



Assembly of Western European Union

DOCUMENT 1587

4 November 1997

FORTY-THIRD SESSION

European cooperation on the procurement of defence equipment
lessons drawn from the Symposium

REPORT

submitted on behalf of the Technological and Aerospace Committee
by Mr Lenzer, Rapporteur

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ASSEMBLY OF WESTERN EUROPEAN UNION
43, avenue du Président-Wilson, 75775 Paris Cedex 16 – Tel. 01.53 67.22.00

*European cooperation on the procurement of defence equipment –
lessons drawn from the Symposium*

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¹ Adopted unanimously by the Committee

² *Members of the Committee* Mr Marshall (Chairman), MM Lenzer, Atkinson (Vice-Chairmen); Mrs Aguiar, Mr Arnau, Mrs Blunck, Mrs Bribosia-Picard, MM Cherribi, Cunliffe, Diana, Mrs Durrieu, MM Etherington, Feldmann, Fillon, Mrs Gelderblom-Lankhout, MM López Henares, Lorenzi (Alternate: Speroni), MM Luís, Martelli, Olivio, Polydoros, Probst, Ramírez Pery, Sandrier (Alternate: Le Grand), MM Staes, Theis, Valleix, Mrs Zissi.

Associate members: MM Kıratglioglu, Yurur.

N.B. *The names of those taking part in the vote are printed in italics*

Draft Recommendation

on European cooperation on the procurement of defence equipment

The Assembly,

- (i) Considering that security and defence in Europe must be founded on autonomous military assets which are interoperable with those of our transatlantic allies;
- (ii) Considering that these assets must rest on a European defence industry that is competitive on the world market;
- (iii) Noting that the defence budgets of western European countries are decreasing, or showing insignificant growth, that markets are shrinking, competition is becoming keener and technological developments are leading to exponential increases in the cost of new weapons systems;
- (iv) Taking the view that Europe is tackling this situation with a dispersed defence industry, fragmented assets and surplus production capacity;
- (v) Noting that these shortcomings are mainly due to the fact that each country has maintained as many independent national capacities as possible even though there is no sufficiently large market in Europe to absorb investment in research and development;
- (vi) Stressing that no single European country has a defence industry able to meet all its requirements in this field;
- (vii) Considering that a European market must constitute the bedrock of a European defence industry;
- (viii) Considering that European cooperation is essential for the armaments sector and has to be achieved by rationalising the industry, which implies restructuring at the national and European levels;
- (ix) Taking the view that this process requires prior agreement to be reached among the states on the definition of common requirements that would enable a sufficient market to be established;
- (x) Welcoming the initiatives taken by the OCCAR countries vis-à-vis WEU in order to obtain the status of subsidiary body;
- (xi) Considering, however, that all the consequences of such a status must also take effect, including the possibility for all member states to benefit from them;
- (xii) Welcoming the fact that the Euclid Cell has embarked on Phase 2 of its work;
- (xiii) Considering that there will be no satisfactory solution to the harmonisation of requirements at European level unless the process starts in the research phase;
- (xiv) Considering that while there is no doubt that the creation of WEAO is a major step along the road leading to a European armaments agency, the Charter by which it is governed gives rise to serious reservations.
- (xv) Stressing, moreover, the desirability of involving the central and eastern European countries in any thinking and work on armaments cooperation.
- (xvi) Welcoming the creation of the WEU Military Committee, which should provide a fitting framework for the definition of common European defence requirements,

RECOMMENDS THAT THE COUNCIL

1. Urgently request the Military Committee to carry out a study for the purpose of identifying common general and equipment requirements;
2. Invite the countries to provide a detailed description of programmes for the replacement of military equipment so that a European replacement timetable can be drawn up for the short, medium and long term;
3. Convene at the earliest possible opportunity a meeting of the WEU defence ministers whose agenda would be confined to cooperation on defence equipment procurement;
4. Involve the central and eastern European countries in any thinking and work being done in this field;
5. Prepare and submit to all the governments concerned a draft agreement for the purpose of applying to WEAO provisions similar to those of the Agreement of 11 May 1955, and of giving contracts concluded under the auspices of WEAO a binding nature so as to give practical effect to the clause conferring equality of status on all the members of that organisation,
6. Grant OCCAR the status of a subsidiary body with all the effects that entails, in particular, participation in its work of all those members wishing to be involved.

Explanatory Memorandum

(submitted by Mr Lenzer, Rapporteur)

I. Politico-military aspects

1. European cooperation in the armaments field has been a political and military objective since the end of the second world war. Finabel, the Standing Armaments Committee, Eurogroup, IEPG, WEAO and OCCAR are just some of the steps along the long and difficult road towards what so far have been rather meagre results.

2. The Declaration on the role of WEU and its relations with the European Union and with the Atlantic Alliance appended to the Treaty on European Union by WEU member countries mentions, with reference to WEU's operational role, the objective of strengthened cooperation in the armaments field in the context of "the establishment of a European armaments agency".

3. Article J.7.1 of the Treaty of Amsterdam states that "The Western European Union (WEU) is an integral part of the development of the Union providing the Union with access to an operational capability notably in the context of paragraph 2. It supports the Union in framing the defence aspects of the common foreign and security policy". Paragraph 2 specifies that: "questions referred to in this Article shall include humanitarian and rescue tasks, peacekeeping tasks and tasks of combat forces in crisis management, including peacemaking". Finally, paragraph 1 adds that: "The progressive framing of a common defence policy will be supported, as Member States consider appropriate, by cooperation between them in the field of armaments".

4. It is quite clear that security and defence in Europe must be founded on autonomous military assets which are interoperable with those of our transatlantic allies. Such assets in turn depend on having a European defence industry which is competitive on the international market.

5. Unfortunately, however, the present situation in the European defence industry shows little difference with the situation two years ago described in Assembly Document 1483. At a time when defence budgets are decreasing, or showing insignificant growth, markets are shrinking, competition is becoming keener and the costs of

new weapons systems are rising exponentially due to technological development

6. Europe is confronting these challenges with dispersed efforts on the part of its industry, fragmented assets and surplus production capacity. All these shortcomings are mainly due to the fact that each country persists in maintaining as many independent national capacities as possible when the European market is clearly not developed enough to absorb all the investment being poured into R&D and industrialisation. The situation in the United States is different in that the home market there is already sufficiently big to make it worthwhile for firms to invest on a large scale with reasonable chances of success

7. All this confirms the view that a European market must form the bedrock of a European defence industry that is competitive on world markets

8. There can be no solution to these problems without a pooling of efforts. Cooperation in Europe started out as political before embracing economic objectives, but in the case of programmes, even those in the aerospace sector which have been a marked success, it falls short of requirements in both quantitative and qualitative terms

9. The European defence industry must be restructured at both national and European levels. It must consolidate the trend that has started towards the creation of multinational firms, even if this means impinging on areas that states consider to be strategic. Prior to such restructuring, states must agree on a definition of their common requirements in order to create a sufficiently large market

10. Furthermore, these changes are a prerequisite for strengthened cooperation in which both states and firms must agree on a division of responsibilities

11. At the beginning of this report we take note of the efforts being made to provide Europe with a suitable institutional framework to promote armaments cooperation. The transfer of the IEPG to WEU and its transformation into

WEAG were a step in the right direction. The subsequent creation of the Western European Armaments Organisation (WEAO) was also a major achievement.

12. A fundamental remark is called for at this juncture. The only way to overcome the difficulties encountered in harmonising requirements at European level is for the harmonisation process to start as of the research stage. This is what makes the Euclid programme (European cooperation for the long term in defence) so crucial. Indeed, we are already feeling the benefits of the

initiative that was taken with the creation of the Euclid Cell.

13. While the creation of WEAO must, from a political standpoint, be hailed as a major step forward in that it has been given its own legal personality, its Charter nevertheless gives rise to serious reservations. Some considerations on this matter are given at the end of this report and the Appendix contains comments on the legal status of WEAO drafted by Mr Adam at the request of the President of the Assembly, Mr de Puig.

Table 1

*Trends in government expenditure on military R&D
in various countries over the period 1989-96*

All figures are given in US dollars on the basis of 1990 prices and exchange rates.

Country	1989	1990	1991	1992	1993	1994	1995	1996	1989-94
US	43 000	40 000	38 000	37 000	37 000	33 000	32 000	32 000	228 000
France	5 900	6 800	6 000	5 600	5 100	5 000	4 800	-	34 400
UK	4 000	3 900	3 700	3 400	3 600	3 200	3 400	-	17 900
Germany	1 900	2 100	1 900	1 800	1 500	1 400	1 500	-	10 600
Japan	660	720	770	830	900	920	1 000	1 100	4 800
Sweden	670	650	780	680	640	490	560	-	3 910
Italy	800	490	670	640	650	630	320	-	3 880
India	460	430	420	430	520	570	-	-	2 830
Spain	440	490	470	390	320	270	280	-	2 380
South Korea	150	230	240	270	320	320	350	370	1 530
South Africa	390	310	220	180	130	130	130	-	1 360
Canada	250	230	190	200	180	180	150	-	1 230
Australia	180	170	160	160	160	150	-	-	980

Sources · OECD Main Science and Technology Indicators, No. 2 (1996) and No. 2 (1995). Government of India, Department of Science and Technology, Research and Development Statistics, for a number of years. J. Cilliers, *Defence research and development in South Africa*, African Security Review, Vol. 5, No. 5 (1996), p. 42. and Table 7.10

14 OCCAR is part of the overall effort being made to achieve consistency. The bilateral programme which was born at the December 1993 Franco-German summit in Bonn has become a project with four participant countries (France, Germany, Italy and the United Kingdom) which signed the agreement establishing the new organisation in November 1996 at Strasbourg

15. A few weeks ago in Munich, the Director of OCCAR, Mr Prévôt, described the principles underlying that agreement:

- the priority to be given to cost-effectiveness in defence firms' procurement policy decisions,
- the need over the longer term for harmonisation of user requirements and various national technological policies;
- consolidation of the European industrial base through greatly increased competitiveness,
- abandon of the principle of *juste retour* by programme and an effort to achieve a better overall balance spread over a number of programmes and a period of several years;
- the open-door principle, i.e. the possibility for other countries to join OCCAR subject to two conditions: acceptance of the five principles and significant participation in a cooperation programme conducted under the auspices of the organisation.

16. At their Noordwijk meeting in 1994, the French and German Defence Ministers said that what was then a Franco-German initiative could be considered as the precursor of a European armaments agency. At that time, *Defense News* took the view that this initiative could become one of the pillars of the future European armaments agency

17. Moreover, in his address at the Munich Symposium Mr Guddat, the German National Armaments Director, said that WEAO and OCCAR were complementary and were pursuing the same aims

18. OCCAR is currently working on a timetable for the integration of short- and long-term

programmes and on rules mainly governing acquisitions, contracts, financing and programme management, although these will not be ready until late 1998. Furthermore, it would appear that the OCCAR member countries are doing what they can to ensure that the organisation acquires a legal personality so that it can become a WEU subsidiary body. This solution would confirm the political will to place the project in the context of the sole European organisation with competence in defence matters.

19. It is to be hoped that this process will meet with success since it would solve the current legal and political problems.

20. The decision taken in May 1997 to create the WEU Military Committee is of crucial importance as it will provide the proper framework for defining the joint requirements that need to be met - in particular, the joint use of equipment.

21. These latter points were discussed in Munich in the address given by Colonel Vezinhet on behalf of the Planning Cell. While he explained that the definition of military requirements was not the Cell's main task, his description of its work and the proposals he made for the future were a considerable source of inspiration to the discussions at our Symposium.

22. Colonel Vezinhet stressed in particular that WEU could state its force - and therefore its asset - requirements through NATO and could also make out the case for force compatibility. If it wishes to have some degree of autonomy, WEU will have to ensure that in following this course of action it defines force targets covering all its requirements through the use of European assets

23. General Capizzano, the Italian Deputy National Armaments Director, concluded his address by stating that the fact that "common views are widely shared in the defence sector at operational level could be a significant spearhead to open the way to European integration". In his opening address the Committee Chairman, Mr Marshall, stressed that a great deal of political will (hitherto inexistent in your Rapporteur's opinion) was needed to make progress in this field

Table 2
Proportion of cooperative programmes in Europe (percentages)

Country	Exclusively national programmes	Cooperative programmes	Imported equipment	Total
France	81	15	4	100
United Kingdom	80.6	10.5	8.9	100
Germany	10	75	15	100
Italy	30	50	20	n a
Spain	55	12	33	100
Sweden	70	15	15	100

Source: C. Serfati: *Les industries européennes d'armement*; Paris: *La documentation française*, 1996, page 59.

Note: The source of the statistics for Italy was an interview given by an Italian defence expert in July 1997.

II. Industrial aspects

24. European cooperation in armaments implies the creation of structures and links between the various European industries, governments and institutions. Such links should serve to facilitate joint European armaments programmes and procurement. The process of cooperation should be considered in the light of the changing role of European armies, which are no longer simply vowed to territorial defence.

25. Following the end of the cold war, European armed forces are increasingly being called upon to intervene outside their original territorial boundaries in operations involving peacekeeping, humanitarian intervention, policing, embargo enforcement and conflict prevention. These forces should be flexible and ready for rapid deployment; they should include mixed forces (army/navy/air force), be multi-European and possess high-tech equipment. It is necessary for Europe to rationalise the equipment of its armies if such forces are to be used successfully. Reaching this goal will only be possible if European armies buy equipment from a common European source. Defining common goals concerning military operations outlined under the Petersberg tasks is a precondition for European cooperation.

26. Harmonisation of weapons procurement in the light of European consolidation and intervention for peacekeeping purposes raises the question of European cooperation in defence programmes. European defence companies have to

face economic competition on two fronts, internal and external. When referring to "internal" economic competition, the focus switches to the fragmentation of the European defence industry.

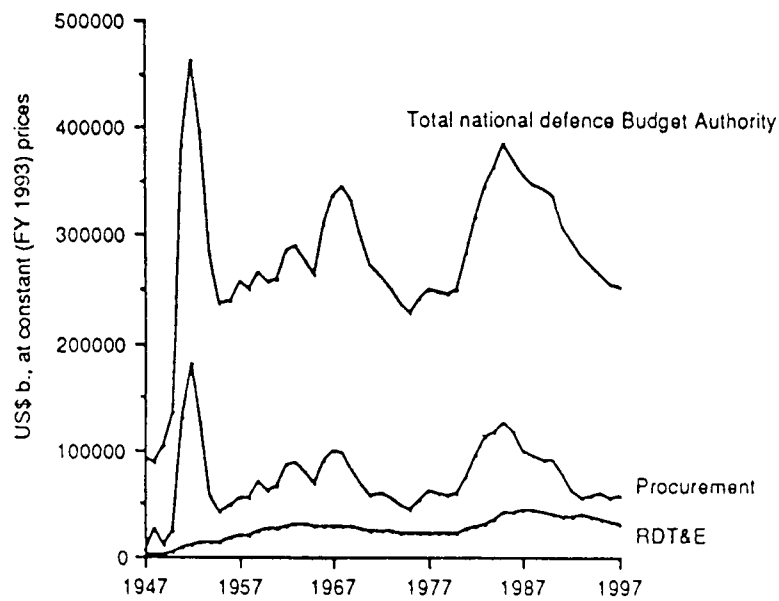
27. In most cases, European defence firms are competing against one another for sales contracts within the diminishing European armaments market. Internal competition induces a reduction in profit margins since competing firms will try to secure a contract by making their product more attractive to the buyer, i.e. by offering the lowest possible price. "Internal" competition also diverts or reduces existing resources which could be employed in a more profitable way, such as investment in research and development where Europe lags behind its transatlantic competitor.

28. The United States spends four times as much as Europe on research and development, which explains how it can produce highly competitive advanced technology equipment¹. R&D is a key factor for the survival of the European defence industry. Producing high-tech equipment enhances competitiveness on world markets. European firms have the ability to produce such equipment and R&D costs can be reduced through joint programmes. Cooperation should take place in the initial stages of development in order to avoid any future misunderstanding between partners on the finalisation of the product.

¹ (see Tables 3 and 4) Address by Air Chief Marshal Sir Patrick Hine, Symposium on European cooperation on the procurement of defence equipment, Munich, 1-2 October 1997.

Table 3

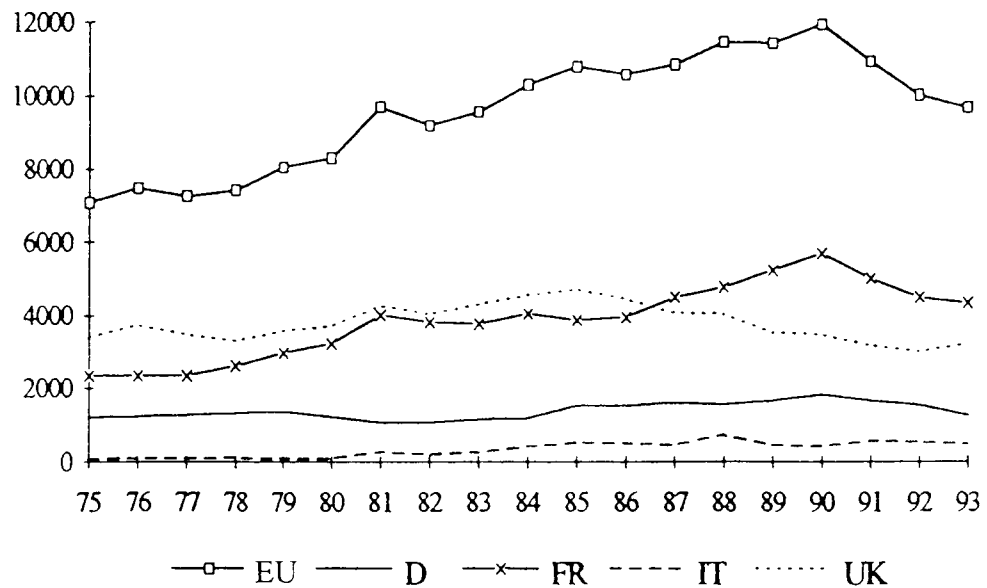
Total US national defence, procurement, research and development, testing and evaluation budgets for the financial years 1947-97



Source: The Defense Budget Project, based on US Department of Defense data.

Table 4

Public funding for defence research and development work in the European Union from 1975-93 (in millions of constant ecu at 1992 prices)



Sources: From 1975-90 successive publications of *Le financement public de la recherche et du développement*, Eurostat, Luxembourg From 1991-93 successive publications of *Recherche et développement, Statistiques annuelles*, Eurostat, Luxembourg

29. Cooperation, however, is double-edged. While it undoubtedly reduces costs per country and harmonises equipment, it can lead to the emergence of impediments, which in turn can slow down the programme. A partner will have specific needs and demands to be included in the programme which might clash with those of other members of the group. In order to minimise any future obstacles, it is necessary to analyse in detail the requirements of each potential partner prior to launching a programme. Cooperation in equipment production and procurement should not be undertaken without clearly outlining the parameters under which the programme should be developed as there is a risk that the partner nations will hamper the programme with the resulting loss of the technological edge the product was intended to have.

30. European industrial overcapacity compounds the problem. In order to maintain its technological and sales capacity, Europe has to reduce the number of firms competing with one another in specific sectors such as aerospace or armoured vehicles. Consolidating the industry will not only reduce costs and secure a European home market, but will also result in the harmonisation of equipment within European armies.

31. Due to budgetary restrictions, European governments are increasingly forced to cut back the procurement budgets of their armed forces. This process is achieved by reducing the quantity of equipment (i.e. aircraft, tanks, naval vessels etc..) In order to maintain their profit margins, European defence firms are forced to increase unit prices and/or increase exports. Increasing unit prices further weakens a firm's competitiveness. Increasing exports becomes the rational solution for maintaining sales and profit margins.

32. However, certain nations have restricted access to markets because their national defence industries adopt export policies which take into consideration the humanitarian track record of the importing nation. But the biggest obstacle and danger to the European defence industry comes from the United States' defence sector

33. Over the past decade, the US has strongly consolidated its defence industry through mergers of giant companies such as Boeing/McDonnell Douglas, Lockheed Martin/Northrop Grumman and Raytheon/Hughes. By reducing "internal" competition, the US has allowed its industry to

fully focus on external markets. This process has helped North American companies spread their costs and redeploy resources previously allocated for dealing with "internal" competition to research and development.

34. The defence industry produces highly competitive equipment at low cost thereby causing unit prices to drop. The consolidation of the American defence industry has made it a formidable and highly competitive sector. It should be noted, however, that this process was only made possible through sheer political will and financial incentives from governments.

35. The US also has the advantage of being a single nation where the issue of equipment procurement and foreign policy is not as problematic as in Europe "[] the total defence-related turnover in the US was about \$86 billion with a comparable figure for Europe of about \$32.5 billion. The figure for Europe is roughly 38% of the figure for the US"² The consolidated privately-run American defence industry enjoys an oligarchic national market, where competition is scarce. Europe consequently suffers from transatlantic competition, which merely aggravates the "internal" difficulties faced by its own defence industry.

36. Europe's problem is that it is composed of a variety of nations, with diverging goals and armament procurement needs, no clearly defined common foreign policy and a diminishing European defence market. The European defence industry suffers from the coexistence of private and nationalised firms. Consolidation is impeded by this environment as private firms are reluctant to conduct joint programmes with nationalised firms, whose economic strategy is influenced by political decisions.

37. Nationalised firms, because of political involvement, do not always act according to the same economic rules as the private companies. Privatised industry exists solely for the purpose of making profits. The goals of government-run firms, however, are more ambiguous as they take in economic and political elements.

² Address by Mr Graham Woodcock: Symposium on European cooperation on the procurement of defence equipment, Munich, 1-2 October 1997

38. With most of Europe facing an unemployment crisis, governments are reluctant to privatise their defence industries since this process almost certainly implies restructuring and job losses. BAe is a prime example of this. Before being privatised the company employed an estimated 130 000 people in 1988. By 1995, because of restructuring, its labour force was reduced to about 40 000. It should be noted however, that following the privatisation and restructuring process, the company has achieved an unprecedented level of competitiveness, with sales of £7.5 billion. Over 80% of BAe turnover is generated overseas which emphasises the need for European defence firms to turn towards foreign markets³.

39. Acquiring export markets overseas, however, implies increased equipment competitiveness, whether it be technological or financial. Keeping the industry nationalised might save jobs in the short run through the use of economic protective measures, but because of stronger US competition European nations might be forced to shut down their defence industries completely in the long run due to their lack of competitiveness on world markets. Decreasing competitiveness implies lower sales profits and fewer resources available for research and development.

40. As nationalised and/or uncompetitive firms continue to survive through artificial means (i.e. continued government subsidies), there is a possibility that the technological quality of their products will decrease, thus worsening their declining sales figures. A proper analysis of the environment and conditions in which European firms should be privatised is essential for their survival.

41. The might of North American firms poses not only a threat to the European defence industry but also to European defence strategy and foreign policy. If the European defence industry disappears through lack of competitiveness and fragmentation, allowing the United States to be

come the world's major weapons manufacturer, Europe will no longer have any choice in armaments procurement and will consequently be dependent on American technology and arms sales. This will have a direct effect on European foreign policy and defence strategy as European nations might no longer be able to act independently without the United States' consent. It is essential for Europe's defence industry to survive if it wishes to remain independent of the United States.

42. Independence, however, does not imply isolation. The transatlantic link should be viewed as a strong and positive structure for peace and security. NATO remains Europe's only dynamic military defence structure currently capable of dealing with instability around the world and more specifically within the geographic boundaries of Europe. Europeans and Americans should view the development and strengthening of NATO as a positive step towards European security.

43. Some European parliamentarians have however stressed that while NATO is a powerful instrument in European security, it might be too large and slow to tackle certain tasks. NATO is still trying to redefine itself in the post-cold war era. Institutions such as WEU are more suited, because of their size and flexibility, to intervene in certain areas and in predefined conditions, such as those outlined for the Petersberg tasks.

44. WEU and NATO should not be perceived as competing but rather as complementary institutions. Once again, however, if these institutions are to take action in future theatres of conflict, the forces involved must have harmonised equipment. NATO has already harmonised its forces in different areas. If WEU is to intervene with the use of armed forces, its task will be facilitated if troops use the same equipment, implying convergence of joint armaments programmes and procurement (see Table 5).

³ Address by Air Chief Marshal Sir Patrick Hine; Symposium on European cooperation on the procurement of defence equipment, Munich, 1-2 October 1997.

Table 5

Comparison of the numbers of different armaments produced by the industries of Europe (the Twelve plus the five EFTA countries) and the United States (situation at 30 June 1993)

Category	Number of armaments		European producer countries
	Europe	US	
Assault tank	4	1	UK, F, FRG, IT
Armoured infantry fighting vehicle	16	3	F (3x), FRG, UK (2x), IT (3x), SU, GR (2x), SP (2x), AUT, CH
Self-propelled 155 mm howitzer	3	1	F, FRG, UK
Fighter-bomber	7	5	F (2x), UK, SU, FRG/IT/UK, SP/FRG/UK/IT
Ground attack/training	6	1	UK, SP, IT (2x), IT/Br, FRG/F
Strategic bomber	0	1	
Heavy transport aircraft	1	3	IT
Anti-tank helicopter	7	5	F (2x), UK, IT (2x), FRG, FRG/F
Heavy transport helicopter	2	4	F/FRG, IT/UK
Assault gun	7	1	B, F, UK, SP, FRG, IT, AUT
Portable surface-to-air missile	4	1	F, UK (2x), SW
Anti-ship missile	9	3	F (2x), UK (2x), IT (2x), Nor, SU, FRG
Air-to-air missile	8	4	F (3x), UK (2x), SU, IT (2x)
Anti-air missile	3	3	UK, F/FRG, IT
Anti-radar missile	3	3	F, UK, IT
Anti-tank missile	8	5	F/FRG (2x), UK, IT/Br, SU, SP/US
Anti-submarine torpedo	9	2	UK (2x), SU (3x), IT, FRG, F (2x)
Frigate	11	1	F (3x), UK, FRG (3x), NL, SP, DK, IT
Mine hunter	4	2	F/NL/B, UK, FRG, IT
Aircraft carrier (planes and helicopters)	3	1	UK, IT, SP
Aircraft carrier (planes)	1	1	F
Cruiser-destroyer	0	1	
Conventional submarine	7	0	FRG (3x), IT, NL, UK, SU
Nuclear attack submarine	2	1	F, UK
Total	125	53	