

EUROPEAN MILITARY-INDUSTRIAL COOPERATION

No 20, May 2001

Members of the Advisory Council on International Affairs

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Foreword

On 14 July 2000 the Ministers of Foreign Affairs and Defence asked the Advisory Council on International Affairs for its advice on the development of a European military-industrial policy.¹ Both ministers emphasise the fact that the development of a European Security and Defence Policy (ESDP) presupposes the presence of a high quality industry, capable of providing European countries with good, modern equipment when it is needed and under competitive conditions. At the same time they point out that the new momentum in the development of an ESDP and the new dynamism in military-industrial cooperation have as yet had few tangible effects on European equipment cooperation. This they attribute to the fact that national military and industrial interests have remained a very dominant factor in the procurement policy and the defence equipment policy of European nations. Until now these national interests often formed an obstacle to opening up the defence equipment market and to the joint development, production and procurement of equipment. As far as the Netherlands is concerned, the Ministers continue, there is a 'clear willingness to allow national industrial interests to be less prevalent, provided other countries also actively work towards the greatest possible openness in the defence equipment market, certainly within Europe and preferably also on a transatlantic level'.

Against this background the Ministers submit a number of questions for the Advisory Council relating to six different areas of interest:

- 1) An assessment of the general political and industrial climate for an open common market for defence equipment, including an assessment of the differences between big and small European countries.
- 2) Suggestions for the way in which positive attention for the ESDP can be translated into greater political support for a European defence equipment policy.
- 3) Options for a concentration of European military-industrial strength while maintaining healthy competition relations.
- 4) An analysis of the possibilities for a European Armaments Organisation and, in this context, the significance of Article 296 of the EC Treaty.
- 5) Suggestions on how to achieve effective and equitable transatlantic military-industrial cooperation.
- 6) Possibilities for European R&D programmes for (more) defence-related projects

These questions were examined by the Peace and Security Committee of the Advisory Council on International Affairs. This Committee consists of the following members: A.L. ter Beek (Chairman), Prof. G. van Benthem van den Bergh* (vice-Chairman), Dr. A. Bloed, Dr. Ph.P. Everts*, Prof. F.J.M. Feldbrugge, Lieutenant General G.J. Folmer (rtd.)*, J.G.N. de Hoop Scheffer*, Prof. K. Koch, Dr. M. van Leeuwen, Rear Admiral R.M. Lutje Schipholt (rtd.)*, L. Sprangers, Prof. B.A.G.M. Tromp*, General A.K. van der Vlis (rtd.)*, E.P. Wellenstein* and Prof. Dr. F. Wielenga. The members whose names are marked with an asterisk participated in the working group which prepared the advice, under the chairmanship of Prof. B.A.G.M. Tromp. Dr. B. Knapen, P. Dankert en Prof. J.Q.Th. Rood of the European Integration Committee of the Advisory Council on International Affairs were correspondent members of the working group. The activities involved in producing the advice were supported by

1 The request for advice is attached to this document.

the official advisors to the Peace and Security Committee Commodore H. Emmens, B.W. Bargerbos (Ministry of Defence) and H.G. Scheltema (Ministry of Foreign Affairs) The secretariat was in the hands of H.A. Würzner (Secretary Peace and Security Committee), with the support of interns G. D. van der Staaij, A.C. Buyse en M.F. de Lange. The text of the advice was adopted by the Advisory Council on International Affairs at its meeting on 20 April 2001.

In preparing the advice the members of the working group consulted representatives of the Ministries of Defence and Economic Affairs, the Netherlands Defence Manufacturers Association (NIID), Stork, Thales Nederland and the German Ministries of Foreign Affairs and Defence. In addition the working group also paid fact-finding visits to Brussels (European Commission, Dutch Permanent Representation to the EU), France and the United Kingdom. The Advisory Council on International Affairs would like to express its gratitude for the particularly intensive support it received at the Dutch Embassies in Berlin, London and Paris and at the Dutch Permanent Representation to the European Union and the German Embassy in The Hague. Members of the working group also took part in the symposium 'The globalisation of the defence industry. Policy implications for NATO and ESDI' organised on 29 and 30 January 2001 by the British Royal Institute of International Affairs (RIIA). A list of those consulted by the working group and of the speakers at the RIIA symposium is attached to this document as Annex II.

The Advisory Council has established that the European defence industry consists of a core of major, prominent companies and a periphery made up essentially of sub-contractors, both domestic and international. Defence companies in four countries – the United Kingdom, France, Germany and Italy – make up the core of European defence industry. They account for 80 per cent of European defence production and 90 per cent of European Research and Technology (R&T).² Within the individual countries the defence industry – insofar as it exists – frequently consists of a number of relatively large arms manufacturers, usually with a vertical organisation, and a larger number of specialist companies focussed on niche markets.³ Aircraft production and defence electronics⁴ make up seventy per cent of the European defence industry, with a great deal of additional value being ascribed to components and sub-systems – often of a commercial nature – produced by medium-sized and small companies.

Over the last five years in particular there have been a large number of mergers and take-overs in the defence industry, both in the United States and in Europe, leading to a substantial restructuring of the military-industrial sector. The most important

2 K. Vlachos, 'Safeguarding European competitiveness. Strategies for the future of European arms production and procurement', Paris 1998 (WEU Institute for Security Studies, Internet version), p. 8.

3 HThe core of national companies is by no means always part of the core of European companies. For example Hollandse Signaal Apparaten (Thales Nederland) is undeniably one of the biggest Dutch defence companies but it holds only joint 70th place on the SIPRI list of the top 100 defence companies. No other Dutch companies appear in the top 100. See: SIPRI, Yearbook 2000, London 2000, p. 331. 'Niche markets' in this paper refers to small, specialist sectors of the defence market.

4 K. Vlachos, 'Safeguarding European competitiveness', p. 8.

military-industrial sectors (the production of fighter aircraft, helicopters, missiles, satellites, electronic systems, army systems and, to a certain extent, naval ships) are increasingly dominated by a small number of ever more internationally oriented companies. Through holdings, joint ventures and military cooperative programmes they are establishing numerous connections, both among themselves and with smaller specialist companies. Annex III gives an overview of the major defence conglomerates in each sector. In the discussion about the adaptation of European military-industrial policy to take account of the factors outlined above there are three categories of players: governments, industries and international organisations. Governments determine their interests primarily by weighing up cost effectiveness and (national) industrial interests. The defence industries' prime concern is their continued existence, which is translated into a search for optimum profit margins, productivity and market value. Finally, international agencies are seeking to create favourable conditions for international cooperation between these industries while incorporating, obviously, an important role for themselves. The questions put by the government in the request for advice all relate essentially to the shifts and changes taking place within and between the parties mentioned above. This is reflected in the structure of this advice.

As far as the Advisory Council is aware there has to date been no comprehensive analysis of the way in which at the end of the 1990s the changes in the military-industrial sector, on the one hand, and the position of governments and international organisations, on the other hand, are interlinked. The Advisory Council therefore felt that it was first necessary to establish a situation report before being able to assess the Dutch position as a whole. While fully aware that such a situation report significantly affects the length of the text, the Advisory Council believed that this would be compensated for by the added value for the Dutch debate. This advice also includes a brief discussion of various European and American armaments programmes. However, it is not the role of the Advisory Council to express opinions on the operational, financial or industrial advantages and disadvantages of specific weapon systems which the Dutch government is considering buying or has bought. The Advisory Council is also fully aware that specific areas covered in this advice have much ground in common with advice issued previously by the Advisory Council.⁵ Where relevant this will be indicated in a footnote.

In order to provide an insight into the interaction between changes in the military-industrial sector, the position of governments and international organisations and how these affect Dutch interests, this advice will be preceded by a summary and a list of the recommendations. Specific recommendations to the government are given in italics in both the summary and the main text. In the main text each chapter begins with a resume of the specific questions from the request for advice covered in that chapter. Chapter 1 of this advisory paper considers the link between the European Security and Defence Policy (ESDP) and the interests of the European military industry. Chapter 2 then gives an overview of the most important changes within the European defence sector in recent years. Chapter III takes a closer look at transatlantic military-industrial relations, followed in Chapter IV by an evaluation of the institutional and organisational aspects of European military-industrial policy. Chapter 5 offers an analysis of Dutch interests in this whole area.

5 This applies particularly to the subject of arms exports. In this context we refer to earlier Advisory Council advisory papers 'Conventional arms control; urgent need, limited opportunities' (Advice 2, April 1998) and 'Africa's struggle. Security, stability and development' (Advice 17, December 2000).

Summary and recommendations

1. The context

In many ways the defence industry of 2001 can no longer be compared with that of the early 1990s. Partly as a result of the end of the Cold War the defence sector has undergone a 'secularisation' process, through which it is taking on more and more of the characteristics of civilian industry. At the same time the traditional very close cooperation between national defence industries and governments are put into perspective. The world-wide decline in defence expenditure, increase in equipment costs, rapid technological changes, the more business-like attitude of governments and the increasing influence of the stock market on defence companies have also led to new commercial strategies for the defence sector being developed throughout the world. The key aspects are optimising productivity and ensuring the broadest possible market access. To achieve this defence manufacturers have focussed on concentration and consolidation, the reordering of industrial activities, rationalisation, a more aggressive export policy, internationalisation, participation arrangements and, finally, globalisation.

1.1. Industrial developments

In the United States the consolidation of the national defence industry has been promoted by the government since 1993. This has resulted in a slimmed-down defence industry. It is now dominated by four large 'systems integrators' (Boeing, Lockheed-Martin, Raytheon, Northrop-Grumman); companies with sufficient size, capital and skills to develop, produce and integrate all the key parts of major weapon systems themselves (or to have it done for them). In Europe the 'secularisation' process only took off at the end of the 1990s. Since European national defence budgets have now frequently become insufficient to support the continued existence of national industries, the European changes are primarily focussed on internationalisation: the European defence industry is currently acquiring a strong transnational nature.

This internationalisation has actually not followed the course initially expected or most keenly awaited by the politicians. The plan by the six largest European arms manufacturing countries to establish a single pan-European defence company, the European Aerospace and Defence Company (EADC) failed. However, as a result of a merger and integration process the European defence industry is increasingly dominated by three large companies, which concentrate primarily on the production of military aircraft, missile systems and electronics. But many other military sectors are also, albeit to a lesser extent, dominated by an ever-decreasing number of internationally oriented companies. Through holdings, joint ventures and military cooperative programmes they are establishing an increasing number of connections, among themselves and also with smaller specialist companies.

The Advisory Council sees this 'naturally developed' structure as not simply a second best result following the failure of an EADC. If the three major European defence manufacturers succeed in manufacturing efficiently, economically and to a high technical standard, one will even be able to say that this diversity of industrial interests forms a realistic reflection of European political practice, characterised from the outset by its multiple nature. In addition this allows a certain degree of intra-European competition – in which transatlantic interests also have a role to play – to be maintained, thereby preventing the creation of a 'fortress Europe'.

1.2. *Interaction between security policy and military-industrial policy?*

In the view of the Advisory Council European governments should now reassess their relations with national defence industries. This requires political, military-strategic, financial and industrial choices. These choices will have to be made on the basis of divergent, sometimes conflicting, arguments and interests. Governments do now seem increasingly inclined to see the defence industry as a 'normal' branch of industry, which must be able to pay its own way. But at the same time they want to keep control of areas such as arms exports and military-industrial sensitive information. In an industrial sector which hovers between two different worlds – defence and the free market – such an ambiguous position is perhaps unavoidable. However it seems recently to have become even more divided: while financial and economic considerations are pushing companies increasingly towards internationalisation, security policy has remained essentially a national matter, in spite of the political progress made with the European Security and Defence Policy (ESDP). *In this context the Advisory Council has concluded that the link assumed by the government in its request for advice between a European military-industrial policy and the ESDP does not exist under present circumstances.* The lack of common strategic principles and operational concepts means that for the present the ESDP cannot be assumed to be giving direction to a European military-industrial programme. On the other hand, over the last few years European defence companies have been driven more by economic motives than by the political desire for closer European defence cooperation.

In 2001 the interests of the European defence industry are not solely at European level, they have become – depending on the circumstances – national, transatlantic or even global. So when referring to a European military-industrial policy which is beneficial for European defence industry, one should ensure that the interests of industry do not run into conflict at other levels. The focus should therefore be on a policy aimed at creating favourable conditions. *The Advisory Council notes that the growing number of transnational company relations within the European defence industry should be supported by uniform legislation, a minimum of internal trade barriers and a market which is as open as possible. In the view of the Advisory Council a policy based on this aim would require as a minimum clear European agreements regarding reciprocal supply guarantees, harmonised export procedures, the exchange of confidential information and agreements on a European Research and Technology policy. The harmonisation of military-operational requirements is a big step further, but should certainly be the ultimate aim.*

1.3. *European consultation*

In the opinion of the Advisory Council implementing the above agreements leads to a classic "prisoners' dilemma", where the rationality of collective interests does not correspond to the sum of the interests of individual states. This dilemma is clearly visible in European arms discussion fora, where the principles and conditions for defence equipment cooperation have been discussed for decades with no concrete results. Until a few years ago these discussions took place primarily within NATO and the WEU. Since 1997 a common military-industrial policy has also been discussed within the European Union. In its so-called Bangemann report the European Commission advocated a number of practical measures, falling within the competence of the European Union, to stimulate a common European defence market. Since according to Article 223/296 of the EC Treaty the defence industry itself – at least with regard to 'the essential interests of its security' – is excluded from the effect of EU market forces the European Commission has proposed that the conclusions of the Bangemann report be incorporated into a common position by the EU Member States. The aim of this was to

establish the political desire to implement the proposed measures. Regrettably the Advisory Council has concluded that this political will was not apparent in 1997 and is still lacking today. For this reason the European Commission today maintains a position of extreme caution with regard to this sensitive subject. *This notwithstanding, the Advisory Council believes that there is a growing need for clear, consistent legislation for the European defence industry, particularly in view of the intensification of transnational cooperation at company level. Given industry's increasing need for clarity and transparency the Advisory Council is of the opinion that a regulatory role for the European Union in the first pillar, that is to say with the involvement of the European Commission, will eventually prove unavoidable. The Advisory Council considers such a development to be highly desirable, not least because it could provide a strong impetus to the strengthening of the European integration process. The Advisory Council therefore strongly recommends that the proposals from the Bangemann report be kept on the agenda of EU discussions, if only initially for tactical reasons.*

The Advisory Council also considered the creation of a 'European Armaments Agency' within the EU structures, a matter which could become topical if the decision were taken to integrate the WEU armaments discussions (the Western European Armament Group and the Western European Armament Organisation) into the EU. *The Advisory Council notes that incorporating the WEU discussion, either in the first pillar, or in the Common Foreign and Security Policy, or in a form straddling several pillars would encounter major problems. The advice of the Advisory Council is therefore to allow the WEU arms discussions forum to retain its independent status for the time being so that it can justify its existence.*

Besides the activities of NATO, the WEU and the EU the 1990s in Europe witnessed two multinational select initiatives in the field of European military-industrial cooperation. In establishing OCCAR France, Germany, the United Kingdom and Italy sought to give an impetus to joint project management for military-industrial cooperative programmes. It works on the principle that the current practice of 'just returns' ('juste retour'), with the purchase of foreign equipment being compensated for in the form of counter orders for the national defence industry, no longer applies. It is replaced by a so-called 'global balance' arrangement, where the 'just returns' can be spread over several projects and several years. In addition France, Germany, the United Kingdom, Italy, Spain and Sweden also took the initiative of signing a Letter of Intent (LoI), later expanded to a 'Framework Agreement', with the aim of establishing reciprocal arrangements relating to transnational movement, supply guarantees, export procedures, the protection of sensitive information, Research and Technology, the harmonisation of military requirements and the exchange of technical information. *The Advisory Council concludes that although such 'exclusive' forms of cooperation are in conflict with the idea of economic and security cooperation within the EU as a whole, they are the only possible effective structures currently taking shape.*

2. Policy implications for the Netherlands

The Advisory Council believes that if one can distinguish between 'big' and 'small' European countries then with regard to the military-industrial field the Netherlands is undeniably one of the small countries. Dutch industry is primarily a supply industry, with the exception of the naval shipbuilding sector and the corresponding sensor and command system industry. The difference between 'big' and 'small' is considered to be important by the Advisory Council because in the European defence sector there is a clear split between the political interests linked to large, 'self-creating' defence industries and the interests which correspond to the small, primarily supply industries.

The policy of the 'big' European countries seems principally aimed at counterbalancing their loosening grip on their national defence industries through multinational cooperation. This does not necessarily lead to the liberalisation of the European defence market. On the contrary, for the 'systems integrators' and 'platform builders' (manufacturers of military land vehicles, ships and aircraft) there is, because of the major financial interests and the small number of customers and suppliers, by definition an inadequate market effect which will remain distorted if the market is opened up further. The industries involved therefore opt for bilateral or multilateral cooperation as a way of sharing the cost of Research and Technology and development. Even for the (relatively speaking still national) naval shipbuilding sector this is essential in order to survive.

The interests of the 'small' European countries relate primarily to maintaining a specialised supply industry, a leading role in specific technologies, dominance in niche markets and also (limited) employment. The problems for supply companies are very different from those of the systems integrators and platform builders. At this lower level there are a large number of suppliers and a relatively large number of customers. Thus breaking open the supply market would lead more easily to the free play of market forces than at the level of the systems integrators and platform builders. The political sensitivities at this level are also much less.

With the above in mind the Advisory Council makes the following recommendations:

A. A consistent, uniform and strict application of Article 223/296 of the EC Treaty
The Advisory Council notes that the abolition of Article 223/296 of the EC Treaty is politically not an option. However, there is growing international support for the uniform and strict application of this article. Such an approach allows greater clarity, predictability and openness in the European environment in which the Dutch defence industry operates. The Advisory Council recommends that in this area the Netherlands should approach other interested EU Member States. At the same time it should advocate a clear distinction between, on the one hand, integrated weapon systems and military platforms, which could be excluded from the effect market forces, and, on the other hand, subsystems, components and services by suppliers for which the European market could be opened up.

B. The Netherlands and OCCAR

The Advisory Council notes that, from a project management point of view, the principles on which OCCAR is based offer distinct advantages. Bringing new projects into the OCCAR system avoids the project organisation constantly having to reinvent the wheel. The 'global balance' working practice adopted by OCCAR will also function satisfactorily provided a strict control is kept on the ultimate fair exchange between the procurement of equipment through OCCAR and industrial participation in programmes. The Advisory Council stresses that the fairness of the exchange should be reflected in the technological level at which the 'global balance' is calculated. The Advisory Council concludes that OCCAR will only be able to satisfy its principles if the following four conditions are met:

- 1) OCCAR should manage a large number of programmes;
- 2) Within OCCAR there must be clear agreement on the security of supply;
- 3) As far as possible countries should harmonise the timing of their procurement requirement;
- 4) OCCAR member nations should harmonise the requirements for materiel to be procured through OCCAR.

The above conditions place severe demands on the OCCAR member nations and will not all be attainable in the short term. Time will tell whether membership of OCCAR meets Dutch expectations, and this will depend in part on whether other member nations are prepared to promote the interests of the defence supply industry. It is not possible to give judgement on this at this stage. On the other hand if the Netherlands does join OCCAR it is not obliged to take part in other OCCAR programmes if it derives no benefit from doing so. However, the Advisory Council is of the view that Dutch participation in the Letter of Intent initiative (see below) would be difficult if the Netherlands is not also part of OCCAR; even though officially there is no link between the two initiatives.

C. The Netherlands and the Letter of Intent/Framework Agreement

The Advisory Council notes that the core of the discussion regarding the Lol relates to the tension which built up during the 1990s between the continued restrictive, national military-industrial policy of European governments and the industrial practice of increasing transnational cooperation. The Advisory Council believes that it would be highly undesirable for the Lol states to create a permanent division between their own military-industrial interests and those of other EU Member States. In the long term such a split could cause alienation between the two groups. In this light and in view of the undeniable political impasse concerning the European Commission proposals, as set out in the Bangemann report, the Advisory Council would encourage other countries to join the Lol as soon as possible, beginning with the Netherlands and Belgium, in part because of their involvement in OCCAR projects. The Advisory Council also believes that the Lol countries should make use of the so-called Ad Hoc European Armaments Policy Group (POLARM) to keep the other EU states closely informed of progress within the Lol and to consult them on future developments of the Lol initiative. In this connection the Advisory Council would wish to point out that defence-related subjects at the Nice European Council are unfortunately excluded from any form of enhanced European cooperation ('coopération renforcée').

In the event of the Netherlands joining the Lol current arms export policy would be up for discussion. The Netherlands would then find itself in the same position as countries such as Germany and Sweden which also maintain a strict arms export policy. The government would have to work together with these countries to find solutions acceptable to Dutch political opinion.

D. Changes to the Dutch compensation policy

The Dutch compensation policy was born out of the lack of international trade opportunities for the Dutch defence industry. The Advisory Council believes that in the event of progress being made with regard to the areas discussed above (the strict application of Article 223/296 of the EC Treaty, a more open market and a widening of the membership of the Lol/Framework Agreement) it will be necessary to gradually abandon the current compensation policy. In that sense Dutch industry will have to be able to reckon on other forms of help from the government. For example, the Ministries of Economic Affairs and Defence should help to strengthen the position of the Dutch defence industry in relation to the European and American systems integrators and platform builders. One could envisage a more consistent approach to Dutch military exports – for example by creating a single official point of contact – and greater emphasis on participation arrangements. These could perhaps be achieved through compensation agreements for materiel procurement in other areas. The Ministry of Defence could also examine to what extent function-specific procurement could be introduced instead of the existing technical specific policy. There are lessons to be learnt here from the British practice of

'Cardinal Points Specification'. By specifying the requirements for military equipment only in relation to the key functional points one can avoid defence orders being 'tailored' to particular manufacturers and can ensure that companies seek cost-effective applications for specific functional requirements.

E. Dutch procurement policy: the best equipment for the best price

The 1991 Defence White Paper opted for a procurement policy with the emphasis on 'off-the-shelf' purchasing (obviously with the appropriate compensation). However in recent years the Ministry of Defence has tended to abandon this programme in favour of an approach geared more to participation in international equipment programmes. The Advisory Council would point out here that such a shift in the procurement pattern can have a favourable effect, provided it takes place under the correct conditions. In the case of too pragmatic a procurement pattern one may miss out on the chance of an early share in the development of new technology. Such technology allows the creation again of centres of excellence within Dutch industry capable of operating on the international market. In addition, participating in international equipment development avoids the Netherlands getting a reputation for being an opportunistic country – a 'free rider' – with which it is impossible to make satisfactory agreements. Sometimes there is no 'off-the-shelf' alternative available. Finally, extending the life of equipment – used increasingly to keep costs under control – is often only feasible through international cooperation.

This notwithstanding the Advisory Council believes that the principle of 'off-the-shelf' procurement should be retained as part of the attempt to obtain the best equipment for the best price. In the Council's opinion a further shift in procurement towards international projects and participation will only be justified if, and depending on the extent to which the Dutch defence industry's access to the international market is structurally improved and guaranteed. Strict application of Article 223/296 of the EC Treaty and the favourable development or widening of the Lol/Framework Agreement are key factors. In addition particular attention should be paid to the principles of a competitive procurement policy, clear price agreements and payment on the basis of actual progress.

F. Research and Technology policy

Attempts to establish a common European Research and Technology (R&T) system have floundered as a result of differences in opinion among the European states relating to aspects such as the openness of research, the ways in which research contracts are awarded and the implementation of the 'just returns' principle. All choices which are justified from a community point of view and which threaten to lead to a distribution of tasks whereby some European countries will have to be content with research at a lower technical level are categorically rejected by the research establishments and the individual states concerned.

Despite the lack of progress in the field of military R&T in the European Union the Member States have entered into lots of bilateral R&T cooperative agreements, oriented towards complementary knowledge and research. The Advisory Council believes that the further development and widening of these bilateral contacts represents a more practical and successful approach than trying to establish an EU-wide military R&T policy, however desirable this might be. It should also be noted that the increasing importance of civil technology in the production of defence equipment (dual use) already means that defence-related technological developments may be considered for subsidies as part of existing European research programmes. Such an aim should in the view of the Advisory Council be fully supported by the government.

G. The Netherlands and the American defence industry

The Advisory Council notes that transatlantic cooperation between defence industries is made considerably more difficult by the American government's reticence with regard to non-American companies. The so-called 'International Traffic in Arms Regulations' (ITAR) represent one of the major institutional American obstacles for European industry. A further complicating factor is the US Congress, which is able to hamper international cooperation in a variety of ways. The possibility of technological 'leaks', political distrust and the protection of American jobs mean that Congress is reticent – not to say negative – with regard to transatlantic military-industrial projects. In the view of the Advisory Council decision making in Congress would only become favourable to transatlantic cooperation if a sufficiently balanced merger between a European and an American systems integrator were to be achieved.

From a US point of view the Netherlands' status as a trustworthy European military-industrial partner is illustrated by the fact that at the end of 2000 it was invited to take part in discussions over bilateral ITAR exception provisions. The Advisory Council recommends that the government react positively to the American invitation for further discussions. At some stage the question will arise as to whether, and if so how, Dutch export regulations should be adapted to American commercial practice. The Advisory Council would point out that, quite apart from the problems this might raise on the domestic political front, in this case the Netherlands is in the same position as the UK, France, Germany and Norway, which have also been invited to take part in bilateral discussions. This could conflict with the arrangements set out in the letter of Intent and thus would require closer agreement, certainly within the Lol group. In the view of the Advisory Council a wish by the Netherlands to join the Lol would mean that our country would need to harmonise the discussions with the United States in a broader framework of European partners, in the full realisation of the dilemmas this will cause.

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All things considered, the Advisory Council believes that for the Netherlands opting for a strictly European or transatlantic course would be artificial. Furthermore, the recently agreed joint venture between Thales and Raytheon demonstrates that the French defence industry, for example, is also increasingly entering into cooperation with American companies in strategic sub-sectors. A definitive choice, whichever it might be, would certainly cause problems for the Dutch defence industry. For individual companies the US is too important a market to lose. In addition the European defence market, which in 1999 represented military exports three times as high as those to the US, can – provided open competition at supplier level is encouraged – offer many new industrial and political perspectives.

I The political context

What does the Advisory Council think the government should do to ensure that the positive attention for the ESDP is translated into greater political support for a European defence equipment policy?

I.1 The European Security and Defence Policy (ESDP)

Since 1998, when the United Kingdom announced that it wished to play a serious role in the field of European defence, there has been a discussion of a type previously not thought possible over European Security and Defence Policy among the EU Member States. At the European Council in Nice (December 2000) agreement was reached on a policy forum (a Political and Security Committee (PSC) which will operate within the EU framework on the basis of Article 25 of the Treaty of Nice), a military objective (the ability to execute corps -size military operations) and a general indication of the way in which the EU will interact with NATO (balancing between greater European military autonomy and the recognition of the paramount importance of NATO in relation to security).

Twelve months before the European Council in Nice, during the Helsinki European Council (December 1999) European heads of state and heads of government had already examined the desirable military capability of the EU Member States. The intention is that by 2003 Member States must be able to deploy within 60 days and for one year combined EU military forces equivalent to an army corps (approx. 60,000 persons). Since Helsinki the EU Member States have concentrated primarily on developing the necessary institutional structures. At the same time the operational reasoning behind the military strength has remained uncertain. At the so-called Capabilities Commitment Conference (November 2000) the EU Member States did result in earmarking 100,000 persons, 400 aircraft and 100 ships for EU operations, without however developing a strategic vision for their deployment. The possible deployment of a combined EU military force is for the time being based on a number of 'Illustrative Mission Profiles', ranging from the forcible separation of belligerent parties to humanitarian relief.⁶ The proposed scenarios are based on relatively low levels of force and take no account of the possibility of escalation. As a general rule such scenarios provide policy makers and military planners with only a limited amount of direction, given that they are not intended to be of use in determining which resources are required by which situation. There is also no clear indication of the geographical scope of European operations.

Further there is a lack of clarity relating to the degree of independence of the European military capability under consideration. According to various European statements a combined European military force should be able to operate 'autonomously'.⁷ It should therefore have the appropriate command and control, intelligence capability, logistic

6 During a press conference in the margins of the informal meeting of EU Defence Ministers in Rouen (22 September 2000) the French Minister of Defence, Alain Richard, listed four separate 'Illustrative Mission Profiles' to be developed by the EU member states: 'separation by force, conflict prevention (preventive deployment), humanitarian aid and evacuation'.

7 See for example the declaration of St. Malo (December 1998) and the Presidency Conclusions from the Cologne European Council (June 1999) and the Nice European Council (December 2000).

support and combat support from navy and air force in order to be able to execute 'the most demanding crisis management tasks' (declaration of St. Malo) or 'the full range of Petersberg tasks' (Helsinki European Council). In this connection France has put forward ambitious plans. In a 'Plan of Action' President Chirac has made proposals including European chains of command, autonomous intelligence gathering, possibilities for 'power projection' and command, control and communications (C3) capabilities. In contrast the British proposals seem to be limited to creating possibilities for the deployment of an effective force drawn from European nations. If this requires autonomous European capabilities, then in British eyes these will have to be established in close cooperation with NATO partners (in other words, the United States). With regard to defence the EU would operate as an 'intelligent customer of NATO's military Services', but not as an autonomous defence organisation.

There are therefore still considerable political differences of opinion over the degree of autonomy of any European defence capability. At the end of 1999 the British government – in response to American pressure - even tried discreetly to replace the concept of autonomy by the weaker wording 'missions in which the United States does not wish to be involved'.⁸ It is noteworthy in this context that the Franco-British summit in St. Malo in November 1998, the Helsinki European Council (December 1999) and the closing statement of the Capabilities Commitment Conference continue to refer to 'autonomous capacity to take decisions and, where NATO as a whole is not engaged, to launch and conduct EU-led military operations'. In the Helsinki text this sentence is followed by the condition that this process 'will avoid unnecessary duplication and does not imply the creation of a European Army'. The ESDP Presidency Conclusions from Nice also refer to 'une capacité autonome de décision et d'action dans le domaine de la sécurité et de la défense', although 'cela n'implique pas la création d'une armée européenne ... pour les états membres concernés, l'OTAN demeure le fondement de la défense collective de ses membres, et continuera à jouer un rôle important dans la gestion des crises.'

The question is, of course, how 'unnecessary duplication' on the one hand and 'capacité autonome de décision et d'action' on the other hand will be interpreted in the various capitals. For the government in London it means enhanced European capabilities which are seen by the US as a contribution to more balanced transatlantic relations without at the same time creating the impression that Europe is 'going it alone'. For France the key starting point is the independence of European military capabilities.⁹ These divergent British and French points of departure can only be reconciled due to the fact that at present the United Kingdom is being led by practical considerations, whereas France is concentrating on strategic visions for the long term. Acting in accordance with the common political will to develop further the ESDP the two countries

8 J. Howorth, 'Britain, France and the European Defence Initiative', *Survival*, vol. 42, no. 2, Summer 2000, p. 44.

9 The French notions of a fully autonomous European defence capability, which would be capable of deploying without NATO assets have received virtually no European support. Apart from Sweden and Belgium, the EU Member States have (albeit for various reasons) sided with the UK whenever France placed too much emphasis on the on the autonomous nature of European defence. Germany stated unequivocally that any weakening or exclusion of NATO is undesirable. See: J. Howorth, 'European integration and defence: the ultimate challenge?' (WEU Institute for Security Studies) Paris 2000, pp. 46-49.

have always been able to overcome their differences of philosophy. The calculated ambiguity which flows from this may well suffice for the creation of a blueprint for European political military decision making, but at the same time it will have important limitations for the realisation of a European defence capability.¹⁰

1.2 A political-military or an economic perspective?

The government's request for advice presumes that there is a link between the ESDP and a European military-industrial policy. The Advisory Council is of the view that in the present situation such a link cannot be made. Although it was never actually put to the test during the Cold War NATO has always been an efficient military organisation, ready for battle, without there ever having been an explicit link with military-industrial policy. One can of course counter this with the fact that the effectiveness of the Treaty organisation is due to the American military preponderance within the Alliance, to efficient common procedures and decision-making mechanisms and to the fact that for a long time military-operational cooperation within NATO could remain essentially limited to geographical harmonisation (between national 'sectors') of the defence against the Warsaw Pact. Nevertheless, it is true that the effectiveness of any internationally composed military organisation is primarily dependent on good coordination and interoperability. The latter is helped by the common definition of equipment requirements by the participating states, rather than a common military-industrial policy as such.

Given the ambiguity surrounding the ESDP it is not realistic to take this as a starting point for European military-industrial cooperation at the present time. The first step towards the political-military direction of military-industrial policy would have to be to establish common military-strategic principles. These would then form a basis for the development of planning hypotheses, and later of operational scenarios, thereby allowing generic European capabilities to be formulated. Only such an exercise could indicate the direction to be taken by European governments to achieve a cohesive equipment policy and thus, in the long term, steer a European military-industrial policy as set out in 4.1. of this advice. Quite apart from the question of whether formulating such a common strategy is politically feasible, it must be concluded that the desire for greater military effectiveness has as yet not served as the driving force for a military-industrial policy.¹¹ After all, this desire has existed for decades without ever producing any concrete result.¹² The reasoning behind European military-industrial policy in recent years can better be sought in economic necessity. The gulf between ESDP and European military-industrial cooperation can be clearly illustrated by the wave of mergers leading in 1999 to the creation of the French-German-Spanish European Aeronautic Defence and Space Company (EADS). If this had been the consequence or result of the St. Malo process, one would have rather expected a close cooperative venture between companies such

10 See: F. Heisbourg, 'Europe's strategic ambitions, the limits of ambiguity', in: *Survival*, vol. 42, no. 2, Summer 2000, p. 5.

11 The term 'secularisation' is used by P. Gummett and W. Walker, 'Britain and the European Armaments Market', *International Affairs* 3/1989, p.442. Others, such as P. de Vestel, 'Defence markets and industries in Europe: time for political decisions?', Brussels 1995 (WEU Institute), refer to 'civilianisation'. American analyses refer namely to 'commercialization'.

12 A. Politi, 'The future of the European defence industry', in: G. Lenzi (ed), *WEU at fifty*, (WEU Institute for Security Studies), Paris 1995, p. 69.

as British Aerospace (BAE) and the French electronics concern Thales/Thomson-CSF. This was actually the cherished wish of the British government, but it was never taken seriously by the defence industry itself, mostly because of the great cultural gap between British and French industry which existed at the time. Nor was the Franco-German cooperation within EADS in any way forced by politicians. On the contrary, the French and German governments were only informed at a very late stage of the proposed cooperation between the companies involved, Dasa and Aérospatiale-Matra.¹³

1.3 A national or an international perspective?

The conclusion has been drawn above that it is currently not realistic to take the European security policy as a basis for a European military-industrial policy. Thus the concept that this policy should be approached from a purely economic perspective is insufficiently justified under current European circumstances. For example, the military procurement policy within the Member States of the European Union does not always correspond with the interests of industry. Despite many attempts the EU Member States have been unable to achieve agreement on the harmonisation of their procurement cycles, materiel requirements, a flexible exchange of national industrial interests ('just returns') and supply guarantees (security of supply). International consultation, be it in NATO, the WEU or the EU, has in the past remained ineffective in precisely these areas because of a lack of harmonisation. It seems that principles that in a national context are logical and rational form obstacles in the current international environment. This is a classic 'prisoner's dilemma', where the rationality of states' collective and national interests do not coincide. In an industrial sector increasingly characterised by transnational cooperation the urgent need to remove the obstacles resulting from the governmental interests of individual states is growing daily.

As long as the governments of the EU Member States remain unwilling to solve the above problems through agreement – which for each EU member state would mean fundamental changes to the current procurement policy – international consultation will fail to produce the solution. This applies to both consultations within the international fora mentioned above and to discussions in future ad hoc coalitions. Chapter IV of this advice looks at this subject in greater detail.

¹³ B. Schmitt, 'From Cooperation to integration: defence and aerospace industries in Europe' (WEU Institute for Security Studies, Chaillot Paper 40), Paris 2000, p. 38.

II The defence market

What is the Advisory Council's assessment of the general political and industrial climate for a European military-industrial policy and for an open common market for defence equipment?

II.1 The 'secularisation' of the defence sector

As early as the nineteenth century the major European states began to recognise the importance of actively supporting and protecting their national defence industries. Protected from commercial market forces, the national defence industries tailored their activities to ever more complex procurement systems, where the specifications of the end product became more important than the effectiveness or efficiency of the production process. This led to the interests of industry and government becoming ever more closely intertwined. This practice was maintained during virtually the whole of the twentieth century; even after the two World Wars one of the prime concerns of European governments – both within NATO and the Warsaw Pact – was to ensure at all costs that the national technological standard was equal, or preferably superior, to that of the adversary.

Well before the end of the Cold War the drawbacks to this linkage of interests between governments and the military industry began to become apparent. Each individual industrial nation trying to maintain its own defence industry gave rise to an indefensible degree of costly duplication and industrial fragmentation. Falling defence budgets in the US and the UK led those countries as early as the 1980s to adapt their military-industrial policy, with cost-effectiveness factors playing an increasingly important role in the procurement of defence equipment. British and American companies were thus forced to become more efficient. This 'commercial pressure' intensified and spread widely after the end of the Cold War, resulting in major changes to the military-industrial system that had been developed since the nineteenth century.

Some analyses refer in this context to the 'secularisation' of the defence industry. By analogy with the historical process whereby important sectors of society were removed from the control of the Church, this refers to the adoption by the defence sector of the characteristics of the free market, causing the disappearance of its exclusive (primarily non-market) characteristics.¹⁴ It should be emphasised that to a certain extent this 'secularisation' relates to *relative* changes. The altered attitude of governments has only partly changed the character of the defence industry. In the view of many important players (more so among politicians than in industry) the defence industry still retains an in-built intrinsic political appeal.¹⁵ There follows a more detailed discussion of five fundamental aspects of the process of 'secularisation' of the defence market. They are the

14 The term 'secularisation' is used by P. Gummett and W. Walker, 'Britain and the European Armaments Market', *International Affairs* 3/1989, p.442. Others, such as P. de Vestel, 'Defence markets and industries in Europe: time for political decisions?', Brussels 1995 (WEU Institute), refer to 'civilianisation'. American analyses refer namely to 'commercialization'.

15 A. Politi, 'The future of the European defence industry', in: G. Lenzi (ed), *WEU at fifty*, (WEU Institute for Security Studies), Paris 1995, p. 69.

worldwide fall in defence expenditure, the rise in equipment costs, technological changes, the new government attitudes and the increasing role of private capital.

Falling defence expenditure

Since the end of the Cold war most NATO Member States have made considerable reductions in their defence budgets. With the disappearance of the massed threat from the Eastern Bloc the level of defence expenditure became increasingly hard to justify politically. Higher priority could thus be given to other political areas, such as education, public order, the welfare sector and above all the budgetary discipline agreed upon within the framework of the EMU.¹⁶ Between 1989 and 1998 defence expenditure in France, Germany and the UK fell by 12, 24 and 28 per cent respectively.¹⁷ The rapid fall of the first few years did not continue at the same rate after 1995. Nor is there any indication of a reversal of this trend.¹⁸ In many cases the reduction in the defence expenditure affected primarily equipment budgets (procurement and research), in other words expenditure felt directly by the defence industry.

Rising equipment costs

The fall in defence expenditure is in stark contrast to the increase in the development costs of ever more accurate and more complex weapon systems, a trend which actually dates from the beginning of industrial weapons manufacture, but which has accelerated considerably over the last few years. Because of the strategic changes which have taken place since the end of the Cold War these weapons are increasingly expected to satisfy the requirements for operational mobility (they must be able to change position rapidly) and flexibility (weapon systems must be able to operate under divergent geographical conditions in differing multinational frameworks against diverse opponents). Mobility requires a long distance transport capability, and for weapon systems possibly airtransportability. Flexibility requires factors such as good observation and reconnaissance assets and powerful interoperable communications systems. Maximum personal protection and precision weapons also have a high priority. Armed conflicts have to be able to be fought out with the minimum possible collateral damage and the fewest possible risks for own troops. Industrial and technological developments make such requirements ever easier to achieve. This accumulation of new requirements has caused the true costs of developing main battle tanks to rise by a factor of three since 1960, with the development of aircraft – in real terms – becoming at least 25 times as expensive as it was in the 1950s.¹⁹

Falling defence expenditure itself is also responsible for increased costs. Cuts lead to orders being postponed and reductions in armaments programmes. This in turn causes a drop in production activity and thus an increase in the unit cost.²⁰ Thus the repercus-

16 K. Vlachos, 'Safeguarding European competitiveness', p. 12.

17 The Economist, 13 January 1996, p. 63.

18 SIPRI, Yearbook 2000, London 2000, p. 234.

19 For example an F-16 (1976) was seven times as expensive as an F-86 (1950). F-16s cost at least USD 30 million each. The F/A-18F developed later costs around USD 50 million and the future F-22 is expected to cost around USD 100 million. European aircraft have undergone similar increases.

20 It has been calculated that in the case of the NH-90 helicopter delays and reductions in orders caused costs to increase by over 30%. Similar complications mean that the unit cost of a Rafale fighter aircraft has already doubled.

sions of increased development and production costs and the drop in defence expenditure have a cumulative effect. They also have important implications for the number of new armaments programmes entered into. In the 1950s the United States could afford to introduce six new types of fighter aircraft into service, in the 1960s two new types and in the 1970s also two new types. The plans for the next generation of American fighter aircraft are based on a single model (Joint Strike Fighter) which, with minor modifications, is supposed to be suitable for use by the air force, the navy and the Marines. In contrast, in Europe there are still three different industrial fighter programmes (Rafale, Eurofighter and Gripen). This triplication is already causing serious problems. As the number of European acquisition programmes drops, the consequences for companies which are excluded will grow. They will be more or less forced to give up their activities in that particular defence sector.

Technological changes

Throughout the world the end of the Cold War led to major changes in military strategic concepts. These changes were based not only on new threat analyses and new military tasks (more emphasis on crisis management), but also on new technologies introduced into various defence sectors during the 1990s.²¹ Current strategic thinking is based to a significant extent on the so-called 'Revolution in Military Affairs' (RMA) which owes most of its success to the Allied victory in the Gulf War. The RMA involves the integration of, on the one hand, information gathering (intelligence, surveillance, reconnaissance) and, on the other hand, the military processing thereof (command, control, communications, computing).²²

The key systems which make up the RMA are based on modern electronics, information technology and telecommunications. The link between these systems is their civilian origin. There is no longer talk of a military 'spin-off' into civilian markets - the process now tends much more to spin in the other direction ('spin-in'). This should be explained not only by the great innovative power of civilian companies; financial considerations also have a role to play. Because the life cycle of successive generations of electronic, telecommunications and information systems has now dropped to less than four years, the defence industry can no longer afford to develop purely military components. The limited quantities of these components alone would be enough to send unit costs sky high.

The growing role of civilian technology in the defence sector is one of the most marked and most substantial changes which the defence industry has undergone in recent years. On the one hand companies manufacturing 'classical' weapon systems are increasingly making use of civilian technologies which they have not developed or would not have been able to develop themselves. On the other hand these technologies are becoming more important than the so-called weapon platforms themselves

21 See for example, Advisory Council for International Affairs, 'Developments in the international security situation in the 1990s; from unsafe security to unsecured safety' (Advice 10), The Hague 1999, pp. 9-18.

22 This development also affects non-American NATO partners, such as the Netherlands. It is illustrated by the introduction of new operational information systems into Dutch higher headquarters and by the 'battlefield management systems' and 'soldier digital assistants' at lower levels. Another example is the RNLA and RNLAF cooperative project Titaan (theatre independent tactical army and air force network), whereby information and communication technology is used to achieve a high degree of integration of operational command and control between the two Services.

(aircraft, ships, land vehicles). System integration and military electronics have, in recent years, been the most important – possibly the only – growth sectors for the defence industry. As a result of these developments it is increasingly difficult to distinguish between defence industry and civilian industry. In this context there is talk of the growing ‘dual-use’ nature of military production.

New governmental attitudes

The use of commercial elements in military systems is facilitated by a changing official procurement policy. To save the defence budget and to cut the costs of military products governments have, in recent years, become more and more prepared to accept the idea of defence systems being put together using technology available on the free market. This is closely linked to another change in official procurement policy: governments are increasingly behaving like ‘critical customers’. Faced with a continued stream of cuts, many governments have changed from a ‘regulated model’ (priority for specific national projects) to a model where arms procurement is based on a high ratio of price/quality and (potential) international competition. The close links between governments and their national defence industries have thus been replaced by more commercial relations.

The increasing role of private capital

Falling defence expenditure has meant that a number of countries (France, Italy, Spain, Sweden) reduced their state influence at the end of the 1990s and allowed companies to privatise. Nowadays all the major European and American electronics, aviation and space companies which also produce high quality defence systems have been privatised and are listed on the stock exchange.²³ Since the 1990s shareholder participation in key sectors of the European defence industry has caused a revolution, with the traditional dominant technical-official corporate culture making way for a culture of ‘corporate governance’, out to maximise profits and optimise the use of capital.

Thus ‘shareholder value’ has become one of the key aims of defence companies. However, this does not remove the fact that the defence industry is ridden with characteristics which hold little attraction for investors. For example, the long term outlook for the defence market remains limited, the development of defence products involves extremely high R&T costs, defence sales are subject to enormous fluctuation and product cycles are exceptionally long (in the defence sector things are calculated in decades, which is unheard of in the civil sector). Such circumstances lead to uncertainty regarding the short-term profit-earning capacity of military-industrial investments.²⁴ The question thus arises as to whether in the longer term defence companies will continue to be able to attract sufficient capital via the stock exchange. It can be pointed out that the effect of financial market forces in the defence sector will encounter restrictions here. If certain strategic technologies threaten to disappear from countries as a result of high R&T costs and limited commercial applications, governments are likely to feel obliged to fill the financial gap left in the market. Discussions on the need for a government supported ‘Defence Industrial and Technology Base’ (DITB) seem to be concentrating to a growing extent on these fringes of the market.

23 One exception is the situation in Germany, where the three major producers of military equipment for the army (Rheinmetall, Diehl and Wegmann-Krauss Maffei) are still either owned or dominated by particular families. See: P. Lock, ‘Rheinmetall: a paradigm of restructuring of the defence sector in Germany’, see: www.peter-lock.de/rheinmetall.html.

24 A. Nicoll, ‘Lockheed and Raytheon cast giant shadow’ in: Financial Times, 26 January 2000.

II.2 New business strategies

As mentioned before, as a result of the 'secularisation' of the defence sector the European defence industry feels increasingly called upon – or obliged – to adopt the logic of the free market economy. The key aspects are to optimise productivity and to ensure the widest possible access to the market. To this end European defence companies have developed seven strategies: concentration and consolidation, a restructuring of industrial activities, rationalisation, a more aggressive export policy, internationalisation, participation agreements and, finally, a global approach. A detailed description of these strategies follows. It should be pointed out that it is sometimes difficult to separate them and that one is frequently an extension of another. Nevertheless, this categorisation makes it possible to demonstrate how the defence industry has responded to the challenges of the 1990s and the structural changes that have resulted.

Any evaluation of this development must take account of the time factor. Many structural changes can only be introduced to new military-industrial programmes. The major projects currently appearing on the market (such as the Tigre combat helicopter and Eurofighter 2000) were set up during the 1970s and 1980s under circumstances very different from those of today. The eventual effects of the 'secularisation' of the defence sector and to what extent these will be felt in the efficiency of industrial programmes will only be visible in a few decades' time.²⁵

Concentration and consolidation

Of the world's hundred biggest defence companies in 1990, by 1999 twenty-four were no longer operating independently as a result of mergers and take-overs. Half of these had disposed of their military production completely. The rest had been taken over by or merged with other defence firms. During 1999 a further ten major defence firms were subsumed into larger industrial conglomerates. As a result of this wave of concentration, which dramatically increased the size of the biggest defence companies, the five biggest industrial conglomerates became responsible for almost 41% of defence production worldwide. In 1990 this figure was only 21%. This type of concentration is one of the obvious survival strategies adopted by defence industries to avoid duplication of effort, to combine resources for R&T, to maintain investment resources and at the same time to increase the share of the market.

Initially this consolidation process did not lead to increased international cooperation. On the contrary, states tried to protect their national defence industries by encouraging the creation of 'national champions', large companies with a national production monopoly in one or more sub-sectors.²⁶ In Europe this sort of process could be observed primarily in France, the United Kingdom and Germany.

Although across the world there are still thousands of small and medium-sized defence companies, there are nowadays only a very small number of defence firms capable of producing the most technologically advanced systems. Without exception these are

25 For example, it has been calculated that it will take 20 to 30 years to change European military-industrial policy. See: W. Walker, Ph. Gummett, 'Nationalism, internationalism and the European defence market.' Paris 1993 (WEU Institute for Security Studies; Chaillot paper 9), p. 28.

26 See for further considerations: T. Taylor, 'West European Defence Industrial Issues for the 90's, in: Defence Economics, vol. 4, 1993, p. 116.

large companies. Some are referred to as 'systems integrators' because they have the skills, the technological expertise and the financial assets to develop, produce and integrate all the key parts of major weapon systems themselves (or to have it done for them). During the 1990s the size and influence of these 'systems integrators' increased. Most remarkable was the development in the United States where following a wave of mergers and take-overs – supported by the American administration²⁷ – only four 'systems integrators' remained, of which two were truly gigantic (Lockheed Martin and Boeing).²⁸ This development cost the jobs of a million American employees.²⁹ The US government's decisions in 1998 to block the take-over of Northrop Grumman by Lockheed Martin and, in 1999, to oppose the merger of General Dynamics and Newport News Shipyards, indicate that the American government has come to the conclusion that company concentrations in the US have reached their limits. In particular it would now seem to be worried about a vertical integration of companies, which could hamper reciprocal competition and innovation.

The question arises as to whether the four remaining defence giants will not continue to struggle with their new size and with the enormous internal diversity resulting from the mergers.³⁰ The Swedish research institute SIPRI concluded recently that the American 'newly formed giants [in 1999] experienced sharp falls in profits and share prices and were preoccupied with consolidation.'³¹ Further consolidation would inevitably lead to a loss of the elementary knowledge and technological capacity built up by defence companies over the years.³² Although the limit has been reached for mergers between the largest American companies, there is currently a second wave of consolidation taking place at a lower level. This is primarily based on the merger of supply companies (subcontractors) and is being encouraged by the hiving-off of non-strategic areas by the major companies.

Restructuring of industrial activities

Since the early 1990s virtually all major defence companies have developed strategies to diversify their production. To this end some companies have disposed of their

27 In 1993 a 'last supper' was held for the US Minister of Defence, Les Aspin, and representatives of the major American defence industries. The Minister asked the representatives to 'Go forth and merge'.

28 In 1998 Lockheed Martin had 165,000 employees and a turnover in excess of USD 26 billion (of which 18 billion from military products). In the same year Boeing had 231,000 employees and a turnover of USD56 billion (of which 16 billion from military products). See: SIPRI, 'Yearbook 2000', p. 328.

29 G. Adams, 'The necessity of transatlantic defence co-operation' in: G. Adams i.a., 'Europe's defence industry: a transatlantic future?' London 1998 (Centre for European Reform), p. 44.

30 A. Nicoll, 'Struggling to stay on target', Financial Times, 31 March 2000.

31 SIPRI, 'Yearbook 2000', p. 299, 304, 305. SIPRI list three problem areas that have become apparent since the concentration process:

- 1) the burden of debt incurred by companies in order to take over other firms and problems during industrial integration have led to reduced profitability and a sharp decrease in share values;
- 2) reduced competition has led to a reduction in the American government's influence on the American military-industrial sector;
- 3) the industrial concentration process has been at the expense of diversification into civilian sectors.

32 IISS, 'The military balance 1999/2000', London 1999, p. 284.

defence activities completely. The financial risks could no longer compete with the profit expectations. In contrast other companies have drastically expanded their defence activities. In this way a number of small European 'platform' (land vehicles, aircraft, ships) manufacturers have converted to 'systems integrators' and some defence companies have also turned to the provision of military services.³³

Especially in the aviation and space sector, and also defence electronics, there has been a growing role for commercial activities. Diversification into civilian sectors even became one of the core strategies. The aim was to use a combination of civilian and military activities to counterbalance the yo-yo effect of the particularly heavy fluctuation of military and civilian sales ('anti-cyclical policy'). The 'dual-use' nature of electronics and the expected benefits of using civilian research for military production ('spill-over effect') reinforced this diversification process.

Rationalisation

In order to improve their efficiency and profit margins in a 'secularising' defence sector, virtually all defence company found themselves obliged to rationalise their production and management. Many defence companies have adopted production techniques from the commercial sector to cut down on operating expenses and speed up production. In the European defence industry rationalisation considerations have also led to a drastic downsizing of excess capacity and a reduction in overheads, resulting in a large number of redundancies.³⁴

This rationalisation now also seems to be encountering limits. Whereas the threat from the Warsaw Pact during the Cold War ensured that companies were judged essentially by the quality of their products (if products were unsatisfactory the whole production line was shut down), many production lines are now being kept open with a view to keeping jobs. One of the results of this is that there are still three different main battle tanks being produced in Europe³⁵ at a time when it is questionable whether the future European defence market will justify the production of even one European tank.³⁶ The same applies to aviation: the production of three European fighter aircraft is incompatible with the (potential) demand. It is often argued that keeping open various European defence industries within one sector is the reason for Europe lagging behind the United States technologically. Many European assets are being devoted to keeping separate companies running, which means that there is too little left for innovative technology.³⁷

Not only in Europe, rationalisation has also had only limited success in the United States. The Swedish research institute SIPRI concludes that the wave of consolidation

33 Companies are expanding the scope of their activities by taking over certain privatised tasks from the armed forces, particularly in the field of maintenance and logistics.

34 Job reductions in the defence industry: Germany -57%, Spain -53%, UK -37%, Sweden -36%, Italy -33% and France -21%. IISS, 'The military balance 1999/2000', London 1999, p. 284.

35 The British Challenger, the French Leclerc and the German Leopard.

36 'The shape of the battle ahead', in: The Economist, 18 November 2000.

37 B. Clark, 'More harm than good? The dangers of defence industry consolidation', in: G. Adams i.a., Europe's Defence Industry: a Transatlantic Future?, London 1998 (Centre for European Reform), p. 17.

within the American arms industry has not produced sufficient rationalisation of production lines. One explanation was that the official policy offered too little stimulus in this area: 'It did not provide sufficient compensation to workers and communities affected by plant closures, so it was undermined by political resistance. As a result, the number of major weapon platform lines has not in fact declined in the US. Rationalization has been meagre'.³⁸

Increased exports

During the course of the 1990s defence companies turned increasingly to the export of their products in order to make up for the loss of sales in a declining domestic market. This trend was particularly strong in France and the United Kingdom. The rise in the turnover of the British and French defence industries from the middle of the 1990s is due to increased exports. In 1998 the UK exported 48% of its national defence production. In France the figure was 40%. Relatively speaking arms exports from the United States have remained at a lower level. They rose from 13% of national armaments production in 1987 to 21% in 1997.³⁹ Nevertheless, in 1999 American weapons manufacturers were responsible for almost 50% of the world's arms trade. The UK was in second place with almost 19%, followed by France with 12.4%.⁴⁰ This growing export autonomy makes an effective export policy, oriented towards arms trade control, more difficult to achieve.⁴¹

Internationalisation

As pointed out earlier, in spite of the rationalisation process to which the defence industry has been subject, particularly in Europe there is still a considerable amount of duplication of effort in the production of defence equipment, even though national markets remain restricted. The rise of 'national champions' in various European countries has even reinforced this. However, the continuing restricted market and overlapping production processes have also caused companies to incorporate a certain degree of 'internationalisation' into their survival strategies; an aim which pursues the 'Europeanisation' set in motion during the 1960s. At that time the costs of modern weapon systems had already risen to such an extent that France, the UK and Germany had to establish partnerships in order to be able to develop new weapon systems (Jaguar and Tornado fighter aircraft; Roland and Paams missile systems). Originally these partnerships did not involve common commercial structures. They were primarily based on industrial work-sharing, with each partner being responsible for a clearly defined part of the development and production of the whole product. Despite the ad-hoc nature of this type of cooperation, it became interwoven to such an extent that by the end of the 1970s it was no longer possible to speak of national defence industries for certain military-industrial sectors. From the 1980s European governments began to distinguish between industrial capabilities which they wished at all costs to continue to develop

38 SIPRI 'Yearbook 2000', p. 305.

39 SIPRI 'Yearbook 2000', p. 319.

40 IISS, 'The military balance 2000-2001', London 2000, p. 288.

41 See for arms exports and the security problems of Africa: Advisory Council on International Affairs, 'Africa's struggle. Security, stability and development' (Advice 17) The Hague December 2000). See for a more general analysis: Advisory Council on International Affairs, 'Conventional arms control; urgent need, limited opportunities' (Advice 2) The Hague April 1998.

nationally, capabilities which could be developed internationally and capabilities which could be drawn from the international market.⁴² With this in mind in a number of cases defence companies entered into semi-permanent international cooperative partnerships. Development and production were still shared between the participating companies, but sales, after-sales and programme coordination were increasingly performed by a common organisation, which also acted as the public face of the cooperating companies.

Not only has the *number* of international military-industrial cooperative partnerships increased considerably since the 1980s (from ten in the late 1970s to eighty by the mid-1990s), the *nature* of international cooperation has also changed. Whereas in the mid-1980s there was a rapid rise in the number of mergers and take-overs among defence companies, the beginning of the 1990s saw an increase in the number of joint ventures tailored to specific acquisition programmes (joint procurement). The intention was that this type of cooperation would keep in check the development and procurement of major European weapon systems, which had become too expensive to be borne by individual countries. However, some of these joint ventures turned out not to be cheaper, but rather more expensive than national projects. This was as a result of costly 'just returns' arrangements, but also of conflicting interests.⁴³ The participating defence industries turned out to be far more interested in reinforcing their own technological basis, rather than cooperation or increased efficiency. They first attempted to use internationalisation to postpone a painful rationalisation process.⁴⁴ In addition the complexity of the international administrative and industrial organisation made for extra costs and political problems made life difficult for the new European cooperative partnerships.⁴⁵ For example, it initially appeared impossible for France, Germany, the UK and Italy to set out common requirements for their Eurofighter programme. After five years of discussion the four countries managed to agree a single specification, which had however to allow for the possibility of producing different versions of a single Eurofighter. In the meantime the disagreement between France and Germany on the subject of industrial contracting had escalated to such an extent that the French government took the decision to withdraw from the project and develop its own aircraft (Rafale). Once the Eurofighter project finally got under way, without the French, it was plagued by numerous differences between the British and the Germans with regard to technical specifications, funding, development and production. Similar problems have also arisen with the joint Tigre combat helicopter project, which was launched with powerful political support from France and Germany, but which soon ran into delays because of difficulties in harmonising requirements. The common European development of the Horizon frigate also suffered the same trials, this time because of British-Italian disagreements.

42 'Le Livre Blanc sur la Défense' Paris 1994 (Documentation française), p. 153; quoted from: P. de Vestel, 'Defence markets and industries in Europe: time for political decisions?' Brussels 1995 (Chaillot paper 21), p. 31.

43 'Just returns' refers to the obligation on companies selling equipment to place compensatory orders with industry in the countries purchasing the foreign equipment.

44 M. Colvin, 'European armaments restructuring and the role of WEU' Paris 1998 (WEU Assembly document 1623).

45 B. Schmitt, 'From cooperation to integration: defence and aerospace industries in Europe' Paris 2000 (Chaillot Paper 40), p. 16.

Given the changes in the defence sector, by the second half of the 1990s it became clear that a laborious, ad hoc, project-based cooperation between defence industries was no longer enough to achieve the desired level of efficiency and profit. The Eurofighter, Tigre and Horizon programmes were all unable to deliver their product on time. They also threatened to be too expensive to be able to compete with American equipment. Once this was recognised a number of European countries (UK, France, Germany, Italy, Spain and Sweden) tried, at the end of the 1990s, to reach an integrated pan-European cooperation in the form of a European Aerospace and Defence Company (EADC). This pan-European company never actually came to fruition. One of the main reasons for this was the decision by one of the companies involved, British Aerospace (BAE), to stop negotiations when the opportunity arose to take over the British-American defence electronics company GEC-Marconi. In response to this the German aerospace industry concentrated increasingly on cooperation with France, which led in October 1999 to the foundation of a new European international aviation and defence conglomerate, the European Aeronautic Defence and Space Company (EADS), a cooperative partnership between the German Dasa, the French Aérospatiale-Matra and the Spanish CASA.

Thus over a period of two years the European military-industrial landscape changed dramatically. In the aircraft building sector two major – but very different – industrial players remain: EADS and BAE. While the former has a primarily horizontal structure and owes its strength to building civilian aircraft, the latter has a vertical organisation and specialises in defence products. Thanks to its take-over of GEC-Marconi the British company has also become an important producer for the North American market. There are now over 25,000 people working there for BAE.⁴⁶ The company is one of the Pentagon's key industrial discussion partners and more and more of its turnover is now in the US.⁴⁷ BAE has further strengthened its position on the American market through its take-over of the department of Lockheed Martin which manufactures control systems and the department responsible for aviation electronics.⁴⁸ The Pentagon says that it treats BAE as an American company, which has advantages when it comes to procurement and to future take-overs of American companies. BAE has also embarked on close collaboration with Boeing and Lockheed Martin through the Joint Strike Fighter programme. Because of its strong position on the American market BAE sees itself not as a European defence firm, but as a global company.

Even though the activities of EADS are centred far more on Europe, BAE and EADS do in fact work closely together in a large number of joint ventures: 68% of the EADS turnover results from joint industrial activities with BAE; 25% of BAE's turnover comes from cooperative programmes with EADS. It is true that over 30% of BAE's international programmes are carried out jointly with American companies, but this figure does not take account of the fact that this cooperation relates primarily to the transfer of British technology to American companies. In contrast BAE's European programmes are focused more on joint product development and thus have greater added value.⁴⁹

46 The take-over of the Lockheed Martin Aerospace Electronics department (AES) meant that the number of Americans employed by the British in July 2000 rose from 18,000 to 25,000. See: 'BAE Systems chief's approach is step-by-step', in: Financial Times, 24 July 2000.

47 'Sir Janus', in: The Economist, 23 December 2000, p. 112.

48 Frankfurter Allgemeine Zeitung, 3 June 2000.

49 R.P. Grant, 'Transatlantic armament relations under strain', in: Survival, Vol. 39, no.1., Spring 1997, p. 121.

Despite the dominance of the military aircraft construction and defence electronics sector by BAE and EADS there are other companies active in this sector, all of which follow their own course. These include the Italian Finmeccanica, the Swedish Saab, the French Dassault Aviation and particularly Thales (Thomson-CSF). The latter is the leading European defence electronics company. It made a deliberate decision not to be part of the EADS wave of mergers, but wishes to concentrate on strengthening its own commercial activities and on a global approach to its defence activities. By taking over smaller companies in Australia, Brazil, South Korea, Singapore, South Africa, the UK and the US, Thales is more or less buying its way into various domestic markets. The jewel in the crown in this process was the take-over of the British company Racal. This made Thales the second British defence company and world leader in the fields of military telecommunications and maritime radar equipment. In addition Thales has strengthened its position in the US through entering into numerous 'teaming arrangements' with American companies. Furthermore, the company recently entered into a joint venture with the American company Raytheon.

The internationalisation of the European defence industry has chiefly been within the high tech sectors of the aviation and space industry, the construction of missile systems and defence electronics. This internationalisation has also taken place within the production of army systems and naval shipbuilding, albeit to a lesser extent. Since 1999 various transatlantic and intra-European take-overs and mergers have taken place, leading to industrial concentration.⁵⁰ During the course of 1999 these have led to a substantial, general restructuring of the European defence industry. It is currently dominated by a relatively small number of increasingly internationally oriented companies. Through 'holdings', 'joint ventures' and military cooperative programmes these companies are establishing numerous connections, both among themselves and with smaller specialist companies. As mentioned earlier, Annex III gives an overview of the major European defence conglomerates in each sector.

It should be made clear that these developments within the defence industry should not be seen as simply a 'second best' solution following the failure to establish an EADC. If the three largest European defence manufacturers succeed in producing efficiently, economically and to a high technical level, one will even be able to state that a diversity of industrial interests forms a realistic reflection of the European political practice, which from the outset has been characterised by its multiple nature. In addition, a certain degree of intra-European competition – in which transatlantic interests also play a role – is maintained, thereby avoiding the creation of a 'fortress Europe'.

Participation

The most recent developments in the defence industry point to a trend, whereby participation in the development of defence systems is becoming increasingly important. An initial indication of this is, for example, the way in which the Joint Strike Fighter programme has been set up. If this project goes ahead the key characteristic will be not so much the enormous size, but rather the approach. The JSF-project would be the first American arms programme in which non-American companies are involved from the outset. The size of the programme, the huge development costs and the international interests have prompted the two prime contractors, Boeing and Lockheed Martin, to devise a new set-up for the supply of components and sub-systems. Both companies work with supplier teams and have abandoned the principle of 'just returns'. In order to

⁵⁰ See for an overview: SIPRI, 'Yearbook 2000', p. 309.

keep programme costs at an acceptable level both prime contractors are working with suppliers chosen for their qualifications rather than their nationality.⁵¹ This new approach has changed attitudes to suppliers among other aircraft manufacturers, such as the Eurofighter project organisation. The Netherlands has received the assurance that it can join the Eurofighter programme as a full partner so that it can participate in the development of the third tranche of Eurofighters. Thus the Netherlands has been offered the same conditions for participation as in the JSF programme.⁵² The aircraft manufacturers Saab and Dassault have in fact also made a similar offer to the Netherlands.

Globalisation

The 'secularisation' of the defence sector has produced three defence markets, each with its own dynamism, but with a high level of reciprocal influence:

* National markets. During the course of the 1990s the capabilities considered by states to be of national importance were placed with the 'national champions',⁵³ which continue to enjoy special attention from the government, even if some have been integrated into international cooperative partnerships. For their part the 'national champions' remain dependent on the same governments for a considerable share of their sales.

* Regional markets. The internationalisation of the European defence industry is not (yet) institutionalised, but there is undeniably a convergence of European economic and political interests and increasing cooperation on new arms programmes among European companies. The consolidation process within the American defence industry, together with the close military-industrial links between the United States and Canada mean that there is also a North American regional defence market.

* Global markets. In particular in the case of sophisticated weapon systems (defence electronics, military aviation, missile systems) internationalisation has crossed the boundaries of specific regions and taken on a global face. The growing costs of the development and production of these weapon systems and the worldwide restrictions on defence budgets have led to a scaling-up by defence firms which is no longer compatible with a national or regional company strategy. Global strategies have in turn led to heightened competition outside Europe and the US, but at the same time to more intense transatlantic collaboration. In addition, in countries outside Western Europe and North America there is a growing willingness on the part of governments to allow national defence industries to be taken over by foreign firms; a process being seized upon readily by some European and American companies. This is particularly true of Australia, Brazil, South Africa, South Korea, Indonesia and Malaysia.

Earlier in this report the conclusion was reached that at the present time it is not possible to take the ESDP as the starting point for European military-industrial cooperation. On the basis of the findings of this chapter the conclusion may be drawn that the interests of the defence industry are also unsuitable as indicators of the direction to be taken by closer European defence cooperation. On the one hand account should be

51 A. Nicoll, 'An industrial fighter' in: Financial Times, 10 November 2000.

52 J. Janssen Lok, 'Dutch invited to become Eurofighter partner', in: Jane's Defence Weekly, 18 October 2000.

53 In fact all major American and European systems integrators can still, to a certain extent, be considered 'national champions', despite their global activities.

taken of the influence of national market considerations on the military-industrial policy of the individual European governments. On the other hand as a result of internationalisation, some European defence industries have gone well beyond the borders of Europe. Any European military-industrial policy which fails to recognise this development, concentrating only on the protection and strengthening of mutual European cooperation, could have harmful repercussions for the worldwide position of European defence industry. *A European military-industrial policy wishing to benefit European defence industry should, in the view of the Advisory Council, concentrate on measures to stimulate the industry. The aim is to support the growing number of transnational partnerships within European defence industry – within the bounds of political possibilities – through uniform legislation, minimising internal trade barriers and opening up the effects of market forces.*

III Transatlantic aspects

How can European countries better work towards removing obstacles to access to the American market?

How can governments on both sides of the Atlantic contribute to transparent relations and promote both competition and cooperation?

III.1 Industrial interests

The American military-industrial policy has similar priorities to those in many European countries: retaining an own industrial and technological basis, technological superiority, promoting exports and guaranteeing the supply of materials and materiel ('security of supply'). There are also major differences between the American and European defence markets: the European NATO Member States have a total personnel strength of 2.5 million and a joint defence budget of USD 160 billion. Of this only USD 8 billion is spent on Research and Technology (R&T) and 32 billion on procuring new equipment. The US has over 1.5 million personnel and a defence budget of USD 250 billion, of which 25 billion is spent on R&T and 42 billion on procuring new equipment. Despite these differences the defence industry on *both* sides of the Atlantic sees good reasons for strengthening ties in *both* directions.

The internationalisation in Europe and the consolidation in America have both led to a reduction in the number of major producers of defence equipment. In the United States four large systems integrators remain. In Europe the production of sophisticated weapon systems is essentially in the hands of BAE Systems, EADS and, to a lesser extent, Thales (Thomson-CSF). These major European concerns are endeavouring to gain access to the American market in order to build up a sizeable and relatively stable order book. Since the mid-1990s Europe has developed an interest in working together with American firms, or even taking them over. For political reasons European governments, particularly the UK and German governments, have encouraged their national defence industry to operate not only on a European basis, but also on a transatlantic basis. At the same time among subcontractors there is also an increasing balance in the flow of transatlantic trade.⁵⁴

The American defence industry went for consolidation earlier than the European competition, but has been slower to react to the internationalisation of the defence sector. The explanation for this is the relatively stable and sizeable domestic market. For years arms exports were not seen as a way of increasing turnover, but rather as additional source of income with products designed specifically for the American market. Cuts in the American defence budget changed this position. By the end of the 1990s global interests had already begun to play a central role with American defence industry as well. Although mergers between the major European and American defence firms are not expected in the short term, it is probable that the number of transatlantic joint

54 G. Adams, 'The necessity of transatlantic defence co-operation', in: G. Adams i.a., Europe's defence industry: a transatlantic future?, (Centre for European Reform) London 1999, p. 44. The Advisory Council learnt from Mr Burchard Schmitt that one should be thinking of a transatlantic 'supply market' of the value of around USD 12 billion per annum.

ventures and production agreements will continue to grow over the coming years.⁵⁵

III.2 American military-industrial policy

Official American policy represents a formidable obstacle to transatlantic military-industrial relations. As a result of the economic boom experienced by the US during the last decade and its worldwide military-technological dominance the American government has tended towards an attitude of 'assertive unilateralism'. The American transatlantic policy thus increasingly inclines towards a situation where matters are considered on a case by case basis to see which option is the most advantageous, rather than the broad, harmonised political approach advocated – of necessity – by European countries.⁵⁶

Political principles

Despite differing political signals, the transatlantic priorities of the American government over the past decade lay not so much with improving military-industrial cooperation, but rather with promoting its own military-industrial position and strengthening its own trade position.⁵⁷ On this last point the American government formulated a new policy for conventional arms exports in 1995, which in many ways seems to be at odds with the then declared wish for more intensive American-European cooperation. It is expected that the Bush administration's policy in this area will differ little from that of the Clinton administration.⁵⁸

The current American arms export policy demonstrates a high level of continuity and retains many characteristics from the 'Strategic Trade Policy' of the 1980s: an aggressive trade policy characterised by an intensive national military, political and industrial cooperation, with 'economic security' being seen as an elementary factor of 'national security'.⁵⁹ This link between economic policy and security policy led to a pronounced military-industrial policy with an internal and an external dimension. Internally there was support for an integral 'dual use' policy, backed up by instruments such as the 'Technology Reinvestment Project' (TRP), which attempts to achieve military-civilian synergy in the high tech segment of the market. This approach has led in strategic sectors to a

55 See: A.D. James, 'The prospects for a transatlantic defence industry', in: B. Schmitt (ed.), *Between cooperation and competition: the transatlantic defence market* (WEU Institute for Security Studies, Chaillot Paper 44) Paris 2001, pp. 93-122.

56 J. van Scherpenberg, 'Transatlantic competition and European defence industries: a new look at the trade-defence linkage', in: *International Affairs* 73, 1 (1997), p. 100.

57 J. Howorth, 'European integration and defence: the ultimate challenge' Paris 2000 (WEU Institute for Security Studies), p. 22. In some cases this policy extends to cover commercial activities, such as possible government support for the sale of the civilian version of the Boeing C-17 transport aircraft. See: 'Pentagon gives Boeing plane a push', in: *International Herald Tribune*, 20 March 2001.

58 In the context of this advice no distinction is made between the policy of the Clinton administration and that of the George W. Bush administration. During the conference on 'The globalisation of the defence industry; policy implications for NATO and ESDI' organised on 28 and 29 January 2001 in London by the Royal Institute of International Affairs various American speakers, including former Deputy Secretary of Defense John Hamre, emphasised that the American policy on military-industrial matters would demonstrate a high level of continuity.

59 Van Scherpenberg, 'Transatlantic competition', p. 108.

considerable American lead over other countries in terms of knowledge (stealth, anti-missile systems, 'smart' munitions and military satellite technology).⁶⁰ Externally the American military-industrial competitive strength is seen as a fundamental aspect of the American superpower status, equally as important as worldwide 'power projection'.⁶¹ This link is currently yielding industrial rewards in Eastern Europe, the Middle East and Greece/Turkey, where the EU competition, which can often provide no comparable political and military certainty, often comes off second-best.⁶²

International blockades

The principles described above have undeniably led to problems in transatlantic military-industrial cooperation. As part of the link between economic and security policy the American defence industry is, for example, protected from foreign take-overs by measures such as the very strict policy of the Committee on Foreign Investment in the United States (CFIUS).⁶³ The Pentagon also puts obstacles in the way of growing transatlantic military-industrial cooperation. It applies its de facto right of veto regarding the re-exporting of American technology⁶⁴ not only based on security considerations, but also for commercial reasons. On one occasion, in a competitive fight to provide Finland with new combat aircraft the American government blocked the re-export of the AMRAAM missiles with which the Swedish Gripen aircraft are fitted. This cleared the way for the Finnish purchase of the competing American F/A 18 aircraft.⁶⁵

60 So far European military industry has managed to remain technologically competitive in a number of other sectors. The so-called *Military Critical Technologies List* of the US Ministry of Defense names a substantial number of technologies where European countries have a lead over the US. For an overview from 1996 see: R.P. Grant, 'Transatlantic Armament Relations under Strain', p. 115.

61 Van Scherpenberg, 'Transatlantic competition', p. 108.

62 E. Kapstein, 'Towards an American arms trade monopoly?', in: *Foreign Affairs* 73, 3 (May/June 1994), pp. 13-19.

63 E.M. Graham, P.R. Krugman, *Foreign Direct Investment in the United States*, (Institute for International Economics) Washington 1995, pp. 112-132. The only two significant take-overs authorised by the CFIUS related to take-overs by British firms. See: G. Adams, 'Fortress America in a changing transatlantic defence market', in: B.Schmitt (ed.), *Between cooperation and competition: the transatlantic defence market*, (WEU Institute for Security Studies, Chaillot Paper 44) Paris 2001, p. 27.

64 This advice will not examine further other obstacles to European companies created by the American defence establishment. In this context one might mention the NONFORM classification through which the Ministry of Defence can prevent potential foreign prime contractors from participating in 'US Requests for Proposals' (RFPs). Nor will it contain any judgement of the role of the so-called 'iron majors', the materiel programme managers in the American armed forces who have a great resistance to being dependent on European products. It will also leave aside the secret 'black programmes' of the Pentagon, sizeable weapon programmes to which foreigners have absolutely no access.

65 K. Vlachos, 'Safeguarding European competitiveness', p. 18. Other studies cite more recent examples: because of competing American interests Germany was not permitted to sell modified AIM9L air-to-air missiles to Sweden and Thomson-CSF was prohibited from supplying a Franco-American missile system to South America. A case also arose where German, French and British companies that wanted to export an anti-radar battery – partly using American sub-systems – were suddenly confronted with American competition in certain export markets every time they applied to the US for permission to export. See: R.P. Grant, 'Transatlantic armaments relations under strain' in: *Survival*, Vol. 39, no. 1, Spring 1997, p. 119.

Although such actions may achieve short-term success, they are very damaging to the image of the American defence industry in Europe. One of the reasons why the British government is thought to have chosen the European Meteor missile and not the American AMRAAM for the British Eurofighters, is the fear that it would be too easy for the American government to use the missile technology to block the export of the Eurofighters.⁶⁶

One of the most important American institutional obstacles are the so-called 'International Traffic in Arms Regulations' (ITAR). Under these regulations the license required for military exports or international cooperation has to be approved by both the Department of Defense and the State department. In some cases agreement by the Department of Commerce is also needed. The involvement of these various agencies means that obtaining a license is a time consuming and uncertain business. An additional complication with ITAR is the 'Munitions List' which is linked to the license system. This list contains thousands of components, including civilian products, which have an 'inherent military nature' and thus are subject to an approval procedure. However, the 'inherent military nature' of over half the components on the Munitions List can be called into question. They are often components based on generally accessible technology. There is some doubt as to whether it will be possible to get the list updated. The list is managed by the State Department, which seems to accord no priority to amending ITAR and, at the same time, does not wish to hand over its responsibilities in this area.⁶⁷

Furthermore, the American Congress also plays a complicating role in transatlantic military-industrial cooperation. American legislation gives Congress the possibility to block licenses, which it frequently does in order to support the national defence industry (and thus regional employment).⁶⁸ Congress also has the ability to add new programmes to the defence budget or to scrap existing programmes. This last possibility in particular means that transatlantic projects always have a very unstable basis. Transatlantic programmes such as MEADS and TRACER have never had the financial certainty that purely American programmes have.⁶⁹

66 Th. Hitchens, 'America's vital role', p. 51

67 A. Ashbourne, 'Opening the US defence market', p. 11. en C. Clark, 'State Dept. calls for Arms Exports Controls Review', in: Defense News, 8 November 1999, pp. 1, 26. The ITAR procedure is further complicated by the so-called 'National Disclosure Process'(NDP) established to evaluate the release of certain technological information to specific countries. The NDP is led by the DoD and is subject to a number of strict conditions. For example, the release must be linked to an American interest and the information in question must be protected in the other country in accordance with American norms. The considerations involved in the NDP are very complex and it can thus take a very long time. ITAR and NDP processes often interfere with each other, which means that even less sensitive trade in military products can be delayed.

68 It also happens that the State Department anticipates blocks by Congress and refuses to grant licenses even before the matter is discussed in Congress.

69 MEADS is an Italian-German-American missile defence system and TRACER a British-American light reconnaissance vehicle.

Finally, Congress can also adopt new legislation – for example in the form of a sudden, ad hoc strengthening of the ‘buy American’ legislation – to protect American programmes from transatlantic cooperation.⁷⁰ The possibility of technological ‘leaks’, political distrust and the protection of American jobs mean that Congress is reticent – not to say negative – with regard to transatlantic military-industrial projects. The strategic importance of good political relations with European countries usually has to take a back seat. In the view of the Advisory Council this highlights the fact that military-industrial cooperation solely on the basis of political-military objectives is not feasible. Such cooperation must initially be based on industrial interests. Decision making in Congress will probably only become favourable to transatlantic cooperation if a sufficiently sizeable merger between a European and an American systems integrator were to be achieved.

Defense Trade Security Initiative

Having recognised that the strong global position of American industry would be best served by more efficient export procedures and flexible international industrial cooperation, the American government has made several attempts since 1998 to liberalise the ITAR legislation. The most wide-ranging initiative is the ‘Defense Trade Security Initiative’ (DTSI) launched in May 2000 by Secretary of State Albright⁷¹ and has since been adopted by the Bush administration. This initiative, characterised as ‘the first major post-Cold War adjustment to the US Defense Export Control System’,⁷² was to cover USD 20 billion of American exports and was essentially set up to reinforce the NATO ‘Defense Capabilities Initiative’. As part of the DTSI the Munitions List should be subjected to an annual update. More important is that selected companies in countries with which bilateral agreements would be signed would be allowed to export or import American unclassified defence goods, military-technical data and services without having to obtain the usual licenses.⁷³ Canada was already exempt from ITAR regulations and following the launching of the DTSI there is also the prospect of more liberal legislation for the UK and Australia. In addition the Netherlands, Norway, Germany and France have also been approached to discuss exceptions to the ITAR legislation.

70 Although the 1933 ‘Buy American Act’ does not apply to NATO Member States, since the 1980s Congress has regularly tried to introduce programme-specific ‘buy American’ restrictions which would also apply to the NATO Treaty area. See: Grant, ‘Transatlantic relations under strain’, p. 115.

71 Another is the signing of a (relatively informal) British-American ‘Declaration of Principles’ by the two Ministers of defence with a view to improving reciprocal equipment cooperation. Although this ‘Declaration of Principles’ covers a far wider area than the DTSI this initiative has remained limited to contacts between the Ministries of Defence. The State Department feels it was left out of the negotiations and thus does not wish to be involved in its implementation. In contrast, the DTSI is based on legally binding agreements between governments.

72 Press Statement by Ph. T. Reeker,
www.secretary.state.gov/www/briefings/statements/2000/ps000524d.html.

73 There are a number of conditions (‘five pillars’) attached to these bilateral agreements:

- a corresponding and reciprocal industrial security policy;
- a corresponding and reciprocal arms export policy;
- a long period of successful cooperation in ‘law enforcement’;
- good cooperation in the intelligence field;
- a willingness to sign binding agreements on reciprocal market access.

In the meantime, a year after the announcement of the DTSI, a number of weaknesses inherent in the initiative have become apparent. Not only does it hold out no prospect of amendment for European countries wanting to get into the American market, it also only covers unclassified information, which means that it is unlikely to be able to make up for the shortcomings of the NATO 'Defense Capabilities Initiative'. In addition the DTSI – because of the bilateral nature of the agreements – takes no account of the increasingly transnational nature of the European defence industry or of the arms exports agreements concluded among European states or in an EU context. The EU discussion partners named above will therefore constantly have to check that their transatlantic agreements do not conflict with their own national regulations or with European agreements. An approach whereby negotiations over the DTSI could take place with all the European nations currently involved, or even the whole EU, would be more efficient and more effective. A further major obstacle in relation to the DTSI is the fact that it takes no account of Congress's decisive role. Changes to that role would require a revision of the 'Congressional Export Control Act' which in itself would open up a political and constitutional Pandora's box stretching well beyond the scope of this American trade initiative.

IV Institutional and organisational aspects

What is the Advisory Council's assessment of the general political climate in relation to an open common market for defence equipment?

How can the involvement of the European Commission and the link to the EU internal market policy best be shaped?

Can a new European Armaments Agency be incorporated into the EU?

Do European R&T programmes offer opportunities for defence-related projects

IV.1 Key areas

The preceding chapters include a description of how the 'secularisation' of the defence sector has led to increased international cooperation between European defence companies. To be fully effective such cooperation requires a fundamental change in European governments' policy. There follows an overview of where, in the view of the Advisory Council, concrete progress must be made if successful European cooperation is to be achieved.

Harmonisation of military-operational requirements

First of all it should be said that the harmonisation of operational requirements would be one of the most important means of achieving effective European equipment cooperation. Harmonisation can provide a basis for joint research, joint production and joint procurement of military equipment. For companies harmonisation offers certainty and predictability, which means that production processes can be rationalised and the competitive position strengthened. Common requirements allow governments to combine their purchasing power⁷⁴ and, at the same time, to increase the interoperability of their armed forces.

Although over the years European and transatlantic discussions have enabled progress to be made in determining common military-operational procedures, with regard to the harmonisation of military requirements the results have been extremely limited. The procurement of military weapon systems proves to be a complex process, involving numerous political, military and industrial parties. It is difficult enough to get all the parties to agree in a national context. If the decision making also has to be coordinated on an international level the problems seem to grow exponentially. The different geo-strategic considerations alone mean that European countries have always had differing military approaches. And even where European countries do manage to reach a common requirement, there are still many different preferences for various specifications. Agreement on this level can be made easier by a jointly-developed military strategy, an international military staff responsible for harmonising requirements on the basis of this strategy and agency which underwrites cooperation in procurement. The question to be asked is whether the European countries are prepared to sacrifice their freedom of action for this. Although, as stated in the beginning of this report, the harmonisation of military-operational requirements is one of the fundamental conditions for an effective European military-industrial policy, it does, at present, seem to be only a distant possibility, albeit one that should constantly be borne in mind.⁷⁵

74 By purchasing equipment in larger quantities it is possible to reduce the unit price.

75 Chapter 2.3 refers in this context primarily to the harmonisation of procurement cycles and materiel requirement

Security of supply

The mergers, take-overs and more intensive cooperation among European defence companies mean that the 'security of supply' aspect has become an urgent, topical area. This also applies to countries which previously maintained that on that score they did not have to meet the agreed international conditions. Agreements regarding security of supply are of key importance to European defence companies, which are increasingly working in an transnational context, and thus need more flexibility in the international transfer of their products and components. But in a different way these guarantees are also important to European governments. In the context of their security policy they want not only to maintain a certain autonomy with regard to their own industrial and technological basis, but also to be assured of sufficient equipment, spare parts and munitions in times of crisis. This enables them to continue to execute military operations without having to maintain large permanent, expensive stocks.

A conflict between industrial and official interests is most likely to arise in sectors seen by governments as crucial to national security. European agreements can be reached regarding security of supply in such sectors, however there is a risk that states are in principle prepared to accept military-industrial interdependency, but in practice want to introduce too many exceptions in the name of state security in order to ensure full and guaranteed operational autonomy under all circumstances. For some European states a guaranteed supply of materiel to armed forces also implies a certain degree of 'ownership'. However, this is difficult to reconcile with the growing role of private capital in the defence sector. What role can non-European shareholders play in European companies? How can state ownership be safeguarded in international companies which are no longer under the direction of individual European governments? *Given the problems raised by such questions, the Advisory Council believes that a legislative role for the European Union in the first pillar – in other words, involving the European Commission – is not only highly desirable but, in view of the growing industrial interest, also inevitable in the long term.*

Export procedures

The divergent arms exports procedures of the EU Member States have also become an urgent problem. For international companies it is important to be able to source components and sub-systems from various European countries, which requires not only security of supply but also the harmonisation of export procedures.⁷⁶ In practice the scope and character of national procedures vary greatly, depending on the political orientation, the military-economic ambitions, the traditions and the historically based security interests of the different EU Member States. The right to an opinion on the final destination of national military production which both governments and parliaments reserve for themselves creates uncertainty, which is a considerable obstacle to cooperation between European companies. In a European context there are only two exceptions to this. Germany and France have agreed that components and sub-systems may cross the common border without export procedures. Under the so-called Schmidt-Debré agreement, dating back to 1975, it is up to the government of the country in which the end product is produced to apply its own export procedure correctly in the case of third countries. Secondly, in the Benelux countries arms exports is included in the reciprocal customs union. For exports outside the Benelux there is an obligation to consult.⁷⁷

76 This applies equally to internal EU export procedures and to EU exports to third countries.

77 This obligation does not apply to export to NATO countries or to temporary exports.

The current lack of a common export policy hampers military-industrial cooperation in general and transnational companies in particular. Even transferring components within a company across two European countries requires defence companies to complete complicated export procedures. The EU arms exports 'code of conduct' (Annex II) provides no solution. Not only does this code of conduct not offer any answer to the problems of intra-European military trade, the criteria used, set out by the European Council are only politically (and not legally) binding. The code of conduct gives a harmonised interpretation of these criteria and can be seen as a first step in the direction, but not as the ultimate solution.⁷⁸

Protection of information

In the political-industrial sphere in which transnational cooperation between European defence companies takes place, a balance must be found between, on the one hand, nations' wish to handle classified information confidentially, and, on the other hand, the desire to avoid international projects being hindered by unnecessary restrictions in the movement of people, information or materiel. European harmonisation of security regulations and procedures still encounters a lot of problems. In particular, the United Kingdom fears that the freer circulation of classified information within Europe could damage its transatlantic security cooperation.

Research and Technology (R&T)

For some time the field of R&T has witnessed an accumulation of initiatives within diverse discussion fora, both within NATO and in a European context. Generally speaking the attempts to establish a common European R&T system have foundered on the differences of opinion among European countries with regard to the openness of research, methods of awarding research contracts (on the basis of competition or not) and the implementation of the 'just returns' principle. The lack of a central body means that thus far there has been no question of a systematic transfer of defence-related R&T information, nor has it been possible to develop a common basis for future R&T. One of the most important reasons why attempts have failed is that all European countries tend to specialise in the 'high tech' side of the defence market. This requires major investments, but creates prestige and eventually also a technological lead. All rational solutions leading to a distribution of work whereby parties are allocated a lower technical level are categorically rejected by the research agencies and governments concerned. For the time being each European country prefers to compete in the field of research, in the hope of being able to act as pioneer in critical areas. The result is a high degree of duplication of research, which is all the more serious when one considers the limited scale of the research budgets in European countries. When one compares this with the higher and better coordinated American R&T effort, it becomes clear the risk of an American-European 'technology gap' is a very real one. During the NATO aerial actions in Kosovo it was evident that differences in technological capability can significantly hamper transatlantic interoperability.

However, notwithstanding the lack of EU-wide progress in respect of military R&T EU Member States have entered into a lot of bilateral R&T contracts, concentrating on complementary knowledge and research. Under current circumstances the further development and expansion of these bilateral contracts would seem to be a more practical and successful approach than attempting to establish an EU-wide military R&T policy, although this is highly desirable in the long term. *It should be pointed out that the increasing use of civilian technology in defence applications ('dual use') already offers an*

78 See also: Advisory Council for International Affairs, 'Conventional arms control; urgent necessity, limited possibilities'.

opportunity to open up European research programmes to technological developments related to defence. The Advisory Council believes this aspiration should be supported by the Dutch government.

IV.2 The discussion fora relevant to Europe

There are many bodies in which European countries meet to discuss common armaments and procurement questions or aspects thereof.⁷⁹ Despite converging aims these organisations vary to such an extent in their approach, orientation and memberships (see Annexes 4 and 5) that there is no question of coordination, let alone of clearing out or rationalisation. A key factor is that virtually all European discussion agencies were born of political initiatives resulting from discussions which had previously reached deadlock. The proliferation of consultative structures is thus in inverse proportion to the degree of agreement among European countries. There exists today an 'institutional jungle' which has become rooted in European arms discussions. There follows an overview of the most important organisations and discussion bodies.

NATO

The number of NATO fora dealing with organisation, consultation, cooperation or production in the field of equipment, or sub-areas thereof, is quite impressive. The body known as the Conference of National Armaments Directors (CNAD) fulfils a central role. At the (twice-yearly) CNAD meetings the senior national civil servants responsible for defence procurement exchange ideas with representatives of the Military Committee and the NATO Strategic Commands.⁸⁰ Specific armaments are discussed in four Main Groups, which are directly subordinate to the CNAD. Under these groups there are about 250 further subgroups dealing with the development of new projects. Neither the CNAD nor the Main Groups deal with the execution of projects. This is done by the corresponding NATO Member States, which establish temporary project organisations for this purpose.⁸¹

The aim of the extended structures subordinate to the CNAD is not to develop common weapon systems. In the past discussions on this subject always failed because of divergent national interests.⁸² For this reason NATO has opted for a pragmatic approach, concentrating on improving the interoperability of national weapon systems and getting minimum common requirements approved for the NATO C3I tasks (command, control, communication and intelligence).

79 This advice concentrates on NATO, the WEU, the EU, OCCAR and the Letter of Intent group.

80 For the Netherlands this is the Director-General of Materiel from the Ministry of Defence.

81 In some cases it is considered necessary to establish a longer term cooperative partnership in the form of a NATO Production and Logistics Organisation, such as the HAWK PLO, the NATO Airborne Early Warning and Control Program Management Organisation and the NH-90 project organisation.

82 Initially the CNAD had only a non-binding, advisory role. The forum works well for the exchange of information and the establishment of a 'collaborative climate' within the Alliance. CNAD approval for projects is however of little practical value. It does not confer preferential treatment in terms of the procurement policy of NATO Member States. See: K. Hayward, 'Towards a European weapons procurement process', Brussels 1997 (Chaillot paper 27, Internet version), p. 12.

As part of the Defense Capabilities Initiative NATO Member States are working towards a higher degree of interoperability and an improved NATO Defence Planning Process (NDPP). This initiative could lead to improved cooperation within the European procurement processes.⁸³ It should, however, be stressed that the pragmatic approach to armaments discussions within NATO, the great emphasis on national authorisation and the fact that France does not participate in the discussions mean that NATO is less appropriate as a central body for military-industrial agreement and harmonisation of procurement within Europe.

Western European Union

During the European Council in Nice (December 2000) the EU Member States declared their willingness to take on the crisis management tasks of the Western European Union (WEU). However, the future of the equipment cooperation bodies is still unclear. At the present time the WEU still has a number of bodies involved in this field, such as Eurocom (for communications systems), the Western European Logistics group (WELG) (for logistic support) and Eurolongterm (coordination of defence planning). All these groups developed from working groups of the former NATO-Eurogroup (Independent European Programme Group (IEPG)).

In addition there is the Western European Armaments group (WEAG) founded in 1993 by the European NATO nations. This forum deals with the strengthening of the industrial and technological basis for European security, the harmonisation of requirements and norms for armaments, cooperation in the field of R&T and also the opening up of European defence markets to international competition. The WEAG is not based on a treaty text, but should rather be seen as having grown out of the practice of cooperation. Since WEAG agreements are not legally binding their execution depends on the political willingness of the individual Member States. It can be concluded that this non-binding nature has resulted in a lack of political support and interest. Over the years the WEAG has definitely managed to improve dialogue between states, which has resulted in greater harmonisation of operational procedures, but it has not succeeded in achieving true coordination. Even after 24 years of consultation in the IEPG and the WEAG common norms and requirements for weapons and equipment are still a very long way off.

In contrast to the WEAG, the Western European Armaments Organisation (WEAO), to which all WEAG Member States belong,⁸⁴ is formally a subsidiary body of the WEU. In order to promote cooperation in the field armaments, the WEAO has set itself the aim of carrying out activities relating to weapons research, development and procurement. For the time being the administration of the WEAO is carried out by a WEAG research cell. The establishment of the WEAO means that the WEAG R&T related decisions can be executed within a clearly defined legal framework, as part of the legal personality of the WEU. This legal personality also allows the WEAO to enter into contracts with defence companies and research institutes, which is bound to be beneficial for the coordi-

83 One of the key points of the DCI is, for example, 'to examine and put in place or expand where appropriate, arrangements for cooperative acquisition and management of certain logistic stocks'. See: Windt en Van Harskamp, 'Veel gepraat maar weinig wol?' [*Much ado about nothing*], in *Militaire Spectator*, yr. 170 (2001), number 1, p. 29.

94 See Annex IV.

nation within the WEAG. To date the results of these efforts have been too limited to be able to judge whether these activities really will bear fruit.

In 1998 the Ministers of defence of the WEAG Member States called for concrete proposals for the foundation of a European Armaments Agency (EAA) to be linked to the work of the WEAO. This EAA should focus on the development of a European industrial and technological basis to promote European independence in the armaments field. In addition, the agency would be responsible for establishing common European military requirements and norms, promoting full armaments interoperability so that units can be integrated into larger military formations, an efficient R&T policy, rationalised legislation and open market conditions. As yet this idea has not progressed beyond the planning stage.

Organisation Conjointe de Coopération en matière d'Armement (OCCAR)

Pending the arrival of a European equipment agency Germany and France founded a bilateral armaments agency in 1993. The aim was – initially for the benefit of the Euro-corps – to manage new equipment programmes jointly and thus to increase efficiency. At the end of 1996 these two countries plus the United Kingdom and Italy decided to establish OCCAR to manage armaments programmes in a broader context. In September 1998 the four nations signed the 'Convention on the Establishment of the OCCAR' in order to give OCCAR legal status. The participating nations hope that OCCAR will enable them to make savings in armaments programmes through better management, more efficient contracting procedures and integrated industrial projects. In addition OCCAR will also work towards a common investment and technology policy. It has set itself the target of improving procurement, for example by agreeing identical rules of competition.

At present France and Germany are involved in most of the projects executed by OCCAR (Tigre combat helicopters, Milan and Hot anti-tank missiles, Roland air defence system). In addition there are also bilateral projects, such as the Franco-Italian future surface to air family (FSAF) and a number of trilateral projects. The Cobra anti-artillery radar was the first integrated (France, Germany and UK) OCCAR project. In the meantime the Airbus A-400M transport aircraft and the GTK/MRAV armoured vehicle have also been brought under OCCAR.⁸⁵

There is a possibility that OCCAR will be expanded to include the Netherlands and Belgium. Sweden and Spain have also expressed a wish to be part of OCCAR.⁸⁶ The OCCAR statutes allow European countries to join, provided they meet all the conditions and actually participate in OCCAR programmes. In April 1999 the Dutch government officially announced its participation in the GTK/MRAV programme and agreed to make NLG 245 million available for the development phase of this programme.⁸⁷ Thus the Netherlands meets the conditions set by OCCAR. Parliament has been promised that membership of the procurement agency will be preceded by a political debate. Belgium

85 D. Barrie, B. Tigner, 'OCCAR finally moves toward oversight role', in: Defense News, 11 December 2000

86 Spain has said that through CASA participation in the Airbus it already satisfies the OCCAR membership criteria.

87 Ministry of Defence, 'project "Replacement of M577 and YPR armoured vehicles', letter to Parliament, 9 January 2001.

decided in the summer of 2000 to buy 7 Airbus A-400M aircraft. This would enable Belgium to have access to OCCAR.

For the time being OCCAR has the handicap that almost all the projects managed by the organisation had been going for years and were only brought under OCCAR administration at a late stage. In some cases these projects had a troubled history which was later blamed on OCCAR's inability to function correctly. One example of this was the link between OCCAR and the Trigat anti-tank missile project.⁸⁸ The GTK/MRAV programme has also been under pressure following the French decision to have its own armoured vehicle developed by the French national defence industry (GIAT). These cooperation problems are not so much symptomatic of OCCAR, but are rather caused by complications outwith the scope of the organisation. In contrast, for the A-400M programme OCCAR has been involved as contracting agent from the outset. This project will thus be the first where OCCAR can truly prove its additional value.

The Framework Agreement/Letter of Intent (LoI)

With OCCAR the participating nations have set off along a pragmatic path aimed primarily at procurement and which in the longer term will achieve greater efficiency, but which offers no solution to the problem areas outlined at the beginning of the chapter. This does not mean that these problems are ignored. In 1998 the Ministers of Defence of the six biggest European arms manufacturing countries (France, Germany, Italy, Spain, Sweden and the United Kingdom) decided to sign a 'Letter of Intent' in which they set themselves the goal of improving the harmonisation of their military-industrial legislation. To this end they have set up six working groups dealing with the harmonisation of supply guarantees, export procedures, the protection of sensitive information, research and technology, the harmonisation of military requirements and the exchange of technical data. The conclusions of these working groups will eventually be incorporated into an international treaty. In order to avoid time-consuming ratification procedures this treaty will enter into force as soon as two countries have filed their instrument of ratification. In July 2000 the Letter of Intent was transformed into a more concrete Framework Agreement, which provides a framework for the deliberations.⁸⁹ The six participating nations have agreed that other European countries can join the agreement once they themselves have ratified it. EU Member States can submit an application to join; other European countries may join on invitation.

So far experiences with the LoI process have been mixed. More progress has been made in the technical area than in the political area. For example, LoI agreements in respect of the protection of information are clearly defined. If one country releases information for the purposes of a cooperative programme the other participating LoI states are expected to follow suit. With regard to the R&T policy agreement has been reached on the procedures to be followed and the LoI states have agreed to keep each other informed of developments in their research policy and programmes. With regard to military requirements, the governments concerned have agreed to develop a joint concept, to harmonise procurement policy and to establish a common profile for future

⁸⁸ The Trigat programme was developed during the Cold War for large scale tank attacks but due to countless delays was not implemented until last year. In the meantime the weapon no longer meets operational requirements which are currently focussed primarily on manoeuvrability and a low weight. For these, and other, reasons the United Kingdom, the Netherlands and Belgium have withdrawn from the Trigat project. The programme will probably now just die quietly.

⁸⁹ For the text of the Framework Agreement see: <http://projects.sipri.se/expcon/loi/indrest02.htm>.

investments and joint purchase norms. In time this should lead to a 'long-term master-plan' for future requirements. In addition the Lol countries have also agreed to harmonise armaments programmes and procurement methods.

The above agreement is at odds with the ambiguity which persists within the Lol countries with respect to security of supply. For example, the Lol Member States have accepted that transnational companies should retain control over the distribution of their activities. This might mean that these companies hive off industrial capacity within countries in the interest of greater general efficiency. However, at the same time the Lol countries insist on maintaining their right to oblige companies to keep certain strategic capabilities in their country.

One of the most important, but also one of the most politically sensitive areas making up the Lol process is arms exports. In this respect the Framework Agreement goes beyond the practice of the EU Code of Conduct; its first and primary aim is to simplify export procedures, both between Lol countries and with regard to exports to third countries. In principle the Framework Agreement can ensure free movement of military goods between Lol Member States. These are brought under a 'global licence' per Lol project. For export to third countries the Lol would like to establish a 'white list' of acceptable final destinations.⁹⁰ This advice will return later to the subject of the relationship between these Lol activities and the initiatives of the European Commission.

European Union

As described in Chapter 1, the European Union's security and defence policy is still young and not yet mature. It is therefore not surprising that the discussions within the EU on the subject of military-industrial policy do not yet take account of common military requirements for the ESDP. The emphasis of the discussion lies far more with industrial policy. This is discussed in two EU fora. In the first pillar (community policy) the subject arises in the context of common industrial policy. It is true that military products, to the extent that they relate to the 'essential interests of security', are excluded from this policy in accordance with Article 223/296⁹¹ of the EC Treaty, but this does not disguise the fact that the distinction between civilian and military production is growing ever more vague as a result of the increasing use of 'dual use' technology in weapon systems. From a procedural point of view the Commission has the right of initiative for the completion of the internal market in the first pillar. It can propose guidelines and open up protected markets. In the second pillar (Common Foreign and Security Policy), which includes the ESDP, the European Commission is simply one of the parties to the discussion, at least as long as no political agreement has been reached on subjects. The Commission takes part in debates and can submit proposals, but has no exclusive right of initiative as in the first pillar. In the second pillar the EU Member States are in control.

90 There are no plans for a regular update of the 'white lists'. However, the Framework Agreement does include a revision clause applicable when a final destination country falls victim to internal troubles or forms an international threat.

91 Where reference is made to a dual article of the EC Treaty the first article number refers to the 'old' EC Treaty (pre-Amsterdam) and the second number to the current treaty. This avoids confusion when reading documents which pre-date the Treaty of Amsterdam.

The second pillar

The second pillar of the European Union includes the 'Ad Hoc European Armaments Policy Group' (POLARM), which focuses on armaments policy, and the 'Conventional Arms Exports Working Group' (COARM) for the harmonisation of policy on exports to third countries. The deliberations in these groups are complicated by the difference of approach between the countries that want to maintain current European practice and those Member States prepared to accept changes. The intergovernmental nature of the discussions of the deliberations also makes things difficult: agreements are not binding and, it has been proven, are often not implemented. Under the Portuguese and French EU Presidencies in 2000 there was no meeting at all of POLARM. Under the Swedish presidency it did meet in January 2001.

The deliberations in both consultation bodies have their own dynamics, different from other second pillar working groups, because they operate on the border between the first and second pillar. In practice they are closely linked to the activities of the so-called 'Dual Use Group' in the first pillar, which are directly related to Article 113/133 EC on common trade policy. According to a number of judgements by the European Court since 1997, 'dual-use' goods should fall within the scope of trade policy and not be subject to the restrictions of Article 223/296 EC. Although this would seem to be a clear expression of the Commission's position, this is in fact not the case. Some EU Member States do their very best to put the Court judgements into perspective and the European Commission therefore feels obliged to display great caution in this area.

The first pillar

As stated earlier, according to Article 223/296 EC arms production and trade fall out with the rules of the common market, to the extent that they relate to the 'essential interests of security'. Opinions differ as to the interpretation of this statement, between the Member States themselves and most certainly between the Member States and the European Commission. Since 1990, partly as a result of the falling market for defence products, the Commission has on a number of occasions felt it necessary to intervene in this sector on the basis of its competence in matters of the common market policy. The proposals made by the Commission to reconcile this ambiguous situation with a correct interpretation of the treaty rules – and eventually to contribute to a common European armaments policy – focus primarily on promoting internal market forces and strengthening a common technological basis. The Commission has expressed a wish to make an effort within the context of the first pillar in favour of mergers between defence companies and clear corresponding legislation. Further, the Commission will concentrate on simplifying legislation in respect of the transfer of materiel within the European Union. It has also pledged to introduce open competition in this area. This latter aim is technically very complex and politically very sensitive.

In 1997 the Commission published what was then the most comprehensive policy document yet on the European defence sector: 'Implementing European Union strategy on defence-related industries' (COM (97) 583). This publication, also known as the 'Bangemann Report', contains practical proposals for a European equipment policy and an action plan for establishing a common armaments market. It contains the following twelve objectives:

- 1) The simplification of intra-community transfer of defence goods by means of a less complicated licensing system.
- 2) The development of a European partnership statute for transnational enterprises.
- 3) The promotion of open tender procedures for defence equipment.

- 4) The restructuring of European R&T projects in a community framework.
- 5) The standardisation of equipment procurement.
- 6) The abolition of customs duties on certain defence products.
- 7) Commission support for small and medium enterprises through the creation of enterprise groups.
- 8) The amendment of the competition policy to allocate the Commission its own responsibilities for the supervision of the defence industry.⁹²
- 9) The establishment of clear 'dual use' competencies for the Commission, based on Article 113/133 EC.
- 10) The possibility of support measures for diversification and conversion in the defence industry (through structural funds).
- 11) The opening up of defence markets to European manufacturers.
- 12) Research into the effects of the expansion of the European Union and the possible integration of the defence industry from new Member States.

According to a community interpretation the Commission action plan falls entirely within the scope of its competence in the first pillar. However, given the extent of the overlap with second pillar discussions and the considerable political sensitivities in various EU Member States the need for intergovernmental approval is unavoidable. The Commission has therefore proposed that the conclusions from the 'Bangemann Report' become part of a common standpoint of the EU Member States in the sense of the institutional rules of the second pillar. The aim of such a common standpoint would be to set out the political will to prepare the corresponding executive legislation.

This political will seems largely to be absent. Since 1998 neither POLARM nor the General Affairs Council has managed to obtain agreement on the Commission proposals. Most recently this subject was discussed by the Council in November 1999, when it was only able to note 'that cooperation in the military-industrial field is of great importance and that work on it should continue with the possibility of eventually adopting a common standpoint in the light of developments relating to the ESDP'. On the basis of its discussions with third parties the Advisory Council has drawn the conclusion that it was chiefly the British government that opposed a stronger role for the European Commission. Formally the British government maintains that the Commission report has been overtaken by the dramatic changes which have taken place in the European defence industry since the end of the 1990s. However, the Advisory Council has the distinct impression that it is primarily the orientation of British military-industrial interests, which lie in both continental Europe and the United States, that is behind the British reluctance. On the one hand the British government is working hard to ensure the success of the ESDP. For example, it refused to tolerate BAE's detached attitude to Airbus.⁹³ On the other hand the success of the ESDP should not lead to excessively robust military-industrial structures which might damage British industrial interests in the US. Things will only become clearer once there is a better understanding of how the British national security interests, the functioning of the internal market and the global ambitions of a restructured European defence industry interact. At the present

92 In practice this would mean that the Member States would have to accept a more restrictive application of Article 223/296 of the EC Treaty. The Commission proposes that Article 223/296 would only apply to very sensitive information or to the protection of truly essential interests. It would establish a notification procedure for such cases in order to guarantee a certain degree of transparency.

93 See: 'Londen dreigt BAE: opstappen uit Airbus onacceptabel' [*London threatens BAE: quitting Airbus not acceptable*], in: NRC Handelsblad, 15 June 2000.

time neither France nor Germany is prepared to counterbalance the British position.⁹⁴

The Advisory Council notes that among EU Member States the political will to achieve a cohesive military-industrial policy, which would inevitably mean a greater role for the European Commission, is still lacking. The governments of the six Lol countries prefer a pragmatic approach, whereby they *themselves* determine the modalities and parameters of transnational military-industrial cooperation. The Advisory Council also notes that in the meantime the European Commission itself is displaying great caution with regard to this sensitive subject. As yet the Commission seems to believe that the chance of success is too small and the political risks of new initiatives are too great. Nevertheless the importance of clear, consistent legislation for the defence companies in Europe is growing daily, especially with the growing intensification of transnational cooperation between the companies involved. *Giving these companies' growing requirement for clarity and transparency, the Advisory Council believes that a legislative role for the European Union – in other words, with the involvement of the European Commission – is not only highly desirable but also inevitable in the longer term. The Advisory Council also feels that such a legislative role could provide an important impulse to the strengthening of the European integration process. Therefore the Advisory Council strongly advises that the Bangemann Report's proposals should be kept on the agenda of EU discussions, even if only out of tactical considerations.* These proposals are far from having been overtaken; there is a sizeable overlap with elements of the Lol discussions and in time they will become more urgent and more topical.

IV.3 Possible future structures

It is clear that for the time being consultations between the major arms manufacturing countries in the context of the Lol and OCCAR are at intergovernmental level and separate from any broader European structures. At this stage OCCAR and the Lol group seem to favour deepening rather than widening, with the exception of the possible Dutch and Belgian membership of OCCAR. Nevertheless in the long term both fora might accept that an EU-wide extension of their membership could be advantageous. The key advantages are:

- 1) The European countries outside OCCAR and the Lol represent a sizeable sales and supply market. Involvement in the creation of a European military-industrial policy would encourage them to cooperate with the Lol and OCCAR Member States.
- 2) As outlined in Chapter 4, increasing the effectiveness of European defence industry really necessitates the harmonisation of military-operational requirements, and logically this should involve *all* ESDP partners.

For the stimulatory role of the WEU and the EU it is also important to find a satisfactory, efficient way of operating which will be to the benefit of European interests. The question arises as to whether the dissolution of the WEU and the possible continued existence of the WEAG have a role to play here. In the WEAG discussions various options have been examined, with the most prominent being the take-over of WEAG activities by the EU and an independent existence for the WEAG.⁹⁵

⁹⁴ Germany does not appear to want to force the issue in discussions with the United Kingdom. The French government seems to be unsure whether its current military-industrial policy can be reconciled with greater influence from the European rules of competition.

⁹⁵ Other possible options are bringing the WEAG under NATO control and establishing a completely new armaments discussion forum. The latter option would seem to be politically unrealistic and would mean further growth in the existing 'institutional jungle'. France would be bound to oppose any increased role for NATO in armaments discussions.

Before any discussion can take place regarding the incorporation of the WEAG/WEAO – and eventually a European Armaments Agency (EAA) – into the EU, it will first be necessary to resolve the matter of divergent memberships.⁹⁶ It will also be necessary to find a way of tackling the tension which exists between the first and second pillar in relation to military-industrial matters. In this context the location of a European Armaments Agency within the EU would encounter major problems. Integrating the WEAO/EEA into the first pillar requires a decision by a new Intergovernmental Conference (IGC). Given the already crowded agenda of the next IGC, due to be held in 2004, it is unlikely that the presidency will support this idea, particularly as the Member States seem already to be in favour of the WEAO/EEA being integrated into the first pillar. The alternative, integration of the WEAO/EEA into the second pillar is also a problem. For example, how can the legal personality of the WEAO/EEA be combined with the status accorded to the second pillar in the Treaty of Amsterdam? It is to be expected that the Commission – as guardian of the internal market – will oppose totally new competencies in a protected sub-market in the second pillar.

Given the problems outlined above, the best solution would be a mixed community-intergovernmental approach: decisions on the general objectives and broad strategies are the province of the second pillar; the Commission can be tasked with the execution (legislation and stimulating policy) and thus could pursue the tasks of the WEAO. Such an approach might well work satisfactorily in an EU framework, but there remain plenty political sensitivities, an IGC decision would be needed and there will be problems with the non-EU members of the WEAG, such as Turkey.

Allowing the WEAG/WEAO to retain its independent status for the time being avoids these problems. In addition the WEAG, with its greater number of members, would offer a broader basis for a transatlantic dialogue. It would be necessary for a certain amount of the legal framework of the WEU to remain intact and also to find a solution for the administrative support of the WEAG/WEAO, which is currently carried out by the WEU. However, retaining an autonomous status for the WEAG/WEAO must not stand in the way of a growing role for the EU in the military-industrial field.

All in all the Advisory Council has reached the conclusion that the options for a future for the WEU equipment cooperation discussions within the European Union are difficult to implement. Earlier in this advice it concluded that thus far the results of the WEAG discussion have been far from impressive. In view of this the recommendation is to allow the WEAG/WEAO to continue in an independent form and to justify its existence following the dissolution of the WEU.

⁹⁶ Some EU Member States, including the Netherlands, have suggested that the OCCAR structure could expand to become a central EU-wide procurement agency. Although OCCAR has a pragmatic approach, any form of institutionalisation would certainly lead to problems comparable with the WEAO/EAA problem examined here.

V Policy implications for the Netherlands

How does the Advisory Council see the differences between big and small countries? Would there be major advantages for the Netherlands in a distinctly European or transatlantic course?

Competitiveness and a high technological level demand the concentration of industrial strength, which in itself can pose a threat to competition relations. How can governments prevent this and help establish optimum relations?

What is the Advisory Council's view of the significance of Article 223/296 EC?

The request for advice states that in recent years national military and industrial interests have remained a highly dominant factor in defence equipment policy. In the opinion of the government these interests often form an obstacle in the attempt to open up the European defence equipment market and to establish common equipment development, production and procurement. In addition the government notes that in the Netherlands there is a clear will to 'allow national industrial interests to be less prevalent, provided other countries also actively work towards the greatest possible openness in the defence equipment market'.⁹⁷ This willingness reflects the tension between the wish to obtain the best possible equipment for the lowest possible price in a strong competitive market and the need to protect the Dutch defence industry in the existing defence market as long as other countries do the same.

In the Netherlands this tension ultimately leads to a relatively reticent attitude on the part of defence companies. The government supports the development of military equipment, but the basic principle is that industry itself must ensure that it retains sufficient competitive strength and gets enough orders. The government has also set itself the task of promoting open market conditions in the Dutch defence market. The government's agreement to the 1990 take-over of Hollandse Signaal Apparaten (HSA) by the French company Thomson-CSF indicates that it is open to internationalisation. However, this openness has not prevented the Netherlands requesting compensation for defence orders placed with foreign companies.

The question then, is how this openness relates to the developments described earlier in this report. Throughout Europe the 'secularisation' of the defence sector has undeniably led to a more business-like relationship between governments and the defence industry. At the same time it has resulted in a concentration of strength in large European and American defence conglomerates, which has largely passed the Netherlands by. Furthermore, the governments involved seem to be making little effort to open up the defence market to allow the concentrated industrial forces a free run. This being the case, the Netherlands will have to choose between two more or less conflicting interests:

- a) keeping one's hands tied as little as possible, thus being free to buy equipment from the best manufacturer with favourable compensation orders (a 'pick and choose' policy);
- b) the possibility of perhaps achieving greater efficiency in the longer term through a common policy.

It is not possible to make a reasoned choice between these options without some degree of insight into the size and the nature of the Dutch defence industry and the specific industrial interests linked to it.

⁹⁷ See the request for advice.

V.1 The Dutch defence sector

The role of the government

In 1999 the Ministry of Defence spent approximately NLG 3 billion on equipment and materiel. In addition almost NLG 500 million was spent on military infrastructure.⁹⁸ At slightly over one per cent of the total materiel expenditure of the OECD countries the Dutch procurement figure is, internationally speaking, very modest. Dutch expenditure is also strongly determined by a small number of sizeable orders, which means there are great annual variations.⁹⁹

The principle behind the Ministry of Defence's purchasing policy is 'the best equipment for the best price'. Such a principle does not conceal the fact that the purchasing pattern of the Dutch government is very much oriented towards national industry: in 1999 70% of the total value of all defence orders were placed with Dutch companies.¹⁰⁰ Approximately 30% of the total value of defence orders went to foreign companies, notably to the United States.

An outline of the Dutch defence industry

Size

The scale and composition of the Dutch defence industry are such that the Netherlands can only play a minor role in developments on the European and global markets. A report on the Dutch 'defence-related industry' prepared by the PriceWaterhouseCoopers (PWC) consultancy in December 1998 for the Ministry of Economic Affairs reveals that the total turnover for the Dutch defence industry in 1997 was approximately NLG 3.4 billion. Almost 10,000 people are employed in this industrial sector. Defence-related goods to the value of NLG 1.9 billion were exported (55% of the total turnover), mainly in the aircraft construction and communications, command and control sectors. The PWC study also shows that the Dutch defence industry is primarily made up of derivatives from civilian industrial activities. In 1997 the military turnover of companies making up the Dutch defence industry amounted to only 6.4% of their total turnover. The military export accounted for 10.6% of their total export and the number of 'military' employees made up 8.2% of their total work force. On the basis of these figures it can be seen that for Dutch defence-related companies the military activities account

98 The Directorate-General of Materiel (Ministry of Defence), 'Jaaroverzicht materieelbeleid 1999' [*Annual report on materiel policy 1999*], The Hague 2000, p. 9. The equipment expenditure for the Ministry of Defence in 1999 amounted to approx. NLG 6.6 billion. Of this 3.2 billion went on materiel operating costs and NLG 3.4 billion on investment. The figure for investment includes expenditure on building and infrastructure. For 1999 this amounted to NLG 472.5 million. In 1999 the investment quota (the investment expenditure as a percentage of total defence expenditure) was 22.5%. This is significantly lower than the 28 to 30% given as a minimum in the 1993 Defence Priorities Review. For an examination of this see: Advisory Council on International Affairs 'Developments in the national security situation in the 1990s', p. 41.

99 PriceWaterhouseCoopers, *The Dutch defence-related industry*, (study on behalf of the Ministry of defence), December 1998.

100 The Directorate-General of Materiel), 'Jaaroverzicht materieelbeleid 1999' [*Annual report on materiel policy 1999*], p. 25.

for less than 10% of their activities as a whole.¹⁰¹ Although no reliable figures are available it is obvious that also the military R&T activities of Dutch defence-related industry are limited. According to some analysts, there is only one Dutch 'self-creating' defence company: Hollandse Signaal Apparaten (HSA/Thales Nederland). Apart from this company there are apparently no other Dutch companies that spend a substantial share of their revenue on the development of military technology. This also has implications for the international stature of the Dutch companies concerned. If they do not invest in the further development of their own products, they can hardly expect to play a leading role in the international military-industrial field of influence.

Composition

According to PriceWaterhouseCoopers the Dutch defence-related industry can be divided into three groups:

- 1) 5 relatively large export-oriented companies accounting for 60% of the total turnover of Dutch defence-related industry: Koninklijke Schelde Groep (KSG), RDM Technology, Fokker Aviation (Stork Aerospace Group), HSA/Thales Nederland and Ballast Nedam.¹⁰²
- 2) 55 smaller export-oriented companies accounting for 22% of the total turnover of Dutch defence-related industry.
- 3) 87 companies not focussing on military export and making up the remaining 18% of the total turnover of Dutch defence-related industry.

Only the major companies concerned with the manufacture of army systems and naval shipbuilding, RDM, KSG and Stork – all three of which manufacture primarily for the Dutch market – concentrate on building military platforms. The rest of the Dutch defence industry is involved in producing parts, components and sub-systems. They act as subcontractors.

Not only the variations in size of the Dutch defence-related companies, but also the large number of sectors in which they operate and their historically based structures mean that Dutch defence companies have different interests when it comes to market forces. For example, HSA/Thales Nederland is part of Thomson-CSF (Thales) and thus well integrated into broader European structures. Stork, on the other hand, seems to be far more dependent on national defence policy (procurement, compensation). In the military information and telecommunications sectors national boundaries have more or less disappeared, whereas naval shipbuilding has not yet started on the necessary restructuring and primarily serves regional interests. It is therefore not surprising that the 'secularisation' of the defence sector and the resultant European concentration process is perceived in very different ways within the Dutch defence industry. Some companies assume that it will mean new opportunities for subcontractors. These could be fairly small orders for companies which excel in certain niches in the defence market. Other companies are more pessimistic. They feel that concentration in the European defence industry is essentially taking place in the United Kingdom, France, Germany and Italy – and to a certain extent also in Spain and Sweden – and fear that the major 'systems integrators' and 'platform builders' in these countries will not concern themselves with the question of how to involve subcontractors from other countries

101 In the light of this it would be inappropriate to refer to the 'defence industry'. The term 'defence-related industry' seems more applicable. However, for reasons of clarity and consistency this report opts for the former term.

102 The fact that Ballast Nedam is a construction company (which undertook military construction activities in the Middle East) indicates that PWC took a very broad definition of defence-related industry.

V.1 The Netherlands and the European defence industry

Where do Dutch interests lie?

If a distinction is to be made in the military-industrial field between 'big' and 'small' countries, then this distinction will certainly not follow the lines drawn during the Nice European Council in December 2000. For example, on the basis of its military-industrial capacity Sweden has to be considered as a big country, whereas the Netherlands, with the exception of HSA/Thales Nederland and naval shipbuilding, has hardly any 'self-creating' defence industry and thus clearly belongs to the small countries. The difference between big and small is relevant in the context of the request for advice, given the clear division in the European defence sector between big, 'self-creating' defence companies and small, supply companies; a division which means that the interests of states vary considerably.

As evidenced by the discussions in the context of the 'Letter of Intent', the policy of the 'big' European countries seems principally aimed at counterbalancing their loosening grip on their national defence industries through multinational cooperation. This does not necessarily lead to the liberalisation of the European defence market. On the contrary, for the 'systems integrators' and 'platform builders' there is, because of the major financial interests and the small number of customers and suppliers, by definition an inadequate market effect which will remain distorted if the market is opened up further. The major European defence firms operate in an environment with a limited number of suppliers who, thanks to massive investments are able to offer integrated, technologically excellent systems to a limited number of customers (governments with great purchasing power). The European governments linked to the 'systems integrators' and large 'platform builders' (United Kingdom, France, Germany and Italy, Spain and Sweden) have never been very much in favour of the significant effect of market forces because of the corporate risks involved.

The interests of the 'small' European countries lie more with maintaining a specialised defence industry, a leading role in specific technologies, dominance in niche markets and retaining (limited) employment. In this context the small countries cherish their transatlantic links and enter into numerous relationships with American companies in order to safeguard the sale of components and subsystems, to produce American equipment under licence or to act as agent for an American company. But at the same time the strengthening of European defence cooperation has increased the political pressure for cooperation at European level. Naval shipbuilding in particular needs such cooperation to survive.

For the subcontractors the situation is very different from that of the 'systems integrators' and 'platform builders'. Subcontractors do operate in an environment with a relatively large number of suppliers and a relatively large number of customers, a number which seems to be continuing to grow. After all, the systems integrators in the big countries are concentrating more and more on their overarching (integrating) tasks, while the production of subsystems and components is being dispersed across subcontractors, including those in 'small' European countries. It would be desirable to encourage this dispersal and to achieve a geographical spread across Europe so that industry in small countries has a real chance of participating in major projects. Given the large scale of supply and demand, opening up the market for subcontractors would be more likely to lead to the effect of market forces than with 'systems integrators' and 'platform builders'; the political sensitivities are also much less. In view of the preponderance of subcontractors in the Dutch defence industry, Dutch interests lie with a

more open and more transparent market for subcontractors. The effects of market forces make it easier for Dutch companies to compete on a European level.

The Netherlands and Article 223/296 EC

The situation relating to Article 223/296 EC was analysed in Chapter 4 of this advice. There it was noted that for some time the European Commission and the EU Member States have been in disagreement with regard to what exactly constitutes the 'essential interests of security' of the Member States, which exempt the European defence industry from market forces, and to what extent the authority of the Commission is sufficient to monitor the common market. The Netherlands has always been in favour of the greatest possible openness on the European defence market as this is the most advantageous for the competitive position of Dutch defence industry. In the run-up to the Maastricht Treaty the Netherlands even tried, in vain, to have Article 223/296 EC abolished completely. Objections by the big countries together with the high threshold implied by such a step (treaty changes) meant that the initiative failed.

In view of the insuperable political problems associated with abolishing or amending Article 223/296 EC, the Advisory Council believes no more attempts should be made to alter the text of the EC Treaty. Rather efforts should concentrate on the consistent, strict and uniform application of Article 223/296 EC. This approach would ensure clarity, predictability and openness in the European environment in which the Dutch defence industry operates. Uniform application means that agreement will have to be reached within the EU regarding the limits and the area of application of Article 223/296. France is also thinking along these lines.¹⁰³ The Advisory Council recommends that in this area the Netherlands should seek contact with other interested parties. It should also plead for a clear distinction between, on the one hand, integrated military systems and platforms which could be considered as constituting 'essential interests of security', and thus being exempt from market forces, and, on the other hand, subcontractors' subsystems, components and services, for which the market should be opened up and to which Title IV EC (rules relating to competition) and Article 130/157 EC (industrial policy) apply.¹⁰⁴ In the view of the Advisory Council it is in the interest of both 'systems integrators' and 'platform builders' and subcontractors to introduce open competition into the suppliers' market. This open competition will ensure that the price level of subsystems and components will remain at a reasonable level. On the other hand it will allow the subcontractors to operate in larger markets.

Market forces at subcontractor level require first and foremost a transparent environment. Thus a more detailed interpretation of Article 223/296 EC would need to be

103 The United Kingdom and Germany are also studying a more consistent application of Article 223/296 EC, albeit in a less vigorous way than France. A suggestion made to the Advisory Council in the United Kingdom was the 'reversal of the burden of proof' with regard to the 'essential interests of security' of military-industrial sectors. This would mean that states would first have to prove the 'essential interests of security' of these sectors before invoking Article 223/296. The Advisory Council is not clear how this could be demonstrated.

104 It should be pointed out that the European rules of competition do not preclude states, in certain circumstances, continuing to support companies supplying military components and subsystems. For example, the Commission approves government support to companies operating in a market with virtually no suppliers and where the profitability of a product is in doubt. On these grounds Irish support for the Aer Lingus connection between Dublin and Strasbourg/Brussels was deemed acceptable.

accompanied by the regular publication in a European bulletin of tenders for military subsystems and components. The American 'Commerce and Business Daily' and the British 'Defence Bulletin' could serve as an example. There are already similar arrangements in existence within the WEAG. The WEAG Member States' requirements for military materiel and services are published in the 'WEAG Contracts Bulletin for Military Requirements'.¹⁰⁵ The Advisory Council emphasises the importance of this practice and recommends the regular publication of tenders for military subsystems and components.

The Netherlands and OCCAR

The Advisory Council notes that the principles behind OCCAR are oriented towards the interests of major defence industries, and not towards those of subcontracting defence companies. OCCAR is primarily concerned with the relationship between the major companies and governments, whereas Dutch defence companies really need some structure to be brought into the relations between prime contractors and subcontractors. This problem has also been recognised by the Dutch Secretary of State for Defence. In a letter to the Lower House dated 3 June 1999 he wrote 'that through Dutch membership of OCCAR the Dutch defence industry will potentially have access to a larger market. However, the guarantee of proportional participation per project will disappear. This is more critical for the Netherlands than for the other OCCAR countries, as it will reduce the possibility of achieving a 'global balance' in the short term.'¹⁰⁶ Elsewhere the Secretary of State for Defence indicated that the benefits of Dutch OCCAR membership lie primarily in improved project management. The parliamentary reports of the debate concerning Dutch membership of OCCAR show that Parliament has severe doubts about equipment procurement through OCCAR.¹⁰⁷

The Advisory Council concludes that for project management the OCCAR principles offer considerable benefits. Placing new projects under OCCAR means that the project organisation does not have to constantly reinvent the wheel. The OCCAR 'global balance' working practice can also function satisfactorily, provided a strict control is maintained on an eventual fair exchange between acquiring equipment via OCCAR and industrial participation in programmes.¹⁰⁸ The Advisory Council stresses that the fairness of the exchange should be reflected in the technological level at which the 'global balance' is calculated. The Advisory Council concludes that OCCAR will only be able to satisfy its principles if the following four conditions are met:

- 1) OCCAR should manage a large number of programmes;*
- 2) Within OCCAR there must be clear agreement on the security of supply;*
- 3) As far as possible countries should harmonise the timing of their materiel procurement;*
- 4) OCCAR member nations should harmonise the requirements for materiel to be procured through OCCAR.*

105 Not all military requirements are published in this bulletin. Naval ships are not included.

106 Parliamentary Document 26 636, no. 1.

107 Parliamentary Document 26 396, no. 7.

108 Traditionally the 'just returns' are calculated per year and per programme. The 'global balance' principle takes account of a balance spread over a number of years and a number of projects. This allows work sharing among OCCAR partners to be arranged on the basis of broad economic criteria rather than on narrow, yearly 'nationality criteria'

The above conditions place severe demands on the OCCAR member nations and will not all be attainable in the short term. Time will tell whether membership of OCCAR meets Dutch expectations, and this will depend in part on whether other member nations are prepared to promote the interests of the defence supply industry. It is not possible to give judgement on this at this stage. On the other hand, if the Netherlands does join OCCAR it is not obliged to take part in other OCCAR programmes if it derives no benefit from doing so. However, the Advisory Council is of the view that Dutch participation in the Letter of Intent initiative (see below) would be difficult if the Netherlands is not also part of OCCAR; even though officially there is no link between the two initiatives.

The Netherlands and the Letter of Intent/Framework Agreement

The Advisory Council notes that the core of the discussion regarding the Lol relates to the tension which built up during the 1990s between the continued restrictive, national military-industrial policy of European governments and the industrial practice of increasing international cooperation. The Advisory Council is not convinced that discussions on this subject should only take place in a separate group of six countries. It is of course an important fact that the defence industries in the Lol countries account for almost 90% of the total military-industrial turnover: there is also a certain pragmatism attached to first obtaining agreement among these countries. But this notwithstanding, European countries with smaller industries are equally interested in the agreements on the six areas of interest the Lol intends to cover. Clearly the Lol countries are endeavouring to achieve with a small group of countries something which is considered either politically undesirable or not feasible with fifteen EU states.

The Advisory Council believes that it would be highly undesirable for the Lol states to create a permanent division between their own military-industrial interests and those of other EU Member States. Transnational cooperation in the military-industrial sector relates to the defence industries in all EU Member States and is not confined to 'systems integrators' and 'platform builders'. It also relates to the relationship between major defence industries and subcontractors, particularly with regard to customs tariffs and 'security of supply'. In the long term a division of agreements could lead to alienation between Lol states and the remaining EU Member States. The worst scenario imaginable would be if the other European states were to have the impression that a finalised Lol package was being imposed on them. Ultimately such an alienation could damage the industrial interests (sales, supply) of the Lol states themselves. It should also be pointed out that it is quite impossible to reconcile a separate Lol market for defence equipment with the concept behind a common European market.¹⁰⁹

In this light and in view of the undeniable political impasse concerning the Bangemann Report, the Advisory Council would encourage other countries to join the Lol as soon as possible, beginning with the Netherlands and Belgium, in part because of their involvement in OCCAR projects. The Advisory Council also believes that the Lol countries should make use of the so-called Ad Hoc European Armaments Policy Group (POLARM) to keep the other EU states closely informed of progress within the Lol and to consult them on future developments of the Lol initiative. As stated earlier, the

¹⁰⁹ This is all the more true where – as concluded earlier in this advice – an increasing number of military components and systems contain 'dual use' goods, to which the EU competition policy certainly should apply.

Advisory Council believes that presenting the other EU Member States with a completed, finalised package of Lol measures would inevitably lead to political resistance. In this connection the Advisory Council would wish to point out that defence-related subjects at the European Council in Nice are unfortunately excluded from any form of enhanced European cooperation ('coopération renforcée') among a smaller group of Member States.¹¹⁰

In the event of the Netherlands joining the Lol group the question of arms exports would be discussed. The Dutch policy has neither 'white lists' nor 'global licences'. However the Netherlands takes the signature of the UN Arms Register as a consideration for arms exports, which is not included in the Lol practice.¹¹¹ A further point of attention is the role of the EU 'Code of Conduct' on arms exports, which is an integral part of Dutch policy. The 'Framework Agreement' refers in a general way to this code of conduct, but contains no detailed discussion of the specific criteria of the 'Code of Conduct'. Lol states such as Germany and Sweden, which also have a strict arms exports policy, are in a similar situation. It will be necessary to work together with these countries to find solutions acceptable to Dutch political opinion.

Changes to the Dutch compensation policy

The Dutch compensation policy was born out of the lack of international trade opportunities for the Dutch defence industry. *In the event of progress being made with regard to the areas discussed earlier in this report (the strict application of Article 223/296 of the EC Treaty, a more open market and a widening of the membership of the Lol/Framework Agreement) it will be necessary to gradually abandon the current compensation policy. However, it is not expected that this policy will be completely rejected, if only because transatlantic military-industrial relations are not subject to the effects of market forces. The complete abolition of compensation would in any case probably not lead to a reduction in costs, at least not while other countries continue to use such an industrial obligation. The Advisory Council believes that it is important for the Dutch defence industry to be able to continue to count on government support, albeit in a different way from now. The Dutch government – in the form of the Ministries of Defence and Economic Affairs – should act as an open, consistent partner for Dutch defence industry, helping to strengthen its position vis-a-vis European and American 'systems integrators' and 'platform builders'. In this light the Advisory Council would recommend the government to study the possibilities for a more consistent approach to Dutch military exports – for example by creating a single official point of contact – and for greater emphasis on participation arrangements. These could perhaps be achieved through compensation agreements for materiel procurement in other areas. The Ministry of Defence could also examine to what extent function-specific procurement could be introduced instead of the existing technical specific policy. There are lessons to be learnt here from the British practice of 'Cardinal Points Specification'. By specifying the requirements for military equipment only in relation to the key functional points one can avoid defence orders being 'tailored' to particular manufacturers and can ensure that companies seek cost-effective applications for specific functional requirements. In*

110 Article 27B of the Treaty of Nice states that: 'Enhanced cooperation ... shall relate to implementation of a joint action or a common position. It shall not relate to matters having military or defence implications.' EU Member States are free to join an enhanced cooperation if they so wish and provided they meet the conditions; this is certainly not the case with the Lol.

111 See also: Advisory Council on International Affairs, 'Conventional arms control; urgent need, limited opportunities', which contains the suggestion for this consideration

addition companies do not have to commit themselves to specific, frequently overpriced technologies which could be replaced by cheaper (commercial) alternatives.

Dutch procurement policy: the best equipment for the best price.

Following significant overspending on materiel development during the 1980s¹¹² the 1991 Defence White Paper opted for a procurement policy based on 'off-the-shelf' purchasing (obviously with the appropriate compensation).¹¹³ According to the Defence White Paper this method of procurement has 'the advantage of limiting technical and quality risks. The development has been completed. The price is also known.'¹¹⁴ During the first half of the 1990s the Ministry of defence more or less followed this policy, as demonstrated by the purchase of Apache combat helicopters. However, recent participation in the development of the GTK/MRAV armoured vehicle and the Fennek reconnaissance vehicle represents a deviation from the established practice of buying 'off the shelf'.

The Advisory Council would point out here that such a shift in the procurement pattern can have a favourable effect, provided it takes place under the correct conditions. In the case of too pragmatic a procurement pattern one may miss out on the chance of an early share in the development of new technology. Such technology allows the creation again of centres of excellence within Dutch industry capable of operating on the international market. In addition, participating in international equipment development avoids the Netherlands getting a reputation for being an opportunistic country – a 'free rider' – with which it is impossible to make satisfactory agreements. Sometimes there is no 'off-the-shelf' alternative available. Finally, extending the life of equipment – used increasingly to keep costs under control – is often only feasible through international cooperation.

This notwithstanding, the Advisory Council believes that 'off-the-shelf' procurement should remain the starting point as part of the bid to obtain the best equipment for the best price. In the Council's opinion a further shift in procurement towards international projects and participation will only be justified if, and depending on the extent to which the Dutch defence industry's access to the international market is structurally improved and guaranteed. Strict application of Article 223/296 of the EC Treaty and the favourable development or widening of the Lol/Framework Agreement are key factors.

With a view to controlling costs, the following principles, taken by the Advisory Council from British procurement practice, should be given particular attention:

- 1) Competitive tendering. Companies should submit competitive tenders for equipment programmes.¹¹⁵

112 This refers particularly to the development and production costs of the Walrus submarines and the Improved Leopard I. See for general comments: 'De plank: om van te kopen of om mis te slaan?', in: Carré 3, 2001, pp. 20 en 21.

113 In this advice 'off the shelf' is taken to mean buying fully developed and tested equipment. This definition differs from that used in some analyses, where 'off the shelf' refers specifically to a military application of commercial goods.

114 Ministry of Defence, 'Defence White Paper 1991: The Netherlands armed forces in a changing world', The Hague 1990, pp. 189, 271.

115 Where international competition is impossible or undesirable the price of national tenders can be compared with that of existing, foreign equipment (contestability).

- 2) Fixed price contracts. The manufacturer must bear the risk of overspending. However, if companies do manage to produce more cheaply the profits are theirs.
- 3) Payment on progress. The government should pay in instalments, based on tangible progress in projects. This allows the government to retain financial control during the whole process.

These principles enable the government to avoid additional costs for equipment programmes coming off the defence budget. In addition the defence industry is also motivated to work as efficiently as possible.

V.3 The Netherlands and the American defence industry

The Advisory Council observed a certain degree of ambivalence among the Dutch defence industry with regard to American-Dutch military-industrial relations. On the one hand it is agreed that American defence industry is a very good partner for Dutch industry. On the other hand it is recognised that the American authorities have put in place considerable obstacles making open Dutch-American cooperation difficult, or in some cases even impossible.

Industrial cooperation

The Joint Strike Fighter programme, in which European partners, including Dutch industry, were approached regarding participation at an early stage of the programme, is often quoted as an example of good cooperation with American defence industry. This open attitude is in contrast to the Eurofighter programme, where much less participation is offered, even now that the Netherlands has received approval to join the Eurofighter project organisation as a full partner.¹¹⁶

The Advisory Council wishes to emphasise that in judging transatlantic military-industrial relations one should avoid thinking in terms of two 'blocs'. Transatlantic industrial cooperation is significant and is continuing to expand. This relates not only to more intensive contacts between major companies, such as British Aerospace and Boeing, but also to closer contacts between American systems integrators and European subcontractors. Boeing, for example, has thousands of subcontractors, including thousands of European subcontractors, for which until recently the method of development and production of their components was prescribed in detail. This is now changing. Inspired by the decentralised structure of Airbus Boeing is allowing its subcontractors increasing freedom in the development of components and subsystems. This new policy is leading to ever closer relations. A balance has also been achieved in transatlantic trade at subcontractor level.

American government policy

As explained earlier in this advice, for a long time the American government did not consider Europe to be a full partner. As evidenced by the Defence Trade and Security Initiative (DTSI), the importance of international cooperation in safeguarding the American global competitive position is gaining increased recognition. However, there is still a great fear that American technology will be exported without any further control over it. This fear also exists in the case of Dutch-American cooperation. It was necessary to apply a great deal of diplomatic massage before Dutch industrial participation in the JSF programme was accepted. However, once the Americans were convinced of the benefits offered by Dutch-American cooperation it was very easy to set up a 'virtual transatlantic enterprise' in which seven Dutch companies are currently participating.

¹¹⁶ J. Janssen Lok, 'Dutch invited to become Eurofighter partner'.

From a US point of view the Netherlands' status as a trustworthy European military-industrial partner is illustrated by the fact that at the end of 2000 it was invited to take part in discussions over bilateral ITAR exception provisions. *Despite the shortcomings of such exceptions explained earlier in this report, such as those of the DTSI, the Advisory Council recommends that the government react positively to the American invitation for further discussions. At some stage the question will arise as to whether, and if so how, Dutch export regulations should be adapted to American practice. The Advisory Council would point out that, quite apart from the problems this might raise on the domestic political front, in this case the Netherlands is in the same position as the UK, France, Germany and Norway, which have also been invited to take part in bilateral discussions. This could conflict with the arrangements set out in the letter of Intent and thus would require closer agreement, certainly within the Lol group. In the view of the Advisory Council a wish by the Netherlands to join the Lol would mean that our country would need to harmonise the discussions with the United States in a broader framework of European partners, in the full realisation of the dilemmas this will cause.*

It is not expected that the problems with the American policy outlined in Chapter 3 will lead immediately to a change of course by the 'small' European countries. These will probably continue to follow for some time an ad hoc policy, if only for tactical reasons with respect to the 'big' European countries. Obviously there are also economic and military-strategic advantages linked to good transatlantic relations. For example, the high level of compatibility between American and Dutch equipment facilitated the intensive deployment of Dutch F-16s during the Kosovo crisis. This sort of 'coalition warfare' may be jeopardised if the focus is entirely on European military-industrial cooperation. Participation in American programmes can also be advantageous for the small countries, particularly if these programmes deliver cheaper and better equipment than the European competition through economy of scale. The tendency on the part of small countries to focus increasingly on the United States will grow as cooperation in Europe becomes more selective and less flexible.¹¹⁷

V.4 A consideration

Greater orientation towards European military-industrial cooperation would seem only be profitable if there is a real chance of European projects running better in the future. If European cooperation fails it will have quite the opposite effect. In addition European military-industrial policy is only likely to succeed if European governments manage to bring about a significant national and international rationalisation process. However, with the current production of various European combat aircraft and various types of main battle tank this rationalisation process is still a long way off. It would also be useful for European politics to actively promote further cooperation in the defence industry. At present this does not happen enough, one reason being that the various European armed forces have very divergent equipment specifications.

All things considered the Advisory Council believes that for the Netherlands choosing either a strictly European or transatlantic course is not an option. Furthermore, the recently agreed joint venture between Thales and Raytheon demonstrates that the French defence industry, for example, is also increasingly entering into cooperation

¹¹⁷ In this context the term 'selective' refers to multilateral cooperative partnership, such as the 'Letter of Intent'.

with American companies in strategic sub-sectors.¹¹⁸ A definitive choice, whichever it might be, would certainly cause problems for the Dutch defence industry. For individual companies the US is too important a market to lose. In addition the European defence market, which in 1999 represented military exports three times as high as those to the US, can – provided open competition at supplier level is encouraged – offer many new industrial and political perspectives.¹¹⁹ This advice hopes to contribute to this.

118 Ph. Migault, 'Thales et Raytheon renforcent leur coopération' [*Thales and Raytheon enhance their cooperation*] in: *Le Figaro*, 16/17 December 2000.

119 According to the Directorate of Foreign Economic Relations of the Ministry of Economic Affairs Dutch exports of military goods to other EU Member States in 1999 amounted to roughly NLG 340 million (of which NLG 178 million to Germany alone). In the same year Dutch exports of military goods to the United States amounted to approximately NLG 119 million.

Annexes

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Subject

The development of a European military-industrial policy

Dear Mr Lubbers,

At its meeting in Helsinki on 10 and 11 December 1999 the European Council took new steps towards the development of a European Security and Defence Policy (ESDP). Among other things the European Council approved a goal for ground forces, namely a force of 50,000 to 60,000 strong. In Helsinki decisions were also taken relating to international aspects of the ESDP: the establishment of a standing Political and Security Committee, a Military Committee and a Military Staff, which pending final decisions will first operate as interim bodies.

The approach adopted by the European Union with regard to the development of an ESDP is in accordance with earlier NATO decisions, in particular that of the NATO summit of April 1999, in which the Alliance expressed its willingness in principle to make available planning staffs, command facilities and other collective resources for operations under the leadership of the European Union. This will prevent unnecessary duplication of effort.

A common European security and defence policy presupposes the presence of a high quality industry, capable of providing European countries with good, modern equipment when needed and under competitive conditions. The Cologne European Council emphasised particularly the desire to "strengthen the industrial and technological defence base, which we want to be competitive and dynamic". For several decades European countries have been cooperating on equipment, first primarily within the "Independent European Programme

Group" and then in the "Western European Armaments Group" (WEAG). This cooperation attempted to harmonise operational requirements and procurement schedules, to improve the rules for joint projects and to stimulate joint research and development. Other relatively recent initiatives are the founding of the OCCAR armaments agency in 1996 by Germany, France, Italy and the United Kingdom and the "six nation initiative" of July 1998, in which the same four countries and Spain and Sweden express their agreement in principle to extended armaments cooperation.

However, the emphasis in European defence equipment cooperation in recent years has lain with industry. Mergers, take-overs and other forms of cooperation have ensured that European companies, most noticeably in the space and aircraft sector, have scaled up. Examples of this are the British Aerospace take-over of Marconi in the United Kingdom and the merger of Aérospatiale and Matra. This was followed by the merger of Aérospatiale-Matra, Dasa and the Spanish Casa to form the European Aeronautic, Defence and Space Company (EADS) and the recent purchase of the British company Racal by the French Thomson-CSF. This makes Thomson-CSF the third European consortium in the world's top ten military producers, the others being EADS and British Aerospace. The industrial restructuring is intended to make the European defence industry more competitive. Other important conditions for this include reduced costs, increased productivity and an improved market effect. This may sometimes require drastic measures: it is by no means certain that the necessary political will exists. In this context the question arises as to how the principles of the Internal Market relate to the restructuring of the European defence industry.

With this major restructuring the European industry is following in the footsteps of the American competition, which has already undergone a far-reaching process of reorganisation and scaling up. However, the American defence industry is not solely a competitor: it is increasingly a cooperative partner with whom European industry can obtain comparative advantages. Until recently it was primarily British industry that had close transatlantic links, but in the meantime companies from other European countries, most noticeably France and Germany, have acquired American partners. Up to now politics have limited the possibilities for cooperation. The United States in particular imposes strict security demands on cooperation, which companies from some countries are virtually by definition unable to fulfil. In addition the American market is very inaccessible to foreign enterprises wishing to be able to make a bid on a competitive basis. Forms of industrial cooperation can contribute to openness and transparency in transatlantic defence equipment relations. This is important because the construction of a viable, competitive European defence industry may be accompanied by suggestions for protective measures against foreign, in other words American, competition. As indicated earlier, to achieve openness and transparency it will be necessary to remove some of the obstacles, especially in American legislation, including in the area of technology transfer.

The new momentum in the development of a common European security and defence policy and the new dynamics of industrial cooperation have as yet had few tangible effects on equipment cooperation. It is significant that the passage in the documents of the Helsinki European Council referring to "strengthening the European industrial and technological defence base" repeats almost word for word the text from Cologne. Judging by this text it would seem that with regard to equipment nothing worthy of note happened between June and December 1999. Reality is different, but no more positive.

During the course of 1999 the EU was namely unable to achieve agreement on a Commission proposal for a common position on European defence equipment policy. The proposal

contained a number of measures relating to the imposition of customs duties on military goods, putting out to public tender and cross-border movement of military goods. Accepting this common position would have been a further step towards demolishing the persistent taboo on EU involvement with this subject. This turned out not to be possible. Nevertheless this subject will appear again on the agenda in 2000. If the EU takes over the tasks of the WEU a solution will also have to be found for the WEAG. The outlines of this are not yet clear.

Over the years military-operational cooperation among European countries has intensified. This cooperation is important, not least because it can contribute to increasing interoperability. However, experience teaches us that operational cooperation alone does not lead to the standardisation of materiel.

All in all, over the last decades we have seen that national military and industrial interests can be a very dominant factor in procurement policy and the defence equipment policy as a whole. Until now these national interests often formed an obstacle to opening up the defence equipment market and to the joint development, production and procurement of equipment. As far as the Netherlands is concerned there is a clear willingness to allow national industrial interests to be less prevalent, provided other countries also actively work towards the greatest possible openness in the defence equipment market, certainly within Europe and preferably also on a transatlantic level.

The current situation, whereby cooperation at governmental level is lagging behind that at industrial level, can have adverse consequences. It is conceivable that several major European conglomerates will be left over on the supply side. In that case there is in principle a risk that European industry will determine the European defence market. This danger could certainly arise if European governments, either singly or as part of a combined European expression of requirements, were not prepared to consider a non-European offer. The question is how government and industry, working together and bearing in mind each other's responsibilities, can encourage optimum relations. This will require good arrangements for government participation in defence companies and government support, for the harmonisation of arms export policy to third countries and for cooperation in research and development.

Against this background we have a number of questions for the Advisory Council:

- What is the Advisory Council's assessment of the general political and industrial climate for a European military-industrial policy and for an open common market for defence equipment? How does the Advisory Council see the differences between large and small European countries? Is there such a difference between the defence industry in the six countries mentioned above and other European nations, including the Netherlands, that a true common policy would be inconceivable? Would the Netherlands benefit from an explicit pro-European or transatlantic direction in this area or would the interests of the Netherlands be better served by a policy of choices being made on a case by case basis?
- In the opinion of the Advisory Council, how should the government ensure that the positive attention being given to the CESDP will be translated into greater political support for a European defence equipment policy which has a strong industrial and technological base and which promotes international competitiveness? How can this best be achieved, bearing in mind the relevant statements from the Cologne and Helsinki European Councils?

- Competitiveness and a high technological level demand the concentration of industrial strength, which in itself can pose a threat to competition relations. How can governments prevent this and help establish optimum relations?
- Is it possible to integrate a new 'European armaments organisation' into the European Union? How can the involvement of the European Commission and the link with the EU's internal market policy and industrial policy best be taken into consideration? In this context, what is the vision of the Advisory Council with regard to Article 296 and the possible need to amend it?
- How can a European military-industrial policy be implemented in an open manner, in particular with regard to the United States? How can European nations act to remove the obstacles to access to the American market and to stimulate effective, more equitable transatlantic cooperation? What are the implications for competition relations of the discrepancy between American and European expenditure on defence technology research? How can governments on both sides of the Atlantic contribute to transparent relations and encourage both cooperation and competition?
- It is frequently not easy to distinguish between civilian and military technology. Until recently defence was more or less a taboo subject for the EU. Now that this attitude has been consigned to the past the question arises as to whether the Advisory Council believes that European R&D programmes offer opportunities for (more) defence-related projects.

On behalf also of the Minister of Economic Affairs and the Secretary of State for Foreign Affairs we are asking the Advisory Council on International Affairs for advice on these and possible other matters relating to the development of a European military-industrial policy. The future of the WEAG will be discussed by Ministers of Defence in mid-November and may also be included on the agenda for the Nice European Council. For this reason we would like to receive your advice by the beginning of November 2000 if possible.

We remain yours sincerely,

MINISTER OF DEFENCE

MINISTER OF FOREIGN AFFAIRS

F.H.G. de Grave

J.J. van Aartsen

**List of people consulted and of speakers at the conference on
'The globalisation of the defence industry' (London, 29 en 30 January 2001).**

1. Netherlands

H.R. Boswijk	Chairman Board of Directors, Thales Nederland
J. Dibbetz	Director Netherlands Defence Manufacturers Association (NIID)
B. Kwast	Directorate-General of Materiel, Ministry of Defence
Dr. J.A. Schoneveld	Commissioner's Office for Military Production, Ministry of Economic Affairs
Brigadier General H.J.G.J. Teussink	Directorate-General of Materiel, Ministry of Defence
Prof. A. Veenman	Chairman Board of Directors, Stork N.V.
W.H. Wiedeman	Commissioner for Military Production, Ministry of Economic Affairs
M.C. Wolters	Department of Arms Control and Arms Export Policy, Ministry of Foreign Affairs

2. France

Chr. R. van Beuge	Her Majesty's Ambassador in Paris
J. Kraak	Dep. Head Political Department, Embassy Paris
M. Krop	Dep. Chef de Poste, Head Political Department, Embassy Paris
Colonel A.C. Tjepkema	Defence-attaché, Embassy Paris
G. Araud	Director Security Policy, Ministry of Foreign Affairs
D. Argenson	Deputy Director Multilateral Cooperation, Delegation General for Armament, Ministry of Defence
Admiral J. Bétermier (rtd.)	Advisor Board of Directors, EADS
Ph. Coq	Deputy Director Aeronautics, Missiles and Space, Delegation General for Armament, Ministry of Defence
C. Deneuvel	EADS, area-sales manager
Chr. Dumas	EADS, Vice-President international development
R. Eskinazi	President-Director Europa, Thales
M. Mabilie	EADS, Senior Vice-President business development
B. Rézat	Dep. President-Director, Thales
G. Schlumberger	Directorate of Strategic Affairs, Ministry of Defence
Dr. B. Schmitt	WEU Institute for International Security Studies
M.A. Vinolo	Vice-Chairman Board of Directors, EADS

3. United Kingdom

W.O. Bentinck van Schoonheten	Her Majesty's Ambassador in London
W.A. Bas Backer	Counsellor, London Embassy
Captain W.T. Lansink	Defence attaché, London
Commander G.L. Kouwenhoven	Defence equipment attaché, London
Dr. D.H. Allin	International Institute for Strategic Studies, editor 'Survival'
Dr. A. Ashbourne	Independent consultant, Ashbourne Beaver Associates
K. Becher	Senior Fellow, International Institute for Strategic Studies
M. Bell	Group Head of Strategic Resources, British Aerospace Systems

M. Codner	Assistant Director, Royal United Services Institute
Mrs J. Darby	Deputy Head of European Union Department, Ministry of Foreign Affairs
W. Ehrman	Director International Security, Ministry of Foreign Affairs
Major Gen. P. Gilchrist	Executive Director 2, Defence Procurement Agency
Prof. K. Hayward	Head Research, Society of British Aerospace Companies
J. Hunt	Director Aerospace and Defence Industries, Ministry of Trade and Industry
T. Hanson	International Relations Group (OCCAR), Defence Procurement Agency
G. Moore	Manager Defence Industries, Ministry of Trade and Industry
A. Noble	Deputy Head Security Policy Department, Ministry of Foreign Affairs
A. Radcliff	International Relations Group (Lol, bilateral matters), Defence Procurement Agency
B. Rimmington	Assistant Director of EC Company Mergers, Ministry of Trade and Industry
S. Simon	Assistant Director, International Institute for Strategic Studies
Prof. R. Smith	Birkbeck College (Applied Economics), London University
A. Staunton	Head Aviation Section; Aviation, Maritime, Science and Energy Department, Ministry of Foreign Affairs
Sir Robert Walmsley	Chief Defence Procurement Agency

4. Germany

M. Biermann	Directorate of Security Policy, Ministry of Foreign Affairs
Brigadier Gen. J. Bornemann	Dep. Head Staff Department, Political-Military Affairs and Arms Control, Defence Staff, Ministry of Defence
W. Frank	Department of Defence-Economic Cooperation, Directorate-General of Materiel, Ministry of Defence
W. Hermann	Head of Department International Equipment Cooperation, Directorate-General of Materiel, Ministry of Defence
Dr. R. Schumacher	Director Security Policy Ministry of Foreign Affairs

5. Brussels/European Union

Dr. B.R. Bot	Her Majesty's Permanent Representative to the European Union
J.G.S.T.M. van Hellenberg Hubar	Netherlands Permanent Representative to the Western European Union/Representative on the Politics and Security Committee of the European Union
L. Kuyper	Economic Department, Permanent Representation to the European Union
Major E. de Landmeter	Netherlands Permanent Military Representation in Brussels
M.J. de Vink	GBVB/ESDP Department, Netherlands Permanent Representation to the European Union
Dr. D. Zandee	Defence Council, Netherlands Representation to the European Union

L. Briët	Dep. Director Political Affairs, Directorate-General of External Relations of the European Commission/European Commission Representative on the Politics and Security Committee of the European Union
Mrs F. Rey	Policy Office, Directorate-General of External Relations of the European Commission
G. Titley	European Parliament

6. Speakers at the conference on 'The globalisation of the defence industry'

Dr. G. Adams	Director Security Studies, George Washington University
Chr. Avery	Equity Research, Airlines and Aerospace, JP Morgan
R.G. Bell	Assistant Secretary General for Defence Support, NATO
Sir John Bourn	Auditor General, National Audit Office
J. Campbell	Aerospace and Defence Electronics Sector, Lehman Brothers
R. Crosby	Director Integrated Systems, Northrop Grumman
J. Dowdy	McKinsey
J. Dromey	Transport and General Workers Union
Dr. Th. Enders	Defence and Civil Systems Division, EADS
Dr. J. Gansler	Former Undersecretary for Defense for Acquisition, Technology and Logistics, United States
Air Marshall T. Garden	Former Vice Chief of the Defence Staff, United Kingdom
Dr. J. Hamre	Former Deputy Secretary of Defense, United States
Air Chief Marshal	Air Force, United Kingdom
Sir Richard Johns	
Prof. K. Hayward	Society of British Aerospace Companies
G. Hoon	Minister van Defence, United Kingdom
W. Hopkinson	Former Deputy Director, Royal Institute of International Affairs
B.P. Jackson	Strategy and Planning, Lockheed Martin
Lord Levene of Portsoken	Deutsche Bank
Lord Marshall of Knightbridge	Director Royal Institute of International Affairs
M.J. Marshall	Director Marshall of Cambridge
Sir Charles Masefield	Group Marketing Director, British Aerospace
Gen. K. Naumann (rtd.)	Former Chairman, NATO Military Committee
A. Nicoll	Financial Times
J. Oughton	Directorate of Defence Logistics, Ministry of Defence, United Kingdom
Sir Geoffrey Pattie	Terrington Management
Admiraal J. Perowne	Vice SACLANT, NATO
N. Prest	Director Alvis
B. Rétat	Deputy President-Director, Thales
Major Gen. A.P. Ridgway	Chief of Staff Allied Command Europe Rapid Reaction Corps (ARRC)
Lord Robertson of Port Ellen	Secretary-General van de NATO
Prof. H. Sapolsky	Director Security Studies, Massachusetts Institute of Technology
Prof. T. Taylor	Director Defence management and Analysis, Cranfield University
Sir Robert Walmsley	Director Defence Procurement Agency
J. Wohler	Business Development, Raytheon Company

Annexe III

Consolidation and internationalisation have led to the following situation in the European defence industry.¹²⁰

Amounts in millions of dollars

Sector	Company	Total turnover	Military turnover
1) Aircraft construction	BAE Systems	13.000	8.700
	EADS	11.500	1.500
	Dassault Aviation (Aérospatiale 45,8%)	3.830	1.870
	<i>Alenia Aeronautica</i> (Finmeccanica)	1.200	600
	Saab (BAE Systems 35%)	410	410
	Aermacchi	200	180
	2) Helicopters	<i>Eurocopter</i> (EADS)	1.890
<i>GKN Westland</i> (GKN)		-	-
<i>Augusta</i> (Finmeccanica)		590	400
3) Missiles	<i>Matra BAE Dynamic s</i> (BAE Systems 37,5%, EADS 37,5%, Finmeccanica 25%)	2.700	2.700
	<i>Airsys, Short Missiles Systems</i> (Thales)	-	-
	Saab (BAE Systems 35%)	590	590
	LFK (Dasa 70%, Matra BAE Dyn. 30%)	390	390
	<i>Bodenseewerke Gerätetechnik</i> (Diehl)	220	180
	4) Space	<i>Astrium</i> (EADS 75%, BAE Systems 25%)	2.450
<i>Alcatel Space</i> (Alcatel/Alsthom 51%, Thales 49%)		1.420	240
<i>Alenia Spazio</i> (Finmeccanica)		590	-
5) Electronics	Thales (incl. missiles)	8.500	4.900
	BAE Systems (partly with AMS)	-	-
	EADS	-	1.200
	<i>New AMS</i> (BAE Sys. 50%, Finmeccanica 50%)	1.200	1.200
	Sagem	3.180	570
	Smiths Industries	1.990	460
	Saab (BAE Systems (35%)) Ericsson	- 23.200	370 260

¹²⁰ Based on: SIPRI, 'Yearbook 2000', p. 308. 'Joint ventures' are shown in italics.

Sector	Company	Total turnover	Military turnover
6) Army systems	<i>Rheinmetall DeTec</i> (Rheinmetall)	2,000	2.000
	GIAT Industries	1.200	1.200
	<i>Royal Ordnance</i> (BAE Systems)	800	800
	Krauss Maffei Wegman	740	740
	<i>Swiss Amm./Swiss Ordnance</i> (RUAG Suisse)	-	-
	<i>Vickers</i> (Rolls Royce)	1.480	570
	Alvis Vehicle	440	410
	<i>Alenia Difesa</i> (Finmeccanica)	-	300
	7) Shipbuilding	DCN	1.900
<i>HDW</i> (Babcock 50%, Preussag 25%, Celsius 25%)		1.100	500
<i>VSEL and Yarrow Shipbuilders</i> (BAE Systems)		-	-
Bazan		490	420
Fincantieri		2.460	260
Vosper Thornycroft		400	250
<i>Blohm & Voss/Thyssen Nordseewerke</i> (Thyssen- Krupp)		370	200

Variations in membership

WEU	Western European Union
WEAG	Western European Armaments Group
OCCAR	Organisation Conjointe de Coopération en matière d'Armement
LoI	Letter of Intent
EU	European Union
NATO	North Atlantic Treaty Organisation

M	member
AM	associate member
O	observer status
AP	associate partnership

	WEU	WEAG	OCCAR	LoI	EU	NATO
Austria	O	O			M	AP
Belgium	M	M			M	M
Bulgaria	AP					AP
Canada						M
Czech Rep.	AM	O				M
Denmark	O	M			M	M
Estonia		AP				AP
Finland	O	O	M	M	M	AP
France	M	M	M	M	M	M
Germany	M	M			M	M
Greece	M	M			M	M
Hungary	AM	O				M
Iceland	AM					M
Ireland	O				M	
Italy	M	M	M	M	M	M
Latvia	AP					AP
Luxembourg	M	M			M	M
Netherlands	M	M			M	M
Norway	AM	M				M
Poland	AM	O				M
Portugal	M	M			M	M
Romania	AP					AP
Slovakia	AP					AP
Slovenia	AP					AP
Spain	M	M		M	M	M
Sweden	O	O		M	M	AP
Turkey	AM	M				M
United Kingdom	M	M				
United States			M	M	M	M

Overlapping objectives

WEU	Western European Union
WEAG	Western European Armaments Group
OCCAR	Organisation Conjointe de Coopération en matière d'Armement
LoI	Letter of Intent
EU	European Union
NATO	North Atlantic Treaty Organisation

	WEU (working groups)	WEAG WEAO	OCCAR	LoI	EU ¹²¹	NATO
Standardisation of norms/requirements	X					X
Harmonisation of procurement		X	X	X	X	
R&T		X	(X)	X	X	X
Harmonisation of requirements	X	X	(X)	X	X	
Support for joint programmes		X	X			X
Harmonisation of export policy				X	X	
Security of supply		X	X	X	X	
Competition			X		X	

121 EU working groups and the European Commission.

List of abbreviations

BAE	British Aerospace
C3	Command, Control and Communications
CFIUS	Committee on Foreign Investment in the United States
CNAD	Conference of National Armaments Directors
COARM	Conventional Arms Exports Working Group
DITB	Defence Industrial and Technology Base
DTSI	Defense Trade Security Initiative
EAA	European Armaments Agency
EADC	European Aerospace and Defence Company
EADS	European Aeronautic Defence and Space Company
EC	European Community
EMU	European Monetary Union
ESDP	European Security and Defence Policy
EU	European Union
HSA	Hollandse Signaal Apparaten
IGC	Inter Governmental Conference
ITAR	International Traffic in Arms Regulations
JSF	Joint Strike Fighter
LoI	Letter of Intent
NATO	North Atlantic Treaty Organisation
NIID	Netherlands Defence Manufacturers Association (Nederlandse Industriële Inschakeling Defensieopdrachten)
NDP	National Disclosure Process
NDPP	NATO Defence Planning Process
OCCAR	Organisation Conjointe de Coopération en matière d'Armement
POLARM	Ad Hoc European Armaments Policy Group
PSC	Political and Security Committee
PWC	PriceWaterhouseCoopers
RMA	Revolution in Military Affairs
R&T	Research and Technology
RIIA	Royal Institute of International Affairs
SIPRI	Stockholm International Peace Research Institute
TRP	Technology Reinvestment Project
UK	United Kingdom
US	United States
WEAG	Western European Armaments Group
WEAO	Western European Armaments Organisation
WELG	Western European Logistics Group
WEU	West European Union

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