



# The EU and armaments co-operation

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# 1 Introduction

It has become a cliché to observe that Europe's armies need many new military capabilities. But European governments are still doing very little to remedy the problem. On current trends, they will be unable to meet their commitments to both NATO and the EU, to provide the armed forces that are needed for the military challenges of the 21<sup>st</sup> century. Given that defence budgets are unlikely to rise dramatically, and that the cost of new military technologies is soaring, governments will need to extract more value out of each euro they spend. It therefore follows that they need to pay more attention to improving European co-operation on armaments. Greater co-operation in armaments could lead to significant benefits, including better value-for-money for taxpayers; greater harmonisation of military requirements and technologies, which helps different European forces to work together more effectively; and a more competitive European defence industry.

To achieve more effective armaments co-operation, European governments need a more open defence market, manage joint equipment programmes better, and develop an EU armaments policy. The history of European armaments co-operation shows that none of these three goals will be easy to achieve. NATO and the Western European Union (WEU)<sup>1</sup> have tried to improve multinational armaments co-operation for decades, with depressingly little success. Defence remains the most 'national' of all policy areas, in the sense that the EU's member-states are very reluctant to give up sovereignty to international organisations. Yet, many of the current challenges facing European armed forces – such as regional conflicts in the Balkans, or the global threats of terrorism and the proliferation of weapons of mass destruction – require pan-European responses.

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<sup>1</sup> The Western Europe Union is a defence pact of which ten EU states are full members. Over the past few years its organisation has been more-or-less merged with that of the EU, though its members remain bound by a treaty which obliges them to defend each other in case of attack.

Europe's defence industry has become more transnational over the past decade. A series of mergers and acquisitions led to new international defence companies emerging. These firms include the Franco-German-Spanish European Aeronautic Defence and Space Company (EADS), British-based BAE Systems, French-based Thales, and MBDA, a missile manufacturer owned by French, German, British and Italian interests. The driving force behind the creation of these firms has been the need to consolidate resources and reap the economies of scale that make it possible to compete against the might of bigger American companies.

However, American defence firms have the double advantage of the sheer scale of their domestic market, with the US defence budget amounting to \$380 billion in 2002, and of operating under a single regulatory framework. The EU member-states, in comparison, spent a combined total of approximately \$150 billion on defence in 2001.<sup>2</sup> Even if Britain, France and Italy have increased their budgets recently, the overall level of defence spending in Europe is not increasing significantly. And although governments have encouraged cross-border defence industry consolidation, as well as several co-operative programmes, they have done little to streamline their procurement systems or regulatory environments. EU defence companies must therefore operate in a highly fragmented market. As a result, although EU countries collectively spend roughly 40 per cent of what the US spends on defence, the real military capabilities they can deliver are perhaps only 5 or 10 per cent of those in the US. The concept of a 'European' defence industry will be meaningless if the European market remains fragmented into many national pieces.

A more integrated market would make it easier for governments to buy the best equipment at better prices across Europe. Europe's six main arms-producing states (France, Germany, Italy, Spain, Sweden and the UK) have already recognised the logic of harmonising some defence market rules. In 1998 they signed an agreement known as the 'Letter of Intent', which will have a

major impact on a variety of cross-border armaments regulations. But its provisions are limited to helping transnational companies to operate across borders, and they do not establish a common market among the signatories.

A number of EU governments would like to see the EU taking on a role in regulating a common defence market. For example, the EU could decide that the European Commission should regulate the trade in defence goods, on the basis of the harmonisation principles agreed in the Letter of Intent (of which more later). The Commission already has a role in regulating markets for some civilian goods that are used by European armed forces. But several member-states oppose giving the Commission a policing role in the defence market, because of its lack of experience in dealing with sensitive military matters. They argue that any EU role in defence markets should be confined to the Council of Ministers, where the governments are represented and the Commission has little say. In any case, the Council of Ministers already manages the EU's embryonic defence policy.

But the fact remains that neither new rules, nor new regulators can guarantee that Europe's forces receive better equipment on time and at a better price. Due to the rising cost of defence systems, European governments frequently have to acquire new weapons by pooling resources in collaborative projects. Yet governments have encountered innumerable problems with multinational equipment programmes, which often lead to cost over-runs and delivery delays. For example, the Eurofighter, a four-country project, should enter service during 2003, seven years after the original target date. If governments managed such programmes more efficiently, ministries of defence would be more likely to receive their products on time and within budget. Too often these programmes have suffered from disputes over work share and financial arrangements. A far better approach would be to create a common set of basic procurement procedures for managing collaborative programmes.

<sup>2</sup> Based on aggregate figures from the International Institute for Strategic Studies, *Military Balance*, 2002-2003.

Possibly the most serious obstacle to European armaments co-operation is the lack of political commitment. The notorious case of the A-400M transport aircraft provides just one example of the problem. Five years ago, nine European countries agreed that they needed a new military transport plane, but today the programme remains shrouded in uncertainty. Plagued by budgetary delays, the A-400M amounts to nothing more than a plywood model. In many respects the A400M is a symbol of Europe's inability to improve military capabilities significantly, despite the ambition of its leaders to give the EU a greater role in international security.

At the Helsinki summit in 1999 the EU agreed to work on the creation of a common European security and defence Policy (ESDP). The point of the ESDP is to allow the EU to carry out small-scale "crisis management" operations, when NATO is not involved. The EU has therefore committed itself to a 'headline goal' (a force of 60,000 troops), plus supporting naval, aerial and civilian capabilities, that are supposed to be ready by the end of 2003. The EU wants to be able to tackle the so-called Petersberg tasks (humanitarian relief, rescue missions, peacekeeping and peace-making) without having to rely on the US for transport aircraft, intelligence gathering, command and control, and other capabilities. The EU governments have therefore signed up to a series of military capability goals. However, these European efforts have so far produced only meagre results, and without new military equipment the EU will struggle to prove its worth as an international security actor.

The EU could help to ensure that its members meet their armaments commitments by developing a common armaments policy. The basic aim of such a policy should be to provide stronger political direction for European co-operation in this area. In practical terms the policy should be specifically linked to meeting the EU's military capability goals. This would not work unless the EU managed to apply pressure to governments in ways that NATO has not been capable of doing; for example by publishing an annual progress

report on the EU's military assets, and then naming and shaming the governments which fail to fulfil their promises.

Non-Europeans sometimes worry that any moves towards improving European armaments co-operation will create a 'Fortress Europe' – and that non-European defence suppliers would then be excluded from competing for contracts. Such a development would not be in the general interest of European industry or taxpayers. It would harm prospects for the increasingly close relations between European and US armaments firms – and those relations are essential so that European companies can increase their access to the huge US market, and to secure their future in the face of flat European defence budgets. Nor would a 'Fortress Europe' be good for those European countries that are not major arms producers: they want a healthy level of competition for defence goods, including competition from outside the EU, to help keep down prices.

The importance of transatlantic armaments co-operation to NATO is beyond the scope of this paper. But European members of the alliance will have to consider the impact of better intra-European armaments co-operation on transatlantic relations. If handled properly, efforts to improve co-operation within Europe and across the Atlantic should be complementary rather than mutually exclusive. For example, improved armaments co-operation would be likely to improve the Europeans' military capabilities, which would benefit NATO as much as the EU. And a more integrated European market that remained open to American companies would help to encourage further transatlantic consolidation.

The Europeans should not wait for the US to remove blockages to transatlantic co-operation. They could help kick-start a transatlantic reform process by improving their own defence market. The Europeans cannot expect the US to agree with them on issues such as security of supply and information – crucial for the

development of a more open transatlantic defence market – if they cannot agree on these issues amongst themselves.

Europe's armies need much new equipment if they are to carry out the full range of missions expected of them. And taxpayers' money should be used as efficiently as possible in the defence arena as much as elsewhere. In short, better European co-operation in armaments would help the EU to play a more effective role in global security.

## 2 Defence industrial challenges

European governments have to think strategically about how they want the European industry to develop because of the dramatic changes in the global defence industry in recent years. The end of the Cold War prompted a significant decline in global defence spending, although some countries have reversed this trend since September 11th 2001. Meanwhile, US outlays continue to dwarf Europe's. In 2002, the US defence budget will amount to an awe-inspiring \$380 billion – the \$80 billion increase over the 2001 figure is greater than the French and British defence budgets combined. More specifically, the US spent \$40 billion on research and development in 2001, whereas France, Germany and the UK – the main European purchasers and producers of arms – spent a total of approximately \$7 billion. Moreover, the US spent \$60 billion on procuring new equipment in 2001, while France, Germany and the UK combined spent just \$16 billion.<sup>3</sup>

As defence budgets declined in the 1990s, so too did the industry. The US defence industry engaged in a series of mergers and acquisitions throughout the decade. This process of consolidation led to the creation of 'prime contractor' companies such as Boeing, Lockheed Martin, Northrop Grumman and Raytheon. The European defence sector has engaged in a similar process of consolidation, including cross-border mergers, and is now dominated by three combines: BAE Systems (UK), EADS (France-Germany-Spain), and Thales (France). But consolidation has been mainly limited to aerospace, missiles and electronics. Neither land armaments nor naval shipbuilding has been greatly affected by mergers. And despite the recent consolidation, the ownership structure of the Europeans defence industry remains exceedingly complicated, criss-crossed by numerous shareholdings, joint ventures and consortia. Experts describe the situation as the 'European spaghetti bowl'.

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<sup>3</sup> International Institute for Strategic Studies, Strategic Survey, 2002-2003.

Some European companies are also competing globally and developing relationships with other defence suppliers around the world. For example, BAE Systems owns, or has stakes in, companies in South Korea, Saudi Arabia and South Africa, and makes the majority of its sales in the United States. Thales is similarly positioned in Australia, South Korea, Brazil and the UK. For both BAE Systems and Thales, the 'home' government is no longer the dominant source of revenue.<sup>4</sup>

However, the US dominates the global defence industry. To illustrate: the three dominant European industrial players had a combined turnover in defence goods of \$22 billion in 2000, while the top three US firms had more than double that, with a combined turnover worth \$49 billion. American suppliers occupy four of the top five places in the global defence revenue league, BAE Systems is in fourth place, EADS is in seventh and Thales in eighth. US companies make up half of the top 100 defence firms in the world, and 63 per cent of global defence revenues; the UK has 10 companies with a 14 per cent share; France has 7 firms with a 9 per cent share; and Germany has 3 companies with a 1.5 per cent share.<sup>5</sup>

Another change in Europe is that more of the bigger players are now, like their US counterparts, majority-owned by private shareholders. For example, the German company Dasa would not agree to the merger that created EADS until the French government relinquished its position as the majority shareholder of the French partner, Aérospatiale Matra. Privatisation puts these defence companies under the same pressures as their civilian counterparts to report regular financial results and turn a profit, and they have fewer government guarantees of capital or contracts.

Changing military requirements are also affecting the industry. The aerospace sector was traditionally the driving force behind the defence industry. But these days a set of new military technologies based on computers and telecoms, and pioneered by the US – sometimes categorised as the 'revolution in military affairs' (RMA)

<sup>4</sup> Andrew D. James, 'Comparing European Responses to Defense Industry Globalization', *Defense & Security Analysis*, Vol.18, No.2, 2002.

<sup>5</sup> Katia Vlachos-Dengler, 'From National Champions to European Heavyweights', *RAND Documented Briefing*, 2002.

– are becoming more important. The RMA depends as much on innovations in the civilian sector as those which come out of defence laboratories. The 'digitisation' of the battlefield, stemming from the RMA, allows commanders in distant headquarters to locate on screen, in real time, the location of their forces and those of their opponents, and to guide weapons precisely to their targets. It encourages military officers to think in terms of communications 'networks' that link the air, naval and ground forces, rather than to focus on traditional 'platforms' such as aircraft, ships and tanks. This type of 'network-centric' warfare will further change the defence business, pushing it in the direction of space-based communications and information technologies.

The costs of new defence systems, such as unmanned aerial vehicles (UAVs), have risen so steeply that only the US can contemplate producing and buying all the latest military technology. And even the US is not completely self-sufficient. On the one hand, Europeans do not need the number and variety of advanced systems that the US is procuring and developing. On the other hand, the campaigns in Kosovo and Afghanistan, which revealed a growing transatlantic capability gap, left the impression that "Europe has not yet left the starting block with respect to the RMA".<sup>6</sup> No single European country can afford to buy or develop the full range of new systems, which means that governments have to combine their resources to acquire major new capabilities. Moreover, without sufficient investment in R&D, Europe will continue to lag far behind the US in weapons technologies.

The scale of the US defence budget means that US suppliers are not so dependent on exports or cross-border collaboration to sustain their businesses. They have to deal with a single procurement process and a single set of market rules, which helps them to rationalise production. European defence companies, on the other hand, often depend on exports, and increasingly on multinational programmes. This means they must deal with

<sup>6</sup> Robert P. Grant, 'The RMA – Europe can keep in step', *Occasional Paper No.15*, EU Institute for Security Studies, 2000.



numerous different procurement and regulatory environments. For example, EADS has three very distinct 'home' markets, France, Germany and Spain, and deals with 12 other EU defence markets.

In addition, the largest arms-buying countries in Europe are far from wide open to foreign competition. Among these, the UK market is the most competitive, with foreign companies able to compete for roughly 50 per cent of defence contracts. But the largest arms-buying countries are also the major arms-producers, and the other producer countries retain a bias towards procuring most defence goods on a national basis only. They do this partly because they want to sustain 'strategic' industries, and partly to protect jobs.

The six major European arms-producing countries account for more than 90 per cent of defence equipment production in the EU. This means that most European countries are primarily consumers rather than producers – although many smaller countries are major subcontractors and component suppliers. The consumer countries do not feel an obligation to always 'buy European'. From a consumer government perspective, competition between European and American suppliers is desirable, because it brings prices down, and often helps get a better deal for local industry involvement. Thus Belgium, Denmark, the Netherlands and Norway all bought F-16 jet fighters from Lockheed Martin in the US, rather than the European alternatives.

Transactions involving equipment at this level of sophistication do require the approval of the supplier's home government, and also usually include some 'off-set' arrangements, according to which the manufacturer shares some of the workload with local industry. Ireland, for example, agreed a deal with Sikorsky Helicopters of the US in 2002 that included a local work-share arrangement. Eurocopter was expected to win the Irish contract, but Sikorsky's promise to share work with a troubled local aerospace plant helped the American firm win the competition.

The American Joint Strike Fighter (JSF) programme will dominate defence industrial relations across the Atlantic for many years to come. The Lockheed Martin-led project offers participating countries the prospect of valuable work for their local industry in advanced aerospace technology. Six European countries – Denmark, Italy, the Netherlands, Norway, Turkey and the UK – have signed up to participate in the JSF programme. It is the biggest defence contract in history, worth \$200 billion over the next 30 years. The aircraft will be the fighter jet of the next generation, and it is due to come into service in the US by 2010. The basic model can be adapted to allow short take-off and landing, for use from aircraft carriers, and it benefits from the latest stealth technology. The Pentagon has ordered 2,900 units. To illustrate the gap in transatlantic purchasing power: the largest European order comes from the UK – 150 planes altogether.

In the meantime, three fighter jets are currently produced in Europe, the Eurofighter, which is a joint venture between Germany, Italy, Spain and the UK, the French Rafale and the Swedish-British Gripen. They are all effective aircraft but their technologies are aging, compared with the latest developments in the US. In the near term, the Europeans lack the resources to develop a European competitor to the JSF.

Four of the European countries that have ordered the JSF – the Netherlands, Norway, Denmark and Turkey – have decided to keep their current F-16 fighters in service until the new US aircraft is available, and are thus out of the market for the Eurofighter, the Rafale, and the Gripen. The other two European participants in the JSF programme, Italy and the UK, are also partners in the Eurofighter programme.

The European aircraft do have some advantages. They can enter service more quickly than the JSF, as Rafale and Gripen are already in service, and Eurofighter is scheduled to arrive in 2003. Some



countries simply cannot afford and do not require all the new technologies that the US can offer. For these reasons Austria recently chose to buy Eurofighters, while the Czech Republic is expected to buy Gripens. But the lucrative export market is extremely competitive, and in spring 2002 Eurofighter and Rafale lost a \$4 billion South Korean contract to Boeing's F-15.

If the JSF programme develops Eurofighter-style problems, such as escalating costs and delivery delays, Italy and the UK might conceivably join the French in considering how to develop an alternative European programme for next-generation fighters. Otherwise so many European countries will be involved in the JSF that in the long term Europe will not be able to sustain a competitive and indigenous fighter jet industry.

If European governments want a chance of staying in this business – for UAVs if not for manned aircraft – they should, as a first step, create a single military aircraft company. Otherwise European firms are likely to become mere subcontractors for US fighter jet projects. And if the Europeans continue to invest insufficient resources in R&D, the same will hold true for future defence systems based on communications and information technology. Of course, if American equipment is better and cheaper, the case for acquiring it rather than a European alternative is strong. However, not all American equipment is better or cheaper. And since US systems are usually produced with the Pentagon's needs in mind, they do not always match European requirements. Moreover, many of the larger equipment projects bring together European and US companies. Therefore the debate over whether to choose European or American equipment is often redundant.

There is already a competitive transatlantic market for sub-components, and prime contractors like BAE Systems and EADS would like to see this extended to integrated products like aircraft and communication systems. A more open transatlantic market would be ideal, even though there are currently many legal and

political obstacles to a truly level playing field. Industry is certainly moving in this direction, thanks to a number of transatlantic industrial partnerships.<sup>7</sup> BAE Systems had US sales worth \$4 billion in 2001, participating in US-led project teams. BAE Systems benefits greatly from the UK's position as the most trusted ally of the US.

However, for other European companies, penetrating the American defence market through joint ventures, investments, or strategic co-operation is more difficult, partly due to American fears that technology could end up in undesirable hands. Even so, EADS and Northrop Grumman have signed a memorandum of understanding which links their businesses in electronics, while Finmeccanica of Italy has a joint venture with Lockheed Martin to produce military transport aircraft. And Raytheon and Thales have entered into an electronics joint venture. A major transatlantic defence merger has not yet happened, but industry's inclination to co-operate on a transatlantic scale is clear. The challenge now is for governments to catch up.

BAE Systems, Thales, and EADS all have businesses large enough to talk to American firms on equal terms. But it is far from clear that the US and European governments are willing to allow transatlantic mergers. Part of the problem is uneven market access, and repeated calls by Europeans on the US to open its defence market are justified. While American companies account for roughly 50 per cent of European defence purchases, European firms account for a paltry three per cent of the US market.<sup>8</sup> Lord Robertson, the NATO Secretary-General, emphasised this point in May 2002 when he said:

“In the recent past, I have been brutal with European audiences about the need to invest in capabilities and spend defence funds more wisely, but the United States has also a major role to play in facilitating European defence modernisation, and thus transatlantic armaments

<sup>7</sup> See 'Europe's defence industry: A transatlantic future?', CER, July 1999.

<sup>8</sup> See Alexandra Ashbourne, 'Opening the US defence market', CER, October 2000.

co-operation. On a number of occasions I have called on the United States to ease unnecessary restrictions on technology transfer and industrial cooperation, and specifically to liberalise its export policies.”<sup>9</sup>

The Bush administration is conducting a major review of its export policies, and a US government report is due in spring 2003. But until this market access situation changes, a truly open transatlantic market is not a realistic prospect. But that should not give the Europeans an excuse for delaying the creation of a single defence market in the EU.

### 3 A European defence market

Europe needs a more integrated defence market, if Europe’s defence industry is to remain competitive. Greater cross-border co-operation would allow larger economies of scale, increased industrial competition, and thus lower prices, particularly for more advanced equipment. While some firms have consolidated across borders to form new defence companies on a ‘European’ scale, the European marketplace is not yet ‘European’ enough.

In theory, a common European defence market would allow free movement of most defence goods amongst EU member-states. This would allow cross-border competition for defence contracts. Defence ministries would be able to purchase equipment from the company that offered the best financial and technical package, regardless of its national origin. At a minimum, a common market would require a simple licensing system for the transfer of goods among EU states, and a common customs tariff. But so far European governments have resisted the temptation to open up their defence market. Governments justify protectionism in the defence sector on the grounds that it is a ‘strategic’ industry. Governments have two principal justifications for protectionism: a desire to sustain industries and technologies that may be vital for future job generation; and the acknowledgment that the defence business is more sensitive than others, for example because the quality of its products affects a nation’s military prowess.

A more integrated market for defence equipment need not be an unrealistic goal. Many parts of modern weapons systems do not have to be kept so closely under wraps, for many of their components are on the commercial market. For example, military information technologies are increasingly adapted from commercial

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<sup>9</sup> Lord Robertson, ‘Defence and security in an uncertain world’, keynote speech at Forum Europe, Brussels, May 17<sup>th</sup> 2002.

applications. Of course, the most sensitive defence goods would not move around freely in the European marketplace. However, since countries can develop technologies for systems such as fighter jets together, they should also be ready for a more integrated market for these types of equipment.

A more integrated market is particularly important in the present public spending climate: European governments are not increasing defence spending significantly, nor are they likely to do so in the near future. European governments can no longer contemplate using scarce defence euros to sustain uneconomic sectors of their national defence industries. They should make a greater effort to consider the European option, remove barriers in the defence sector, and pool more of their industrial resources. This would require a basic regulatory framework for the defence trade in Europe. The negotiation of such a framework would, however, be extremely complex and politically sensitive, given that it would deal with core issues of national security. To overcome such political difficulties, Europeans need to build on existing accords like the Letter of Intent.

The Letter of Intent, signed in 1998 by the six main European arms producing countries – France, Germany, Italy, Spain, Sweden and the UK – is a serious attempt to begin harmonising some national armaments regulations. The Letter focuses on six areas: security of supply, export procedures, security of information, research and technology, harmonising military requirements, and intellectual property rights. The six states signed a treaty in July 2000 on the basis of the Letter of Intent. When the treaty enters into force in any two countries, they will be able to apply the treaty's provisions without waiting for the others to ratify it.

If successful, the agreement may prove to be the foundation of a future common European defence market.<sup>10</sup> However, the Letter of Intent focuses mainly on encouraging further cross-border industrial consolidation, and helping transnational companies like EADS to operate on a cross-border basis, rather than on creating a

<sup>10</sup> See Burkhard Schmitt, 'From co-operation to integration: defence and aerospace industries in Europe', EU Institute for Security Studies, *Chaillot Paper 40*, July 2000.

more open market for defence goods. Another problem is that the Letter involves only the arms-producing countries, without input from the rest of Europe. Countries that are predominantly arms importers would be more likely to join in if their subcomponent manufacturers were able to compete for producer-country contracts in a broad European market. In any case, some smaller countries are participants in co-operative programmes with Letter of Intent signatories. Therefore they will ultimately have to be included in the framework of the Letter. A European market needs the participation of many, not just some, European governments.

A European institution would have to run a common European defence market allowing open trade and competition in all but the most sensitive defence goods. Could the EU regulate a European defence market? EU involvement could lend the harmonisation process greater political legitimacy than the more exclusive and limited Letter of Intent, and the EU could extend its experience in the single market to the defence trade. But who within the EU should take the lead?

The European Commission could have a regulatory role regarding the less sensitive sorts of equipment, taking advantage of the rules already established in the European single market, to promote, where appropriate, cross border competition and lower prices. Defence goods related to the 'essential interests of security' – as stipulated in Article 296 of the EU treaties – are currently one of the notable exclusions from the Commission's regulation of European industry. At the moment the Commission's role in the defence market is confined to 'dual-use' products that are components of both civilian and military equipment.

The main arms-producers in Europe adhere to a broad interpretation of Article 296, maintaining that almost all goods used for defence purposes are related to 'essential interests of security'. This prevents the Commission from having a meaningful involvement in the defence market, with the result that

governments can protect their national companies from foreign competition. However, the Commission's role in the growing sector of 'dual-use' products (goods used for both civilian and military purposes) gives it a foot in the door. For example, in February 2002 the Commission started legal action against 10 member-states for not applying common customs tariffs on dual-use products. This legal action should help reactivate the discussion on the Commission's role in regulating defence goods, and on Article 296.

In 1997 the Commission produced a report on the European defence sector that is often referred to as the Bangemann report (after the German Commissioner who wrote it). This included practical proposals for creating a common armaments market, including a simpler licensing system for internal transfers of defence goods in the EU; the promotion of open-tender procedures for defence equipment; and the abolition of customs duties on certain defence products. Other measures suggested in the report included amending the rules of EU competition policy, to allow the European Commission to supervise trade in all but the most sensitive types of defence equipment; standardising procurement procedures; and establishing clear competences for the Commission around 'dual-use' products.<sup>11</sup> The enterprise commissioner, Erkki Liikanen, has repeatedly urged the leaders of EU member-states to implement the Commission's proposals, but so far with little success.

A July 2002 document from the Commission, known as the STAR 21 report, suggests a new approach: the Letter of Intent could be used as a basis for an EU-wide agreement on defence market rules.<sup>12</sup> It recommends that the Letter of Intent signatory states should open a dialogue with the Commission. The aim of such a dialogue would be to extend the Letter of Intent to all EU member-states, while giving the Commission a regulatory role in the defence market, similar to that proposed in the Bangemann report.

<sup>11</sup> See the European Commission report, 'Implementing European Union strategy on defence-related industries', 12<sup>th</sup> November 1997.

Available from [www.europa.eu.int/comm/enterprise/defence](http://www.europa.eu.int/comm/enterprise/defence).

<sup>12</sup> European Commission, 'Strategic aerospace review for the 21<sup>st</sup> Century', Enterprise Publications, July 2002. Available from [www.europa.eu.int/comm/enterprise/aerospace](http://www.europa.eu.int/comm/enterprise/aerospace).

However, while the STAR 21 report was right to recommend extending the Letter of Intent to all EU members, the major EU arms producers are unlikely to allow the Commission a major role in a European defence market for the moment. They point out that the Commission has little experience in defence industrial matters. For the time being, therefore, an inter-governmental approach to harmonising defence market rules is more likely to succeed.

At a minimum, the Council of Ministers should adopt the Letter of Intent as an EU-wide measure. The governments should create a special body, composed of national officials, to supervise the implementation of the agreement. This would probably prove extremely slow and complicated, but as an inter-governmental process it would be much more likely to have the support of the major arms producing governments.

Another reason to favour a predominantly inter-governmental approach in the near term is that the EU will need to work in tandem with NATO on armaments co-operation. As the Council already has formal links with NATO's planning staff, it should be relatively straightforward to extend the same principle to armaments co-operation. Non-EU NATO members are likely to prefer to deal with the inter-governmental Council, where they have already established channels of communication, than with a supranational body like the Commission.

As a general principle the EU should not try to develop its role in armaments without co-operating with NATO. In the same way that EU officials work with NATO planners on operational issues and the sharing of military assets, the EU should work with NATO to find ways of mutually re-enforcing their respective efforts in the armaments arena. NATO should also do more to promote a transatlantic defence market, although its record so far suggests that it is unlikely to make much progress in the foreseeable future (see Chapter 5). One useful way forward, would be for the six Letter of Intent states to propose a multilateral dialogue with the

US, with the aim of reaching agreement on the basic elements of a more open transatlantic defence market.<sup>13</sup>

But for the EU, the difficulty of adhering to a strictly inter-governmental approach is that in the medium term it may prove inadequate, due to the limitations of the Letter of Intent and competing national interests. As the STAR 21 report recommends, EU member-states should also re-interpret Article 296 of the EU treaties. The Commission should receive a mandate from EU member-states to regulate a common market for the less sensitive defence products, such as armoured vehicles, and some components of fighter jets and military ships. For those goods policed by the Commission, a common market would require a simpler licensing system for intra-EU transfers, and common customs duties. At a later stage governments could try to extend these arrangements to the movement of more sensitive goods, for example UAVs and cruise missile technology. But if the EU could take only these first, limited steps, it would be going a significant way towards creating a more integrated European defence market.

## 4 European defence programmes

Europe needs more ‘bang for its buck’. However, even if Europe makes progress in further defence industry consolidation, and in integrating its defence market, there is no guarantee that military capabilities will improve markedly. Despite the campaign against global terrorism, the present political climate and other demands on public funds do not augur well for defence budgets. But the size of budgets is not the only problem. The Europeans waste much of the money they do spend. EU governments therefore need to think much harder about collective research, development and procurement, if they wish to improve their military capabilities.

Multinational procurement projects will become increasingly necessary. It is certainly true that, if badly managed, such projects can be costly in political, financial, and military terms. A 1999 review of 75 major European defence programmes by McKinsey & Company showed that cost overruns were 30 per cent higher on multinational programmes than on comparable national projects. In-service dates for the same multinational projects slipped 40 per cent on average, compared with 10 per cent for national programmes.<sup>14</sup>

But in principle the advantages are many. Joint programmes, where two or more countries get together to manufacture and purchase defence equipment, allow greater economies of scale because of the larger order books. Such savings should please finance ministries and taxpayers. But saving money by pooling resources in joint projects would also allow Europeans to contemplate acquiring more advanced weaponry.

Another advantage of joint procurement is that common equipment can help countries work together on international missions. Such

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<sup>13</sup> Gordon Adams, ‘Transatlantic Defence-Industrial Co-operation and American Policy’, CEPS/IISS European Security Forum, November 25<sup>th</sup> 2002.

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<sup>14</sup> John Dowdy, ‘Bureaucracy is killing Europe’s defence industry’, Wall Street Journal Europe, 26<sup>th</sup> May 1999.

‘inter-operability’ is vital for the success of military coalitions, whether peacekeeping in East Timor, or the Kosovo air-campaign. For example, French fighter jets did not have an all-weather capability during the Kosovo conflict, which greatly hindered the French air force’s ability to conduct missions with other NATO allies. Defence ministries need to recognise that if they developed and procured more capabilities together, they could conduct joint missions more easily.

Finally, joint procurement brings political benefits. It encourages greater convergence of thinking about international security among European governments, which helps foster a common European ‘strategic culture’. If the EU or NATO is to succeed in improving European military capabilities, neither can avoid including joint procurement amongst their defence policy aims.

In fact Europeans have long recognised the value of joint procurement, and numerous multinational programmes have been undertaken since the 1960s, some with industrial and commercial success. Examples include the Franco-German missile group, Euromissile, and the Tornado fighter-bomber that was built by Germany, Italy and the UK.

But multinational programmes are not easy to pursue successfully. They require a high degree of political and military co-operation. There must be agreement on military and technological requirements, funding, allocation of manufacturing contracts, delivery dates, and the way the programmes are managed. The major problem is that differences between national procurement processes can complicate and slow down joint projects, which must meet the needs of all the governments involved.

Traditionally, European procurement projects are run based on the *juste retour* (fair return) principle. The application of *juste retour* requires governments to ensure their domestic defence industries receive a workload proportionate to the state’s financial

contribution. This has frequently resulted in rising costs and late deliveries. Sometimes *juste retour* even led to technical shortcomings, as some countries requested work in areas where they lacked technical expertise, usually to try to develop indigenous technology.

The example of the failed Anglo-French-Italian Horizon project, which was supposed to have built a common air-defence frigate, illustrates these problems. Arguments over specifications – the British wanted a larger vessel with a better radar – and work-sharing arrangements led to huge delays. Three years after starting the project in 1996, the in-service date had slipped by five years, while expected costs had risen 20 per cent over the original budget. As a result the UK left the project in 1999, concluding that it would be quicker and cheaper to build frigates on its own.

The five-country Eurofighter project provides another example of the many problems that can arise with joint procurement programmes. Originally conceived during the 1970s, an agreement was reached on the basic outline of the aircraft in 1980. But irreconcilable differences between the participating states meant that France left the programme and pursued the national option, the Rafale. These disputes centred on capability preferences: France emphasised a ground-attack role and needed planes that could operate from aircraft carriers, whereas Germany and the UK preferred an interceptor. Since then, the programme continued to be dogged by differences over equipment specifications and difficulties over funding. The first deliveries of the Eurofighter are scheduled to arrive during 2003, seven years after the original target date of 1996. However, the Meteor missiles that are supposed to equip the Eurofighter have not yet been developed or tested, despite a contract agreement in 2000, due to German funding delays.

Europe’s slow progress on improving joint procurement is not for want of ideas. Numerous reform proposals have been suggested, including the creation of a fully-fledged European armaments



agency. The point of such an agency would be to run joint procurement programmes and harmonise national procurement processes. A declaration was attached to the EU's 1991 Maastricht treaty, calling for the creation of such a European armaments agency. More than a decade later it still does not exist.

## OCCAR

The Joint Armaments Co-operation Organisation (known by its French acronym OCCAR) is a serious attempt to improve the efficiency of European joint procurement. It has evolved from a bilateral agency set up by France and Germany in 1993. In 1996, Italy and the UK agreed with the original partners to broaden the concept and create OCCAR. A treaty establishing OCCAR as a legal entity entered into force in 2001.

OCCAR's key task is to create a clearly defined set of procedures for managing common programmes. This should save money and time by cutting out most of the government interference that has dogged joint programmes. It should allow companies to deal with one programme management team, operating under familiar guidelines, instead of trying to co-ordinate the requirements of different national teams. And OCCAR procedures allow companies to deal with a familiar set of general guidelines for each programme. In the past, companies dealt with than different rules for each project.

High level policy issues are dealt with by the OCCAR Board of Supervisors, comprising the national armament directors of the member nations. The OCCAR director acts as a general supervisor but has no direct control over the programmes. The central office in Bonn defines the general policy goals and provides support services, but the programme teams are relatively autonomous. Programme managers have full authority over their projects, and are responsible for scheduling, costs and performance, and are free from national interventions in day-to-day management.

OCCAR is open to all countries that meet the strict entry conditions, which include participation in an equipment programme that is managed by OCCAR. Spain, Belgium and the Netherlands are in the process of joining, while Sweden and Finland are considering the possibility. Countries can also participate on an *ad hoc* basis in some OCCAR programmes. Luxembourg, Portugal, and Turkey are not members, but all intend to participate in the A-400M transport aircraft programme, which will be the first to be fully managed by OCCAR.

A welcome innovation by OCCAR is the modification of the traditional *juste retour* principle. In its traditional form, *juste retour* is applied each year on a programme-by-programme basis. OCCAR follows a broader approach, centred on a multi-year and multi-programme balance, with work-participation criteria linked less closely to financial contributions and political considerations.

Under present OCCAR rules, the defence industry of a member-state must receive work worth at least 66 per cent of its government's financial contribution to a programme.<sup>15</sup> This is progress compared with traditional *juste retour* practice, under which a national industry received work equivalent to the full amount of its government's financial contribution. Moreover, the 66 per cent threshold is supposed to be reviewed on an annual basis.

If the work-to-finance relationship were eliminated completely, so that work was allocated only to firms that submitted the most attractive tenders, governments could concentrate on agreeing performance requirements for the finished product, such as range and speed. Technical specifications would be left to industry to decide. This would greatly increase the economic efficiency of joint programmes. At present, there is no chance of such a radical reform. However, as more states join OCCAR, it will become increasingly complicated to work out 'global balance' agreements. As a start, OCCAR's governments should agree to cut the 66 per cent threshold to 50 per cent for future programmes.

<sup>15</sup> Convention on the establishment of the organisation for joint armament co-operation (OCCAR), Annex III, 1998.



So far, many of the OCCAR-managed programmes have been Franco-German projects, initiated before the organisation existed in its present form. These include Tiger combat helicopters, Milan and Hot anti-tank missiles, and the Roland air defence system. Other OCCAR projects include a surface-to-air anti-missile programme (FSAF) pursued by Italy and France, while the UK is involved with France and Germany in the Cobra programme to produce long-range battlefield radar. The UK, along with Germany and the Netherlands, is also part of the multi-role armoured vehicle programme (MRAV), sometimes referred to as 'battlefield taxis'. Many of these programmes have encountered difficulties, which has not helped OCCAR establish its credibility, even if the difficulties pre-date OCCAR's existence.

A particular problem for OCCAR is that national defence officials do not use the organisation early enough in the procurement decision-making process. If the defence ministries are to take full advantage of OCCAR, their officials need to engage with it from the earliest possible stage in the procurement process. For example, there is scope for OCCAR to manage programmes in their early research and development phase. The six Letter of Intent member-states are part of the European Technology Acquisition Programme (ETAP), set up to develop future aerospace technology in Europe. OCCAR could manage this programme.

In the long-term, when more states have joined OCCAR and it has managed more projects, could the organisation evolve into a European armaments agency? The European Convention, which is discussing the future institutional and political shape of the European Union, is due to present a draft constitutional treaty for the EU in summer 2003. The Convention has a working group for EU defence policy, which should present its proposals for reform at the end of 2002. Michel Barnier, the Chairman of the defence working group (and a European commissioner), has suggested that OCCAR should form the basis for an EU agency.<sup>16</sup>

<sup>16</sup> Cited in 'Well they're talking', *The Economist*, 2<sup>nd</sup> November, 2002.

In theory, OCCAR could not easily become an EU body unless all the member-states joined it. Those outside it are unlikely to support OCCAR becoming a fully-fledged EU armaments agency. Yet it would be time-consuming and complex for every member-state to join OCCAR, as the existing members have to set the terms for new members. Until more countries join, OCCAR should remain independent and continue to concentrate on establishing its credibility as manager of European joint procurement projects. Since non-members can already participate in OCCAR programmes, in practice it would manage European collaborative programmes. However, when a majority of EU countries have joined OCCAR, it should become an EU agency. A majority of EU member-states would amount to eight countries at present, but this threshold would change if 10 new countries joined the EU in 2004.

The EU has faced difficulties in setting up regulatory agencies without a treaty change, because of a Court of Justice ruling that restricts the Commission's ability to devolve its powers.<sup>17</sup> However, granting OCCAR the status of an EU agency should not require changes to the EU treaties. Since OCCAR would not have a regulatory role in the single market, it would not impinge upon powers already exercised by the Commission.

It is possible that one or a few member-states which did not want to join OCCAR would veto its becoming an EU agency. Those already in OCCAR should then propose extending the EU treaties' provisions for 'enhanced co-operation' – which allow a group of member-states to move ahead of the others in some policy areas – to defence, where they do not currently apply. Doing so would permit those countries that wish to develop OCCAR's role as an EU armaments agency to go ahead.

<sup>17</sup> Alasdair Murray, 'European economic reform: tackling the delivery deficit', CER, October 2002.

## 5 The EU and armaments co-operation

Efforts to improve armaments co-operation in Europe remain fragmented, involving a large number of institutions and processes in addition to OCCAR and the Letter of Intent group. While all these groupings share similar basic aims, there is great variation in their approach and competences. If European armaments co-operation is to improve, a central body must provide greater political leadership. The EU is developing a new defence policy, and as a result it is a strong candidate to provide more direction for European armaments co-operation. But to do so successfully, the EU should learn from the experiences of other institutions like NATO and the WEU. Both NATO and the WEU have tried to improve European armaments co-operation, but with little success.

### **NATO and the WEU**

NATO has attempted to promote transatlantic armaments co-operation amongst all its member-states since the 1950s, while the WEU has done the same among European members of NATO since the 1970s. In NATO, the Conference of National Armaments Directors (CNAD) meets twice a year with representatives from NATO's Military Committee to discuss procurement priorities for NATO forces. The Western European Armaments Group (WEAG), composed of national armaments directors, performs a similar European-only function in the WEU context. The members of WEAG include all members of the EU except Ireland, and all European members of NATO except Iceland.

Both these groups provide some political co-ordination and discuss common armaments standards. They also try to develop

more efficient use of resources through the increased harmonisation of military requirements. For example, in the 1950s NATO members agreed on a common standard for rifle bullets. Other shared aims include opening up national defence markets to cross-border competition, strengthening the defence-industrial base of member-states, and increasing co-operation in research and development (R&D).

However, neither NATO nor the WEU has a strong record in the area of armaments co-operation, mainly because they do not have the authority to force member-states to act. Ten years after starting discussions on acquiring a ground surveillance system, NATO armaments directors have still not agreed on whether to buy an American product or to wait for the Europeans to build one.

Neither NATO nor the WEU has the ability to develop common weapon systems or manage joint programmes. Instead, member-states involved in joint projects have set up special bodies to manage them. For example, the NATO Eurofighter and Tornado Management Agency (NETMA), composed of representatives from the four participating member-states, manages the Eurofighter programme. Although OCCAR is now taking on the role of managing European programmes, eliminating the need for separate management bodies.

To make better progress on co-operation, the members of the WEU armaments group established the Western European Armaments Organisation (WEAO) in 1996. WEAO was created as a kind of European armaments agency in waiting. In the meantime it is trying to reduce costly duplication of R&D. Unfortunately, national ministries have hampered WEAO's core research programme, European Co-operation Long Term in Defence (EUCLID), by limiting the movement of research funds across borders, and a lack of financial support. EUCLID receives only 100 million euro per year, which is less than 1 per cent of the total amount of money EU members spend on military R&D.

In May 2001 the WEAO member-states signed the European Understandings for Research Organisation, Programmes and Activities (EUROPA) memorandum. The idea behind EUROPA is to make the EUCLID programme more flexible, by shifting the focus to co-operation among industries such as aerospace rather than state-owned agencies and laboratories. Under EUROPA, governments can shift research funds more easily across borders so that industries can pool money to fund specific projects; and member-states are permitted to operate in smaller groups for more sensitive projects. The EUROPA memorandum is a modest step in the right direction. But EUCLID will not make a major impact on European military R&D without more money and political support.

### **The obstacles to co-operation**

Why has Europe done so little to improve armaments co-operation? As already stated, defence is still the most national of policies, and different countries have different agendas, for example on how to set up and manage a central armaments agency. French and German officials often argue for an EU armaments agency along the lines set out in the Maastricht treaty. Such an agency they say would give strategic guidance to common armaments efforts, and take over various functions from other agencies. Thus it would run WEAO's EUCLID research programme, and manage OCCAR projects such as the A-400M transport aircraft.

British officials are not convinced of the merits of the EU having any role, even on the political level. They worry about the 'politicisation' of any new agency. They want OCCAR to get on with proving its competence in its core tasks, and establishing its credibility, before it is transformed into something more powerful. The British are also concerned that EU involvement could duplicate what already takes place in NATO and the WEU armaments organisation, without bringing any extra benefits. But the British should ponder the poor record of the WEU and NATO in the area of armaments co-operation.

The WEU armaments group failed to produce much in the way of concrete results because the WEU itself was a weak and dormant organisation. Now that most of the WEU's functions have been transferred to the EU, the armaments group is even less likely to achieve anything. The WEU could not force member-states to keep their armaments commitments and it has proved little more than a talking shop.

NATO should promote a single market in armaments and defence technology. If NATO could establish common rules on export controls, technology transfer, security of supply, monopolies and fair procurement, the allies would be more likely to trust each other and open their markets. A single armaments market would make it easier for NATO forces to use common equipment and thus work together more effectively. However, worries about national security, as well as pork-barrel politics, have prevented the creation of a common market (as they have among EU countries). NATO has had little success in fostering armaments co-operation, because, like the WEU, it also cannot force member-states to keep their armaments commitments.

### **An EU armaments policy**

The Europeans will not make a better job of armaments co-operation without greater political direction from a central institution. The EU is the only body that is likely to provide this type of leadership. The EU is already developing a European security and defence policy (ESDP), as part of its attempt to bolster its role in international security. If the EU's governments want to develop an effective European defence policy, they cannot ignore co-operation in the arena of armaments. If the EU develops its involvement in armaments co-operation, it should focus its work on harmonising military requirements, and on encouraging member-states to pool more of their defence research resources.

EU member-states agreed to a European capabilities action plan (ECAP) during the Spanish presidency in the first half of 2002. The

plan aims to accelerate EU efforts to fill some 'collective capability' shortfalls. At the 1999 Helsinki summit, EU member-states decided to develop such collective capability goals, particularly in the fields of command-and-control, intelligence and strategic transport.<sup>18</sup> At the time of writing, the EU has met 110 out of the 144 capability shortfalls it identified in 1999. Although this is not bad progress, the remaining capability gaps include vital areas such as strategic transport; command, control, computers and communications (C4); and intelligence, surveillance and reconnaissance (ISR). The EU's rapid reaction force is supposed to be ready for deployment by the end of 2003, but EU governments will not meet all their capability commitments by that time.

The conclusions of the Helsinki summit also called for 'increased efforts to seek further progress in the harmonisation of military requirements and the planning and procurement of arms'. The Laeken European summit in December 2001 gave the incoming Spanish presidency a mandate to 'reinforce co-operation in the armament field in the form considered appropriate by the member-states'. However, since Laeken there has been little progress. EU member-states should now use the European capabilities action plan as a basis on which to formulate a common armaments policy.

To provide greater political leadership and cohesion to its armaments efforts, the EU should first establish a formal council for defence ministers, to manage its defence policy. The EU's security and defence policy is part of the broader common foreign and security policy (CFSP). The General Affairs and External Relations Council (GAERC), composed of national foreign ministers runs CFSP, and therefore also manages ESDP. At the moment, the defence ministers only meet informally.

Who would chair a formal EU council of defence ministers? Under existing institutional procedures, the defence minister from the country holding the EU presidency would chair a new defence council. This situation has been complicated. During the second

<sup>18</sup> Presidency conclusions, Helsinki European Council, Annex IV, December 10<sup>th</sup> and 11<sup>th</sup> 1999.

half of 2002, Denmark has held the EU presidency but being outside EU defence policy, the country which follows Denmark into the presidency – Greece – chairs EU meetings dealing with defence issues.

An EU council of defence ministers would be answerable to the foreign ministers council (GAERC). And if the foreign ministers could not resolve a dispute in the defence council, then the European Council, comprising of national heads-of-government, would deal with the issue. To be effective a council of defence ministers should meet at least four times a year. The purpose of the defence council would be to encourage peer group pressure among defence ministers, and more generally educate national defence ministries in the workings of the EU.

But to ensure that peer group pressure works, and to force member-states to make good on their commitments, the EU needs to do two specific things. First, to ensure that member-states meet their capability goals, the EU should establish a transparent review mechanism. One reason why NATO has been unsuccessful in cajoling states to stick to their promises is the absence of clear and open methods of scrutiny. The EU should learn from NATO's failure. It should set up an independent panel of capability experts to produce, once a year, a public report on whether member-states are meeting their targets or not. The main task of this autonomous unit within the Council secretariat should be to check whether countries are delivering on their capability pledges. But the unit could also, through exchange of 'best practice', promote the cause of defence reform, particularly in the area of procurement planning.<sup>19</sup>

Second, the EU should also consider whether it needs a 'public face' for the ESDP – a deputy to the High Representative for foreign policy – to co-ordinate defence policy, chair a formal defence ministers' council and review capability goals. This 'Mr ESDP' should also devote some time to improving European armaments

<sup>19</sup> See Gilles Andréani, Christoph Bertram and Charles Grant, 'Europe's Military Revolution', CER, March 2001.

co-operation. He or she should start by encouraging national governments to co-ordinate their spending on military research and development. He should cajole European governments to harmonise their requirements for military equipment, and in some cases to develop specialised roles. Also, Mr ESDP should help stimulate competition amongst defence suppliers by promoting a Europe-wide defence market.<sup>20</sup>

The European Union formally took over most of the political and military functions of the WEU in 2002, though not its work on armaments co-operation. Separated from its political or military tasks, there is no logic in maintaining the WEU's armaments group (WEAG), which brings together national armaments directors. Instead, the EU should take over this function. National armaments directors, who already meet informally should therefore meet at least four times a year, ahead of meetings of EU defence ministers. This forum should also meet NATO's armaments directors, in much the same way as EU and NATO ministers and planners already meet, to prevent unhelpful duplication.

A committee of national experts, known as POLARM (the Ad Hoc Working Party on a European Armaments Policy), gathers in the EU council secretariat to discuss the state of European armaments co-operation. The country holding the EU's presidency calls on POLARM to meet as it sees fit. However, POLARM has yet to make much impact and rarely meets – it did not meet at all in the first half of 2002. To give it a more influential role, POLARM should become a permanent body within the EU's military staff. An EU armaments policy will need such a permanent body to conduct day-to-day work, and to help prepare the four annual meetings of the national armaments directors.

The EU military staff should promote the harmonisation of military requirements, in line with the agreed common capability goals. The military staff is already engaged in long-term strategic

<sup>20</sup> Daniel Keohane, 'Time for Mr ESDP?' in 'New designs for Europe' CER, October 2002.

planning, and in theory it should be able to extend its remit to the harmonisation of requirements fairly easily. However, the EU military staff's harmonisation efforts would amount to little without the member-states agreement. For this harmonisation work to have any impact, requirement harmonisation goals should be included in the EU's capabilities action plan. Furthermore, if the EU does create an independent panel of capability experts to review progress and produce a public report, their work should include requirement harmonisation goals. The public report would 'name and shame' those governments holding up progress. Those involved in this work, as with other aspects of EU defence planning, will need open channels of communication with their NATO counterparts. The EU defence ministers, assisted by the EU's armaments forum, would give strategic direction to this work on harmonisation.

Kori Schake, a defence analyst now working in the US National Security Council, has suggested that the EU should create closer links between R&D and procurement, arguing that a new EU body should pool national contributions to research, development, and procurement.<sup>21</sup> François Heisbourg, director of the Paris-based *Fondation pour la Recherche Stratégique*, has proposed not only that the EU should agree to spend a certain percentage of GDP on defence, but that EU states should also agree to spend minimum amounts on defence R&D in national budgets.<sup>22</sup>

To overcome the current paralysis, and to give greater political direction to European R&D efforts, the EU military staff should take over WEAO – the WEU's research cell. This would include the management of the EUCLID programme, which should be linked more closely to the EU's military capability goals. In the medium term the EU should build on the EUCLID programme and create its own, larger R&D fund. Such a fund would reduce wasteful duplication of national spending, and should be co-ordinated by the EU military staff. In the long term, if OCCAR became an EU

agency, the EU could merge WEAO with OCCAR. The advantage would be that the same project management rules, which EU governments would have agreed to, could then apply to both R&D and procurement projects.

It is clear from many opinion polls that Europeans want the EU to perform more effectively on the global stage. If the Union could develop an armaments policy that enhanced military capabilities, sustained technological development and spent defence euros more efficiently, it would show its citizens that the EU can make a difference. And the United States would welcome an effective EU armaments policy which helped the Europeans to boost their military contribution to the Atlantic alliance, so long as it did not exclude American suppliers from the European market.

<sup>21</sup> Kori Schake, 'Constructive duplication: Reducing EU reliance on US military assets', CER, January 2002.

<sup>22</sup> François Heisbourg, 'The EU needs defence convergence criteria', CER Bulletin, June/July 1999.



## 6 Conclusion and recommendations

Europe desperately needs more military capabilities. Contrary to the perceived wisdom, the main problem is not the amount of money Europe spends. At present, EU spending on defence is 40 per cent of the US level, and roughly 20 per cent of the global total, which should be adequate to fulfil its security ambitions. However, NATO's European members are struggling to meet the defence capability commitments that they signed up to at the 1999 NATO summit, while EU members have not done much better at meeting the Union's military equipment goals. Since funding is likely to remain roughly constant, the Europeans cannot boost their military capabilities without reducing the duplication of their efforts on research, development and procurement.

Pressure for a more integrated European armaments effort is also coming from industry. In the last decade Europe's armaments sector has changed dramatically. Reduced defence budgets and rising equipment costs have led to transnational mergers of defence companies, so that a European defence industry is taking shape. But the companies cannot reap the benefits of these mergers unless a more integrated European defence market also emerges.

Cash-strapped defence ministries will find it increasingly hard to buy modern defence systems unless they collaborate more on joint equipment projects. Multinational programmes are also vital to maintaining a competitive industry. But the record of multinational projects is poor, as many have actually increased costs and some products are delivered years after the original target date. To improve the performance of joint programmes, at a minimum Europeans need common project management guidelines.



Many political obstacles have hampered armaments co-operation in Europe, and institutions such as NATO and the WEU have failed to overcome these hurdles. The EU, therefore, should become directly involved in armaments co-operation, as part of its broader defence policy.

If Europeans do manage to improve their co-operation in armaments, the beneficiaries would include a more competitive European defence industry; governments that would get badly needed military equipment at better prices; and taxpayers who would get more value for money. To reap the benefits of armaments co-operation, European governments, defence companies and armed forces need to work together to:

- ★ **Create an EU forum for armaments co-operation to manage an EU armaments policy.** The EU should set up its own national armaments directors' forum, to run an EU armaments policy. This policy should be part of the broader European security and defence policy, and should have the specific target of helping meet the EU's military capability goals. The EU national armaments directors forum should be answerable to an EU defence ministers' council. The forum should also meet with its equivalents in NATO, to minimise duplication. POLARM, the group of national officials (below armaments directors level) that occasionally meets in the council secretariat to discuss armaments questions, should become a permanent body. POLARM should run the EU's armaments policy on a daily basis, and prepare the meetings of the EU's armaments directors.
- ★ **The EU military staff should work on the harmonisation of military requirements.** In the past, national governments' inability to agree on military requirements weakened or destroyed many joint procurement projects. The EU's military staff could use the EU's capability action plan, which sets out equipment priorities for EU forces, as a basis for its

harmonisation work. But to help the EU cajole member-states into agreement, requirement harmonisation goals should be included in the EU's capability action plan. EU military planners should also have open channels of communication with their NATO counterparts and their military harmonisation work to avoid unhelpful duplication.

- ★ **The EU should take over the Western European Armaments Organisation (WEAO).** To sustain their ability to produce future defence technologies, Europeans need to pool more of their resources for military research. The EU military staff should take over WEAO – the research cell of the WEU – to co-ordinate R&D efforts with broader EU defence policy aims. In the longer term, the EU should build on the EUCLID research programme and create its own larger research and development fund, and the EU's military staff should co-ordinate it.
- ★ **Reduce OCCAR's work-share threshold.** To increase their returns from joint procurement projects, Europeans need a streamlined set of management procedures. OCCAR is the only agency that can offer such consistent management guidelines for co-operative weapons programmes. OCCAR modifies the traditional industrial work-share practice by guaranteeing that a national industry receives a work-share equivalent to at least 66 per cent of the money invested by its government in all OCCAR programmes. But to enhance the efficiency of future European procurement projects, its members should cut OCCAR's 66 per cent financial work-share threshold to 50 per cent. And as more EU member-states join OCCAR, EU governments should consider turning OCCAR into an agency of the Union.
- ★ **The EU should regulate a Europe-wide defence market.** After the recent process of consolidation, a 'European' defence industry has emerged. But Europe still needs a more integrated defence market. Therefore, the EU should adopt the provisions

of the Letter of Intent – signed in 1998 by the six major arms-producing countries – to harmonise some defence market regulations for the whole Union. The Council of Ministers, which already manages the EU's defence policy, would then be responsible for implementing the provisions agreed in the Letter of Intent. However, to minimise the risk of inter-governmental gridlock in the Council of Ministers, EU governments should give the Commission a mandate to regulate a common defence market for less sensitive defence products.

