

Opening the US Defence Market

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Introduction

Many European defence companies aspire to gain access to the US defence market.¹ America has the largest defence budget in the world – some \$280 billion, or 3.3 per cent of GDP in 2000 – and is the source of much of the world’s most advanced defence technology.² In contrast, the defence budgets of the EU countries, at approximately \$145 billion, are only 1.8 per cent of GDP. America’s defence budget, like that of most EU countries, fell rapidly during 1990s. But in recent years, unlike the European budgets, it has risen again.

Europe’s defence companies can no longer rely on domestic orders to maintain a defence industrial base. With the Asian economies still recovering from the financial crises of 1997, the United States has become the principal target of Europe’s defence companies. But for the most part, the US defence market is closed to European companies. No foreign company has yet acquired or merged with a major US prime contractor.

Rapid, wide-ranging consolidation of the global defence industry in the past decade has left only four big aerospace prime contractors in the US³ and just three defence giants in Europe.⁴ The risk of this consolidation is that rival “fortresses” on either side of the Atlantic could emerge, with companies on one side excluded from competing for contracts on the other.

The only constructive solution that would maintain genuine competition would be transatlantic tie-ups: mergers, acquisitions or teaming arrangements in which Americans and Europeans co-operate. This is a strategy favoured by many European defence industrialists. However, the protectionism of the US government and its reluctance to allow the opening up of its defence market is a major obstacle to transatlantic alliances. The Europeans, of course, have their own protectionist instincts. But because the European industry remains smaller and, in some key areas, less technologically advanced, it has a more evident self-interest in working with the Americans than vice versa.

In fact, transatlantic alliances have myriad potential benefits for the US Department of Defense (DoD) – most significantly, increased access to the European market for exports of American equipment. But such benefits are unattainable unless the US government and Congress remove many of the buttresses of what is, virtually, a Fortress America.

In 1999 there were real hopes that the Department of Defense (DoD) would attempt to open up the US market. But the American government remains largely unwilling to do so. This is not just because of simple protectionism. The government has serious concerns about the risks of technology transfer to European countries, and it is keen to protect its technological superiority.

1 The author would like to thank all the members of the Centre for European Reform’s Defence Industry Working Group, as well as Lucy Reilly Fitch, Paul Gebhard, Charles Grant, Alasdair Murray and Kori Schake for their assistance and comments in the drafting of this working paper.

2 The Military Balance, IISS, 1999.

3 Boeing, Lockheed Martin, Raytheon and Northrop Grumman.

4 BAE Systems, EADS and Thomson-CSF.

Some efforts to open the US defence market were made in 2000. But the Declaration of Principles signed in February by Britain and America was a statement of intent rather than a concrete pledge by the US to open up its defence market. In May 2000, US Secretary of State Madeleine Albright announced the Defense Trade Security Initiative (DTSI), a moderate liberalisation of the tight US export controls. The initiative, however, has serious limitations: it only relates to unclassified technologies and to date only affects the UK, Australia and Japan. This is a source of tension between Britain and its European partners, many of which – jealous of the US-UK “special relationship” – feel they are treated as inferior states by the US government.

Unless the US government is prepared to open up its defence market, America’s ability to exploit cutting-edge commercial technology could suffer. Global commercial suppliers may become unwilling to offer their products to the Department of Defense, if the procurement system remains so restrictive. The US domestic defence industry would then suffer from reduced competition. Europeans and Americans need to build a truly transatlantic defence industry in order to prevent huge strains in the security relationship which has bound them together in NATO for over 50 years.

This paper examines the key issues hindering the opening of the US defence market – in particular the roles of the different branches of the US government. After reviewing consolidation in Europe over the past two years, it compares the experiences of US companies competing in the European market with European companies’ successes in America. The paper assesses the legitimacy of the Europeans’ complaint that defence trade across the Atlantic is very much a one-way street. It studies the processes by which the US government controls defence exports and access to US technology, and asks what the government can do to encourage the building of transatlantic bridges.

The paper analyses the two recent attempts by the US government to allow greater access to its defence market — the Declaration of Principles and the DTSI. It also evaluates recent and current transatlantic programmes. In conclusion, the paper reaffirms the importance of transatlantic industrial tie-ups to stimulate competition and encourage globalisation. However, it concludes that unless the US government makes a greater effort to reform its export control and technology transfer legislation, the US defence market will remain closed to European defence companies.

Opponents of transatlantic defence industrial co-operation

Some US industrialists argue that transatlantic defence tie-ups are irrelevant. They believe that a transatlantic defence base is a political rather than an economic goal, and that mergers between prime contractors will not solve the key problems facing the industry. American companies, such as Lockheed Martin, want access to the European market, but there is no guarantee that they would get it by merging with a European prime contractor. Those opposed to transatlantic co-operation also claim that with the existing (and increasing) technology gap between the US and Europe, there is little that merged transatlantic companies could actually do together.

These American industrialists further argue that the lack of obvious cost savings would ensure stock market opposition to any such merger – and for the US industry, the attitude of Wall Street is crucial. Lockheed Martin and Raytheon, in particular, have seen their share values plummet over the past 12 months; investors have realised that recent defence consolidation has created huge problems of indigestion. These two companies are now technically vulnerable to a foreign takeover bid, despite their huge size and large order-books. In practice, of course, the US government would not allow this to happen. In any major transatlantic merger, the US would have to be the senior partner.

The benefits of transatlantic defence industry co-operation

It is not just Europe that would gain from closer links with the US defence industry. Transatlantic defence industrial co-operation would also benefit America, and the DoD in particular.⁵ The US would gain greater access to European technology, capital and skilled labour. Higher levels of joint R&D would allow greater and faster modernisation of both the American and European defence industries. Transatlantic links would also ensure genuine competition.

The only alternative would be the creation of Fortress Europe and Fortress America. But this scenario would lead in the short term to EU companies falling further behind. This, in turn, could weaken NATO and the Common European Security and Defence Policy (CESDP). Even though America is capable of acting unilaterally in the military field, it usually prefers to act in coalition with its allies. And that could become virtually impossible without sufficient inter-operability of forces and equipment. A strong transatlantic defence industrial base may help to achieve interoperability. Furthermore, if American firms had a greater presence in Europe they would have a better chance of influencing European procurement rules.

There are, however, risks associated with cross-border technology transfer and defence industrial integration. In the most extreme cases, classified technology could be lost through espionage, or end up in the hand of so-called “rogue states” such as Iran or Iraq. But as far as America’s national interest is concerned, the above-mentioned benefits clearly outweigh these risks.

Recent European consolidation

The pattern of recent defence industrial consolidation in Europe will influence potential transatlantic teaming arrangements. This is because the takeover of Marconi Electronic Systems by British Aerospace (BAE) in January 1999, and the subsequent creation of the European Aeronautic Defence and Space Company (EADS), laid the foundations for the building of transatlantic bridges, rather than the creation of a single European mega-firm.⁶

BAE’s announcement was greeted with bitter disappointment by other European defence companies, particularly DaimlerChrysler Aerospace (Dasa), whose executives believed they were on the verge of securing a deal with BAE. They felt that the chance of creating a pan-European aerospace and defence company which included the British had been lost, for the new UK-based group would be so much larger than its partners.

BAE’s move highlighted the fact that defence industry restructuring in Europe is led predominantly by industry, rather than by governments. Prime Minister Tony Blair had indicated that he, like Dasa, would have preferred a European, rather than a national merger, yet BAE decided to follow its own course. By effectively ruling itself out of involvement in a pan-European company, BAE now has little choice but to look across the Atlantic for future partners.

In contrast, recent defence mergers in continental Europe have taken place across national borders. The European Aeronautic, Defence and Space Company (EADS) was formed in October 1999 through the merger of Germany’s Dasa and Aérospatiale-Matra, itself the recent product of consolidation within the French defence industry. The new group has an important toe-hold in the Spanish market due to an earlier tie-

⁵ See the Final Report of the Defense Science Board Task Force on Globalisation and Security, published in December 1999.

⁶ Until December 1999, when the company was renamed as BAE systems, British Aerospace employed BAe as its abbreviation.

up between Dasa and Construcciones Aeronauticas and in April 2000 signed a joint-venture deal with Alenia Aerospazio, the aerospace division of the Italian firm Finmeccanica. While EADS is now the largest aerospace company in Europe, it cannot yet compete in terms of defence sales with the merged BAE and Marconi (renamed BAE Systems in December 1999). But EADS' major asset is a controlling stake in Airbus.⁷

In January 2000 the French firm Thomson-CSF announced its intention to acquire the British company Racal. This deal not only made Thomson-CSF the second largest defence company in the UK, but also offered the French valuable access to the American defence market (see below).

However, the existence of these European multinational joint ventures has created serious problems for the parent companies when they have tried to access the US defence market, or build closer transatlantic relationships. For the US government still prefers to deal with European countries – and companies – on a bilateral basis.

European successes in the US market

A major difficulty for would-be exporters on either side of the Atlantic is the inherent tendency of governments to support domestic defence industries. Governments are relaxed about the globalisation of other industries, such as pharmaceuticals, but still see defence as a special case – a source of national pride, and part of a distinct national identity.⁸ Despite this, the Americans have managed to penetrate the European market (see below), thanks to their significant technological and cost advantages over the Europeans. In marked contrast, the Europeans have had only limited success in America. BAE, Thomson-CSF, EADS and Rolls Royce are among the few companies active in the US.

Even the fiercest critics of BAE's takeover of Marconi Electronic Systems concede that BAE's real gain was Tracor, a medium-sized electronics firm acquired by GEC-Marconi in 1997. With over 10,000 employees, Tracor is, to date, the largest European acquisition in the US.

GEC had to employ a "proxy board" to run Tracor. A proxy board is a mechanism unique to the US: it is a group composed entirely of American citizens which oversees the day-to-day running of a company. Unlike other European companies, such as Dasa, which resent outsiders running their US operations, both GEC and BAE are less concerned about this. GEC accepted that it would never be allowed access to the many "black" (highly classified) programmes run by Tracor, but felt that the foothold it gained in the United States more than made up for the inconvenience of the proxy board.

In 2000, BAE further increased its presence in the US. In April it purchased Lockheed Martin Control Systems, a division of Lockheed Martin that produces flight controls for the Boeing C-17, among other aircraft; and in July it announced the acquisition of Lockheed Martin's Aerospace Electronics Business, which supplies parts for the highly sensitive F-22 fighter. As a result, BAE now has over 25,000 employees in the US. Such a significant presence stands BAE in good stead for future teaming arrangements with American firms, such as Boeing.

The French company Thomson-CSF has been active in the US market since the mid-1980s, when it won a contract to supply a radio network to the US army. This is particularly surprising because the Franco-American defence industrial relationship –

⁷ EADS now controls 80 per cent of Airbus, compared with BAE Systems' 20 per cent.

⁸ See *Europe's defence industry: a transatlantic future?* (CER, 1999).

built on mutual suspicion and antipathy – is not always the smoothest. The takeover of the British company Racal can only improve Thomson-CSF's standing in the US. The French firm will probably now use its British flag when operating in the US and thereby surmount some of the security restrictions that are tighter for non-British firms.

Thomson-CSF is currently number three in the world in defence electronics. To retain that position, it needs access to the US market. Its current – and arguably very successful – strategy is to create teaming arrangements with American firms on co-operative programmes, rather than trying to merge with them. Thomson-CSF now runs over 40 different transatlantic programmes. It tends to link with small companies in need of its technology, although perhaps the most successful partnership to date is with Raytheon. In 1999 the two companies co-operated on a programme to supply NATO's air defence system.

Thomson-CSF has succeeded in the US by demonstrating that its employees are “good citizens”, supporting US activities, and scrupulous in all matters relating to classified information. The company's Washington DC spokesman, who is French, suggests that he is the “acceptable face of France” in the US. Thomson-CSF's reward for “good citizenship” is that the US government has replaced the proxy boards on some of its US acquisitions and joint ventures with “Special Security Agreements” (SSAs).

A Special Security Arrangement creates a board composed of US nationals and citizens of the country of the parent company. For example, the board of Thomson Training Systems – which works on the F-16 simulator – includes two American citizens and two French Thomson-CSF employees. When the board discusses issues with possible national security implications, the French are excluded. Thomson-CSF is less concerned about SSAs than the time the US government takes to process export licensing agreements – up to five months in some cases.

EADS recently agreed a strategic alliance with Northrop Grumman, covering surveillance and reconnaissance equipment. The two firms will also work together on the weather radar for the A400M transport aircraft. A full merger between the two companies, however, is unlikely. The Dasa wing of EADS pulled out of earlier talks in 1999, complaining that US government restrictions on export controls, technology transfer and the requirement for a proxy board were too onerous. This is not the first time that Dasa has run into problems with US regulatory practice. Earlier in the 1990s, Dasa sold CMS, its small ordnance US subsidiary, in part because of resentment over the proxy board requirement.

In recent times the DoD and State Department have suspected that technology transferred from the US to Germany has sometimes ended up in the hands of “rogue” states. But a major hurdle to US-German co-operation was removed when Dasa's parent company, the automotive giant Daimler-Benz, merged with the American car firm Chrysler in 1998. This deal was beneficial for Dasa: in 1999, it was able to sell 62 armoured Mercedes vehicles to the Marine Corps, and there are high hopes for significant follow-up orders.

But the creation of the US-German conglomerate may not necessarily have long-term benefits for Dasa, now that the aerospace division is part of the Franco-German company EADS. The French link may well be detrimental to EADS' US ambitions, although EADS maintains that it is committed to increasing its presence in the US market. EADS has sold civilian helicopters through Eurocopter, aircraft from Airbus and Ariane space launchers to the US. But there have been no military sales to date.

One area where Europe has been able to penetrate the US market is the engine sector, partly because engine technology is less sensitive than other defence technologies, and partly because it is an area in which the US is not vastly superior to Europe.

Transatlantic links date back to 1974, when General Electric (GE) allied itself with the French firm Snecma. In response, Rolls Royce teamed up with Pratt & Whitney (P&W), so that there were two competing transatlantic teams. P&W has also partnered the German engine-maker MTU.

Rolls Royce's takeover of Allison Engine Co. in 1995 "sparked a creation of security requirements that were unprecedented in the extent of control to be exercised over both classified technology and unclassified export-controlled technology".⁹ In a radical step in April 2000, however, the DoD announced that it was lifting the proxy board requirement for Allison, replacing it with a more flexible SSA. While this is a positive move by the DoD, it remains to be seen whether SSAs will replace proxy boards on a more widespread basis.

Rolls Royce is probably the best example of effective European penetration of the US defence market. American firms were unwilling to invest in Allison. Rolls Royce was prepared to pay a premium for the company and preserve American jobs and technology. In some aspects of the aero-engine business, however, the British technology was superior to that of the US. Rolls Royce moved many Allison employees into the UK commercial engine division. The company sensibly uses American employees to lobby the US government. Rolls Royce's experience suggests that in order to succeed in the US, European firms need to build businesses there, and to employ Americans in senior positions.

US successes in the European market

Compared with Europe's limited experience in America, the US has had little difficulty in penetrating the European defence market, not only through exports but also through licensed production. F-18 fighter aircraft, Apache and Chinook helicopters, C-130 Hercules transport aircraft, Tomahawk cruise missiles and Patriot and Stinger surface-to-air missiles, are just some examples of US products that European countries have acquired in the past five years. Even the French have bought US early-warning aircraft.

In the absence of an up-to-date European alternative, many European countries fly US transport aircraft. In 2000, eight European countries are reconsidering their air transport requirements.¹⁰ With the European alternative, the Airbus A400M, still lacking budgetary funds, other European states are likely to follow the British example and lease either Boeing C-17 "Globemasters" or the Lockheed Martin C-130J to fulfil their immediate needs.

The US is also dominant in the airborne ground surveillance sector. In 1999 the American firm Raytheon secured an \$800m contract to supply the UK with ASTOR – an airborne ground surveillance radar. However, the company was unsuccessful in the hotly-contested competition to supply beyond-visual-range missiles for the Eurofighter (see below), where it lost out to its European rival. Nonetheless, that is a small setback for the US, which has an excellent record of equipment sales to Europe. The widespread acquisition of US defence equipment by European countries reinforces the Europeans' belief that trade across the Atlantic is mostly a one-way street, and that American protectionism is preventing reciprocal access for European companies.

⁹ *Defense News*, 10th January 2000.

¹⁰ The countries in need of air transport are Belgium, France, Germany, Great Britain, Italy, Luxembourg, Spain and Turkey.

Obstacles to opening the US defence market

Europe – as seen from Washington DC

Despite some European defence companies managing to gain limited access to the American market, the predominant view of the US government is that closer transatlantic defence industrial relations are unlikely for the time being. America is concerned about the security implications of technology transfer that would be a concomitant of such tie-ups. The US wants to protect its technology from falling into the wrong hands.

Many government officials perceive that Europe (en masse) has lax export security controls. They fear that technology would end up in Iraq, Iran or Libya.¹¹ In theory, Europeans, especially the British, French and Germans, have rigorous technology transfer controls. But a senior figure in the US Department of Commerce notes that not all EU countries have the same laws, and nor do they enforce them with the same degree of competence.

Europe's sometimes different approach to foreign policy has also made closer co-operation harder to achieve. Crucially, different European states have varying perspectives on which countries should be traded with and which should be classified as "rogue" nations. French defence industrialists, in particular, are well aware of the problems these differences can cause. They admit freely that French foreign policy – especially in the Arabian Gulf – is sometimes at odds with British or American thinking. A convergence of foreign policy in Europe would undoubtedly boost the chances of increased transatlantic co-operation.

In recent years, the US has made its perceptions of different European states very clear. In 1998, speaking off the cuff – but alas for him, not off the record – the then deputy defense secretary, John Hamre, classified trading partners of the US into three groups: A, B and C. Group A included Britain and Norway, B took in France and Germany and C was reserved for Russia and China. That distinction, even though it was never official policy, still permeates DoD thinking.

This "ABC" mentality is a real hindrance to closer transatlantic industrial relations. This is principally because – especially at prime contractor level – there are no longer national champions in Europe. The DoD may agree to do business with BAE Systems, which it views as a British company, but how does it handle BAE's joint venture with France, Matra BAE Dynamics, or the fact that it owns 49 per cent of the German STN Atlas Elektronik, and 50 per cent of the Anglo-Italian joint venture, Alenia Marconi Systems?

The creation of EADS is a further cause for concern for the US, especially since it involves France. The DoD is particularly worried about the allegations of French industrial espionage in the US. While the French in Washington are working hard to portray a better image of themselves, it is hard for them to surmount the lack of trust in the intelligence community and the political elite.

It is apparent that the lack of clear national boundaries in European defence companies makes the creation of transatlantic joint ventures extremely difficult. If Dasa, for

¹¹ These concerns were reflected in the letter of 15th March 2000 sent to Secretary of State Madeleine Albright by Senator Jesse Helms and Congressman Benjamin Gilman, which also reflected the concerns of State Department employees. Many analysts in Washington DC believe that State Department officials actually wrote the letter for Helms and Gilman to sign.

example, signs a Memorandum of Understanding (MoU) with the US, the MoU technically only covers German citizens. Dasa's non-German employees would not be covered by this MoU. They would require specific security clearances from the US. Joint ventures are further complicated by the existence of government holdings in some European defence companies. Americans often doubt that a commercial entity can function successfully if it is partially state-owned, and the security implications of state ownership cause even more difficulties. Europeans argue that the DoD and State Department have not followed the leadership of their defence companies: industry realises that the future is transnational and transatlantic, but the government departments have not adjusted to that mindset.

The US government and the International Traffic in Arms Regulations (ITAR)

The way the US government takes decisions on defence industrial issues also hinders closer transatlantic co-operation. The granting of an export licence, for example, is a decision made jointly by several government departments: the DoD and State, and in certain cases, the Department of Commerce. And overseeing all of the government departments is Congress, which ultimately has the power to veto any decision with which it does not agree.

This decision-making process is inevitably time-consuming and unwieldy: State and DoD are often at odds, with markedly different attitudes to technology transfer and the granting of export licences. Such conflicts can deter foreign defence companies from trying to access the US market. These companies are also concerned at the role of Congress. Clearly, reform of the governmental decision-making process is needed, whether or not the US market opens to foreign players.

America's government is committed to protecting its defence industry and its domestic defence market – an attitude not conducive to building transatlantic bridges. The government's philosophy is enshrined in the International Traffic in Arms Regulations (ITAR), the process by which the DoD and State Department jointly regulate international defence industrial collaboration and exports. It is little more than a mechanism for US protectionism. And without significant reform, the ITAR will actively deter the creation of stronger transatlantic defence industrial relationships.

At the end of 1998, officials at the Pentagon carried out a survey of leading defence industrialists to discover the problems faced by the defence industry on both sides of the Atlantic. Before collating the answers, the Pentagon officials had believed that the major problem faced by industry would be the issue of industrial security – confirming the US government's fear that technology would leak, directly or indirectly, to rogue nations. While that was certainly highlighted as a difficulty, the survey identified the protectionist export control and licensing procedure – the ITAR – as the overwhelming hurdle facing transatlantic defence co-operation.

The US government has traditionally used the ITAR to protect America's technological lead; now the DoD says that it wants to reform the ITAR by allowing more liberal arrangements. Canada is already exempt from most ITAR provisions. The Defense Trade Security Initiative announced in May 2000 indicated that Australia and the UK are candidates for an ITAR waiver.

British Ministry of Defence (MoD) officials, however, are concerned about the implications of such a waiver. They believe that the US will expect the UK to harmonise its export rules in line with American principles, thus causing tension among the EU countries. While the UK MoD supports the opening of the transatlantic market, a senior MoD official notes that the ministry is less enthusiastic about "subscribing to this American vision of the world".

The ITAR governs the US Munitions List (USML). This describes many thousands of components – including non-lethal products and civilian products adapted for military use, such as mechanical and electrical parts – as “inherently military”. Anything that is “inherently military” requires a licence. Much of the technology on the list is now obsolete (especially anything in the computer sector) or is widely available commercially and therefore should not require an export licence.

These severe licensing requirements could deter American commercial suppliers from offering their technology to the DoD. The US risks losing its competitive edge in the global defence market if it cannot benefit from low-cost technology available on the commercial market. But despite ambitious Pentagon plans to shorten the list and speed up the licensing process, the Munitions List is controlled by the State Department, and is therefore likely to remain unchanged.

For many years, the State Department has used export controls as a tool of US foreign policy. When considering export licenses, the State Department has to take into account its two official responsibilities: national security and foreign policy. The State Department is the traditional point of entry into the US for foreign companies, and it works together with the DoD to safeguard America’s defence technology and thereby protect the perceived national interest. The ongoing battle over export controls highlights the tension between the DoD and the State Department, perhaps more than any other single issue.

Some State Department officials see the DoD’s new attitude as a direct critique of their department’s policy. They also suspect that the DoD is challenging the State Department’s primacy in export control regulation. DoD officials counter these claims by stating that the State Department is obstructing them from increasing the flow of technology across the Atlantic. As one high-level DoD staff member put it: “when someone pulls rank on you, they are intellectually in trouble.”

The Commerce Department is also in favour of reform of the US export control process. Its senior officials want to see higher walls around fewer items on the Munitions List. They also note that applications for export licenses are almost always approved. But this claim is countered by Joel Johnson of the Aerospace Industries Association, who points out that most defence companies do not waste time applying for licences that they believe they will not get. Unlike the State Department, the Department of Commerce is more in tune with the globalisation of the defence business. For example, it is not averse to having a foreign defence company owning an American prime contractor. This would be virtually unthinkable for the State Department.

The crucial role of Congress

Concerning export controls and the transfer of defence technology, the State Department not only has to deal with the two other government departments, but also with Congress. And Congress – driven by pork-barrel politics – has an entirely different set of priorities and culture. Congress is kept informed of all defence exports and technically has the power to veto them, even if this is rarely used. Thus, as one Pentagon observer noted: “State is in fear of Congress, because of the notification requirements for all defence exports. While Congress doesn’t create formal obstacles for State and the DoD, there are plenty of informal ones.”

Congress’ role in approving or vetoing defence exports is certainly one of the biggest obstacles to transatlantic defence industry co-operation, as far as European industrialists are concerned. American industrialists insist, however, that this is a false perception. They have frequently stated that the actions of Congress should not be a deterrent to transatlantic co-operation. The Europeans fear that the US Congress could

veto an export or prohibit a joint venture if such an export or venture conflicted with American interests – and especially if it threatened US jobs. This was evident in the debate surrounding the Eurofighter missile (discussed below). There is also the so-called “Israel factor” – the Israeli lobby is particularly active in Congress and strongly opposes defence exports to those nations believed to be hostile to Israel.

A key power wielded by Congress – and the one with the greatest real impact on future transatlantic collaboration – is its control of the US defence budget. Congress can add – at its discretion – supplemental defence appropriations to the budget, as it did in 1999 when it added \$5.6 billion to the \$270 billion defence budget. But Congress can also reduce or suspend funding for particular programmes. This makes transatlantic programmes, such as MEADS or TRACER, particularly vulnerable. Congress will not ensure funding for such programmes unless it is convinced that they will serve the national interest better than a US-only alternative. Issues such as technology leaks, the complications caused by the need for export licences for foreign partners, and the protection of domestic jobs all ensure that Congress tends to look unfavourably at transatlantic co-operation.

The inefficiency of the export control and licensing process

Apart from the inter-departmental rivalry, communication between State, DoD and Commerce is a further problem which affects export controls and thus deters closer transatlantic co-operation. The three departments are only now being linked by a secure computer network. The absence of such a system had previously resulted in extra delays to an already complicated process – one of the most serious grievances of industrialists on both sides of the Atlantic. When the DoD examined the length of time it took to process export licences, it discovered that of the 28,000 licences examined in 1998 (13,000 from Commerce and 15,000 from State) many took over 2 months and the normal processing time averaged 46 days. This has caused real problems for US and European industry. In contrast, export licences in the UK take a maximum of only 20 days to process, and those which only need Department of Trade and Industry approval can be concluded within 10 days.

There are several cases when the inefficiency of the export control process could have had severe implications for international peace-enforcement operations. At the height of the Kosovo operation, for instance, the State Department took two months to approve a licence to sell 35 flares to the Italian Coast Guard, despite the fact that these flares had already been approved for sale to 30 countries and would be used for illumination in the possible rescue of NATO pilots.¹²

The inter-agency National Disclosure Process (NDP), chaired by the DoD, adds a further complication to the export control process. The NDP governs technology transfer on a government-to-government, rather than a business-to-business, basis and determines when it is appropriate to share classified information with nations acquiring American defence equipment or services. The NDP exists to ensure that classified information is only disclosed to foreign governments when there is a clearly defined advantage to the US; and that the disclosed information will be classified with the same level of security protection as in the US.

The NDP decision-making process, however, is extremely lengthy: each case takes at least 30 days to process – and more complicated ones can take up to 270 days. And decisions on the release of classified information often become entangled with the ITAR decision on the authorisation of a specific arms transfer, adding further time delays to an already lengthy procedure.

12 The Congressional testimony of John Douglass, CEO and President of the Aerospace Industries Association.

Transatlantic procurement

When it comes to procurement, the transatlantic relationship reveals a further, significant imbalance. About half of the total defence equipment bought by EU governments comes from the US. In contrast, the US only procures 3 per cent of its defence equipment from foreign suppliers. Even when the US does buy abroad, as in the case of the BAE Hawk jet trainer, the Pentagon insists on manufacture in America. Such statistics support European accusations of US protectionism and do not encourage the idea of closer transatlantic relationships. Many American policy-makers and legislators possess a straightforward belief that all foreign defence equipment is inferior to that of the US.

Current transatlantic programmes

The refusal of Congress to fund transatlantic weapons programmes not only weakens the industrial incentive for transatlantic mergers but also validates European allegations of US protectionism. Congress will only grant funding for transatlantic programmes if it is convinced that they fulfil a defined requirement for the US armed forces. Congress has little interest in the strategic and political ideals which are partly driving the current push for transatlantic defence industrial co-operation. Previous joint programmes have not succeeded because, as Hamre himself has indicated: “They were politically motivated and usually failed because they were not adequately rooted in war-fighting requirements or business logic.”¹³

One successful transatlantic programme is often overlooked by studies of transatlantic defence industrial relations. The Multi-Functional Information Distribution System electronics package, which enables the fast and secure transfer of large amounts of information, is used not only by all four US military services, but also by the Italians, Germans, French and Spaniards. But this programme is the exception, not the rule.

Two current joint programmes – MEADS, the German-Italian-US missile-defence programme and TRACER, the Anglo-US light-armed reconnaissance vehicle – are hanging in the balance. The next DoD budget allocates no money for the production phase of either programme. Congress believes that neither programme is a priority.

Furthermore, the US armed forces think that they do not need MEADS. TRACER meets a clearly-defined requirement, although the US army does not want the programme to succeed, as it believes that a similar vehicle could be produced at a lower cost solely by American companies. But if TRACER collapses owing to the withdrawal of funding by the US government, this could cause a serious strain in Anglo-American relations.

The British government has made clear to the Americans that the failure of TRACER would not only contradict the Declaration of Principles (see below), but also – more importantly – hinder future joint programmes. A letter dated July 6th 2000, from British Ambassador Sir Christopher Meyer to Senator Ted Stevens, warned the Americans that “the threat of US withdrawal from a project which is going well has already sent a sobering message on the reliability of the US as a collaborative partner”.¹⁴ The failure of TRACER would also confirm the UK government’s belief that the US army has the power and the ability to derail a programme previously agreed by its government.

The failing fortunes of both MEADS and TRACER demonstrate that joint programmes which are not only designed to meet an identified need but are also military- and

¹³ *Jane’s Defence Weekly*, 29th March 2000.

¹⁴ As quoted in *Defense News*, 11th September 2000.

industry-led are far more likely to succeed than joint programmes devised by governments for political gains. “Programmes should never be deliberately transatlantic – they should be purely competitive,” argues Gordon Adams of George Washington University.

Perhaps the most contentious transatlantic programme of recent years was the competition to arm British, German, Spanish and Italian Eurofighters with a Beyond Visual Range Air-to-Air Missile (BVRAAM). In May 2000, the British government announced its decision to choose the Meteor missile. This will strongly influence the choices made by the other European partners.

The missile selection was depicted in the media as European versus American, but BVRAAM is a significant transatlantic programme. The victor – the European joint venture Matra BAE Dynamics (MBD), teaming with Boeing – is developing an entirely new missile, Meteor. The main competitor, Raytheon, offered a modernised version of its existing air-to-air missile (ERAAMplus). Raytheon’s consortia involved European companies such as Thomson-Thorn Missile Electronics and Diehl.

A deciding factor for the UK was the fear that – despite written assurance from President Clinton – the export control issue would affect future sales of the Eurofighter. Supporters of Meteor argued that the whole *raison d’être* behind Eurofighter’s development was to ensure that Europe could not be held hostage to Congress and its export veto. Thus arming the plane with a missile that would be subject to American export controls could make Eurofighter hard to export. Many Americans, perhaps unsurprisingly, felt that the export control issue was just a ruse. A senior Pentagon official admitted that the US needs to reform its export control procedure, but he believed that the BVRAAM decision was political: “those who want insularity in Europe support Meteor...it is a political decision made by Tony Blair”.

One programme which has had – until now – a greater claim to be transatlantic is the Joint Strike Fighter programme (JSF). Both the American and British air forces have a clear requirement for new aircraft. The British need, in particular, to replace the carrier-borne Harrier. The Swedes, French, Dutch and Germans will also soon need new, modern aircraft. With an estimated value of \$220 billion, the JSF programme is the largest military aircraft programme in US history. At the present time there are two teams designing the JSF, competing on a “winner takes all” basis: one built around Lockheed Martin, the other around Boeing. As a result of its merger with Marconi, BAE Systems is an associate partner in both programmes. EADS and Dassault may also become involved.

Pentagon spokesmen emphasise that the intention is certainly for JSF to be transatlantic. But the JSF is already coming up against the hurdles typical of any multinational programme. Analysts in Europe and the US are now starting to question just how transatlantic the programme really is. Some American industrialists believe that the British contribution to the development phase is too minimal to warrant the transatlantic label, and the eventual purchase order by Britain will be too meagre to justify co-production of the aircraft. The British government has not specified exactly how many JSFs it will buy, but it is thought that the figure is approximately 120. The US government, in contrast, will order over 3,000.¹⁵

The British participants, in turn, are unhappy with the level of technology that the Americans are willing to share. And as one German industrialist put it: “If the British are unhappy at the limited access they are getting, what hope is there for other Europeans?” The JSF could well be the litmus test of whether there is a transatlantic partnership at all. The US has to decide if it is really serious about building a transatlantic fighter. Previous “transatlantic” aircraft, such as the F-104 and the F-16,

¹⁵ Jane’s Information Group.

were only built under licence in Europe; and contained no European technology. The Europeans, on the other hand, need to decide if they can commit to a substantial number of aircraft and thus justify co-production as well as co-development.

The JSF programme highlights the problems of co-development. If the Americans are not serious about developing a truly transatlantic aircraft, the Europeans may well be tempted to build their own. BAE Systems is already undertaking thorough research into the development of a future offensive air system (FOAS). Although strictly speaking FOAS is a replacement for the Tornado GR4 bomber, BAE Systems could potentially develop a fighter variant of FOAS. Such a move, however, would result inevitably in the creation of rival fortresses. A successful JSF programme, in contrast, would combine the technological strengths of the Europeans and Americans and give a boost to a transatlantic defence industry.

The Declaration of Principles and the Defense Trade Security Initiative

The Declaration of Principles

In February 2000 the British and American Defence Secretaries, Geoff Hoon and William Cohen, signed an agreement to improve the arrangements for defence equipment co-operation and trade between Britain and the US. The Declaration of Principles (DoP) covers five key areas: harmonisation of military requirements, security of information, export procedures, foreign ownership and corporate governance, and defence research. It was greeted by some industrialists as one of the most significant breakthroughs in the move towards transatlantic defence industrial co-operation. Others, however, were far more sceptical – especially employees of the State Department, who were not consulted by the DoD before the declaration was signed.

The declaration recognises the existing imbalance of the transatlantic defence industrial relationship: one of its key proposals is to take steps to ensure that UK companies doing business in the US will in future be treated no less favourably than US industry in the UK. The DoP also emphasised the need to identify areas of common interest, where co-operative procurement might be possible and where it might be feasible to harmonise the acquisition process.

The declaration aims to ease unnecessary restrictions on the movement of information or personnel between the US and UK. On the area of foreign ownership and corporate governance, the declaration states that the process should be industry-led, and that both sides should refrain from imposing unnecessary security restrictions such as proxy boards. Regarding R&D, the declaration reaffirms the intention of the US and UK to set common objectives for research, to avoid duplication and to make greater use of dual-use technology.

While the above message is, in theory, extremely positive, critics of the declaration remark that at best it has been over-hyped, and at worst it is a “waste of space”. According to Gordon Adams, the declaration handled “optical but not substantive problems”. The DoP is only an agenda for discussion and is not legally binding. And the five key areas for reform all require State Department approval.

The Declaration of Principles also omits the all-important role of Congress. The industrial element of the declaration is *passé*, as it ignores the fact that European companies are no longer strictly national. A senior British MoD official admires the visionary principles behind the declaration, but reckons that the US might be promising more than it can realistically offer. He would like to see an effective enforcement mechanism to back up the declaration.

US and French critics of the Declaration of Principles suggest that it is a ruse whereby the US can isolate the UK from its European neighbours. They believe that by creating a special, privileged relationship with certain countries, the US is seeking to undermine the Letter of Intent (LoI) on exports and procurement signed between France, Germany, Italy, Spain, Sweden and the UK in July 1998. The LoI was the start of a process that led to the signing of a Framework Agreement in July 2000.

The Framework Agreement calls for a convergence of practices, especially on security of supply, technology transfer and export controls. It also supports the harmonisation of requirements for the armed forces of the six signatories. The US is certainly wary of aspects of both the Letter of Intent and the subsequent Framework Agreement, principally because of the way exports are handled in Europe: many American government representatives believe that EU export licenses are lax. Some Defense and State Department officials also believe the LoI and Framework Agreement represent a protectionist move.

DoD staff believe that full implementation of the Declaration of Principles will require Congress-endorsed legislation, which will be hard to achieve. Yet the DoD plans to hold talks and perhaps reach similar agreements with Australia, France, Germany and other US allies. The French, in particular, are extremely enthusiastic about this prospect. But in the next few years, it seems likely that the Declaration of Principles will remain a statement of intent rather than anything more substantial.

The Defense Trade Security Initiative

The Defense Trade Security Initiative (DTSI), signed on 22 May 2000, is a far more comprehensive review of the American position on export controls than the Declaration of Principles, not least because it was drafted jointly by the DoD and State Department. This gives it the credibility which the Declaration of Principles lacked. The US government believes that the implementation of the initiative will build up a transatlantic defence industrial base, strengthen international export controls and improve interoperability within the NATO alliance.

The DTSI was designed specifically to support NATO's Defence Capabilities Initiative (DCI). The DCI was agreed upon at the April 1999 Washington summit. Its objective was to ensure the effectiveness of future NATO operations across the full spectrum of Alliance missions, by improving interoperability among allied forces. It concentrates on deployability, mobility, sustainability, logistics, and command and control.

The 17-point DTSI calls for new types of export licences. One new licensing programme aims to approve export licences within 10 days, for any technology that is needed to support the NATO DCI. Another is a 10-day embassy licensing programme, as over one quarter of all licence requests are submitted through foreign embassies located in Washington. The DTSI also encourages greater use of existing licences. These include multiple-destination licences and overseas warehousing and distribution agreements. Until now, separate licences were required for each country to which a piece of American technology was sent, and this technology could not be stored outside the US.

The most important component of the Defense Trade Security Initiative – and the only one in which President Clinton took a personal interest – was the extension of the ITAR exemption to include NATO allies, Australia and Japan. Negotiations have already started with the UK. The exemption would permit – without a licence – the permanent and temporary export, and the temporary import, of certain unclassified defence articles, technical data and defence services. But unlike the Canadian ITAR exemption, whereby all defence companies are included, the exemption would only apply to specific companies identified as reliable by the US government.

A vital component of the initiative covers the US Munitions List. The State Department and the DoD will review portions of the list annually, in an effort to ensure that its contents are up to date. The criteria for inclusion, addition or exclusion would be whether the continued control of the items contributes to the perceived foreign policy and national security interests of the USA.

The DTSI also covers the computerisation of the export licensing process. The DoD has confirmed that it will pay for the computer network that will link it with the State Department and thus speed up the transfer of information between them.

While the Defense Trade Security Initiative contains many points designed to enhance the US export control system, it has numerous weaknesses, which have already reduced its international appeal. The most significant is that the DTSI applies only to unclassified technology and equipment, thus ensuring that technology and capability gaps between the US and its allies will continue to grow. Furthermore, the initiative was designed for implementation under the existing Congressional Export Control Act, through which Congress oversees defence exports. The DTSI would have been considerably more effective if it had contained proposals to review the role of Congress itself in the export control process. Such proposals, however, would raise political and constitutional issues well beyond the scope of the DTSI reform programme.

Another major problem with the DTSI is that it still considers countries on an individual basis and does not take into account multinational ventures such as EADS, where one or more of the components making up the firm may not qualify for the more liberal licensing procedures. French and German industrialists believe that the initiative cements the UK's preferential status in the eyes of the US.

Other critics of the DTSI suggest that it is a process designed to encourage greater exports of US defence equipment at the expense of any European alternative. Lastly, the DTSI does little to tackle the problems faced by European companies operating in the US. The announcement of the Defense Trade Security Initiative is a welcome start towards building a transatlantic relationship. But the US government needs to do much more to help create a transatlantic defence industry.

The impact of the 2000 presidential election

The issue of the presidential election dominated thinking in the US government in 2000. Regardless of who is victorious, the move towards a transatlantic defence industry is likely to continue. Under Al Gore the pace might be more rapid than under George W. Bush. As Clinton's successor-designate, Gore's team should be able to hit the ground running and his advisors will keep encouraging transatlantic defence co-operation.

The attitude towards transatlantic tie-ups under Bush is harder to determine. He has to reconcile some of the traditionally unilateralist Republican attitudes with the demands of corporate, industrial America. A Bush Pentagon would probably support transatlantic programmes. But many of the Republicans in Congress are opposed to the development of a European Security and Defence Policy, which could strain the transatlantic relationship.

The make-up of Congress after the election will also influence the timetable of future transatlantic defence industrial co-operation. The Congressional leader of the Democrats, Dick Gephardt, has shown protectionist leanings. The extreme elements of both parties could hinder the move towards closer transatlantic relations. Those to the left of the Democratic party are against any level of technology transfer to foreign countries (and a number on the far left oppose defence technology altogether), while

those on the far right of the Republicans have a similar view. Aside from the extreme wings of the parties, there is a unanimous belief among analysts, industrialists and policy-makers in Washington DC that Congress will only endorse transatlantic mergers if American jobs were evidently threatened by the absence of such mergers. This is unlikely in the current economic climate.

Conclusion

In the short term, Europe's defence companies are unlikely to greatly increase their presence in the US defence market, even though that is the aim of both the American and European defence industries and the Department of Defense. The complex export control process and the reluctance of the US to transfer technology or procure equipment from Europe prohibits closer co-operation. Future mergers or teaming arrangements will require a significant reform of US export control legislation, large amounts of political good-will on both sides of the Atlantic and the success of transatlantic defence programmes such as JSF. Improved transatlantic defence industrial links would maintain competition in the defence market and at the same time help to strengthen the NATO alliance. Although some opponents of transatlantic mergers believe that they make little sense on economic grounds, the fear of Fortress Europe should be sufficiently credible to override this attitude.

The DoD is committed to reforming the export control process and thereby strengthening the transatlantic relationship. The department has redesigned the Defense Threat Reduction Agency (DTRA), which handles the DoD's export licensing procedure, so that it can field more licences in less time. In May 1999 licences took on average 60 days to process, but in April 2000 DoD staff set a target of processing licences in 15-20 days. They managed to do this by farming out some licences to relevant offices – the US Army, Navy, Air Force and National Security Agency – rather than have the Pentagon examining every license itself. The DoD has doubled the number of personnel working on export licences to 35, and the aim is to increase this to 70 by the end of 2000.

The Defense Trade Security Initiative indicated that some branches of the State Department, especially the political-military section, want to reform the American export control system. But there is still a clear need to change the mindset of the Department as a whole. The State Department has yet to fully come to terms with the post-Cold War environment and so for the foreseeable future, decisions on exports and licensing will continue to be made on a case-by-case basis rather than according to blanket criteria.

In the long term, however, those in favour of opening up the defence market face a number of problems that will be difficult to resolve, not least a hostile Congress concerned with protecting US technology and jobs. But consolidation of the American defence industry, concerns about Fortress Europe, the industrial and governmental needs to retain competition, and industry's desire to operate on both sides of the Atlantic are, in the words of a senior UK MoD official, "powerful, unsentimental reasons" for America wanting to open up the transatlantic defence market.

The US also has to reform its stance on a transatlantic defence industry in order to maintain the strength of its defence industrial base. America is no longer superior in all aspects of defence technology. Many US government officials are unaware of the military's modern-day reliance on commercial technology. While the US defence industry and the DoD's research laboratories certainly used to be the progenitors of new technology, it is now private-sector commercial companies which are taking the lead in R&D spending for future US defence equipment. In 1979, the US government used to spend more on R&D than all of the US private-sector industry put together.

Now, according to the Department of Defense, industry spends almost three times as much as government on defence research – \$130 billion as against \$50 billion per year.

Maintaining the health of the NATO alliance is another powerful reason for endorsing a transatlantic defence industry. Without an opening of the US defence market, the technology gap that already exists in some defence areas between America and its European partners will continue to grow. This would make interoperability even harder to achieve and thus collaboration on peace-keeping and peace-enforcing even more difficult. And that in turn could encourage the US to become increasingly unilateralist.

In the long-term, a transatlantic defence industry would be as good for America as for Europe. But to achieve it, the US needs to redefine its view of Europe and take into account the fact that it is now virtually impossible to deal with Europe on a country-by-country basis. State, DoD, Commerce and Congress will have to undergo radical reform and overcome the “ABC mentality” which has obstructed the push towards globalisation. The government will also need to adapt existing bilateral security arrangements to take into account the new, multinational defence industry alliances. In turn, the Europeans will have to reassure the Americans that technology will not fall into the hands of rogue nations. Europe needs to complete the Framework Agreement process as soon as possible and harmonise export controls.

Most importantly, the US needs to follow the lead of the UK and allow the transatlantic defence restructuring process to be industry- rather than government-led. If industry is allowed to drive the process, there will be an open, competitive transatlantic defence market. If the US government refuses to modernise, Europe could well retaliate by restricting US access to its market. Then the scenario that many on both sides of the Atlantic are determined to avoid would occur: Fortress Europe versus Fortress America. Europe and the US must not allow this to happen.

A summary of recommendations:

For Europe:

- The Framework Agreement signed in July 2000 should be expanded to include other European states, such as the Netherlands.
- All European countries should tighten their export controls, regardless of whether they are signatories of the Framework Agreement, to prevent technology from reaching rogue nations.
- Europe should continue to develop and strengthen its Common Foreign and Security Policy. This is vital for healthy transatlantic relations, as one of the greatest concerns in the US is the fact that Europe does not act in unison on some foreign policy and defence issues.
- European governments must convince the US that “Fortress Europe” does not exist. Where American equipment is clearly superior, as in airborne ground surveillance radar or currently available air transporters, they should purchase from the US.
- European governments should decrease and ultimately relinquish any existing shareholdings in European defence companies.

For the US:

- There should be a complete overhaul of the International Traffic in Arms Regulations (ITAR) to encourage the globalisation of the US defence industry. State and DoD should jointly create a smaller set of regulations which can be implemented *en masse* for all collaborative ventures. The ITAR should distinguish between significant and non-significant equipment.
- State and DoD should shorten the US Munitions List, by as much as 50 per cent, excluding commercial off-the-shelf technology and obsolete computer technology.
- The US government should implement the Defense Trade Security Initiative as soon as possible. It should cover all of America's NATO allies and not just the UK. The US should also negotiate additional declarations of principles, based on the UK model, with other NATO allies.
- Special Security Agreements should replace proxy boards as often as possible for foreign acquisitions of US companies.
- European-designed equipment that is bought by the US should no longer have to be manufactured in America.
- The defence industry needs a Congressional champion to support reform of the defence market. Industrialists on both sides of the Atlantic should devote more effort to cultivating members of Congress in those states with key defence industry sites, to ensure support for transatlantic ventures. They should also educate Congress that some European defence procurement decisions – like some American decisions – may have a significant political component that makes little economic sense but is not a deliberate anti-US policy.
- Secondments between US government departments should become standard policy. This will allow individual departments to gain a greater knowledge of the concerns of the others. US government departments and Congress could also benefit from visits to European governments and defence companies.

For Europe and the US:

- A merger between a European and American prime contractor would force the US government and legislators to handle a practical scenario and force the pace of reform. In turn, the Europeans would have a chance to prove that they are able and reliable partners.

Alex Ashbourne

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