

# **Preparing the Defense Sector for a Common European Security Policy**

[Panel: The EU and NATO]

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## ***Introduction***

The title of this paper could easily draw the analyst into a confusing circle of cause and effect. On the one hand, the title can be taken at face value, meaning that the paper could analyze the ways in which the European defense sector – defense companies and defense-related government agencies and leaders – is responding to the gradual emergence of a “common European security policy.” On the other hand, given the very gradual pace at which such a policy appears to be emerging, it is tempting to consider the title in a different vein. How might the restructuring of the European defense sector serve as a spur to the emergence of a common European security policy? What steps could European defense industrialists take to help European governments purchase and deploy interoperable, sophisticated, and affordable military equipment – the sort of equipment without which European governments will be incapable of enforcing a future common security policy?

Tempting as it may be to take the second course of enquiry, events over the past ten years point to the inescapable fact that, in the absence of concrete political progress towards a European Security and Defense Identity (ESDI), European defense industry has felt insufficient incentive to act as the functionalist catalyst for a common European security policy. In fact, the paper argues that, during this period, European defense industry has faced important structural political obstacles that will continue to act as a disincentive to cross-border integration and consolidation.

The paper is divided into four sections. The first section highlights the strategic context facing the European defense sector after 1988 when visions of a common European security policy resurfaced as a desirable goal. The second section reviews the ways in which the European defense sector responded to the changed strategic environment. The third section analyses the structural obstacles that have hampered the ability and dampened the desire of European defense industry leaders to adapt the defense sector in ways that would match the stated aspirations of European government leaders. The conclusion points to the difficulties that Europe will face in consolidating and restructuring its defense sector even in the event that a common European security policy finally begins to take shape in the wake of the Kosovo crisis.

### ***Challenges to the European Defense Sector: 1989-99***

Pressure for the European defense sector to restructure has indeed been, to a large extent, a corollary of the growing pressure since the late 1980s for West European countries to develop a more autonomous political-military identity. The re-activation in 1987 of the Independent European Programme Group (IEPG), comprising national armaments directors and other procurement and defense research officials, ran in parallel to the release of the Western European Union's (WEU) "Platform on European Security." Parallel efforts to promote the WEU as the manifestation of a European security pillar were, in turn, partly a European response to the seeming divergence in strategic security

priorities between the Reagan administration and its NATO Europe allies between 1984-88, as allied governments struggled to develop a constructive response to the openings that the then Soviet leader, Mikhail Gorbachev, appeared to be offering.

After the end of the cold war, a majority of EU governments sought to inscribe their willingness to cooperate more closely on matters of foreign and security policy into the Maastricht Treaty. The motivations for this initiative were numerous and not always universally shared. Some governments feared an imminent withdrawal of the U.S. conventional military presence from Europe; others believed quite simply that, with the end of the East-West stand-off, Western Europe should take on a greater share of the responsibility for providing for its own security. Whatever their viewpoints, many West European politicians, officials, and industrialists saw restructuring and consolidation of the West European defense sector as an integral element in a nascent ESDI. So long as Europe depended on the United States for key elements of its operational military capability, ranging from transport aircraft to surface-to-air-missiles to reconnaissance and communications satellites, an ESDI would remain more of an ambition than a reality.

However, with defense budgets throughout Western Europe going into free-fall after 1990 and the costs of military modernization continuing to spiral upwards, Europe's ability to buttress its security aspirations with effective and technologically sophisticated defense systems depended on both governments and industry overcoming the fragmentation of European defense production between small and protected national markets. It was increasingly clear that national governments could no longer afford, on

their own, the development costs of many important new defense technologies. Only by pooling their scarce R&D resources and by pursuing economies of scale and cost savings through extended production runs would West European governments stand a chance of affording the sort of military modernization that would offer credible alternatives to U.S. equipment.

In a direct reference to the need to improve Europe's military independence as an adjunct to the development of a common foreign and security policy (CFSP), the WEU Declaration that was published with the Maastricht Treaty in December 1991 called for "enhanced cooperation in the field of armaments with the aim of creating a European armaments agency."<sup>1</sup> The WEU took a first step towards creating this arms agency, christening it the Western European Armaments Group (WEAG). In December 1992, the WEAG took over the IEPG's responsibilities and, through its member governments, began discussion on how the group could turn itself into a genuine European armaments agency.

Following the Maastricht negotiations, the European Commission also launched a series of studies and entered into a steady dialogue with EU member states about ways to open up the European defense market to greater intra-European competition.<sup>2</sup> Under Article 223 of the Treaty of Rome, the trade in defense and defense-related products remained outside the Commission's and the EU's purview. Members of the Commission and some government officials believed that this exception from EU rules not only encouraged

market protectionism for a number of non-defense items, but also ran counter to the Maastricht Treaty's call for greater European armaments cooperation.

Calls for a more open intra-European defense market, a more integrated defense procurement process, and for a general restructuring of the European defense sector were reinforced by two other factors. The first was the dismal performance of European military equipment in comparison to U.S. systems during the Gulf War, and, later, a growing frustration with European dependence on U.S. air and space assets, first in Bosnia and, most recently, in Kosovo.

The second factor was the increasingly competitive nature of the global defense market. European defense manufacturers have traditionally relied on export markets for a large share of their business, as have European defense ministries that want to reap the cost benefits of extended production runs. Since the end of the cold war, however, Russian aircraft and missiles that, previously, might only have been exported to a select group of its global allies, began to be marketed across the globe. At the same time, new arms exporters (Israeli and South African companies, for example) gradually became realistic competitors in many of the world's less developed arms markets. Most significantly, however, the rapid and dramatic consolidation of the U.S. defense industrial base since 1994 and the Clinton administration's explicit support for U.S. defense exports unleashed a powerful new competitor into key export markets, particularly the Gulf, but also including the "new" export markets of central and eastern Europe, and, of course, within the West European defense market itself.

## *The West European Response*

How has the European defense sector responded to these challenges? What genuine progress has accompanied government declarations and the institutional maneuvering of the past few years? Let us look, first, at the progress towards a more coherent European procurement system (the demand side) and, second, at the progress towards industrial consolidation (the supply side).

A common European procurement system remains a distant ambition. This is not to say that EU governments have not worked hard over recent years to develop the mechanisms for a more cooperative approach to weapons procurement.<sup>3</sup> Since its inception, the WEAG has divided its work between three panels. Panel I publishes every year a list of WEAG members' national armaments replacement schedules. Based on this information and the potential for cooperative purchases of defense systems, Panel I develops feasibility studies and European Staff Requirements. A Cooperative Opportunity Consultation Office (COCO) provides information to governments searching for partners on specific projects. Panel II is responsible for overseeing initiatives to encourage cross-border defense research and development, such as the European Cooperative Long-Term Initiative for Defense (EUCLID) program. Panel III, working often in collaboration with the European Defense Industries Group (EDIG) conducts studies into ways to develop a more open European defense market.

In March 1993, European National Armaments Directors decided to set up a working group to determine how to move beyond this preliminary framework and towards the creation of a genuine European armaments agency. However, the working group's initial report concluded that the conditions did not exist for the creation of a formal legal body capable conducting the full range of procurement activities on behalf of WEAG member governments. As a result, at the WEU Ministerial meeting of November 1994, ministers decided to postpone indefinitely their plans to establish a European armaments agency. Instead, in March 1995, WEAG national armaments directors decided to create the Western European Armaments Organization (WEAO) as an executive organ of the WEAG and a subsidiary body of the WEU. Working at a lower level than the WEAG, the WEAO would manage cooperative R&D initiatives such as EUCLID as well as provide the sorts of detailed technical and military requirements information necessary to promote a common armaments procurement policy.

Given the lack of genuine progress towards a common European armaments agency, the French and German governments entered into an arrangement in December 1993 to set up a separate body, outside the WEAG/WEAO, that would serve as a project office for some of the collaborative defense programs that they were either already pursuing or intended to undertake. Best known under its French acronym, OCCAR<sup>4</sup>, the organization was expanded formally in January 1997 to include Britain and Italy, Europe's two other primary remaining arms producers.



Rather than being a formal armaments agency, OCCAR has more modest if still important objectives. It aims to increase the efficiency of project management by establishing transnational groups of main contractors and by helping develop common set of procedures for resolving some of the complex negotiations at the heart of collaborative programs, such as those that occur over intellectual property rights. It also offers its members the opportunity to escape from the inefficiencies of the traditional European system of *juste retour* for defense procurement, whereby work is allocated to each of the countries participating in a joint program in rough proportion to their planned investment or purchase. In theory, OCCAR offers the potential for a more flexible approach to *juste retour*, by providing a framework within which countries could obtain their return over time and over a series of programs rather than on the more restrictive case-by-case basis.

Despite these gradual steps towards instituting a more coherent European defense procurement process, EU governments remain far from transferring national control over defense investment and procurement decisions to a supranational European body. Apart from taking over the management of several existing Franco-German collaborative programs (such as the *Tiger* helicopter) and smaller programs for unmanned aerial vehicles, the experience of OCCAR members in launching their flagship new defense program, the multi-role armored vehicle (MRAV), has been plagued by disputes over the bid process and work-share. Nor has the legal status of OCCAR yet been resolved.

Unlike the WEAO, which possesses the legal capacity to place contracts in its capacity as a subsidiary agency under the modified Brussels Treaty, OCCAR remains in a legal limbo while other WEU members consider whether they wish to confer the same legal

standing on what could become a parallel and more exclusive grouping of European arms producers.

The halting pace of European governments as they confront the challenge of developing a common defense procurement system has had a definite knock-on effect for the pace and shape of European defense industrial restructuring. This is hardly surprising given the fact that national governments are the primary customers for defense companies and domestic defense markets are their core markets, whether for direct sales or as the launch pad for exports around the world.

Despite the increasingly public calls from European ministers for European defense companies to develop into truly European entities, therefore, European government bickering over the future shape of a European armaments agency and continuing government resistance to the Commission's proposals to open up the European defense market send industrialists a clear signal. European defense industrialists have quite naturally taken a cautious approach towards restructuring their operations along European lines.

As a result, the pattern of defense restructuring over recent years has been one of national rather than cross-border consolidation. Admittedly, the raft of cross-border joint ventures established in the 1970s, 1980's, and early 1990's have produced numerous collaboratively developed and produced weapons systems, ranging from the Tornado and Eurofighter aircraft to the Tiger helicopter to surface-to-air and air-to-ground missiles.

They have also deeply entrenched collaborative working relationships between Europe's defense companies. However, despite the explicit call from the British, French, and German Prime Ministers in the summer of 1997 for European defense industry leaders to save costs, eliminate duplication, and respond to the pressures of American competition by consolidating across borders, such consolidation has yet to take place on any meaningful scale.

Quite the opposite, in late 1998 and early 1999, Europe witnessed a further round of national defense industrial consolidation with the decision of the UK's General Electric Company (GEC) to sell its Marconi subsidiary to British Aerospace (BAe) and French approval of the merger of the state-owned Aerospatiale with MATRA Hautes Technologies. BAe's decision put an end, temporarily at the very least, to its advanced discussions with DaimlerChrysler on Europe's first major cross-border merger. Daimler's chief executive, Jürgen Schrempp, declared that the decision has also scuppered the yearlong discussions among Europe's largest defense companies on the formation of a European Aerospace and Defense Company (EADC).<sup>5</sup>

Mid-way through 1999, therefore, the European defense industry is dominated by national conglomerates such as DaimlerChrysler Aerospace, Aerospatiale-MATRA, and British Aerospace. Even after this process of national consolidation, the European defense market appears to be suffering from substantial overcapacity when compared to the United States. In recent years, U.S. spending on defense procurement has averaged \$75 billion, roughly 30% higher than combined West European levels. U.S. spending on

defense-related R&D has averaged \$35 billion; almost three times West European levels. And yet, today, Western Europe possesses six combat aircraft companies, compared to two in the United States; ten missile producers, compared to three in the United States; and at least five major producers of defense electronics, compared to four in the United States.

### **Structural Obstacles to the Emergence of a European Defense Sector**

In order to understand the reasons why the European defense sector has found it so difficult to make concrete progress towards a more integrated procurement system and a more integrated defense industrial and technological base, it is necessary to appreciate the structural nature of many of the obstacles to such integration. The institutional and industrial deadlocks outlined above are merely symptoms of these obstacles.

#### *1. Europe's Gain Will be the Member States' Loss*

At the most basic level, many European governments continue to resist the creation of a more integrated European defense sector for the very same conceptual reason that advocates of European defense integration make their own case. A state's foreign and security policy, just like Europe's, is mere rhetoric without the economic, industrial, technological, and military might to back it up. At every turn, therefore, EU governments that set great store on the pursuit of their national foreign policy interests also throw up

repeated roadblocks to European defense integration, irrespective of their official commitment to the process.

## 2. *No Common Foreign Policy Means No Real Defense Integration*

The lack of any binding agreement among Europe's major powers to pursue common foreign policies has important knock-on effects. The most serious of these is the problem of agreeing upon the military requirements that any collaborative European program must meet. Depending on their national foreign and security policy priorities, European governments have fundamentally different perspectives of the nature of the threats that they face and, therefore, of the sort of weapon systems that they will need to guarantee their security. Britain's island position, for example, gives its military a very specific view of the sort of fighter aircraft it needs to guarantee its security; a view that contrasts with Germany's land-locked position. Italy's naval needs as a Mediterranean power are hard to match with Britain's global power projection requirements.

So long as national governments are focused on different perceptions of the threat that they are likely to face, it remains very difficult to coordinate not only the military specifications of potential joint programs, but also the timing of their acquisition.

Britain's pressing need for new destroyers was a central reason for its recent abandonment of the *Horizon*-type frigate. Timing has also been an important factor in Britain's hesitancy over joining formally the Future Large Aircraft (FLA) program – its military transport aircraft need replacing within a shorter timeframe than the FLA development can satisfy.

### 3. *Export Controls and Market Opening*

The lack of clearly defined European common foreign policies also means that EU governments have yet to develop a common approach to arms export controls (even although EU members have instituted a complex system for coordinating the control of dual-use exports).<sup>6</sup> This has a very significant limiting effect on integration of the European defense sector. On the one hand, defense systems produced by European joint ventures or by other cooperative arrangements must currently contend with obtaining export license approval from more than one government before exporting the system to a third country.

European defense industrialists frequently complain that this is an important disincentive to the conclusion of cross-border mergers. Another consideration is that any decision to weaken Article 223 and form a more open European defense market prior to the harmonization of EU arms export controls would put those companies whose governments pursue strict export control policies at an unfair competitive disadvantage.

### 4. *Producers versus Consumers:*

At the core of the institutional gridlock surrounding the formation of a European Armaments Agency there lies a fundamental conflict of interests between the major arms producers in Europe, such as France, Britain, Germany, and Italy, and those remaining European states that rely far more extensively on imports to meet their defense equipment needs. The former share a common desire to ensure that the European defense market become sufficiently integrated to continue supporting a healthy, if restructured defense

industrial and technological base within each major arms-producing country. The latter set greatest store on retaining the flexibility either to support their remaining domestic, niche defense suppliers or to turn to the United States for cheap, but high-quality defense systems.

Three of the WEAG's "six basic principles" make it clear that Europe's arms purchasers are determined to resist at every opportunity any erosion of the flexibility that they currently enjoy:

"All 13 nations should be entitled to participate fully and with the same rights and responsibilities, in any European armaments cooperation forum.

There should be a single European armaments cooperation forum.

Armaments cooperation in Europe should be managed by the National Armaments Directors of all the 13 nations ..."<sup>7</sup>

Given these restrictions, it is clear why France, Germany, Britain, and Italy have preferred to concentrate their efforts on OCCAR. A Dutch official conceded this May, when the Dutch government submitted its application to join, that, "OCCAR is moving away from the consensus-based NATO and WEU ideal, which is a braking factor in progress."<sup>8</sup> It is also clear why the current OCCAR members plus Spain and Sweden signed a letter of intent last July to develop by June 1999 a blueprint for easing cross-border defense trade.<sup>9</sup>

5. *Producers versus Producers: Sustaining the Linkages Between Government and Industry*

Even as Europe's major armaments producing governments gradually develop a more coordinated approach to preparing and implementing the procurement of collaborative defense systems, they must confront the challenge of how to help their defense companies pursue a parallel path toward cross-border consolidation. This will be a complex process for both governments and industry. Governments view defense contracts as one of the most sensitive forms of government procurement, not only in terms of re-distributing large sums of taxpayers' money within the national economy, but also in terms of subsidizing a national high technology base. While European governments are anxious, therefore, to encourage cross-border consolidation, they do not want to see this take place at the expense of lost jobs and lost national technological expertise.

Sensing this ambivalence within their national governments, European defense companies have, in fact, been receiving mixed signals on how to move forward with cross-border consolidation in the aerospace and defense sector. The most visible symbol of the current impasse has been the *Airbus* program. Formed initially as a "Groupement d'Intérêt Economique," the member companies remain deadlocked over how to transform the grouping into a genuine private company. The participant companies and their governments have so far preferred to maintain the status quo rather than risk the disruption to workshare and production arrangements that would inevitably accompany a full privatization.



One proposed interim step for cross-border defense mergers is that “national holding companies” should split between them the ownership, although not the management, of the new company.<sup>10</sup> This would enable the new company to maintain the political and financial support of its primary customers while organizing its management in a more effective manner. Given the very different procurement styles of the various European defense ministries and the still very different ownership structures of Europe’s leading defense companies, this may be the only viable approach in the interim.

6. *Producers versus Producers: The Role of the United States*

Aside from the difficulties they face in coordinating their military requirements, export policies, and industrial arrangements, Europe’s lead weapons producers also confront a further fundamental obstacle to defense integration. This concerns their differing relationships with the United States. The French have been explicit in their conviction that one of the driving reasons for forming OCCAR was to protect and improve the position of the European defense industrial base relative to the large U.S. defense companies. Then French Defense Minister, Charles Millon, went so far as to threaten Britain’s exclusion from OCCAR unless its ministers accepted the principle of “Euro-preference.”<sup>11</sup>

And yet, the United States is an ever-present force in the European defense market, calling into question the vision of an integrated European defense sector much as it calls into question the viability and effectiveness of a European Security and Defense Identity that would be “separate as opposed to separable” from the United States. At one level,

U.S. companies might offer a defense system that meets a European government's military requirement at a price and with an "offset" package that is impossible to reject (Britain's purchase of the *Apache* helicopter is one case in point).

Any explicit form of Euro-preference would also be counterproductive at a more strategic level. Aside from its very negative impact on U.S.-European security relations, most European governments and companies are also aware that access to the U.S. defense market, however difficult it is today, will be indispensable to the long-term success of Europe's defense industry.

However, it is very hard for European companies and governments to pursue simultaneously a U.S. defense market strategy and a European strategy. In a speech in Washington to the Aerospace Industries Association on November 20, 1998, U.S. Deputy Secretary of Defense John Hamre separated possible defense partner countries into an "A," "B," and "C" categories. Only the United Kingdom ranked in the "A" list. France and Germany were implicitly in the "B" list. European countries either in or aspiring to join the "A" list must consider, therefore, how a European cross-border merger might affect their standing with the U.S. Department of Defense and their access to the U.S. defense market and to U.S. defense technologies.

## *Conclusion*

As we approach the Cologne European summit on June 3-4, 1999, it appears that EU leaders have been driven by the crisis in Kosovo to make good on the pledges of the Amsterdam Treaty and the St. Malo agreement to take concrete steps toward the building of a genuine ESDI.<sup>12</sup> And yet, as this paper has argued, the obstacles to European defense integration are both deeply ingrained and intertwined. The restrictions on intra-EU defense trade imposed by Article 223 of the Treaty of Rome, for example, are only likely to be eased or eliminated after European governments can agree on ways to harmonize their arms export policies. Common EU arms export policies are only likely to become the norm when major EU member states are willing to accept restrictions on the pursuit of their national foreign policies. And, unless EU governments can move beyond their perennial focus on institutional process and toward the actual drafting and execution of a European security policy, to include the setting of common requirements, then Europe's defense companies will continue their mating dances without necessarily ever consummating the marriage.

Moreover, the proposed absorption of the WEU into the EU by the end of 2000 may exacerbate the underlying tensions between Europe's armaments producers and consumers. If this becomes the case and the political context for the further integration of the European defense sector remains uncertain, then global companies such as DaimlerChrysler and BAe will have no choice but to look further outside Europe for ways to expand their business opportunities.

## End Notes

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<sup>1</sup> Declaration of the WEU; C.5.

<sup>2</sup> See, for example, "The European Aerospace Industry: Meeting the Global Challenge," COM(97) 466, September 24, 1997, and "Implementing European Union Strategy on Defence-Related Industries," COM(97) 583, November 12, 1997.

<sup>3</sup> For a thorough review of this process, see Keith Hayward, "Towards a European Weapons Procurement Process," Chaillot Paper #27, June 1997.

<sup>4</sup> Organisation Conjoint de Cooperation en Matière d'Armement.

<sup>5</sup> "DaimlerChrysler Attacks BAe Deal," The Financial Times, April 1, 1999.

<sup>6</sup> For a description of the EU's dual-use export regime, which came into force on July 1, 1995, see Paul Cornish, The Arms Trade and Europe, Chatham House Papers (London; RIIA, 1995) pp. 37-43.

<sup>7</sup> "Western European Armaments Group: History," <http://www.weu.int/weag>

<sup>8</sup> "Europe Pushes Toward Unified Military Policies," Defense News, May 24, 1999.

<sup>9</sup> "Europe Grapples with New Industry Policy," Defense News, June 7, 1999.

<sup>10</sup> This suggestion has been made by a number of French industrialists and is also echoed in the European Commission's communication COM (97) 466 (op. cit.), p. 11.

<sup>11</sup> "French Reform Emphasizes European Cooperation," Defense News, September 16, 1996.

<sup>12</sup> "EU Ministers Back Common Defence Policy," The Financial Times, June 1, 1999.