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Kjell A. Eliassen & Nick Sitter

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Defence Procurement in the European Union

Kjell. A. Eliassen & Nick Sitter

DEFENCE PROCUREMENT IN THE EUROPEAN UNION

Introduction

Despite considerable efforts to integrate, or at least co-ordinate, defence procurement in the European Union, progress has been modest. Although some initiatives have been developed recently, the prospects for a common defence procurement policy remain remote. At the political level, the Western European Armaments Group (WEAG) brings together most EU NATO members in an effort to harmonise arms procurement and discuss co-operation, but with limited results. More recently, two initiatives have been launched by smaller groups of countries in pursuit of closer co-operation in arms procurement. The Organisation for Joint Armament Co-operation (OCCAR) and the Letter of Intent (LoI) both enjoy legal status, and recent years have seen a degree of success, particularly in the form of the first entirely new OCCAR programme on the Airbus A400M. However, most armament procurement is still driven by the member states, and much of it subject to offset provisions. Taken together, these developments add up to significant changes in European arms procurement co-operation, at least compared to the slow pace of developments up to the late 1990s, even if progress can hardly be described as more than modest. Although efforts to establish a European Armaments Agency are underway, there is still a long way to go before Europe has anything like a common armaments policy.

The challenges inherent in developing EU co-operation on defence procurement are related to the very nature of European integration. First, the EU is a predominantly civilian organisation. Second, it is made up of member states with widely differing public policies and procurement practices, not to say policy preferences, security concerns and priorities. Third, European integration has taken the form of a range of functional

trade and some small states' expectations that their increasingly specialised industry may benefit from integration, as well as defence of protected industry in states like France and Spain.

European Integration and Defence Procurement in a Multi-Organisation System

Finally European integration is a pluralist project, based on the EU and a raft of institutions that are tied to the EU in various ways and with differing degrees of overlapping membership. All EU states except Ireland are members of the West European Armaments Group, which also includes all European NATO members except Iceland. This remains the most significant initiative. Smaller groups of states have recently joined together in initiatives for closer co-operation and harmonisation, but so far the effects have been rather limited. Apart from the EU, key organisations include

WEAG and WEAO – the Western European Armaments Group and Western European Armaments Organisation, a broad forum for co-operation on arms procur.92rm

both of which will permit it to extend the single market into the defence sector. In this context, it is beginning to question states' application of article 296. The big four states' initiatives (OCCAR and LoI) represent an effort to transcend offset without giving up a degree of intervention and protection of their national industries. The smaller states tend to be somewhat more sceptical of the benefits of these arrangements.

prompted most states to link defence procurement to general industrial policy, and to use it to enhance demand for domestic industrial produce. Hence the offset provisions, which require domestic industry to deliver civil or military products to the foreign supplier (or, in some cases, government) for, typically, the total amount of the sum spent on procurement in the case of foreign contracts. In other words, domestic industry benefits even from defence procurement abroad. These problems related to institutional and procedural differences among member states, as well as by differences between more *dirigiste* states (France) and states where private industry dominates (Germany, UK), or smaller countries with highly specialised industry (Sweden, the Netherlands). Therefore, despite cost-driven pressure for more efficient arms procurement, integration is problematic. Even where there is political will, wide differences make it difficult to reach agreement on harmonisation, let alone for transnational companies to operate.

Technological Development and Dual Use

Technological developments provide the strongest force counterbalancing national problems, preferences and differences. The key development is the change toward 'dual use' products, i.e. products that are designed for military use but have significant civilian applications (spin-off), or vice versa (spin-in). The increasing prevalence of dual use products means that the traditional distinction between military and civilian specifications is becoming increasingly blurred, with the prospect that military specifications may be replaced with commercial standards. This in turn allows the European Commission some leeway in terms of beginning to comment on defence procurement, despite the defence exemption. Moreover, it is increasingly the case that states cannot go it alone in terms of defence procurement, and in the context of pressure for cost effectiveness this has generated a degree of pressure for re-evaluation and harmonisation of military requirements

The Single European Market

Although the defence sector is exempt from EU rules, the competencies of the EU are gradually being extended toward, if not into, the sector. The European Commission represents the key driving force here, and has focussed on R&D, standardisation and public procurement rules. However, the links between military-industrial policy and the ESDP remain so limited that it is hardly appropriate to speak of an integrated approach to defence procurement. Defence procurement therefore pertains partly to the single market, the EU's first pillar where the Commission has considerable competencies, and partly to the foreign and security policy pillar where policy is made largely by the states. In the latter domain the ad hoc European Armaments Policy Groups (POLARM) hardly counts as a success, as it features non-binding agreements and deliberations have been slow. Nevertheless, given the increasing relevance of single market rules, especially in the context of dual use products, the Commission is likely to take on an increasingly significant regulatory role even in the defence sector.

The Changing Defence Industry in Europe

Finally, the defence industry is providing a significant degree of pressure for change. Despite national differences, there has been a

The central if somewhat nebulous and ambitious goal in terms of developing a common policy on arms procurement in Europe remains a European Armaments Agency (EAA). A group was set up to work on this in 1993, following a WEU declaration to the effect that further examination of “proposals for enhanced co-operation in the field of armaments with the aim of creating a European armaments agency” was required. Consequently, WEU ministers established the Western European Armaments Organisation (WEAO) in 1996, but work on an EAA remains in slow progress. The Assembly of the WEU, which brings together national parliamentarians for its member states, has repeatedly come out in favour of establishing a European Armaments Agency, most recently in June 2002.

One option is to do this by converting WEAG into an EAA. However, although the National Armaments Directors (NADs) have been working on a Masterplan for the EAA, developed in 1998, this has been put on ice until conditions ar

its competition policy role (or as a regulator) the Commission would then gain a considerable supervisory role in the sector. Unsurprisingly, many states resist this. The Commission followed this up by embarking on a number of studies of various aspects of the defence industry, and called for a common armaments policy, but with little or no tangible effect. Moreover, the Commission is attempting to ensure that the defence exemption is limited to strictly military matters. E.g. it recently challenged the German contracts for rubber protection pads for military vehicles that were awarded without an EU invitation to tender, on the grounds that these are used in peacetime for non-military activities.

The Council of Ministers

European armaments policy is also under discussion at the Council of Ministers, where progress is slow because of national differences. In the spring of 2002 the Spanish Presidency presented a set of principles and guidelines for armaments policy which by no means go as far as the Commission's proposals. These principles and guidelines

- put defence procurement in the service of European common defence policy
- call for the establishment of an EAA as an umbrella organisation that encompasses OCCAR
- are based on voluntary participation, transparency and co-operation with other organisations such as NATO
- develop medium to long term techniques for new programmes and co-ordination of calls for tenders
- harmonise operational requirements
- define compatibility criteria for finance of armaments
- co-ordinate R&D efforts
- promote pooling of arms between member states
- foster mergers between defence companies
- and specify the role of National Armaments Directors.

Assessment

Over the last five years the Commission has adopted a somewhat higher profile on defence procurement, in pursuit of common arms procurement rules and a single armaments market. However, this requires not only member state support, but also a degree of integration with ESDP. There is no member state consensus in favour of this. Although several governments regard offset as a necessary evil and would prefer a single armaments market under common procurement rules, there is enough opposition to prevent it. Moreover, the big four have opted for more pragmatic and incremental solutions, preferring the OCCAR and LoI approach to extending the Commission's competencies in this field. To the extent that common arrangements develop and operationalised, these are set to work primarily on an inter-governmental basis, linked only partially to the EU. The three central institutions are addressed below.

WEAG

The West European Armaments Group grew out of the Independent European Programme Group (IEPG), a 1976 European NATO nations (except Iceland) initiative to establish a forum for armaments co-operation. It was transformed to the WEAG in 1992, and is currently made up of 19 member states. The three most recent EU members Austria, Sweden, Finland joined in November 2000, as did the three new NATO members the Czech Republic, Hungary and Poland. Others include the EU members Denmark, Germany, France, Italy, Belgium, the Netherlands, Luxembourg, Spain, Portugal, Greece and the UK, as well as NATO members Norway and Turkey. It is sometimes described as the (future) industrial dimension of ESDP.

The objectives are:

- more efficient use of resources through increased harmonization of requirements
- the opening up of national defence markets to cross-border competition
- strengthening the European defence technological and industrial base

forum that includes most EU and European NATO states. Its main potential is therefore as a forum for drawing up broad frameworks for harmonisation of defence procurement. Although the principal arms producers in Europe, Germany, France, Italy and the UK have opted for closer co-operation in smaller groups, WEAG's potential strength lies in the fact that it remains the only comprehensive initiative and that it works.

OCCAR

The Organisation for Joint Armaments Co-operation, based in Bonn, has become a joint European procurement agency. Founded in 1996 by Germany, France, Italy and the UK, and designed to improve the management of collaborative armament programmes, it gained legal status in January 2001. This enables it to sign contracts with industry on behalf of its member states, but non-members are invited to participate in its programmes on a case-by-case basis. The four original signatories cover well over two-thirds of European defence production. The Netherlands, Spain and Belgium have since expressed interest in membership, despite some misgivings, and several states are participating in OCCAR projects.

The governments that set it up agreed to allot shares of work based on total set of projects it manages rather than on a programme-by-programme basis. This replaces the *juste retour* principle, which sought to align work-share and cost-share between countries in each collective programme.

Its five basic principles include:

- replacing *juste retour* with 'global balance'
- securing the profitability of the armaments industry
- harmonisation of requirements and technology
- promoting a competitive industrial base
- opening the door to other countries

Experiences and Current Status

OCCAR inherited a number of projects including the GTK/MRAV armoured vehicle, Tiger helicopters, Roland air defence systems and Milan and Hot anti-tank missiles, as well as a series of bi- and tri-lateral projects. The Corba anti-artillery radar was its first integrated project, and the Airbus A400M deal, which OCCAR is set to sign off, is its first new programme. It will manage the programme as the contracting authority delegated by the states. Although the A400M project was agreed by eight European governments in December 2001, with Italy pulling out at the last moment, it has encountered further problems and delays in terms of uncertainty surrounding Germany's and Portugal's orders. The project thus illustrates some of the problems inherent in co-operation on defence procurement. However, it also illustrates that non-OCCAR members may participate in programmes on an ad hoc basis, thereby reinforcing the idea of OCCAR as the key basis for future and wider co-operation. With the accumulation of programmes OCCAR's importance has grown, and its case-by-case operation offers some potential for establishing 'best practice'. In the light of these experiences, OCCAR has generally been welcomed by industry as a potential basis for multi-lateral defence procurement programmes.

Assessment

Because OCCAR inherited most of its projects, including their flaws, it has yet to be fully tested. The A400M project is providing the first such test, and it indicates that many of the problems involved in co-ordinated defence procurement between national governments remain. It has met more scepticism from the smaller states than from the big states, which see this as a means for replacing offset with something more efficient but of more or less equal effect. Smaller states are simply less able to extract benefits from these programmes. Nevertheless, the Netherlands and Belgium are expected to join, and despite some misgivings other states are interested. In effect, OCCAR replaces offset with a more

co-operative compensation regime, but questions remain as to whether this is actually more efficient than offset in terms of costs.

The Letter of Intent/Framework Agreement

In July 2000, the UK, France, Germany, Italy, Spain and Sweden signed the Framework Agreement based on the Letter of Intent of 1998, an acco

Although the LoI/FA has not operated long, it has seen some success on procedures for research and technology and the states have agreed to harmonise procurement policy and joint requirements as well as procurement methods. The main achievement is the establishment of a forum where technical issues and industrial policy is discussed, with a view to solving specific problems and addressing the main obstacles to armaments co-operation.

Assessment

Like OCCAR, the LoI/FA represents a pragmatic attempt to address the pressures for changes in defence procurement policies without incorporating this into the EU single market. Again this is largely a big state initiative, albeit with Swedish participation. However, whereas OCCAR operates on a case-by-case or programme-by-programme basis, LoI/FA provides a forum for technical and political harmonisation. Because the initiative is geared toward harmonisation it is perceived as a potential precursor to or building bloc on the way to a single market in armaments. It is too recent to judge as a major success or failure, but medium term success will be measured in terms of whether it establishes a framework within which transnational defence companies can operate effectively.

Conclusion

After more than two decades'

because they can achieve much the same level of protection through joint programmes as case-by-case offset.

Offset arrangements are to some extent a type of prisoners' dilemma, where individual rational pursuit of self interest prevents co-operation that would benefit the actors involved. To the extent that this is the case, much of the problem could be solved by

programmes. Yet all these initiatives remain very much as the stage of initial establishment, and a common armaments policy remains a long way off.