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A Test Bed for Enhanced Cooperation: the European Defence Industry

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The process of restructuring the European aerospace and defence industry began with the joint declaration of the French, German and English prime ministers on 9 December 1997, in which they, for the first time, stated the urgent need for a reorganisation of both the civilian and military branches. While committing themselves to taking the steps required at the national level to favour this restructuring, they extended the appeal to other countries, especially those already involved in joint projects. A few weeks later, the heads of government of Spain and Italy adhered to the declaration.

The importance of this initiative should not be underestimated. After having achieved extraordinary results in the field of economic integration, undertaken monetary unification and decided upon further consolidation of its institutions, the major European countries for the first time declared, at the highest political level, that they were willing to maintain and strengthen their technological and industrial capacity in the defence sector. It was also clear that this decision would inevitably have a propulsive effect on the process of political unification, without which there would be no point in pursuing the integration of security and defence policy.

The need for defence integration has gradually matured in Europe, although this has taken place more through the realisation of shortcomings and risks than through the achievement of positive results. Experience in the Balkans contributed significantly to this, both in Albania, albeit on a smaller scale, and in the former Yugoslavia. In the former, Europe revealed its inability to organise an international operation to prevent the disintegration of a state structure. In the latter,

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the experience was much more negative in that Europe was unable, first, to stop the escalation of the inter-ethnic conflict and, subsequently, to organise and manage the intervention in Kosovo, which eventually took place thanks to the direct efforts of the United States in the NATO framework.

Europe lacked and still lacks not only a military structure with trained and integrated troops, but also adequate equipment. In some cases, Europe just does not have the equipment (airborne command and control systems, all-weather satellite surveillance, anti-missile missile systems), in other cases, it does, but it is controlled by NATO (airborne radar, TLC satellites) and in still others, it differs from country to country (interceptors, ECR aircraft). What Europe does have is almost invariably insufficient in number and often old (tanker aircraft, strategic transport aircraft). Thus, the Balkans gave Europe the chance to perceive its own military weakness and measure the gap with the United States.

Under this kind of pressure, Europe has started to restructure its military capabilities, substantially in three areas: reform of institutions and operational organisation; market integration and industrial concentration.

Building a European defence

European efforts in defence have concentrated on extending the European Union's tasks by taking on responsibility for the so-called Petersberg missions and, to this end, by absorbing the Western European Union (WEU) into the EU. Art. J7.1 of the Amsterdam Treaty of European Union states that "[t]he progressive framing of a common defence policy will be supported, as Member States consider appropriate, by cooperation between them in the field of armaments" (para. 4). It also grants the EU Council the power to guide EU and WEU actions in defence and security matters. It can adopt a common strategy to achieve a European armaments policy.

The December 1999 EU Helsinki Summit took another step forward with the decision to set up, by the year 2003, a corps of 50,000/60,000 troops for deployment within 60 days and for a period of up to one year in Petersberg-type actions and to establish a provisional political-military command while waiting for it to be definitively formalised by an amendment to the treaties. At the beginning of this year, the provisional structure was organised into a Political and Security Committee, a Military Committee and a group of national military experts under the General Secretariat. These provisional institutions constitute the framework within which the future permanent organs will develop and will ensure the necessary political guidelines for the military operational structure being put into place. An unsolved problem is how to have the different European countries participate, in relation to the security organisations to which they belong: of the 15 EU countries, only ten are also members of the WEU; four (Austria, Finland, Ireland and Sweden) are not members of NATO and are only "observers" in the WEU; one (Denmark) is a NATO member, but "observer" in the WEU. Then there are six European countries (Iceland, Norway, Turkey, Poland, Czech Republic and Hungary) that belong to NATO but not to the EU and the WEU.

As for the WEU, there is still doubt about what to do with the Western European Armaments Group (WEAG), a forum for intergovernmental consultation aimed at strengthening European cooperation in the armaments field. Originally it was the Independent European Programme Group (IEPG), an informal body set up in Rome in February 1976 on the basis of a gentlemen's agreement between certain European members of the NATO military structure (Denmark, Germany, Greece, Italy, Luxembourg, Norway, the Netherlands, the United Kingdom and Turkey) and France. Portugal and Spain later adhered, and it was then brought into the WEU as the WEAG in May 1993 with the same structures and the same members. Lacking any legal profile, it has been able to operate pragmatically, avoiding the institutional crises that have afflicted other fora. But its composition has become complicated by the future participation of the new NATO members (Poland, Czech Republic and Hungary) as well as Austria, Finland and Sweden. Furthermore, in November 1996, the Western European Armaments Organisation (WEAO) – a likely forerunner (at 13) of the future European Armaments Agency – was set up within the WEAG to manage defence research projects, procure contracts and provide the latter with research and technological support.

The declaration relative to the WEU annexed to the Treaty of Amsterdam states that "a range of measures, on some of which work is already in hand in WEU, can be taken forward now, such as [...] coopertion in the field of armaments, as appropriate, within the framework of the WEAG, as the European forum for armaments cooperation, the EU and WEU in the context of rationalisation of the European armaments market and the establishment of a European Armaments Agency" (A7). Therefore, the WEAG's growth must be seen in the context of the EU Commission taking on greater initiative in the armaments field. One hypothesis could be to designate the WEAG as the EU's technical expert on armament matters, thereby formalising what already occurs on a practical plane, legitimating the WEAG within the EU and preventing parallel and rival structures from being set up by the Commission. In view of enhanced cooperation, a global architecture within the EU sphere could include the following:

- The WEAG as a collective body and the EU's technical expert, tasked with working out a strategy for opening up EU government procurement, strengthening the defence industry base and, perhaps, coordinating and unifying the requirements and prerequisites of the member countries;
- The Organisation for Joint Armaments Cooperation (OCCAR) for setting up and managing large-scale joint programmes among the member countries (currently France, Germany, Italy and the United Kingdom, but to be gradually extended) in the field of armaments;[2]
- WEAO for the management of R&D programmes;
- a new body in charge of acquiring other materials "off the shelf" and perhaps

2 Set up in November 1996.

of managing smaller programmes.

This arrangement seems to be consistent with the prospect of developing a European Armaments Agency in the EU and could be useful for the debate within the EU on national defence markets and their peculiarities. Certainly it will have to lead to the Europeanisation of other initiatives by small groups of countries such as the OCCAR and the LOI (described later). Furthermore, this objective would be in keeping with a gradual extension of the economic and industrial competences of the present EU structures from the civilian to the military sector. This trend is, in fact, already under way to cope with the progressive military-civilian integration taking place in technology and industry and makes the restriction of EU initiatives to the civilian market appear increasingly anachronistic.

There seems to be another trend, however, to freeze the role of the WEAG, even after the absorption of the WEU into the EU. This was basically the upshot of the 15 May 2000 Porto WEAG Council meeting which, *de facto*, indefinitely postponed solution of the problem of WEAG-EU relations and, in particular, the kind of links to establish between its activities and the initiatives under way in the EU.

Building the European defence market

Given the different legal positions of military and civilian activities within the EU, the Letter of Intent (LOI) signed in July 1998 by the ministers of defence of the six European countries most involved in aerospace and defence production (France, Germany, Italy, Spain, Sweden and the United Kingdom) was definitely the event destined to have the greatest potential impact on the European defence market. The intent was to work out measures to adopt to integrate the respective defence markets. The following subjects, encompassing all the major aspects of the military market, were identified as the basis for discussion: procurement security, export procedures, protection of classified information, research and development, exchange of technical information, standardisation of military requirements, legal relations.

It was felt at the time that the initiative could “advance” integration in the EU’s entire defence market by using as leverage the greater homogeneity of these countries in the sector and their interest in creating the conditions for guaranteeing a strengthening of the European industrial structure, above all with respect to the large-scale integration in the US aerospace and defence industry in the first half of the last decade.

Indeed, there were serious doubts, in the summer of 1998, as to the EU’s ability to go forward with the process of integration in the defence sector since the ambitious Action Plan in that sector worked out in December 1997 by the preceding Commission (indicating the actions to be promoted in the following years to unify the European defence market) had produced no more than the approval by the EU General Affairs Council in June 1998 of a Code of Conduct for exports towards third countries (an important document, but only the first step in harmonising the

various national export policies on the basis of common rules and working out kinds of permanent consultation among partners on the choices to be adopted).

In the end, however, all initiatives come up against the pre-existing fragmentation of the national defence markets, which has produced different levels of aggregation among European countries depending on the projects in which they participate. As a result, there is the Community market for dual products and a small part of military ones, the market of the six LOI countries for military products, that of the four OCCAR countries for common procurement programmes. In addition, there are the difficulties generated by the discrepancies deriving from a country's form of association (member, associate or observer) to the various European institutions (EU, WEU, WEAG). Finally, a clear distinction must be made between the roles of national governments and European institutions (also to eliminate a certain overlapping of proposals and initiatives).

At the beginning of this year, an agreement was drafted for presentation to and signature by the Ministries of Defence. But the "Framework Agreement on Measures to Facilitate the Restructuring and Operation of the European Defence Industry", signed in July, does not seem to fully respect the conditions indicated above in that it is based on maintaining a strong role for governments, rather than strengthening market factors, and on discrimination between LOI and non-LOI European countries. Therefore, the outcome of the initiative, which will now have to interface with the new institutional and military scenario outlined at the EU Helsinki Summit, is not yet clear. In any case, after signature, the agreement will have to be ratified like an international treaty and the necessary links with the individual national legal systems found. Consequently, it will take some time before it comes into force.

Finally, attempts have been made to consolidate the OCCAR. In September 1998, it was brought into the framework of an international convention to give it legal status and allow it to operate more effectively in the procurement field. To date, however, the convention has not been ratified by the states parties.

Integration of the European defence industry

An essential element of the EU's common security policy will be its military capability, now seen – in contrast to the past – as the result of integration and not only aggregation.

In the last fifty years, in fact, technological development has contributed to shifting the concept of military capability from the sum of available means to the integrated management of extremely sophisticated means. This has occurred at the national level and cannot but take place at the European level. If each country has until now been able to set its defence instrument up autonomously, albeit in the framework of a common system of alliances, and put its military capability at the disposal of the system, this can no longer take place in the year 2000. On the military plane, it would condemn Europe to being unable to intervene effectively in any crisis exceeding the low intensity threshold and would make it totally dependent on the choices of its North American ally. Therefore, the logic of the past has to be

set aside and all efforts dedicated to integration, albeit as gradually as required.

The increasing sophistication of weapons systems suggests the same course, as no European country can bear on its own the costs relative to developing them, guaranteeing a sufficient volume of production and mastering the ever more complex technologies involved. At a time of containment and control of public spending, national defence budgets cannot individually ensure the necessary resources.

Up to the end of 1977, collaboration almost exclusively took the form of intergovernmental programmes which were then handed over to the respective national industries. This approach was favoured by the emergence of so-called national industrial champions, starting with Finmeccanica in Italy and Dasa in Germany. During 1998, the idea of making up for the delay in the process of concentration and rationalisation of the defence sector with respect to the United States started to gain currency among several European governments and industries. Despite the difficulties in transforming the Airbus Consortium into a company to bring in the industrial capacities of the French, German, English and Spanish associates,[3] the proposal was to take a major step and expand the industrial horizons of the four partners' aerospace and military activities. Italian and Swedish industries could not be left out, so the group was enlarged to six. This led to the founding of an industrial "monster" known as the European Aerospace and Defence Company (EADC), which was to embrace all aerospace production and most electronic production as well: commercial and military aircraft and helicopters, missiles, systems, avionics, satellites, launchers, space structures. The drawback was that it excluded a number of major European industrial groups, including some of Finmeccanica's most important partners and thus risked having a negative impact on the complex network of company, production, industrial and commercial links that characterise the European scene.

This ambitious dream was brought to a brusque end in January 1999 by British Aerospace's acquisition of the activities of the General Electric Company-UK (GEC) grouped in Marconi Electronic Systems to form BAe Systems, in response to the restructuring undertaken by the French government of the aerospace sector around the Aerospatiale-Matra axis in the summer of 1998. Thus, in the two years ending in autumn of 1999, the process of European industrial concentration was marked by three main features:

- the creation of "national industrial champions" in France and the United Kingdom as well with the mergers mentioned above;
- the strengthening of the national champions through the participation or acquisition of companies in other countries (the Swedish Saab by British Aerospace (BAe), the Spanish Casa by Dasa);

3 Aerospatiale, British Aerospace, Casa and Dasa.

- the establishment of sectoral alliances with the setting up of new joint companies in the field of defence electronics (Finmeccanica-Alenia Difesa and GEC-Marconi Electronic Systems to form Alenia Marconi Systems - AMS), missiles (Matra and Bae to form Matra BAe Dynamics - MBD), helicopters (Agusta-Westland) and space (Matra, Marconi Space and Dasa to form Astrium).

The European response to the American challenge further crystallised in 1999 with the establishment of two large groups: the BAe Systems described above and the merger of Aerospatiale-Matra and Dasa to form European Aeronautic Defence and Space (EADS) including the Spanish Casa. Thus, a definitive heirarchy in the sector can be drawn up, with these two largest European groups sufficiently ahead in terms of aerospace and military sales and size to resemble the second largest American group, Lockheed Martin. However, all three only account for about one half of the sales of the solitary giant in the field, Boeing, while they are a good stretch ahead of the third, Raytheon. Other groups, including the French Thomson CsF and the Italian Finmeccanica lag farther behind. Thus, as regards concentration, Europe has substantially reached the American level.

Transatlantic cooperation/competition

In the United States, industrial concentration was encouraged and guided by the only national authority responsible for procurement, the US Defense Department, which even provided some financial support for the social costs of the operation in return for the considerable savings achieved through rationalisation of spending and production. Two key factors explaining the operation's success were the policy of integrating civilian and military markets, taking advantage of the potentialities of dual-use production, and the export support provided by American authorities, backed by legislation which currently curbs the possibility of foreign penetration of the national market. Closely connected to these policies is the question of technology transfer, at the centre of every debate on transatlantic cooperation.

The future of transatlantic agreements and competition is affected by the ambiguity of those in charge of industrial and defence policies on both sides of the Atlantic: European governments tend to prohibit American penetration on the grounds that their industries have to be strengthened; the US government states that it would like to move in a transatlantic perspective, but does nothing to eliminate the barriers to national markets and favours the dominance of American companies in cooperation agreements, creating obstacles to technology transfer, and promotes their entry into markets where the Europeans are weak.

A special approach to transatlantic relations was adopted by the Americans to obtain European adhesion to the Joint Strike Fighter programme, for production of the new interforces fighter. European countries' participation is proportional to their financial commitment and allows them to be involved from the development stages onward. The United Kingdom immediately took advantage of this

possibility and became a full partner from the start; Italy is an observer but is likely to become a full partner next year.

Relations between the US and Europe in the defence field continue to vacillate between a policy of cooperation and a policy of competition. The dividing line between the two options is very fuzzy, even though European countries seem to have been particularly careful in recent years to favour continental programmes if even a minimum of strategic autonomy was at stake. It must be underlined that Europe is still riven by the same old doubt: should it cooperate with the Americans only when this can be done under conditions of parity or should the objective of cooperation be acquisition of that parity? Indeed, these two factors have always been among most countries' motives for participating in single programmes.

In this context, three European requirements have recently re-ignited the old dilemma: a medium range air-to-air missile for the Eurofighter and Raphael aircraft; a strategic transport aircraft and a tanker aircraft.

In the first case, European industry proposed the Meteor missile, the product of an agreement among various national companies. The US proposal was the AMRAAM, also offering involvement to a number of European industries. After a tough battle, in which the American president, on the one hand, and European ministers and ministries of defence, on the other, entered the field, the British government – the first to have to choose – decided upon the European missile, thus giving the green light to a programme that should produce 5000 units, including exports – for the first time equalling the product volumes that have till now favoured American industries.

From a military point of view, the European programme was considered indispensable to render operational the new combat aircraft in which European countries had invested substantial resources to guarantee autonomy in this sector. The American alternative would have definitively shackled this endeavour and prevented European air forces from adopting the same weapons system, with all the relative advantages in training and logistics. From the industrial point of view, account must be taken of the enormous effort made by European industries to concentrate all missile activity in a single company. From the political point of view, the commitment of European governments to proceed with building a European defence and security identity and to strengthen Europe's military capability demanded that this programme be undertaken as a sign of their common desire to acquire autonomy in some strategic activities and to reduce the technological gap with the United States.

The second programme involving a strategic transport aircraft saw the European A 400 M rivalling a US pair, the C 130 J (with limited capacity) and the C 17 (the "king" of transport aircraft in terms of performance, capacity and autonomy). The unexpected British decision to participate in the A 400 M programme (combined with leasing of two C17s) and the favourable stances of Germany, France, Spain, Belgium and Turkey, brought the total number of aircraft foreseen to over 200, considered the minimum to be able to face the costs of development,

industrialisation and production. Despite the scepticism which had, until recently, led observers to believe that the initiative had failed, Europe has decided to shoulder a major financial commitment to ensure its autonomy in the field of strategic transport. The reasons for this move – not difficult to imagine – are linked to the aim of achieving an effective military capability (impossible without the relative means, including air transport) and to recent experiences in peace-making and peace-keeping operations in which American involvement and support were decisive.

The A 400 M programme might also be used to take another step forward in European cooperation; integrated coproduction could be accompanied by the establishment of a body tasked with management of the European air transport fleet. Although initially managing only some aircraft made available by the individual participants, it could effectively ensure both the training of pilots and technicians as well as logistic support and operational maintenance (leaving structural maintenance up to Airbus, as in the civilian sector). The European fleet could thus constitute the emergency nucleus of Europe's new military capability, but it could also be used for civilian emergencies, such as rapid evacuation of civilians in crisis situations or during environmental disasters. When needed, if there were no European priorities, it could be rented out to individual participants for their specific requirements. Furthermore, the acquisition programme could be managed by the now almost formal body for the management of common programmes, OCCAR.

The third programme in which a choice has to be made between a European and an American solution is a tanker aircraft with which to replace the old tankers and to increase Europe's capability for inflight refuelling. The candidates are the European Airbus A 310 (already chosen by Germany) and A 330, and the American Boeing B 767. Two factors have to be considered by European countries in choosing the tanker: a certain number of aircraft will have to be ensured to lower the costs of design and transformation of the chosen machine, and a European choice could pave the way for joint management of the European fleet, as described for the A 400 M. This would imply standardisation on the basis of one or, at the most, two aircraft, such as the Airbus (taking into consideration that the Airbus family has a number of features in common). Acquisition of an American aircraft would undermine this possibility and would cause competition within the European military market, without any reciprocity on the North American market in sight.

Prospects for the European defence sector

On the whole, one can say that the European defence industry has started to move – although along a number of different paths – towards some kind of rationalisation. There are presently two challenges facing European industry: the need for a technological leap and greater efficiency in supplying the new equipment required by the armed forces; the need to improve competitiveness in order to maintain an adequate share of the international market and to counter American competition.

The premise is to concentrate and rationalise European productive capacities. The fact that Europe has finally equalled its American rivals in terms of size

illustrates how intense this concentration process has been. It should, however, also lead to some reflection on the American experience: in fact, while the process was initially encouraged and supported by the Department of Defense, it was halted at some point, at least when the top of the pyramid was reached, to prevent the advantages of concentration from being jeopardised by the risks connected with a monopoly. This was the reasoning behind the decision to suspend the Lockheed/Northrop merger in 1998.

But the process of integration of the defence market moves along two tracks and the progress made in supply must now be met by parallel progress in demand. Europe lags behind in this field. While studies of the measures to be introduced to bring about this change have been carried out at the political and administrative levels, there have been no concrete results to date.

Then again, European industrial concentration, on the one hand, and the globalisation of the market, on the other, call for an acceleration in the process of adjusting demand quantitatively, but above all qualitatively. In quantitative terms, the defence spending of all European countries taken together amounts to little more than half that of the United States. Given the different level of investment, the share allocated to military procurement in Europe can be estimated at just over 40 percent of US figures. Hence the strong market differential between European and American companies.

But the real stumbling block is that the European market is basically “virtual” as it is split up into national components that prevent any kind of unitary – let alone homogeneous – demand. The budget size, the share dedicated to investment, procedures, application time, planning, R&D support policies, industrial policies, export policies are all factors differentiating European countries.

At the moment, European transnational companies have to take the form of holdings that, in turn, control national subsidiaries which have considerable autonomy in legal, administrative, financial, fiscal and personnel matters and, above all, their relations with military clients. This generates substantial costs that penalise European industry with respect to the US and make it impossible to reap one of the main gains of any concentration process, the possible rationalisation of industrial and technological capacity. Eliminating this overlap by specialising production units, achieving an adequate production volume, sharing research as well as marketing, assistance and logistic support capabilities are the natural and indispensable consequences of mergers.

But these are all still distant objectives because the European Union is divided into 15 national markets, each with its own specific demand breakdown, rules and supply peculiarities. Suffice it to recall that the free circulation of goods, people, services and capital at the root of the unified European civilian market has not yet been introduced in the military sector. In the case of products, national borders continue to be anachronistic obstacles to the construction of a single European market, forcing transnational companies to go through the same procedures, in moving material from one plant to another, as they would for export. Often – in

the majority of cases – shipping to a another European country is facilitated by a minor simplification rather than by a completely different procedure. This renders futile all plans for rationalisation based on establishing one efficient supply source for all parts of the same industrial group. As concerns people, certain constraints linked to exclusively national security controls continue to impede mutual recognition of authorisations among European countries. Thus, a joint venture is forced to operate in each country with a specific authorisation, different for that of the others, making even an exchange of information difficult. And should a technician be transferred from one subsidiary to another, he/she can no longer collaborate freely with his/her colleagues in the former place of employment. In the third case, services, the same problems prevail. Finally, capital: since links with national clients are very close, as in all government procurement, they will no doubt be the last to loosen up.

In this context, it is up to European governments and institutions to take the necessary steps to ensure the following in the military field:

- unification of procurement policies, at the programme, R&D and procedures levels;
- unification and liberalisation of the European internal market;
- unification of rules relative to military exports.

The objective is to do away with the strong “national” connotations of the current rationalisation process and to have it take on a real European and transnational dimension. The problem is complex since it involves reconciling two contrasting requirements: the transnationalisation and integration of industries and the maintenance of individual national defence markets. Setting aside this kind of national reasoning with regard to demand and rules must go hand in hand with the consolidation of a European-wide integrated industry.