com>.

⁴³ Ralph Atkins and Alexander Nicoll, 'Spain "must halt sale of arms maker to US"', *Financial Times*, 7 July 2000, p. 8.

Regulatory framework

Equally, the regulatory framework that governments put in place to govern foreign ownership, technology transfer, arms exports and so forth will heavily influence the strategic options chosen by companies. Certainly, European companies have long cited US controls on firms under foreign ownership, control and influence as a barrier to effective transatlantic operations.⁴⁴ Even BAE Systems, although a major player on the American market, has indicated for some time that a merger with a US prime contractor is probably out of the question, given the regulatory barriers to such a move that currently exist. The company argues that a framework has to be created enabling US and UK companies to handle sensitive technologies in each other's countries.⁴⁵ Thus, the issue has been the subject of intense lobbying both by US and European companies and the US Aerospace Industries Association, and a series of reform proposals have emerged from the US Department of Defense and State Department. The US-UK 'Declaration of Principles' signed in February 2000 provides a bilateral model for the management of transatlantic relationships covering the harmonisation of military requirements, export procedures, information and technology-related security, as well as joint research programmes.⁴⁶ The US Defence Trade Security Initiative announced in May 2000 represents a potentially significant change in US rules on export controls. The Initiative promises to streamline the licence approval process and provide licensing exemptions for unclassified items for qualified firms provided that there is an agreement between the United States and that country. In a separate but related move, security restrictions imposed on Rolls-Royce in its dealings with its Allison subsidiary have been altered eliminating the Proxy company that operated within Rolls-Royce's US subsidiary and incorporating all Allison's activities under a single Special Security Agreement. This eliminated the bizarre situation where security restrictions had meant that engineers in one part of Allison were unable to talk to colleagues in another part on the same site without receiving clearance from the Department of Defense.

⁴⁴ See Richard A. Bitzinger, *op. cit.* in note 4.

⁴⁵ See Alexander Nicoll, 'The coming battle to survive and dominate in the defence industry', *Financial Times*, 30 November 1999, p. 30.

⁴⁶ In July 2000, a Statement of Principles was signed between the US and the Australian defence ministry.

Opportunities

Inevitably, the opportunities that are open to companies will also be a critical factor in shaping transatlantic relationships. The on-going process of post-merger portfolio shaping by companies in both the United States and Europe, as well as consolidation amongst lower-tier US defence companies, present opportunities for transatlantic acquisitions. In the United States, Lockheed Martin and Raytheon in particular have shifted their emphasis from merger-driven consolidation to divestment-driven reshaping of their portfolios, and Lockheed Martin's disposal of its Control Systems and aerospace electronic systems businesses provided BAE Systems with the opportunity to strengthen its position in the United States. On a smaller scale, Raytheon's sonobuoy business was sold to the UK company Ultra Electronics. Similarly, in Europe, portfolio shaping by the Swedish company Saab following its merger with Celsius led to the sale of the Swedish company's Bofors Weapons Systems business to United Defense of the United States.⁴⁷

However, whilst portfolio reshaping may provide opportunities to enter new markets and existing programmes, the limited number of new programme opportunities in the foreseeable future may well act as a constraint on the pace of transatlantic developments. New programmes can act as the focus for transatlantic team building yet – in Europe – the A400M and the *Meteor* missile are the only two major new aerospace programmes for the foreseeable future. In the United States, the emerging KC-X requirement for a replacement for the KC-135 tanker aircraft may provide opportunities for transatlantic teaming, as could the potential US requirements for a new naval air defence missile and a new shipboard radar system.⁴⁸ At the same time, opportunities for cooperation are not necessarily confined to the transatlantic market. Thus, BAE Systems and Boeing teamed to acquire a minority stake in Korean Aerospace Industries and there may be emerging opportunities for further such deals in Asia.⁴⁹ Similarly, partnerships may

⁴⁷ Christopher Brown-Humes 'United Defense set to buy Bofors of Sweden', *Financial Times*, 16 June 2000, p. 30.

⁴⁸ Robert Holzer, 'Standard missile pact could shape pattern for naval cooperation', *Defense News*, 15 May 2000, pp. 1-20; Robert Holzer, 'US Navy seeks foreign aid for new radars', *Defense News*, 22 May 2000, p. 4.

⁴⁹ On Korean Aerospace Industries see, John D. Morrocco, 'Boeing looks to boost global presence', *Aviation Week & Space Technology*, 3 April 2000, p. 37. On the

give access to third countries and – in this respect – Boeing has seen BAE Systems as a strong potential partner, not least because of its access to Saudi Arabia.⁵⁰ Nevertheless, identifying mutually beneficial business opportunities presents some challenges. Even in US companies where senior company executives continue to make positive statements about transatlantic mergers, there is a strong feeling amongst some programme managers that the companies may derive little benefit from giving European companies access to the US market.⁵¹ Equally, the margin that is acceptable to gain access to these markets as well as the technological capabilities that a firm may wish to share are also issues of concern.

Post-merger integration challenges

Equally, strategic options in some companies may be constrained by the post-merger organisational challenges that they face. Thus, during 1999 and 2000, management attention in Raytheon and Lockheed Martin was – by necessity – focused on post-merger rationalisation and portfolio shaping as they struggled to restore investor confidence, improve post-merger management and reduce their debt levels. Similarly, BAE Systems and EADS both face their own post-merger integration challenges.⁵² Clearly, the companies will not allow such issues to stop them exploring transatlantic links but they may well constrain the strategic options open to them – especially those that would have significant financial implications. Indeed, companies on both sides of the Atlantic would do well to learn the lessons of the US consolidation experience, where the leading companies are generally regarded as having over-extended themselves both financially and managerially – with damaging consequences.⁵³

restructuring of the aerospace industry in Asia see, Philip Finnegan, 'Aerospace merger trend takes hold in Asia', *Defense News*, 28 February 2000, pp. 1-60.

⁵⁰ See Andrew D. James, op. cit. in note 35.

⁵¹ Author's interviews with programme managers from Boeing and Lockheed Martin.

⁵² See Pierre Sparaco, 'EADS foresees cultural hurdles', *Aviation Week & Space Technology*, 21 February 2000, pp. 42-3.

⁵³ See Andrew D. James, op. cit. in note 23.

Financial considerations and shareholder value

Indeed, the faltering financial performance of the leading US defence contractors has been a major constraint on them as they have considered their strategic options. Low stock prices and high debt levels have made acquisitions and other equity arrangements difficult. Thus, Raytheon's plans to acquire the defence electronics business of the United Kingdom's Racal came to a stop in large part because of Raytheon's financial and management problems, and this ultimately opened the way for Racal's acquisition by Thomson-CSF (now Thales). Indeed, the financial situation of the leading European companies is generally healthier than that of US companies, not least because most large European deals have been done by swapping assets through stock and a limited amount of cash. In contrast, US consolidation has been based principally on debt through all-cash transactions and consequently the repeat acquirers have dramatically increased their debt-to-capital ratios and damaged their credit ratings.⁵⁴

Accordingly, their recent poor financial performance means that shareholder value is now a predominant theme in the US defence industry. Investor confidence in the leading US defence companies has been shaken as a result of their recent poor performance, and any transatlantic moves by the leading companies are likely to be carefully scrutinised for their implications for return on capital, cash-flow, debt levels and so forth.⁵⁵ Certainly, there is a feeling that, in the current environment, it remains difficult for US companies to create a strong commercial case for transatlantic acquisitions. Many leading Wall Street financial analysts hold a negative view on the matter and one industry survey in 1999 found that many analysts believed that European mergers would dilute earnings because of the limited scope they offered for cost savings.⁵⁶ In Europe, this raises interesting questions. Certainly, the distributed ownership base of BAE Systems means that, like its US counterparts, it has been keen to emphasise its concerns about shareholder value. However, other European firms – not least EADS – are

⁵⁴ Kevin Done 'European aerospace profits booming', *Financial Times*, 6 July 2000, p. 13.

⁵⁵ See Andrew D. James, op. cit. in note 23. These constraints hold particularly for Lockheed Martin and Raytheon. Other companies – such as General Dynamics – are viewed in a more positive light by Wall Street investment analysts.

⁵⁶ *Industry Outlook – GEIA Ten Year Forecast*, Government Electronics & Information Technology Association, Arlington, VA, 1999.

seeking to reconcile more complex shareholding structures, and it remains to be seen what this means for their investment priorities and strategy. There is little doubt that EADS will come under increasing pressure to demonstrate that it recognises the importance of shareholder value, particularly after its relatively poor showing in its Initial Public Offering.⁵⁷ The impact that such factors will have on the strategy of European companies is an interesting and important question as they evaluate the commercial case for greater transatlantic ties.

III.4 The emerging transatlantic industrial landscape

US and European companies are in the process of formulating strategies that take into account these various political, regulatory and commercial influences in this new environment. Developments during 1999 and the first half of 2000 established the elements of a new transatlantic industrial landscape, although the situation is dynamic and the landscape is likely to see further change in the near future.

Emerging strategies

BAE Systems has already forged ahead to create a truly transatlantic business strategy. British Aerospace's acquisition of GEC's Marconi Electronic Systems provided the company with a bridgehead into the US market, not least because it brought with it GEC's recently acquired Tracor business. The newly created BAE Systems built on this US presence when it announced its \$510 million acquisition of Lockheed Martin's Control Systems business in May 2000, and followed that in July 2000 with the \$1.67 billion acquisition of Lockheed Martin's aerospace electronics business.⁵⁸ The latter acquisition was significant not only because it included

⁵⁷ Kevin Done, 'Share price in EADS float well below hopes', *Financial Times*, 10 July 2000, p. 21; Alexander Nicoll, 'EADS market debut fails to take-off', *Financial Times*, 11 July 2000, p. 34.

⁵⁸ Alexander Nicoll, 'GEC in \$1.4bn takeover of US defence group Tracor', *Financial Times*, 22 April 2000, p. 1; John D. Morrocco, 'BAE Systems boosting North American clout', *Aviation Week & Space Technology*, 1 May 2000, p. 31; Andrew Edgecliffe-Johnson and Christopher Parkes, 'BAe in \$1.6bn US purchase', *Financial Times*, 14 July 2000.

within it Lockheed Martin Sanders – the leading company in the electronic warfare market – but it also meant that BAE Systems replaced Lockheed Martin as the largest defence company in the world.⁵⁹

EADS has also expressed its intention to develop a transatlantic dimension to its strategy and entered the competition to acquire Lockheed Martin's aerospace electronics business teamed with the US defence electronics company L-3 Communications. EADS has signed an MoU with Northrop Grumman under which the two companies are exploring opportunities in ground surveillance and a number of other areas of defence electronics, such as aerial targets and decoys, airborne electronic attack and fire control radar. The first product of this relationship was an agreement to offer a 'European version' of a weather and navigation radar, developed by Northrop Grumman, for the Airbus A400M military transport aircraft.⁶⁰ The company's French Chief Executive Officer, Philippe Camus, recently confirmed that EADS plans to strengthen its defence activities (in order to reduce its dependence on Airbus) through acquisitions in the United States. On the other hand he excluded a merger with Northrop Grumman, pointing out that a transaction of this size would not be realistic for the time being.⁶¹

Thales is also seeking to expand its US presence. Despite its ties with Raytheon, Thales has always been rebuffed in its efforts to penetrate the US market due to the Pentagon's long-standing suspicion of French intentions. The company's acquisition in 2000 of the UK defence electronics company Racal may alter Thales's position in the United States. One of Racal's most attractive features to Thales was its established position in the US defence market, where it ranked as a leading supplier of radio systems and data recorders to the US armed forces. The acquisition allows Thales to absorb Racal's proxy structure in the United States and – combined with the fact that Thales was granted a Secret level Special Security Agreement in 1999 for its Texas-based Training and Simulation business – the French company now has a security structure under which it can build a larger US presence. Indeed, Thales has already shown its intent to establish closer ties with US companies by winning two major contracts from Lockheed Martin. The first is to supply electronic warfare equipment for Turkish F-16 fighter aircraft

⁵⁹ Kevin Done, 'BAe set to top the defence league', *Financial Times*, 15/16 July 2000, p. 14.

⁶⁰ John D. Morrocco, op. cit. in note 18.

⁶¹ Interview in *Frankfurter Allgemeine Zeitung*, 2 December 2000, p. 17.

and the second is to supply radio and communications systems for F-16s being sold to the United Arab Emirates. Thales hopes that such contracts will open the door for participation in the JSF programme, most probably through its Dutch or UK subsidiaries Signaal and Racal.⁶²

In contrast, US companies have moved cautiously, preferring to await the outcome of European consolidation before entering into new relationships. Northrop Grumman has been one of the most visibly active companies, with its MoU with EADS. Raytheon has a long-standing relationship with Thales and, as mentioned earlier, explored the acquisition of Racal before withdrawing because of its financial problems. Lockheed Martin has long been engaged in discussions with Aerospatiale-Matra. Similarly, Boeing is seeking to establish a presence in Europe and Asia, and is evaluating joint venture and acquisition opportunities in key markets.⁶³ Indeed, the company's strong balance sheet and healthy cash flow means that it may have more strategic options open to it than Raytheon or Lockheed Martin. At the same time, many US companies see Boeing's participation in the *Meteor* consortium as a model for collaboration at the programme level.

Teaming arrangements

Companies are using a variety of strategies to develop these transatlantic relationships, from programme-specific teaming to strategic alliances and – in some cases – acquisitions. Boeing's entry onto the European *Meteor* team may well open up a range of new possibilities for both Boeing and its European partners. For the Europeans, Boeing's participation offers the possibility that the missile could be fitted to Boeing's F/A-18 and F-15 aircraft as part of their upgrades. For Boeing, it offers an opportunity to strengthen its presence in a sector where it is currently relatively weak with the possibility that *Meteor* could offer an alternative to Raytheon in arming the Joint Strike Fighter.⁶⁴ Similarly, Raytheon's successful bid strategy for the UK Airborne Stand-off Radar (ASTOR) programme provides another

⁶² Jean-Pierre Neu, 'Thomson-CSF monte en puissance sur le F16', *Les Echos*, 29/30 Septembre 2000.

⁶³ See John D. Morrocco, 'Boeing looks to boost global presence', *Aviation Week & Space Technology*, 3 April 2000.

⁶⁴ See John D. Morrocco, 'Looming missile decision to shape transatlantic ties', *Aviation Week & Space Technology*, 7 February 2000.

illustration of the potential of teaming. Thus, Raytheon's bid team for the £750 million programme included GEC Marconi, Bombardier Short Brothers and Ultra Electronics.

Evolution in business relationships

At the same time, there appears to be some evidence of a deepening of established business relationships and an evolution of such relationships from ad hoc teaming arrangements towards – in some instances – more formal alliances.

The deepening relationship between Raytheon and Thales is an example of how companies may build on their existing relationships. Thales (Thomson-CSF)'s relationship with Raytheon goes back a number of years, and the companies collaborate as joint developers, integrators and suppliers to each other on 17 industrial programmes.⁶⁵ A Raytheon-Thales consortium is installing a new air defence system for Switzerland and a Raytheon-Thales joint venture – Air Command Systems International – was awarded the NATO air command and control contract. Raytheon is also part of Thales's team bidding to supply new aircraft carriers to the United Kingdom. Speculation about a deepening of the relationship between the two companies grew during 1999 and the first half of 2000. In February 2000, Chairman and Chief Executive Denis Ranque said that the two companies were working, in consultation with their respective governments, to develop a deeper relationship but it needed an evolution in political thinking for it to succeed.⁶⁶ In June 2000, the two companies were reported to be seeking a joint venture in ground-based radar and air defence command and control systems.⁶⁷ In December 2000, the many months of speculation were ended when Raytheon and Thales announced an agreement to form an equally owned joint venture encompassing their businesses in air defence/command and control centres and ground-based air surveillance and weapons-locating radars. The planned enterprise will have 1,300 employees and pro forma

⁶⁵ Brooks Tigner, 'Raytheon and Thomson-CSF plan joint venture in radar', *Defense News*, 3 July 2000, pp. 1-18.

⁶⁶ Christophe Jakubyszyn and Anne-Marie Rocco, 'Thomson-CSF travaille a un rapprochement avec l'americain Raytheon', *Le Monde*, 3 February 2000.

⁶⁷ Alexander Nicoll, 'Thomson and Raytheon discuss link', *Financial Times*, 29 June 2000, p. 1; Brooks Tigner op. cit. in note 65.

revenues of \$500-700 million.⁶⁸ Certainly, the Raytheon-Thales case illustrates the opportunities for established transatlantic relationships to evolve into deeper strategic alliances in areas of mutual business interest.

Boeing and BAE Systems also appear to be building on their established relationship. The two companies have long-standing relationships through the AV-8B and T-45 aircraft programmes in the United States as well as the UK *Nimrod* maritime reconnaissance aircraft upgrade programme. The two companies appear to be deepening these established relationships through a number of formal and informal alliances across a range of activities. Thus, Boeing has entered the *Meteor* BVRAAM (Beyond Visual Range Air-to-Air Missile) team that is led by Matra BAe Dynamics, and BAE Systems is said to have lobbied the UK Ministry of Defence on Boeing's behalf to secure the lease of Boeing C-17 transport aircraft for the RAF. Also, the two companies have jointly acquired a minority stake in Korea Aerospace Industries.

EADS has also sought to build on links previously established by its heritage companies. On the one hand, Dasa's relationship with Northrop Grumman was a key factor in the signing of the EADS-Northrop Grumman MoU. On the other, EADS appears to be building on Aerospatiale-Matra's links with Lockheed Martin. Thus, for a number of years the two companies have been looking at the opportunities for collaboration on mission aircraft. Aerospatiale and Lockheed Martin have been exploring links for some time, not least in the area of the proposed Multi-Role Tanker/Transport derivative of the Airbus A310 commercial transport as a potential bid for the KC-X. In 1999, the companies joined forces in 1999 to bid for a British requirement for tanker aircraft.⁶⁹

⁶⁸ Jean-Pierre Neu, 'Thales et Raytheon ouvrent le bal des alliances transatlantiques', *Les Echos*, 18 décembre 2000.

⁶⁹ Pierre Sparaco and John D. Morrocco, 'Aerospatiale to explore Lockheed Martin link', *Aviation Week & Space Technology*, 20 January 1997, p. 26; John D. Morrocco, 'Lockheed Martin talks with Airbus partners', *Aviation Week & Space Technology*, 5 May 1997, pp. 20-1; Pierre Sparaco, 'US, Europe explore transatlantic partnerships', *Aviation Week & Space Technology*, 13 September 1999, pp. 37-8.

Acquisitions

However, BAE Systems has been the only one of the leading companies to pursue the acquisition route with the other transatlantic acquisitions involving smaller prime contractors or first-tier suppliers. Nevertheless, the number of transatlantic acquisitions appears to have gathered pace in recent years (see Table 2 at the end of this chapter). Thus, UK companies such as Smiths Industries and Ultra Electronics have made a series of acquisitions that have given them an established position in the US market. At the same time, the acquisition of LucasVarity by TRW – although driven primarily by the demands of the companies' automotive businesses – has created a significant transatlantic aerospace and defence supplier. The acquisition of LucasVarity has provided TRW with a significant presence in Europe through Lucas Aerospace, and this is seen by TRW as a platform for expansion in the European defence and aerospace market. TRW has already shown its intent through its 1999 acquisition of French flight systems company SAAM, and TRW is looking at the opportunities to transfer its Unmanned Aerial Vehicle technology from the United States to meet future UK requirements. At the same time, TRW is teaming with BAE Systems on a contract proposal on the digitisation of the battlefield for the UK Ministry of Defence.⁷⁰ Interestingly, these transatlantic deals have overwhelmingly involved the acquisition of businesses manufacturing subsystems and components, and these lower profile, less politically sensitive transatlantic deals have passed almost without comment. Significantly, the first half of 2000 saw the announcement of two acquisitions by US companies in Europe. Thus, United Defense announced its intention to acquire Bofors Weapons Systems from Saab-Celsius in a move that United Defense sees as a means of gaining a presence in the European market and a platform to build relationships with other European firms.⁷¹ Similarly, it was announced in April 2000 that General Dynamics was to acquire the armoured vehicle manufacturer Santa Barbara Blindados.⁷² The acquisition of Santa Barbara by General Dynamics is the only example of the acquisition of a platform

⁷⁰ Teresa Hitchens, 'TRW Aeronautical Systems strengthens with SAAM buy', *Defense News*, 28 June 1999, p. 22. For a case study of TRW see Andrew D. James, *op. cit.* in note 23.

⁷¹ Christopher Brown-Humes, *op. cit.* in note 47.

⁷² General Dynamics Corp. 'General Dynamics to buy Spain's ENSB, maker of combat vehicles and munitions', *News Release*, 13 April 2000, General Dynamics Corp., Falls Church, VA.

manufacturer, and it may not be a coincidence that – as was noted earlier – it has also stimulated the greatest political dispute.

III.5 Near- and mid-term prospects

Irrespective of these recent developments, however, there are good reasons to be cautious about the prospects for the future. Past experience suggests that the development of a transatlantic dimension to the defence industry is likely to be slow and there are likely to be plenty of political, regulatory and business challenges ahead.

Mega-mergers

Although a number of acquisitions have been completed, full mergers between the leading US and European prime contractors seem highly unlikely in current circumstances. Such deals would require enormous political commitment from governments on both sides and a step-change in attitudes towards national defence industrial capabilities and national security. Equally important, perhaps, the business risks and costs associated with any transatlantic mega-merger would most likely outweigh the potential commercial benefits. To make business sense any deal would need to provide real cost savings through operational synergies and much more than merely market access and political influence. Equally, it seems rather unrealistic to expect major transatlantic acquisition activity while other, less risky and lower commitment forms of US-European industrial relationships remain at a relatively early stage of development for many companies.⁷³ Instead, equity relationships amongst the largest companies are more likely to emerge slowly and then only after they have overcome numerous business and political hurdles. This is not to say that transatlantic acquisitions will not continue and perhaps increase in number. Certainly, small and medium-sized transatlantic acquisitions involving leading defence companies may well occur where they make business sense. Thus, we could see more deals such as those announced by BAE Systems in the United States and United Defense in Europe, and there is likely to be further acquisition activity amongst lower-tier suppliers.

⁷³ Robert P. Grant, op. cit. in note 8.

Growing cooperation

However, cooperation rather than merger will almost certainly remain the principal means by which the leading companies will seek to develop transatlantic relationships. Thus, we are likely to see more programme-specific teaming on new US, European and transatlantic programmes. At the same time, some companies may well identify opportunities in certain business areas to bring their activities together into informal alliances, more formal collaborative agreements or perhaps equity-based joint venture structures. In many respects, this scenario sees the extension of current trends and would seem to be the most practical route to building transatlantic relationships between prime contractors. In time, we may witness an evolution of these relationships and we will quite probably see those companies that have worked together on particular programmes considering the prospects for strategic alliances, and we may see established alliances evolving towards full mergers. This step-by-step approach represents a pragmatic response to the existing political, regulatory and business challenges and will allow the confidence building between governments and the growth of business experience in managing such relationships that are necessary to build a transatlantic defence industry.

III.6 Conclusions

Much of the debate about the prospects for a significant transatlantic dimension to defence industry consolidation has focused on the political and regulatory impediments to closer industrial linkages. These issues are very important but this chapter has also argued that the shape of any future transatlantic defence industry will ultimately be governed by the commercial decisions of the defence contractors themselves. Policy makers are already finding that defence contractors – now almost exclusively in the private sector – are more likely to be influenced in decisions on transatlantic linkages by stock market sentiment, balance sheet issues and business strategy than the concerns of their governments about interoperability and political relations within NATO. Certainly, there are signs that transatlantic industrial relationships are gathering pace but it is nevertheless significant that these new relationships are being led primarily by industry rather than government.

At the same time, whilst we may be seeing the first steps towards a significant transatlantic dimension to the defence industry, the path ahead is littered with potential political, regulatory and business barriers. Not least amongst these is the attitude of US policy-makers. Politically, the time will come – and probably not very far in the future – when the US government will be challenged to prove that it is serious about developing a true US-European two-way street in arms procurement. At the moment, most of the emerging alliances and teaming arrangements appear to be focused on European programmes, and access to the US market has effectively been denied to all except UK-owned companies. The French and German industries are justified in asking when they might gain similar access. For instance, might the United States be willing to purchase a future tanker aircraft for the US Air Force from a Lockheed Martin-EADS team offering an Airbus airframe manufactured under licence in the United States by Lockheed Martin? Might the United States be willing to purchase the *Meteor* BVRAAM to generate competition with Raytheon? Would the US government accept the acquisition of a US company by EADS or Thales? Transatlantic defence industry discussions are awash with rhetorical calls for market access and reciprocity. Of course, creating open defence markets based on procurement policies that curb protectionist instincts is easier said than done, and in practice concerns about national security and local jobs will always remain important. However, there are ways in which the US government could actively promote a two-way street in arms procurement. Thus, in procurement decisions, the Department of Defense could give priority to bidding teams or joint ventures that are substantially transatlantic in composition, in preference to US-only entrants. Such a move would have a dramatic impact on the climate for transatlantic industrial cooperation.

Another way would be to tackle the imbalance in the United States's treatment of its European allies in matters of regulation. The French and German governments – and their defence industries – are already asking when the new regulatory frameworks proposed by the US government will be expanded to incorporate them. The US Defense Trade Security Initiative needs to expand beyond being a US-UK agreement as quickly as practical to ensure that it is inclusive of the major European defence industries. In addition, the regulatory system must embrace a multilateral as well as bilateral dimension. Many of the key players in the European defence industry, such as EADS and Matra BAe Dynamics, are multinational in character and it is unclear whether the current US reforms can fully embrace

such organisational structures. These are important issues. They will test traditional political prejudices – not least the mutual suspicions that have dogged the US-French relationship. Equally, they will influence the opportunities open to EADS and Thales, and the character of their emerging transatlantic relationships. There is no way that either the companies or their governments could – or should – tolerate the *de facto* regulatory advantage held by BAE Systems and other UK companies in the transatlantic defence industry.

Such issues remain to be resolved, but the first moves have already been made towards a significant transatlantic dimension to defence industry restructuring. What will be the next step? There is little doubt that current political, regulatory and business conditions mean that talk of mega-mergers amongst the leading players appears wildly unrealistic – at least for the foreseeable future. Instead, it seems that the creation of closer industrial relationships will continue to be a cautious process that will have to remain sensitive to the business and political realities of the transatlantic environment if it is to be successful. In this way – little by little – a transatlantic defence industry will emerge.

Table 1 Examples of current transatlantic defence industrial relationships

Type	Example	Participants
Licensing	<i>Patriot</i> PAC-3 upgrade for German army	Lockheed Martin (US) EADS (France/Germany/Spain)
Co-production	Rolling Airframe Missile	Raytheon (US) BGT (Germany)
Co-development	Joint Strike Fighter	Full development partners: United Kingdom, United States Associated partners: Denmark, the Netherlands, Norway Informal partners: Canada, Italy Major participants: Israel, Turkey, Singapore
Teaming	<i>Meteor</i>	Matra BAe Dynamics (France/UK) Alenia Marconi Systems (Italy) EADS (France/Germany/Spain) Saab Dynamics (Sweden) Boeing (US)
Strategic alliance	Alliance for medium calibre ammunition	Primex Technologies Inc. (US) NAMMO, AS (Norway)
Joint venture	Lockheed Martin Alenia Tactical Transport Systems	Lockheed Martin (US) Alenia Aerospazio (Italy)
Acquisition	Lockheed Martin aerospace electronics business	BAE Systems (UK) Lockheed Martin (US)
Supply chain	Saab JAS-39 <i>Gripen</i>	General Electric-Volvo Aero (US/Sweden) Honeywell (US) Lockheed Martin (US) Sundstrand (US)

Table 2 Examples of transatlantic mergers and acquisitions 1998-2000

Year	Acquired company	Acquirer	Sector	Price paid
1998	Tracor (US)	GEC (UK)	Electronics	\$1.4bn
1999	LucasVarity (US/UK)	TRW (US)	Electronics	\$7bn
2000 (April)	Santa Barbara (Spain)	General Dynamics (US)	Combat vehicles	\$0.05bn
2000 (May)	Lockheed Martin Control Systems (US)	BAE Systems (UK)	Electronics	\$0.51bn
2000 (June)	Bofors Weapons Systems (Sweden)	United Defense (US)	Ordnance and precision weapons	Not disclosed
2000 (July)	Lockheed Martin aerospace electronics business (US)	BAE Systems (UK)	Electronics	\$1.67bn

Conclusion

Burkard Schmitt

Despite more than 50 years of military cooperation within NATO, armaments has always been a difficult domain for transatlantic relations. The importance of cooperation in this field is widely recognised but important obstacles remain.

One of the major problems that prevent a true Euro-American partnership is the strong imbalance between a powerful and very real 'fortress America' and a large number of small national 'fortresses', which are themselves rivals, in Europe. The situation is therefore very different on the two sides. The paradox is that it is the United States that suspects that a 'fortress Europe' will be created once the Europeans decide to improve cooperation among themselves. For a transatlantic market to become more likely, it will be important to guard against Europe turning into an impregnable bastion as far as armaments are concerned – but it will be just as important to level American fortifications.

In the United States, the obstacles to cooperation are all the more difficult to surmount as they are rooted in a very widespread culture of insularity that pays little attention to the concerns of allies. The strengthening of transatlantic cooperation thus depends on an awareness in Washington that there is a real need for change. Even if recent initiatives might be considered the beginning of such an evolution, persuading the American political class of the virtues of cooperation will be a long-term affair that must involve all the parties concerned on both sides of the Atlantic, in particular US Congressmen.

As Gordon Adams emphasises, there is a real desire in the Pentagon to facilitate transatlantic cooperation, while there is still reluctance in the State Department and the Congress. Given this political resistance, there is a danger that the Defense Trade Security Initiative will be watered down when it comes to implementing it. In addition, the 'declaration of principles' is merely a declaration of intent, and in Europe only concerns the United Kingdom. Equally, restrictions concerning investment remain in place. The

reforms envisaged are thus potentially important but hardly sufficient. Moreover, it remains to be seen whether all European countries will benefit to the same extent, or whether application of the new regulatory arrangements will once again favour British companies. It will be essential to abandon the traditional discrimination against continental European countries so that transatlantic cooperation does not in practice boil down simply to a special relationship between the United States and the United Kingdom.

As in other spheres, the future of transatlantic relations on armaments will depend on two key questions: is the United States ready to treat the Europeans as partners on an equal footing, and will the Europeans manage to devote the means necessary to becoming equal partners?

Among the high-technology industries, the conditions necessary for a balanced relationship between the two shores of the Atlantic now exist: following the creation of BAE Systems and EADS, as well as consolidation in some specific sectors, Europe has groups of a size and technological breadth to allow them to play in the same division as the American giants.

If the new European champions have a handicap *vis-à-vis* their American competitors, it is to be found in Europe's political weakness. The problem is not simply one of budgets: having different perceptions, concepts and objectives, it is only natural that the Europeans spend less than the United States on defence, and that their priorities are not the same. Even the imbalance, in many national budgets in Europe, between personnel and equipment can be redressed once professionalisation and restructuring of armed forces has been accomplished. The real problem (and, from the taxpayer's viewpoint, the real scandal) is the persistence of duplication in Europe and the resulting waste of resources. This phenomenon does not concern only industrial capacity or equipment but also procurement agencies and defence-related regulations. Given the general shortage of public finances, and reduced defence budgets in particular, the absence of a common procurement system and a homogeneous defence economic space is a luxury that defies political and economic logic.

Will the Europeans succeed in creating a common armaments market and policy? Will this be constructed as an integral part of the European Union? If so, will all members of the Union participate, or will it take the form of

enhanced cooperation? If not, will it be organised outside the TEU, or will there be a mixed collection of organisations formed within different frameworks?

The answers to these questions will largely determine the future of European defence but also the future of transatlantic cooperation. It is hard to see how the Europeans could become true partners of the United States if they do not first improve cooperation among themselves. To achieve that, it will be important to:

- maintain the impetus of the CESDP and use it as a catalyst for armaments cooperation;
- coordinate the various initiatives on armaments (LoI, OCCAR, etc.) better, complement them and gradually integrate them into a common framework;
- find the means necessary to guarantee the funding of current projects and finance new R&D/T programmes.

Developing European policy along these lines will not (necessarily) result in the creation of a 'fortress'. Strengthening military capabilities in the framework of the CESDP, for example, will underpin cooperation on armaments in that it will make standardisation and interoperability even more urgent. In today's circumstances, however, it is probable that standardisation will remain in the first instance an exclusively European matter, and that NATO will restrict itself to the question of interoperability between American and European forces. The United States and Europe in fact have strategic interests and politico-military cultures that are too divergent to lead to more extensive harmonisation of their needs. If this hypothesis turns out to be correct, the DCI and the Headline Goal will strengthen transatlantic cooperation, particularly in the field of C3. The positive effects could therefore be limited to a specific part of the armaments market, but one that will become more important in financial and technological terms.

If implementation of the Headline Goal results in better harmonisation of European requirements, cooperation on R&D will also gain from it. The challenge is neither to spend as much as the United States nor (necessarily) to invest in the same areas, but to obtain better cost-effectiveness at the European level. To do that it will be necessary both to restructure national

defence budgets (in order to increase the proportion devoted to investment without raising overall expenditure) and reorganise cooperative structures (to avoid duplication and coordinate national efforts). Improved European R&D performance would make it possible to release extra resources for new investment, which in turn would support transatlantic cooperation: with new research programmes, the possibilities for joint projects would multiply and European industries would become more attractive partners.

It is very probable that intensified cooperation in the fields of defence and armaments will also influence the Europeans' procurement policy. In this respect the American fear that a 'fortress' could appear is not altogether unfounded, but greatly exaggerated. A certain European preference could in time replace today's national preferences, for two reasons:

- industrial integration within the LoI area de facto creates a European market of the main armaments-producing countries, and opening it to American competition will depend on the political willingness of the countries concerned to maintain their own industrial and technological capacity. In areas where that is the case, the main producing countries will certainly apply European preference;
- for the other countries the prospects are less clear: they too could in time move towards a more European procurement policy to the extent that implementation of the Headline Goal encourages standardisation of European equipment. Active participation in the CESDP and the institutions of a future European armaments policy would also encourage non-producing countries to lean in the direction of European preference. An increasing number of links between local companies and the major European groups could be a third factor affecting the procurement policy of the governments concerned.

The consequences of such preference should nevertheless be put into perspective. Firstly, it seems logical in that the factors determining armaments procurement are never purely financial but also political, strategic, economic and technological. Next, European preference would correspond to the United States's strategy, which will certainly continue to give preference to its own industry. Last but not least, preference for one does not necessarily mean the systematic exclusion of the other:

- for non-producing countries, it is unlikely that choosing a more European procurement policy would mean totally closing their defence market to American suppliers. Maintaining industrial competition and American security guarantees are for these countries good reasons not to adopt an exclusive policy of European preference;
- for armaments-producing countries, such a choice does not in any way exclude the partial opening of markets: there remain transatlantic programmes, and off-the-shelf purchases in areas where Europe chooses not to acquire a capacity of its own, but also the participation of American companies in European programmes. At subsystem and component level, the importance of American companies to programmes with European prime contractorship will doubtless continue to increase. Even at system manufacturer level, there is nothing to prevent European governments from encouraging transatlantic alliances when they call for tenders, and European companies to join them – provided that industrial agreements are balanced.

The question of European preference is all the more complex since the European market is still fragmented. The disadvantages of this are obvious: from the industrial point of view, it makes the internal functioning of transnational companies extremely complicated and obliges them to go through complex cooperative arrangements in order to arrive at a sufficient volume of orders. From the political point of view, it creates costly duplication and weakens governments' positions as customers *vis-à-vis* the new transeuropean champions. Yet the idea of a common, even single, defence market in Europe is still Utopian. For the foreseeable future it seems more realistic to strive for an increasing number of joint programmes, better coordination among armaments-producing countries and partial repeal of Article 296 for non-sensitive military goods. It would, in this context, be essential – particularly for the functioning of transnational companies – to establish a regime concerning the free movement of defence goods. In this respect, the LoI agreement provides for a first mechanism for armaments-producing countries but Community regulation along the lines of the regime for dual-use technologies would no doubt be preferable.¹

¹ Dual-use goods may move freely within the Union, because all member states recognise each others' authorisation for exports to third countries.

Neither a certain degree of European preference nor an intra-Community free movement regime would prevent the gradual rapprochement of industries across the Atlantic described by Andrew James. Indeed the aerospace and electronics groups are the most interested in the transatlantic dimension. For them, and in particular the European companies, access to new markets and the search for more economic solutions are very important reasons to demand an overhaul of the present regime. At the same time, the possibilities – and importance – of intergovernmental programmes are limited by divergences of interest and politico-military concepts. That being the case, the most essential thing in the field of armaments is not to launch new joint programmes but to reform regulatory frameworks and procurement policies so that companies can act on both sides of the Atlantic.

Until now, transatlantic discussions on the commercial aspects of armaments have taken place in strictly bilateral settings. From the European point of view, this approach seems particularly difficult – and anachronistic – since most leading-edge industrial capacity in Europe is already organised within transnational entities. Even if bilateral negotiations are successful, the result will be a collection of separate agreements, which is likely to perpetuate discrimination (and therefore tensions) between the ‘good’ and ‘bad’ transatlantic allies, and can only complicate attempts to harmonise regulations in Europe.

In this context, the United Kingdom finds itself in a key position: on the one hand, it is one of the major armaments-producing countries in Europe and is deeply involved in the LoI process; on the other, it has a privileged relationship with the United States and is particularly well placed to satisfy American conditions for greater cooperation. British industry is also stretched between participation in important European joint ventures and greater presence on the American market. If Washington proposes an arrangement to London exclusively, that will be likely to disrupt attempts to consolidate industrial and political links in Europe. British policy will therefore be a determining factor in the future development of Euro-American armaments cooperation.

Whether it is a question of military equipment planning, harmonisation of requirements, R&D cooperation or regulatory issues, the absence of a common policy weakens the Europeans’ position *and* makes Euro-American cooperation difficult. And yet, as Christophe Cornu underlines, a

European armaments policy is still a long way off. European countries still diverge on questions as fundamental as the strategic importance of the defence-related industry, export policy or the attitude to adopt towards the United States. The record of bodies concerned with cooperation is also mixed: the traditional actors like WEAG are moribund, OCCAR remains for the moment only a concept and the success of the LoI will depend on the speed and seriousness with which it is enforced, including in associated areas such as R&D and the harmonisation of requirements.

None the less, armaments is too important an element of defence policy not to be included in the CESDP. Ultimately, it will probably be necessary to go even beyond the purely intergovernmental approach that today characterises European armaments and defence cooperation. At least for certain economic, regulatory and technological aspects, it would doubtless be more rational and efficient to involve the European Commission. The wholesale *communautarisation* of armaments being excluded, it is necessary to consider imaginative arrangements that ensure efficiency, flexibility and coherence.

Since the creation of a European armaments policy in no way rules out improved interoperability within NATO or the strengthening of transatlantic industrial links, American concerns over a 'Fortress Europe' are unfounded. The European objective is not a fight between 'fortresses' but a balanced partnership. But it takes two to tango.

About the authors

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Burkard Schmitt is currently a research fellow at the Institute for Security Studies of WEU. He was formerly an independent researcher and journalist, writing in particular on the Franco-German relationship, the French Fifth Republic and nuclear deterrence. He is the author of the book *Frankreich und die Nukleardebatte der Atlantischen Allianz 1956-1966*. At the Institute for Security Studies he covers nuclear issues, defence industry and armaments cooperation, organising a defence industries task force.

Abbreviations

AECA	Arms Export Control Act
AECMA	European Association of Aerospace Industries (French abbreviation normally used)
AMRAAM	Advanced Medium-Range Air-to-Air Missile
APGM	Autonomous Precision-Guided Munitions
ASTOR	Airborne Stand-Off Radar
AWACS	Airborne Early Warning and Control System
BVRAAM	Beyond Visual Range Air-to-Air Missile
C3	Command, Control and Communications
C4ISR	Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance
CCT	Common Customs Tariff
CESDP	Common European Security and Defence Policy
CFIUS	Committee on Foreign Investment in the United States
CFSP	Common Foreign and Security Policy
CNAD	Conference of National Armaments Directors
COARM	Working Group on Exports of Conventional Arms
COCOM	Coordinating Committee for Multilateral Export Controls
CPD	Coherent Policy Document
DCI	Defence Capabilities Initiative
DITB	Defence Industrial and Technological Base
DoD	Department of Defense
DTSI	Defense Trade Security Initiative
EAA	European Armaments Agency, Export Administration Act
EADC	European Aerospace and Defence Company
EADS	European Aeronautic, Defense and Space Company
EDIG	European Defence Industries Group
EU	European Union
EUROLONGTERM	a study group on long-term military planning and armed forces' operational requirements
FINABEL	a European arms cooperation and coordination group
FLA	Future Large Aircraft
IEEPA	International Emergency Economic Powers Act
IEPG	Independent European Programme Group
IPO	Initial Public Offer(ing)
ITAR	International Traffic in Arms Regulations
JSF	Joint Strike Fighter
JSTARS	Joint Surveillance Target Attack and Radar System
LoI	Letter of Intent
MBT	Main Battle Tank
MEADS	Medium Extended Air Defence System
MIDS	Multifunction Information Distribution Systems
MoU	Memorandum of Understanding
MRAV	Multi-Role Armoured Vehicle

MSOW	Modular Stand-Off Weapon
NADC	NATO Air Defence Committee
NATO	North Atlantic Treaty Organisation
NC3O	NATO Consultation, Command and Control Organisation
NCAC	NATO Committee for Armaments Cooperation
NIAG	NATO Industrial Advisory Group
OCCAR	Organisation for Joint Armaments Cooperation (French abbreviation normally used)
ODTC	Office of Defense Trade Controls
PAAMS	Principal Anti-Air Missile System
POLARM	European armaments policy Council Working Group
QDR	Quadrennial Defense Review
R&D	Research and Development
R&T	Research and Technology
RMA	Revolution in Military Affairs
SNLC	Senior NATO Logisticians' Conference
SSA	Special Security Agreement/Arrangement
TEU	Treaty on European Union
UAV	Unmanned Aerial Vehicle
WEAG	Western European Armaments Group
WEAO	Western European Armaments Organisation
WEU	Western European Union

List of Annexes

- Annexe A US/UK Declaration of principles for defence equipment and industrial cooperation, 5 February 2000
- Annexe B FR/GE/UK joint statement on the restructuring of the European defence aerospace and electronics industry, 9 December 1997
- Annexe C FR/GE/IT/SP/UK joint draft statement on restructuring of the defence industry, 20 April 1998
- Annexe D Extracts from the FR/GE/IT/SP/SW/UK Letter of Intent concerning measures to facilitate the restructuring of European defence industry, 6 July 1998

ANNEXE A

DECLARATION OF PRINCIPLES FOR DEFENCE EQUIPMENT AND INDUSTRIAL COOPERATION

The Department of Defense of the United States of America
and

The Ministry of Defence of the United Kingdom of Great Britain and Northern Ireland
Declaration of Principles for Defense Equipment and Industrial Cooperation

The Governments of the United States of America and the United Kingdom of Great Britain and Northern Ireland have a longstanding cooperative relationship across a broad spectrum of defense activities, including strict enforcement of export policies for armaments and technologies; strong industrial security systems and compatible industrial security practices; close relationships in law enforcement and cooperation on industrial security matters and export control violations; and close relationships in intelligence sharing on matters of counterintelligence and industrial security, and countering economic espionage and export control violations. Moreover, the Department of Defense of the United States of America (U.S. DoD) and the Ministry of Defence of the United Kingdom of Great Britain and Northern Ireland (U.K. MOD) desire to maximize value for money in defense equipment acquisition, based on the principle of competition.

Our relationship is underpinned by the Memorandum of Understanding between the Department of Defense of the United States of America and the Secretary of State for Defence of the United Kingdom of Great Britain and Northern Ireland concerning Principles for Research, Development, Production and Procurement, dated December 13, 1994, and other bilateral arrangements and agreements.

Our past efforts to improve the level of defense equipment cooperation and trade have not realized their full potential. Nonetheless, we believe that it is fundamental to our common interests to enhance the environment for mutual defense equipment and industrial cooperation. We therefore intend to improve significantly the cooperative framework that will facilitate both traditional and new types of collaboration by our defense companies and a more integrated and stronger industrial base. It is also our intention to take the necessary steps to ensure that U.K. industry doing business in the United States will be treated no less favorably than U.S. industry doing business in the United Kingdom. We believe that this initiative will provide an important and welcome opportunity to enhance our mutual interdependence in the defense equipment field.

The U.S. DOD and U.K. MOD intend to apply the provisions of this Declaration and Annex to those matters within their respective areas of responsibility. They affirm the prerogatives of other agencies of their respective governments on certain matters related to this Declaration and Annex and note that in the case of the United States, the provisions of the Declaration and Annex do not apply to matters that are under the jurisdiction of other agencies of the government including the Department of State. They also note that within their respective governments there is ongoing work related to such matters to further the objective of cooperation between their governments, the outcome of which is not

prejudiced by the provisions of this Declaration and Annex. They also affirm their desire to promote similar cooperation between each of them and other allies, both bilaterally and multilaterally.

Therefore, the U.S. DOD and U.K. MOD have reached the understandings reflected in this Declaration of Principles and its Annex attached hereto. The principles established in this Declaration and in the Annex to this Declaration, which is an integral part of the Declaration, are not intended to be legally binding, nor to entail new fiscal obligations on the part of either the U.S. DoD or the U.K. MOD, but to point the way to arriving at future arrangements or agreements which may be legally binding. It is further understood that these future arrangements or agreements may entail amendments to national laws or regulations.

Signed in duplicate at Munich, Federal Republic of Germany, on the 5th day of February 2000.

William S. Cohen, Secretary of Defense, United States of America
Geoffrey Hoon, Secretary of State for Defence, United Kingdom of Great Britain and Northern Ireland

Annex

Purpose

1. The purpose of this Annex to the Declaration of Principles (Declaration) is to indicate the areas in which the U.S. DoD and the U.K. MOD ("the Participants") intend to find common solutions to the problems identified; to define the principles on which appropriate follow-on arrangements or agreements, or amendments to existing arrangements or agreements, will be based; and to establish a process and intended timescale for the negotiation of follow-on arrangements or agreements, or amendments to existing arrangements or agreements, to implement these principles.
2. This Declaration is intended to establish principles for future arrangements or agreements, or amendments to existing arrangements or agreements, which may cover the industrial, investment, and export sectors of defense in both countries.
3. The Participants have the firm intention to pursue the objectives of this Declaration and to adopt, where appropriate, specific arrangements or agreements, or amendments to existing arrangements or agreements between them, to underpin the effective application of the principles specified in this Declaration.

Harmonization of Military Requirements and Acquisition Processes

1. The Participants will seek better means to harmonize the military requirements of their armed forces. To this end, and proceeding from identified capabilities of common interest, the Participants will identify areas in which better harmonization is considered possible. In doing so, they will seek to make use of existing fora, wherever practicable.
2. The Participants will identify projects at an early stage for cooperative research, development, production, and procurement. (See Research and Development, below.)
3. The Participants will examine the possibility of harmonizing the procedures applicable to

armaments acquisition, so as to remove impediments to effective cooperation.

Meeting National Defense Requirements

1. Each Participant will require assurance that the other Participant will facilitate the supply of certain specified defense articles and defense services necessary to discharge their national security and foreign policy commitments. The Participants acknowledge that this assurance of supply is as important for industry as it is for governments, if industry is to adapt to the process of globalization.
2. The Participants recognize the potential for a degree of interdependence of supplies needed for national security. In order to achieve acceptance of this concept, the Participants will explore solutions for achieving assurance of supply for both Participants. These solutions may include obtaining assurances, some of which may be legally binding, relating to the supply of defense articles and defense services, including technical data, agreed upon by the Participants.
3. To further enhance this assurance, and with due consideration for the right of each Participant's government to control the disclosure and use of technical information, arrangements will be considered to enable the other Participant to reconstitute, in exceptional circumstances to be defined, an indigenous supply of a particular defense article or defense service.

Export Procedures

1. The Participants confirm their desire to maintain a strong defense industrial capability as part of their industrial bases and the ability to export defense articles and defense services. Consistent with the intent of this Declaration, they will explore possible approaches to achieving greater transparency and efficiency in their national procedures for exports of defense articles and defense services.
2. The Participants will explore means of simplifying the procedures for export of defense articles and defense services between themselves for their own use.
3. The Participants desire to see an improvement in the efficiency of the procedures for exports of jointly produced military goods to third parties. They will therefore examine the scope for establishing a procedure based on mutually agreed lists of acceptable export destinations for jointly developed and produced military goods and technologies on a project by project basis. These lists would be updated on a continuing basis.
4. The Participants will seek to ensure that their national laws and regulations for defense exports to third parties are implemented in a spirit of cooperation and with maximum efficiency. They will reinforce their cooperation and promote convergence in the field of conventional arms exports. They will pursue necessary measures to harmonize their conventional arms export policies as far as possible and examine means of establishing common standards of implementation.
5. The Participants will establish a high-level council on export control and coordination measures, with a view towards accomplishing the preceding measures.
6. Pending agreements reached pursuant to paragraph 5, above, re-transfers by a Participant of defense articles and services, including technical information, originating in the territory of the other Participant will be made in accordance with existing agreements, arrangements, contracts and procedures between the Participants.

Security

1. The Participants recognize the need to ensure that adequate and appropriate security provisions for the protection of classified information are in force in any relevant U.S. or U.K. company, regardless of any multinational aspects of a company's ownership or management structure. The Participants will endeavor to avoid placing unnecessary restrictions on the movement of staff, information, or material between the Participants or their industry.
2. The Participants will examine means to expedite the transmission of classified information between themselves or between their industries while maintaining the requisite degree of security protection.
3. In doing so, consistent with the General Security Agreement of 1961 between the Governments of the United States of America and the United Kingdom of Great Britain and Northern Ireland, the Participants will ensure that no classified information is passed to companies or persons not suitably cleared or needing to receive it; that no classified information originated by one Participant is passed to a third country national without the consent of the originating Participant; and no information carrying national caveats is passed to foreign nationals.
4. Consistent with the preceding paragraphs, the Participants will use their best efforts, both individually and working together, to lessen the administrative burdens placed on their industry in the establishment and oversight of industrial security measures.
5. The Participants intend to develop procedures to streamline the process for approving visits to government or contractor facilities by employees of the government or contractors of the other Participant that may involve access to classified information.
6. The Participants will jointly address security vulnerabilities posed by new technologies.
7. The Participants will endeavor to harmonize and streamline their security regulations.

Ownership and Corporate Governance

1. The Participants believe that the ownership of defense companies sited in the United States and the United Kingdom is a matter for the companies to determine, subject to the application of the relevant national merger control, anti-trust and other relevant laws. They wish to encourage the freest possible cross-border investment in defense-related industry.
2. While considering the implications for national security of any proposed international merger or acquisition, the Participants will not place unreasonable or unnecessary security restrictions on corporate governance.
3. The Participants will seek to establish arrangements or agreements whereby, on a reciprocal basis, each Participant will apply substantially the same standards in the granting of facility security clearances to companies that are organized and incorporated within its territory but are owned or controlled by entities within the territory of the other Participant, considering, among other factors, any connection with entities owned, controlled, or influenced by entities of any third country. These arrangements or agreements will include measures to address issues of corporate governance as well as security of information held by companies and compliance with national export control regimes.

Research and Development

1. The Participants recognize that technology, research and development are indispensable for maintaining an effective defense industrial base and therefore recognize the need to use the limited resources available for defense-related research and development in an efficient

and effective manner.

2. In the context of this Declaration, the Participants intend to establish arrangements or agreements and make use of existing fora to:

- (a) harmonize research and development programs and exchange information about national research activities where there are common interests with a view towards setting common objectives for research and development, avoiding unnecessary duplication of effort or major gaps in technology and technical capability, and making the most effective use of dual-use and commercial off-the-shelf (COTS) technology;
- (b) increase cooperation in programs that follow-on from research activity, in particular by undertaking technological developments with each other; and
- (c) ensure the adequate funding, and efficient cost sharing, of cooperative research and development.

Technical Information

1. The Participants confirm their desire to maximize the flow of technologies and technical information between themselves and between their defense-related industries. Accordingly, they will explore methods that could facilitate the flow of technologies and technical information between them and between their defense-related industries, while ensuring that the further flow of these technologies and technical information is strictly regulated by the governments. (See Export Procedures, above.)

2. These methods could include, where appropriate, the removal of unnecessary controls on the flow of technology and technical information, different ways to authorize the flow of technology, and different ways to optimize the exploitation for defense of technology investments.

3. The Participants will seek the establishment of arrangements relating to the disclosure, transfer, and use of technical information which will facilitate the efficient operation of U.S. and U.K. defense companies, consistent with proper safeguards. The Participants recognize that technical information received from the other Participant shall not be further disclosed without the authority of the owner and, in the case of classified or export controlled unclassified information, without the authority of that Participant under whose authority the information was created.

4. The Participants will encourage the harmonization of their laws, regulations, and procedures for controlling disclosure and use of technical information in the field of defense.

Promoting Defense Trade

1. The Participants will, on a reciprocal basis, endeavor to diminish legislative and regulatory impediments to optimizing market competition.

2. The Participants will endeavor to revise their acquisition practices to remove impediments to efficient global market operations and to support reciprocity of international market access for each other's companies.

3. The Participants will give full consideration to all qualified sources in each other's country in accordance with the policies and criteria of the purchasing government.

4. Each Participant will explore means to eliminate laws, regulations, practices and policies that require or favor national industrial participation in its defense acquisitions.

Timetable

1. Policy-level discussions concerning the principles underlying this Declaration and its Annex and the intended U.S.-U.K. cooperation and collaboration in facilitating the restructuring of their defense industry will be carried out by appropriate national authorities.
2. Working-level discussions will be held by working groups of subject matter experts, which may include representatives from other government agencies. These working groups may consult with the Participants' defense industries, as appropriate.
3. It is the intent of the Participants that the agreements and arrangements, or amendments to existing agreements or arrangements, envisioned by this Declaration and its Annex be put in place as expeditiously as possible. Accordingly, they will endeavor to develop such agreements and arrangements so that they can be presented to the Secretary of Defense and the Secretary of State for Defence within one year after signature of this Declaration and its Annex. In addition, they will make periodic reports to the Secretary of Defense and the Secretary of State for Defence on the progress that is being made on achieving the goals of this Declaration and its Annex.

ANNEXE B

**JOINT STATEMENT
BY THE PRESIDENT OF THE REPUBLIC
AND THE FRENCH PRIME MINISTER,
THE CHANCELLOR OF THE FEDERAL REPUBLIC OF GERMANY
AND THE PRIME MINISTER OF THE UNITED KINGDOM**

France, Germany and the United Kingdom share a vital political and economic interest in an efficient and globally competitive European aerospace and defence electronics industry. This will help to improve Europe's position in the global market, to promote European security, and ensure that Europe will play a full role in its defence.

We are agreed on the urgent need to restructure the aerospace and defence electronics industries. This should embrace civil and military activities in the field of aerospace, and should lead to European integration based on balanced partnership.

In the field of aerospace and related defence industries, we welcome the fact that a number of European companies, including Daimler-Benz Aerospace, Aérospatiale and British Aerospace, have already demonstrated their intention to regroup their activities. We ask that they should present a clear plan and detailed timetable for this restructuring and integration by 31 March 1998.

The first steps in this process of European civil and military integration should include swift progress in establishing Airbus as a Single Corporate Entity, along the lines advocated by the four Presidents of Airbus on 13 January 1997.

It is primarily for industry to work out the structure required. We undertake for our part to implement the necessary measures in national policies relating to this industry in order to facilitate such restructuring.

We would welcome the involvement of other companies and other European nations as appropriate, while this work moves forward, and particularly those already engaged in collaborative projects.

This initiative is a practical example of co-operation between European partners, which we will promote actively.

9 December 1997

ANNEXE C

JOINT DRAFT STATEMENT OF 20 APRIL 1998

The Minister of Defence of the French Republic, the Federal Minister of Defence of the Federal Republic of Germany, the Minister of Defence of the Republic of Italy, the Minister of Defence of the Kingdom of Spain and the Secretary of State for Defence of the United Kingdom of Great Britain and Northern Ireland, met on April 20 in order to discuss their common interest in the area of defence and restructuring of defence industry.

Ministers consider that a strong, competitive and efficient defence industry is a key element of European security and identity as well as of the European scientific and technological base. If the full benefits from restructuring are to be realised, a number of conditions need to be met. There is a need to harmonise the requirements of their armed forces, to pursue cooperative solutions where possible, and avoid unnecessary duplication of development and production. In this context, there should be full consultation before major decisions are taken. The defence related aspects of procurement policies, including policies of competition and policies on research and technology, and of export procedures should be harmonised. Participation in the European armaments base should be balanced and should reflect the principle of interdependence.

Ministers recalled the Declaration signed by the Head of State and Government of the French Republic, the Federal Republic of Germany and the United Kingdom of Great Britain and Northern Ireland on 9 December 1997, supported by the Heads of Government of the Republic of Italy and the Kingdom of Spain, the objective of which is to facilitate the restructuring of the European aerospace and defence electronics industries.

They took note of the considerable progress underway in the rationalisation of the defence industries in their countries and the various European fora in which they are actively involved, as well as their determination to develop a strong, competitive and efficient European industry.

They acknowledged that it was primarily for industry to establish a rationalised industrial base for European defence, and welcomed the recent report on industrial restructuring in European aerospace and its related defence industries. They encouraged defence industries in their countries to focus on the goals and means of restructuring and to keep up momentum.

Ministers agreed that, in order to capitalise fully on industrial restructuring at European level, it will be a priority for them to seek to harmonise the requirements of their armed forces, their procurement, research and technological development policies and defence-related aspects of their export procedures. In order to meet these objectives, they give high priority to the elimination of certain obstacles to industrial restructuring that fall primarily to them, in the areas of:

- security of supply ;
- export procedures ;
- research and development funding ;
- security of information and personnel clearances ;
- intellectual property rights.

Ministers decided that they would approve in June 1998 a letter of intent which spelt out the objectives and principles for handling these issues and set forth the organisation and timetable for the tasks involved.

ANNEXE D

LETTER OF INTENT
between
THE MINISTER OF DEFENCE OF THE FRENCH REPUBLIC,
THE FEDERAL MINISTER OF DEFENCE OF
THE FEDERAL REPUBLIC OF GERMANY,
THE MINISTER OF DEFENCE OF THE REPUBLIC OF ITALY,
THE MINISTER OF DEFENCE OF THE KINGDOM OF SPAIN,
THE MINISTER OF DEFENCE OF THE KINGDOM OF SWEDEN,
and
THE SECRETARY OF STATE FOR DEFENCE OF THE
UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND
concerning
MEASURES TO FACILITATE THE RESTRUCTURING OF
EUROPEAN DEFENCE INDUSTRY [Extracts]

SECTION 1. OBJECTIVES AND PRINCIPLES

General

1.1 The Participants desire to establish a co-operative framework to facilitate the restructuring of European defence industry.

1.2 The aim of this LoI (Letter of Intent) is:

1.2.1 to indicate the areas in which the participants intend to find common solutions to the problems identified;

1.2.2 to that end, to define the principles, organisation and responsibilities, in order to negotiate appropriate follow-on arrangements and agreements, which could imply the amendment of national regulations where appropriate.

Security of Supply

1.3 The Participants require assurance that the restructuring of European defence industry will not hinder the supply of Defence Articles and Defence Services necessary to discharge their military commitments. Moreover, industry will wish to be reassured that supplies will be maintained when rationalisation across national boundaries is achieved.

1.4 Consequently the Participants will accept mutual interdependence and the possibility of abandoning industrial capacity. To this end, they will examine solutions for achieving Security of Supply under the same conditions for each of the Participants. This will include obtaining commitments, some of which may be legally binding, from each of the Participants involved either in the constitution of a Transnational Defence Company, or in the jointly determined abandonment of activities by a company located within the territory of one Participant to the benefit of a company located within the territory of one or more of the other Participants.

1.5 Through these commitments, the Participant(s), on whose territory is located the Transnational Defence Company or the company which has benefited from the abandonment of certain activities by a company located on the territory of another Participant, undertake(s) in respect of the other Participant(s) involved:

1.5.1 not to hinder the supply to them in peace-time, times of crisis and in war. To that end, the control procedures for the transfer of armaments amongst the Participants should be simplified, with the aspiration gradually to reduce and, where appropriate, remove them in due course;

1.5.2 to ensure that the full or partial take-over of a defence company on their territory by any legal entity outside the Participants territory will not hinder the Security of Supply to, or any other legitimate national security interest of, the other Participants;

1.5.3 to co-ordinate with them in respect of strategic activities, assets and installations belonging to the Transnational Defence Company;

1.5.4 to take protective measures to enable the transfer of the Transnational Defence Company's activities assessed as strategic to at least one of the other Participants on a case-by-case basis.

Export Procedures

1.6 The restructuring of European defence industry should not hinder the ability of the Participants to export Defence Articles and Defence Services.

1.7 The Participants confirm their wish to maintain a defence industry as part of their industrial base and the ability to export Defence Articles and Defence Services. In view of the high sensitivity of defence exports, they will refer to the EU Code of Conduct on Arms Exports agreed to in the framework of the Common Foreign and Security Policy in order to seek greater transparency and efficiency in the export procedures for Defence Articles and Defence Services.

1.8 The Participants will reinforce their co-operation and promote convergence in the field of conventional arms exports. They will take the necessary measures to develop common rules about defence exports, including the harmonisation of their control policies (procedures, lists and authorisation levels), and examine the scope for establishing a standard procedure.

1.9 They will seek means of simplifying the circulation of Defence Articles and Defence Services between themselves, with limited exceptions, for their own use or for any subsequent re-export within the European Union, with the aspiration gradually to reduce and, where appropriate, remove control procedures for transfers between them in due course.

1.10 They will apply their existing national laws and regulations for defence exports to third parties in a spirit of co-operation and in a more efficient way.

1.11 Moreover, they will deal with the issue of recognising the political responsibility of the final exporter, taking into account the need for prior consultation with the Participants involved, within the ambit of the EU Code of Conduct on Arms Exports.

Security of Information

1.12 The Participants recognise the need to ensure that adequate security provisions for the protection of classified information are in force in a Transnational Defence Company without placing unnecessary restrictions on the movement of staff, information and material.

1.13 The Participants will decide the minimum amount of measures that are necessary to protect classified information. The national security arrangements for each Transnational Defence Company will be laid out in a security protocol between the relevant Designated

Security Authorities and the Transnational Defence Company. In addition to this, the Participants will examine methods to enable:

- 1.13.1 classified information, held by a Transnational Defence Company, to be exchanged between appropriately cleared employees of different nationalities on a need to know basis;
- 1.13.2 national personnel clearances in respect of Transnational Defence Companies to be completed expeditiously and be accepted by the other Participant;
- 1.13.3 international visits procedures to be made more efficient.

To this end, the Participants will examine the possibility for harmonising and streamlining their regulations.

Research and Technology

1.14 The Participants are aware that Research and Technology are indispensable for maintaining an effective European defence industry and therefore recognise the need to use the limited resources available for defence-related Research and Technology in an efficient and effective manner.

1.15 The Participants recognise the work on Research and Technology that has been undertaken in other European fora. In the context of this LoI, they intend to establish arrangements, and to make use of work in existing fora, as appropriate, to:

- 1.15.1 harmonise research and development programmes and exchange information about national research activities with a view to setting common objectives for Research and Technology, avoiding unnecessary duplication of effort, major gaps in technology and technical capability, and maximising the employment of dual use technology;
- 1.15.2 initiate co-operation to follow on from research activity, in particular by undertaking technological developments with each other;
- 1.15.3 ensure the adequate funding, and efficient cost-sharing, of Research and Technology by the Participants involved, and allow access to the results to the Participants under fair and reasonable conditions.

Treatment of Technical Information

1.16 The Participants recognise that current restrictions on the disclosure and use of Technical Information could impair the efficient working of a Transnational Defence Company. In doing so the Participants recognise that Technical Information cannot be disclosed by the Participants without the authority of the owner.

1.17 For the purposes of facilitating the restructuring of the European defence industry, the Participants will, therefore, consider arrangements that will embody the following principles and objectives:

- 1.17.1 ownership of Technical Information will, as a general rule, vest in the generator of that Technical Information;
- 1.17.2 subject to the Participant having the right to authorise disclosure and use of Technical Information, the disclosure and use of that Technical Information will be considered favourably taking into account any legal constraints for the protection of that Technical Information.
- 1.17.3 subject to the rights of any third party, the Participants will facilitate the transfer of any relevant Technical Information;
- 1.17.4 the pre-existing rights of the Participants with regard to Technical Information held by Transnational Defence Companies will be adequately preserved;

1.17.5 arrangements will be considered to enable a Participant to reconstitute, in exceptional circumstances to be defined, an indigenous supply of a particular Defence Article or Defence Service to further protect Security of Supply.

1.18 The Participants will encourage the harmonisation of their laws, regulations and procedures for controlling disclosure and use of Technical Information in the field of defence.

Harmonisation of Military Requirements

1.19 The Participants intend to conduct an analysis of their military capabilities geared to the spectrum of missions of the armed forces that takes account of the different characteristics of those missions. Based on this analysis the Participants will seek to harmonise the military requirements of their armed forces.

1.19.1 Future force capabilities must reflect the challenges posed by possible operations (including peacekeeping and peace support operations), interoperability, and developments in technology. Proceeding from identified capabilities of common interest, the Participants should identify areas in which harmonisation is considered possible.

1.19.2 The Participants will identify projects at an early stage for co-operative research, development and procurement.

1.19.3 The Participants will examine the possibility of harmonising the basic procedures applicable to armaments projects (defence materiel acquisition cycle).

Legal Framework

1.20 The Participants have the firm intention to pursue the objectives of this LoI and to adopt, where appropriate, and in accordance with the timetable in section 2.5, specific arrangements to underpin the effective application of the principles laid out in this LoI.

1.21 The Participants have determined that this LoI:

1.21.1 does not represent a legally binding commitment between them under international or national law; and

1.21.2 involves no financial commitment on their behalf.

SECTION 2. ORGANISATION AND TIMETABLE

Executive Committee

2.1 The only permanent organisation envisaged is the Executive Committee. The Executive Committee will be composed of a high level representative of each Participant, who may be represented and assisted by additional experts, as necessary. Each member should act as a focal point in his country for the purposes of this LoI. The Participants intend that the Executive Committee will be responsible for:

2.1.1 co-ordinating the drafting of any arrangements and agreements pursuant to this LoI;

2.1.2 monitoring the effectiveness of the implementation of any international instrument established pursuant to this LoI;

2.1.3 establishing ad hoc Working Groups to carry out tasks pursuant to this LoI;

2.1.4 co-ordinating, reviewing and evaluating tasks undertaken by the Working Groups;

2.1.5 preparing periodic reports to the Participants, as necessary.

2.2 The Executive Committee will take its decisions by unanimous consent of its members. Where such consent cannot be reached, the matter in dispute will be referred to the Participants for resolution. Exceptionally, the Executive Committee may unanimously decide in advance that certain specific decisions may not require the unanimous consent of its members.

Working Groups

2.3 Working Groups, when established, will be responsible for providing policy advice to, or undertaking specific tasks for, the Executive Committee. Members, who may include representatives from each Participant's industries nominated by industry, will be appointed by the Executive Committee. The Executive Committee will determine the terms of reference for each Working Group.

Relationship with Other Organisations

2.4 The Executive Committee, and its Working Groups, will have due regard to any similar work being carried out in other fora, in order to avoid different evaluations of the same problem and to establish, where possible, a consistent and common position. This will particularly apply to the similar work being undertaken by the respective Industry Ministries.

Timetable

2.5 The work will be scheduled as follows:

July 1998 to June 1999 - The Executive Committee and Working Groups will meet in order to negotiate the follow-on arrangements and agreements pursuant to this LoI;

July to December 1999 - Finalisation and signature of these arrangements and agreements.

2.6 Each arrangement and agreement will, where appropriate, describe the time scale for its incorporation into national laws and regulations.

6 July 1998

Just as competition between companies ensures lower prices and higher quality for consumers, competition among regulatory jurisdictions can keep regulators attuned to how their regulations affect employers, consumers and entrepreneurs. Similarly, lack of competition among regulatory jurisdictions in a transatlantic market can shield them from challenge to policies that may be harmful to citizens. Cooperation between regulatory jurisdictions need not lead to a race to the bottom, nor require nations to relinquish their sovereign responsibilities in favor of binding transnational regulations. This publication examines the prospects for transatlantic cooperation in this field, and also the constraints on it. An old debate if ever there was one. How can European companies gain access to the American defence market, one of the most protected in the world? How can industrial partnerships be arranged in such a way that they do not result in either the dilution of the European groups or US monopoly in the most strategic sectors? To what extent, moreover, are these Euro-American partnerships essential for the survival and competitiveness of European defence industries? The prospect of great-power competition between the United States and China is also a concern for Europeans, who aim to find a balance between the former's geopolitical pressures and the latter's economic power. The U.S. policy shift great power competition also means that Washington will increasingly seek to shift the burden of crisis management and counterterrorism to regional partners, including in Europe. More often objects than subjects of the major trends affecting transatlantic security cooperation, European countries are unlikely to find the solutions to the issues they will face in the near future. Moreover, Russia, China and even the United States may benefit from European disunity, and actively seek to use the continent's existing fractures to their advantage.