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THE PROTECTION OF THE EUROPEAN DEFENCE TECHNOLOGICAL AND INDUSTRIAL BASE

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Executive Summary

EU Member States are committed to the maintenance of a strong Defence Technological Industrial Base (DTIB) in Europe. At a meeting of the European Defence Agency (EDA) Steering Board in May 2007 Ministers declared that “a strong DTIB is a fundamental underpinning of the European Security and Defence Policy. It is our DTIB which supplies the bulk of the equipment and subsystems our armed forces require; which ensures that they have the best that world-leading technology can provide for them; and which guarantees that we can operate with appropriate independence”. They also stressed the economic value of DTIB.

As a consequence of the changes in the defence market place the EDA declared “we must therefore press on with developing a truly European DTIB, as something more than a sum of its national parts”. Hence, defence ministers have adopted, however vaguely, the notion that a DTIB is not just a set of entities capable of defence technology generation and production, but an ‘institution’ that needs to be regulated and the elements of which need to be protected.

Over many years, the European Commission has proposed measures to nurture and strengthen defence capabilities in Europe, as well as introduce European means of steering these capabilities. Member states, however, have been more willing to pursue relevant activities in intergovernmental settings - such as OCCAR, the LOI framework and EDA. Although several small steps have been made towards better integration of national DTIBs, major obstacles remain. These range from differences in licensing requirements for intra-community transfers, to the national prerogative of Article 296 of the Amsterdam Treaty.

While there are a number of cautious activities for nurturing a European approach to defence technology-generation and production capabilities in Europe, there are no similar initiatives on the European level for protecting these capabilities from foreign control or ownership. This approach runs the risk of increasing the attractiveness of European defence industrial and technological assets without balancing this with policies and instruments to protect them from foreign investors. This is quite different at the national level, where all member states with significant arms industries have active defence industrial policies, including provisions for the protection of national assets. Although the instruments for protection differ, the principle of protection is seen as legitimate and well established. The main arguments in favour of such policies are: security of supply in crisis situation; protection against technology tapping; and relocation of entities. It is only logical to argue, therefore, that a truly European DTIB also needs a policy to protect defence technology and production capabilities.

Some lessons on the establishment of a European policy on the protection of defence technology-generation and production assets can be drawn from national experiences. Central elements of such a policy are: a statement of purpose; a proper legal foundation; the identification of those capacities that should be protected; and a decision-making body or process. Among these four elements, the only one that currently is being addressed is the identification of capacities and capabilities that are seen as necessary for ESDP.

The European Parliament could take the initiative to begin discussion on a new European policy in this area. It is likely to find support in the Commission but resistance among member states as well as from major defence companies. Objections range from a reluctance to have defence industrial issues treated at supranational institutions, to the perceived need to protect industrial assets from foreign control.

The Protection of the European Defence Technological and Industrial Base

1. Introduction

Defence technology-generation and production capacity in EU member states, currently employing about 600,000 people and supplying over 80 per cent of the weapon systems procured for the armed forces in EU member states, are challenged from two opposite angles.

On the one hand, they are under strong competitive pressure, particularly from the US defence industry. (The US government is outspending European governments on arms procurement by a ratio of about 3:1 (see Table 1) and on military research and development (R&D) by a ratio of close to 5:1 (see Table 2)). This loss of competitiveness vis-à-vis other suppliers reduces the likelihood that European procurements agencies, as well as those in other countries, will buy from European sources. As a result, defence technology-generation and production capability in Europe may shrink, thereby reducing the *ability* to procure from European sources.

On the other hand, economic success also presents a challenge. The aim of European Security and Defence Policy (ESDP) is to create a European Defence Technological and Industrial Base (EDTIB) which is capable of providing the bulk of equipment for European Armed Forces “with less European dependence on non-European sources for key defence technologies”¹. However, the control of certain elements of defence technology-generation and production capacity operating inside Europe by non-European investors, whether financial or corporate, may present problems. The planned creation of a “truly European DTIB” as a “fundamental underpinning of the European Security and Defence Policy”² needs to take into account the risks of foreign ownership of crucial defence industrial capabilities and commercially the most successful companies in Europe.

The two risks are linked. The latter is rising in line with successes in meeting the former. Already, despite the aforementioned differences in procurement and military R&D budgets, European companies are global leaders in a large number of areas of defence technology, ranging from helicopters, to tanks and submarines. Indeed, they remain competitive in most areas of defence technology. The share of European defence companies in global markets which are open for competition is almost identical to that of US defence companies (see Table 3). European companies, such as BAe Systems, are also increasingly successful in the US market, despite the high barriers to entry.

This indicates that many European defence companies, both large and medium-sized, can overcome disadvantages of economies of scale through operating at high degrees of efficiency and market-orientation. Through the introduction of measures to improve the competitiveness of European defence companies (some of which are tabled in Section 6), it can be expected that the attractiveness of European companies for foreign investors will increase. Financial investors from outside the EU already own sizeable parts of the equity of major European defence companies³. The number of European defence companies bought by

¹ Steering Board of the European Defence Agency, 2007, *A Strategy for the European Defence Technological and Industrial Base*, Brussels, 14 May 2007, p. 2

² *Ibid.*, p.1

³ Detailed data is difficult to acquire for publicly traded companies with a broad base of shareholders. As an indication, it has been estimated that half of the shares of Europe’s largest defence firm, BAe Systems is foreign-owned, see <http://news.bbc.co.uk/2/hi/business/3741979.stm>. For a broader analysis of the influence of

corporate investors from outside Europe, including foreign defence companies, is still limited, even though major US companies have acquired important European defence technology-generating and producing companies (for a recent list see Appendix 1). Russian interest in buying a sizeable share in the European Aeronautic Defence and Space (EADS) company in late 2006/early 2007 was a harbinger of possible future rising interest from other parts of the world as well⁴.

Table 1: Equipment spending, United States and EU member countries
In current US \$ billion (estimated)

| Year | United States | EU-25 | Ratio US/EU |
|------|---------------|-------|-------------|
| 1995 | 73.1 | 32.7 | 2.2 |
| 2000 | 74.8 | 28.7 | 2.6 |
| 2005 | 123.3 | 42.4 | 2.9 |

Sources: NATO, <http://www.nato.int/docu/pr/2006/p06-159.pdf>, own estimates based on SIPRI, http://www.sipri.org/contents/milap/milex/mex_database1.html.

Table 2: Defence Research and Development Spending, United States and EU member countries

Military R&D expenditures in US \$ billion, prices of 2004

| | 1996 | 2000 | 2004 |
|---------------|------|------|------|
| United States | 44.7 | 42.4 | 54.1 |
| EU-25 | 12.9 | 11.3 | 11.2 |
| Ratio US/EU | 3.5 | 3.8 | 4.8 |

Source: OECD 2006.

Table 3: Global Arms Exports, United States and EU member countries

Arms exports as defined by US governments in US \$ billion, current prices

| | 1998 | 2001 | 2005 | 1998-2005 |
|---------------|------|------|------|-----------|
| United States | 19 | 10 | 12 | 109 |
| EU | 20 | 13 | 8 | 115 |
| Ratio US/EU | 0.9 | 0.8 | 1.5 | 1.0 |

Source: United States Congress 2006

This study focuses on the second challenge to the emerging EDTIB, without ignoring the first. It is divided into the following sections:

- Arguments for and against protecting crucial defence production capacities against foreign ownership.
- Discussion of instruments available for such protection.
- National approaches to the protection of crucial capacities in DTIBs.

financial markets on defence companies see C. Serfati and L. Mampaey, 'Armaments groups and the financial markets: an "unlimited warfare" convention in the making?', in W. Esner (ed.), *Arms, War, and Terrorism in the Global Economy Today: Economic Analyses and Civilian Alternatives*, Munster: Lit Verlag, pp. 121-147.

⁴ In the summer of 2007 it was reported that state-owned VTB Bank was planning to sell its share of about five per cent

- Implication of the creation of defence companies on a European scale for national approaches to such protection.
- Relevant initiatives taken by the European Defence Agency (EDA), the EU Commission and member states.
- Summary of the main argument and policy recommendations.

2. Arguments for and against protecting DTIB

There is no agreement among experts whether foreign ownership is a threat to a national, or in this case regional, industrial base. Economists have generally argued that foreign ownership does not matter, as long as strategic decisions, for instance over access to technology or the location of research and production, are made on the basis of the maximization of profits. Governments should not interfere, so this argument goes, since this will reduce the efficient allocation of resources.

A strong minority of economists, however, argue that there are good reasons for governments to seek to control decision-making in industries as well as companies, which are important to the economy and/or national security⁵. Foreign investors may not be motivated purely by economic considerations but by gaining access to, and control over, technology. This is more likely for non-European corporate investors, particularly if they come from the defence sector themselves, than for financial investors. It is highly likely, if the foreign investor is a foreign government, or government-owned defence company. In these cases, host governments should protect such entities from foreign ownership. Several EU member countries are also willing to protect their industries for political and economic reasons - in order to save jobs and to support disadvantaged regions.

The protection of production and R&D in the defence field has traditionally been stronger than in other sectors. Defence R&D and production are generally seen as being of strategic importance in themselves as well as for certain industries, such as electronics, shipbuilding and aerospace. The US, for instance, has created a legal framework of control over foreign ownership on the basis that foreign acquisitions of US companies may constitute a threat to national security⁶.

While there is widespread agreement that governments have a case when seeking to control core elements of national DTIBs, there is neither agreement on how extensive such control should be nor what instruments should be properly employed. Some express the view that if a DTIB is truly competitive, protection of defence technology-generation and production capacities is not necessary. Indeed, this position might have informed defence ministers at the EDA Steering Board meeting in May 2007 who, when making a statement on an EDTIB strategy, highlighted many efforts at improving competitiveness but made only scant reference⁷ to the possibility of protecting crucial elements of such a prospective EDTIB.

⁵ Krugmann, Paul. 1996. *Pop Internationalism* Cambridge, Mass: MIT Press, 1996.

⁶ See webpage on Exon-Florio provision and Committee on Foreign Investments in the United States (CFIUS) at <http://www.treas.gov/offices/international-affairs/exon-florio/>

⁷ Identification of key technologies and key industrial capacities is identified as one of the key actions of governments, with the further objective to determine which key industrial capacities “we must preserve or develop in Europe” (EDA 2007, p. 3).

The idea of the protection of crucial elements of a *European* DTIB currently only exists in outline. Many issues remain to be discussed. One is how a DTIB is to be defined⁸. Definitions range from DTIB simply constituting any existing set of relevant entities, to restricting the term to a more limited set of core defence companies which are tightly controlled by a central political authority. While an EDTIB clearly does exist using the first definition, it equally does not using the second definition, as control over defence production and technology capacities lies entirely with national governments in Europe⁹. The second issue is whether or not protection should remain at the national level. Certain states, such as the UK, have emphasized this point and rejected efforts to take a comprehensive European look at defence capacities¹⁰.

On balance, there are good reasons for those in favour of nurturing the EDTIB to be concerned when crucial elements of the EDTIB are not fully 'European' i.e. controlled by European owners, investors and boards of directors. Control can be important for meeting two risks. For example, in the short term, problems could arise if there were a major crisis between Europe and a government that has jurisdiction over a majority of the owners of a European defence DTIB entity. The non-European owner may opt for, or be forced to adopt, policies contrary to European policies. A case in point was the Helms-Burton Act, adopted by the US Congress in 1996, which extended the territorial application of a US embargo against Cuba to include companies operating in Europe. In the long run, ownership by non-Europeans may lead to a weakening of the EDTIB, as non-European owners pull technology out of the EDTIB or shift business from European production sites to non-European production sites.

3. Protection of crucial capacities

The protection of the EDTIB, therefore, has two interrelated elements: One is to increase its economic viability, and the other is to exercise control over core elements. DTIBs, whether national or supranational, can be protected in this manner by a host of policy measures. These can be grouped into the following categories (see also Figure 1):

- **Demand side measures (government as customer).** The simplest of such measures is to legally restrict procurement purchases to those entities, companies and research institutes, which compose the relevant DTIB. One example of such 'demand side' protection is the US 'Buy America' Act. Less obvious, but often equally powerful, are restrictions on the publication of requests for offers, or the demand for highly specific technical standards that are costly to emulate for companies not part of the protected DTIB.
- **Market measures (government as supporter).** Policy measures on the supply side focus on improving the competitiveness of the DTIB. In addition to outright subsidies to companies, government funding of military R&D, financial support for arms exports or the government-funded testing of defence equipment present important

⁸ Dunne, Paul, 'The Defence Industrial Base', in *The Handbook of Defence Economics*, North-Holland, Amsterdam, Chapter 14, 2005.

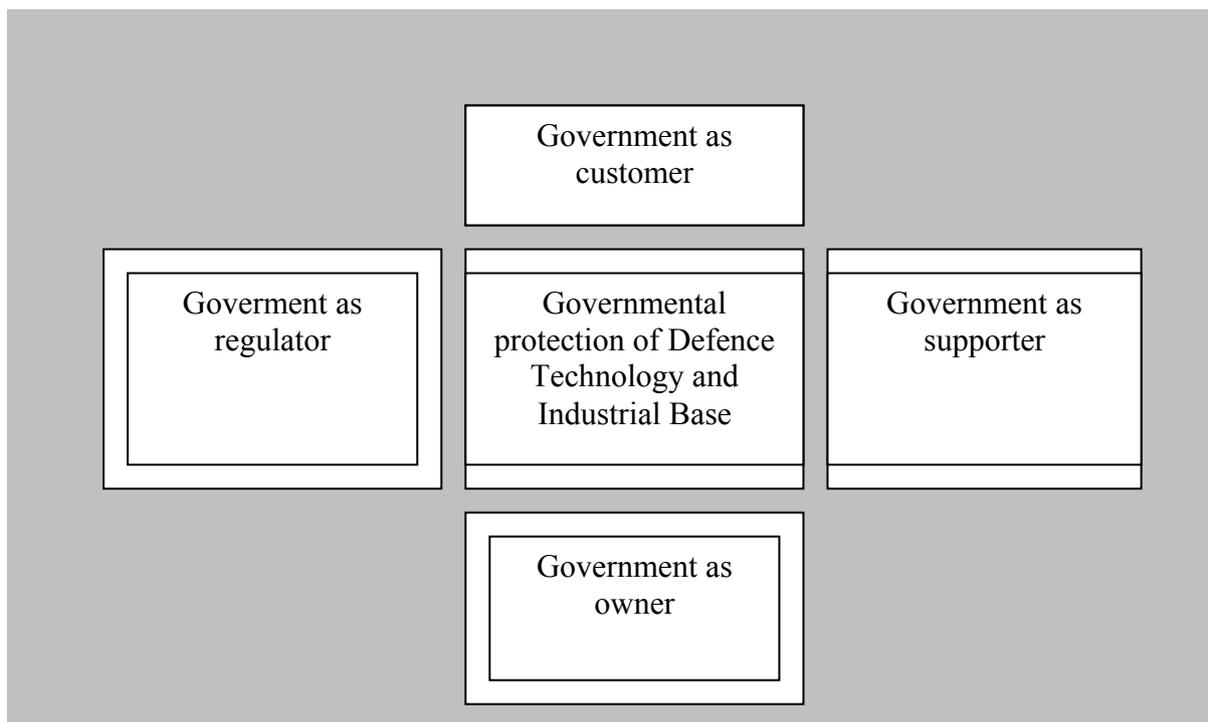
⁹ Based on Article 296 of the Amsterdam Treaty.

¹⁰ The Secretary of State for Defence. 2005. *Defence Industrial Strategy Defence White Paper*, CM 6697, London, December 2005, http://www.mod.uk/NR/rdonlyres/F530ED6C-F80C-4F24-8438-0B587CC4BF4D/0/def_industrial_strategy_wp_cm6697.pdf

forms of support. Another indirect form of support is the elimination of barriers between the military and civilian sectors in industry and R&D.

- **Supply side measures (government as regulator).** Regulations on secrecy requirements or foreign ownership are examples of supply side measures. General competition law also provides instruments to regulate arms production in particular markets.
- **Ownership measures (government as owner).** Finally, governments can protect defence entities by, for instance, maintaining ‘golden shares’ or restricting foreign ownership.

Figure 1: Instruments for the protection of a DTIB



These measures have different objectives and trade-offs. In the defence market, with its low number of competitors, demand-side measures will generally lead to higher procurement costs and lower competitiveness of protected entities. The same is true of the likely effect of ownership measures. Supply-side and market measures also raise procurement costs but have the potential to improve the competitiveness of supported entities. However, this may result in stronger interest from foreign companies to invest in these entities.

The protection of the DTIB not only has a price tag, therefore, it also has to balance various considerations based on the multiple effects of different forms of protection. Paradoxically, efforts to raise competitiveness, both through demand and supply-side measures, may actually lead to a decrease in competitiveness, and protection via restricted ownership may also reduce competitiveness and thus increase the need for further protection.

During the last two decades or so, European governments have moved away from ownership of defence entities. Support through market measures has also decreased, although it remains important in most European countries. In respect of the most important instruments of control over DTIBs exercised by EU governments, namely demand-side and regulatory measures, there has been less change.

4. Protecting of domestic companies from foreign ownership

EU Member State governments have regularly exercised control over their national DTIBs using various instruments mentioned above (see Appendix 2). As a general rule, the larger and economically more important the DTIB in the country, the stronger is the level and intensity of government intervention. The UK presents a partial exception to that rule. Beginning with the 1980s ('Levene reforms'), the UK adopted a hand-offs approach to defence production. However, this did not mean that the UK government did not interfere in particular instances. For example, it sought to procure British helicopters in the mid-1980s despite their lower performance compared to a US competitor. It also did not abolish its policy of holding 'golden shares' in major defence companies, which give it the right to veto foreign ownership. Furthermore, in December 2005 the UK adopted a defence industrial policy that emphasizes:

"In general it is better to use levers that influence the environment or the way we in general interact with it, rather than case-by-case specific interventions; this is more beneficial to all parties and limits the risk of unintended consequences"¹¹.

At the same time it acknowledges that

"On occasion, governments may need to exploit levers more concerned with controlling or restraining parts of industry to ensure access to, or control over, key IPR [intellectual property rights], capability and capacity."

Such interventions can be aimed at further enabling a government's ability to...

"...stimulate the overall health of the defence industry by reducing barriers to entry, encouraging participation, stimulating industry investment and stimulating technology transfer from international defence sources of adjacent industrial sectors; guarantee access to and control over critical technologies and capabilities where these underpin critical military capability and operational sovereignty."

Table 4 illustrates the 'upper end' of those instruments that are available for protection (see also Appendix 2) i.e. legal provisions in cases of attempted foreign company takeovers. Although these provisions have seldom been used, this does not mean they are 'toothless'. Rather they act as deterrents for any foreign companies that might see a chance of acquiring a government permit to purchase a national company. They can also be combined with other instruments to add to the overall deterrent effect.

Table 4: Legal restrictions relevant to defence equity acquisition by foreigners

| | France | Germany | UK |
|-----------------------------|--|---|---|
| Legal base | Décret No. 2003-196, Titre III, Article 7 | Foreign Trade and Payments Act, § 7 (1), (2) | Enterprise Act, Sections 42, 45, 58, 59 |
| Threshold | 25 per cent of voting rights | 33 per cent of shares or voting rights | No explicit threshold |
| Institution involved | Ministries of Economics and Finance, Foreign and Defence | Ministries of Economics, Finance, and Defence | Office of Fair Trade, Ministries of Economics and Defence |

Source: Kuechle, 2004; p. 113, based on information from German Ministry of Defence

¹¹ *Ibid.*, p.32.

Thus, while the number of cases where European governments have formally or informally stopped attempts by foreign investors to buy European arms producers has remained low, major EU member states have created their own legal frameworks to be able to do so, if necessary. The last major country to do so was Germany in 2003. Initiated by the fear that the submarine shipbuilder HDW could be bought up by a competing shipyard from the US, the German government proposed, and its parliament passed into law, an amendment to the 'Foreign Trade and Payments' Act which gives the government the power to veto the foreign acquisition of what it considers to be strategic production assets.

5. The notion of a 'European Defence Company' and protection of the EDTIB

National protection of indigenous defence industrial capacities is increasingly out of step with political and industrial reality. EU member states have agreed, within ESDP, to create a strong EDTIB. Beyond such political statements, the industrial reality is that some of the most important providers of defence technology in Europe have become international, or even global, in terms of market share as well as production base. Major examples are EADS, Thales and MBDA.

These, and other, companies have outgrown national DTIB control. Because they operate key production facilities in several European countries, national efforts to control them are doomed to fail, and may also lead to inefficiencies. Indeed, Europe is full of examples of production arrangements that result in additional costs because governments insist on protecting national production¹².

6. Initiatives relevant for the protection of the EDTIB

As mentioned in the introduction, the prospective EDTIB is challenged from two angles: First, by a lack of competitiveness because of the current fragmentation of both defence markets and the technology-generation and production base in Europe; second, by core capabilities and capacities being 'creamed off' by foreign owners. However, whereas the former challenge has received increasing attention by EU policy makers, the second one has yet to. While the recent initiatives on collection of information on defence production capacities as well as critical technology capabilities listed in Table 6 below are relevant for protection, they do not provide more than the first step towards protecting crucial parts of the prospective EDTIB from foreign control.

For some time the EU institutions have been trying to overcome the limitations of the comparatively (particularly to the US) small national defence markets and DTIBs in Europe. Thus, since the 'Klepsch Report' of 1978, the European Parliament has repeatedly and consistently called for better integration of defence production in Europe¹³. Since its inception, the Council Working Group on Armaments Policy (POLARM) has launched a number of initiatives - for instance on the standardization of defence equipment. Beginning in the mid-1990s, the Commission repeatedly suggested moving towards a single defence

¹² Kuechle, Hartmut. 2006. *The Cost of Non-Europe in the Area of Security and Defence*. Study for the European Parliament, Directorate-General for External Policies of the Union, Brussels, June 2006.

¹³ Brzoska, Michael and Peter Lock, *Restructuring of Arms Production in Western Europe*, Oxford: Oxford University Press, 1992.

market¹⁴. It made little progress, however, because of opposition from EU Member States. The Commission has been more successful in applying competition and merger law to defence companies (for instance, in the case of General Electric/Honeywell¹⁵).

Instead, Member States were more prepared to create relevant multilateral institutions, of which OCCAR (Organisation Conjointe de Coopération en matière d'Armement) and the LOI (Letter of Intent) Process leading to the Farnborough Framework Agreement of 2000 between France, Germany, Italy, Spain, Sweden and the UK are the most important (see Table 5). The latter contains a number of provisions which, when made operational, overcome barriers to better defence industrial integration (see below). However, such provisions are limited to agreed projects, and the participating states.

So far, the broader approach adopted with the creation of the EDA has produced the most promising list of initiatives for the creation of a EDTIB. Some of these have already borne fruit (see Table 5). In turn, this has allowed the Commission to be more proactive, for instance in the fields of intra-community transfer¹⁶, on procurement¹⁷, and clarification of the application of Article 296 of the Amsterdam Treaty¹⁸. However, major restraints remain, the most important of which is the continuing national prerogative over defence industrial matters¹⁹.

All of these activities primarily aim to improve the competitiveness of the EDTIB and thus avoid the first aforementioned risk i.e. to its long-term survival. Several, however, are also relevant to the second risk i.e. maintaining European control over crucial assets.

The first of these activities are the stocktaking exercises, both at the Commission and EDA. Partly overlapping, they have the potential to improve the knowledge base for developing a policy of protection from foreign control. Two of the other Commission initiatives mentioned in Table 5 - on intra-community transfer and procurement -, as well as the EDA initiatives on procurement, are of potential importance, as they aim at strengthening the *European* DTIB. It is hard to see how this could be possible without a policy for the protection of crucial assets. To quote again from the Statement of the EDA Steering Board of May 2007:

“We do not envision this EDTIB of the future as a “fortress Europe”, excluding imports from, or cooperation with, overseas defence industries. But we recognise that the problem of accessing the US defence market, and of establishing balanced technology exchange across

¹⁴ Commission of the European Communities, 1996, *The challenges facing the European defence-related industry, a contribution for action at European level*. Communication COM (1996)10, Brussels, 24 January,

¹⁵ Commission of the European Communities, 2001, *Commission Decision of 03/07/2001 declaring a concentration to be incompatible with the common market and the EEA Agreement Case No COMP/M.2220 General Electric/Honeywell*. Brussels, July 2001.

¹⁶ UNISYS. 2007. *Intra-Community Transfers of Defence Products Impact Assessment Final Report of the study “Analysis of the impact of a proposal for intra- Community transfers of Defence products”, carried out by Unisys for the European Commission*. Brussels, February 2007,

¹⁷ Commission of the European Communities, 2005, *Communication from the Commission to the Council and the European Parliament on the results of the consultation launched by the Green Paper on Defence Procurement and on the future Commission initiatives* Brussels, COM(2005)626, 6 December.

¹⁸ Commission of the European Communities, 2006, *Interpretative Communication on the application of Article 296 of the Treaty in the field of defence procurement, Impact assessment summary, COM(2006) 779 final*, Brussels, 7 December.

¹⁹ Kuechle, Hartmut, op.cit.

the Atlantic, make it natural and necessary for Europeans to cooperate more closely to ensure the future of their own DTIB²⁰.”

However, both Commission and EDA have so far not drawn the logical consequence flowing from these activities and policy statements, namely: that activities to improve competitiveness need to be balanced by policies and instruments that protect crucial assets (if the objective really is to nurture a *European* DTIB). Without such balance, the aforementioned activities by the Commission and EDA run the danger of improving the attractiveness of European defence technology-generation and production assets for foreign investors and owners. As argued above, this, in turn, produces the risks of a loss of control over these assets in times of crisis, technology tapping and entities being relocated.

A similar problem afflicts an additional set of activities, those aimed at achieving security of supply by the EDA and in the LOI Framework. The EDA's Framework Arrangement for Security of Supply²¹ is designed for crises, but lacks a preventive dimension i.e. there are no provisions for ensuring that participating states are in a position to ensure the security of supply in crises. The LOI Framework Agreement also has no such provisions. In both cases, participating states are left to themselves to decide whether or not to adopt policies that protect crucial assets. This approach is not consistent with the general agreed direction towards achieving a truly EDTIB, rather than simply a collection of European national DTIBs.

²⁰ Steering Board of the EDA, op. cit., p. 2

²¹ Steering Board of the European Defence Agency, 2006c, Framework Arrangement for Security of Supply Between Subscribing Member States (sMS) in Circumstance of Operational Urgency, Brussels, 20 September 2006.

Table 5: Overview over activities relevant for the protection of the protection of defence technology-generation and production capacities

| | Objective | Drivers | Main initiatives/achievements |
|------------------------------|--|-------------------------|---|
| Supply side | | | |
| | Standardization of defence equipment | POLARM, Commission, EDA | Studies, conferences |
| | Liberalisation of intra-community transfers | LOI, Commission | Framework Agreement (LOI), UNISYS study and consultation process |
| | Harmonization of EU company law | Commission | Council Regulation (EC) No 2157/2001 of 8 October 2001 |
| | Liberalisation of co-production procedures ('juste retour', offsets, secrecy provisions) | OCCAR, LOI, EDA | Framework Agreement, OCCAR agreements |
| | Security of supply | LOI, EDA | Framework Agreement (LOI), Framework Arrangement for Security of Supply between subscribing Member States in circumstances of Operational Urgency (EDA) |
| | Improvements to supply chain management | EDA | Code of Best Practice in the Supply Chain |
| Demand side | | | |
| | Harmonizing and liberalising procurement | Community, EDA | 'Green Paper on Defence Procurement' Process Code of Conduct on Defence Procurement |
| | Prioritising capability needs | EDA | Document "An initiation Long-Term Vision for European defence capability and capacity needs" |
| | Planning for ESDP requirements | EDA | Capability Development Plan (2007 project) |
| | Harmonization of export regulations | Council, Commission | EU Code of Conduct for Arms Transfers, EU dual-use regulation (EC) No 13334/2000 |
| | Initiating joint research programs | EDA | Joint Investment Program on Force Protection, Software Defined Radio |
| | | | |
| Information gathering | | | |
| | Identifying key technologies | EDA | Initial work (studies) under way at EDA |
| | Identifying key industrial capacities | Commission, EDA | Inventories of defence industrial capacities under way at Commission and EDA |

7. Policy recommendations

On political and economic grounds there are strong arguments in favour of developing policy and instruments for the protection of crucial elements of the emerging EDTIB. While an increasing number of cautious activities for nurturing a European approach to defence technology-generation and production capabilities in Europe are apparent, there are no similar initiatives for protecting these capabilities from foreign control or ownership on the European level. Because of the double risk of losing out on competitiveness and of European control, the current focus on improving competitiveness should be balanced by the development of a policy and instruments for protection of crucial assets. Current activities by the Commission and the EDA lack a clear recognition of the need for such a balance.

Some lessons for the development of a European policy on the protection of defence technology-generation and production can be drawn from national experiences. Central elements of such a policy should include:

- a statement of purpose;
- a proper legal foundation;
- the identification of those capacities that should be protected; and
- a decision-making body or procedure.

Among these four elements, the only one that is currently being addressed is the identification of those capacities and capabilities that are seen as necessary for ESDP. What is particularly lacking - although it is implied in a good number of documents, including recent statements by the EDA Steering Board - is a statement of purpose. Even though all major member states have such policies, a *European* policy of protecting crucial defence technology-generation and production assets is only likely to come about after a lengthy discussion process.

The European Parliament could take the initiative to stimulate the initiation of a European policy of protection of crucial defence technology-generation and production assets. It would probably find support in the Commission but resistance among member states as well as major defence companies. The reasons for such resistance are varied, ranging from a reluctance to have defence industrial issues treated at supranational institutions, to objections in principle against protecting industrial assets from foreign control.

Such an initiative could include the following steps:

- Stimulate debate on the principles of protection of defence technology-generation and production assets in Europe, for instance through hearings and further reports.
- Request the EDA and the Commission to be more transparent about, and debate the outcome of, their current initiatives to map existing capabilities and capacities in Europe.
- Follow-up the EDA's decision to initiate discussion on the identification of crucial defence technology-generation and production assets.
- Recommend to the Commission and/or EDA to commission studies on how such protection could be fitted within the EU legal framework.

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Appendix 1: Acquisitions of European arms producing companies by companies from outside the EU, 2001-2005

| Year | Buyer | Acquired company | Seller | Value (in US \$m) |
|------|------------------------------------|-----------------------------------|--------------------------|-------------------|
| 2005 | Carlyle Group (USA) | NP Aerospace (UK) | Reinhold Industries (UK) | 54 |
| 2005 | Eaton Corporation (USA) | Aerospace fluid and air division | Cobham (UK) | 270 |
| 2005 | L-3 Communications (USA) | SAM Electronics (Germany) | .. | 150 |
| 2005 | Lockheed Martin (USA) ^l | INSYS Group Limited (UK) | ... | . |
| 2005 | Rockwell Collins (USA) | Teldix (Germany) | Northrop Grumman (USA) | 22 |
| 2005 | Stevenson Services (USA) | Stewart & Automotive Technik (UK) | | 47 |
| 2004 | Ceradyne (USA) | Wacker Ceramics (Germany) | .. | 136 |
| 2004 | J. F. Lehman & Co. (USA) | Thales Acoustics (UK) | Thales (France) | .. |
| 2004 | Lockheed Martin (USA) | STASYS Limited (UK) | ... | . |
| 2004 | MSA (USA) | Sordin (Sweden) | .. | .. |
| 2003 | The Carlyle Group (USA) | Fiat Avio (ITA) | Fiat (ITA) | 1 695 |
| 2003 | General Dynamics (USA) | Steyr Spezialfahrzeug (AST) | SSF-Holding (AST) | |
| 2003 | Kohlberg Kravis (USA) | MTU Aero Engines (FRG) | DaimlerChrysler (FRG) | 1770 |
| 2003 | United Technologies (USA) | Chubb (UK) | .. | 1 000 |
| 2002 | Carlyle Group (USA) ^f | QinetiQ (UK) | UK Government □ | 220 |
| 2002 | Herley Industries (USA) | EW Simulation (UK) | | |
| 2002 | Kaman (USA) ^a | RWG Frankenjura (FRG) | Privately owned | .. |
| 2002 | One Equity Partners (USA) | HDW (FRG) | Babcock Borsig (FRG) | |
| 2001 | CAE (CAN) | Unit of BAE Systems UK | BAE | |
| 2001 | Carlyle Group (USA) | Unit of BAE Systems UK | BAE | |
| 2001 | FLIR Systems (USA) | Unit of Saab Tech Elecs SWE | Shareholders | |
| 2001 | General Dynamics (USA) | Santa Barbara SPA | Spain gov. | |

Source: SIPRI website, http://www.sipri.org/contents/milap/milex/aprod/m_and_a_iv.html

Appendix 2: Select Internet Information on Defence Business Opportunities by the US Department of Commerce, Bureau of Industry and Security

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|-----------------------|--|
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| Austria | Privatization policy: Austria has an ambitious privatization program that is largely open to foreign investors. Although there is a policy of maintaining Austrian controlling interest over banks and basic. The government of Austria generally welcomes all foreign direct investment. |
| Denmark | Danish defence companies are privately owned. Thus, there are no "privatization" opportunities. While defence contracts may play an important role for some firms, most Danish companies producing defence products are generally not focused solely on production for the defence sector. There are no known restrictions on foreign competition, with the notable exception of shipbuilding and some instances of low-complexity or low-value contracts when Danish suppliers can meet the requirement. |
| Finland | The Finnish defence industry is in the process of a major restructuring. As the civilian industrial sector moved deeper into privatization, defence industries remained under government control. ...only Finnish nationals may invest in sectors involved with the production or delivery of national security related items. Other restrictions are retained in certain sectors involving safety or health hazards... |
| Hungary | The defence industry, however, is handled as a special group within this privatization program. In 1995, there were about 60 companies in the defence related industry. In most cases, the government retains partial ownership, with share holdings ranging from 25 percent to 50 percent plus one vote. |
| Italy | The Italian defence industry is largely government-owned, but is moving toward privatization. Expectations are that the entire Italian defence industry will be privatized by the end of the century. The development and retention of key technical skills, both military and civilian, is a high priority in Italian defence planning. |
| Netherlands | There are few commercial opportunities in the Netherlands associated with privatization of defence industries, as virtually all Dutch manufacturers of defence equipment are privately controlled and the Dutch Government has withdrawn most of its ownership stakes in the aerospace company Fokker, and its subsidy support for the truck manufacturer DAF. |
| Portugal | The domestic defence industry consists primarily of state owned manufacturing firms and several private firms... The Portuguese Privatization Program, now into its eighth year, has been an unqualified success. Forty six companies have been partially or fully privatized. A simple post facto registration regime for foreign investment took effect in Portugal as of December 4, 1995. |
| Spain | The Government has given high priority to the privatization of its interests in the public sector which may present opportunities for US companies. The government has identified which state-owned companies in Spain can be privatized and the specific approach needed for privatization. It is understood that the plan is to privatize most of the state-owned companies within the next four years. Under existing regulations, foreign companies cannot acquire more than 25 per cent interest in any Spanish defence industry company without Government approval, on a case-by case basis, of an equity interest of up to 49 per cent. Joint ventures in the defence sector require approval by the Government. |
| United Kingdom | Despite severe budgetary pressures, the UK government does not have a formal policy to protect its core defence industrial base. (...) Senior UK MOD officials have, however, indicated that certain sectors of the defence industrial base (aerospace, tanks, shipbuilding and nuclear technology) will not be allowed to perish. |

Source:

<http://www.bis.doc.gov/DefenceIndustrialBasePrograms/OSIES/ExportMarketGuides/EuropeanMktGuideIndex.html>