
U.S. Foreign Military Sales After Europe 1992: Reconsidering Market Strategies

By

Major Charles B. Shotwell, USAF

With the European Community (EC) forming the largest trading bloc in the world (320 million people, 12 nations), those studying the future of U.S. commerce cannot ignore events occurring across the Atlantic. Public concerns regarding "technology give-aways," allied burden-sharing, foreign-subsidized commodity dumping on U.S. markets, and the democratization of Eastern Europe, belie the fact that the future of Europe remains relevant to the U.S. Since the U.S. is the largest supplier to the EC (\$66B in U.S. exports for 1988, or approximately 16 percent of total EC imports), trans-Atlantic links are too important and complex to settle for cursory comment.¹ This article assesses future impacts and options regarding our "Atlanticist" ties.

HISTORICAL BACKGROUND

To keep events in perspective, we must take a look at Europe in historical terms. In 1948, the European Recovery Program (otherwise known as the Marshall Plan) was set against the backdrop of the destruction of the economic infrastructure of much of Europe. On 4 April 1949, the U.S. and 11 other nations signed the North Atlantic Treaty. The goal was to create a strong, self-reliant, democratic Europe, which would thereby be able to deter Stalinist aggression and preserve peace. With security provided for accordingly, Europeans were free to concentrate their energies on other needs.

On the economic front, the Europeans engaged in some self-help programs, beginning with the European Coal and Steel Community (ECSC) in 1952. The European Economic Community (EEC) was created by the Treaty of Rome (1957) with the full knowledge and consent, if not encouragement, of the U.S. The European Parliament and the European Court of Justice were given jurisdiction over the EEC, the ECSC, and the European Atomic Energy Community (EURATOM). Indeed, this kind of cooperation was looked upon with great favor by Americans eager to see a new order in Europe replace the bellicose nationalism that had earlier drawn the U.S. into two world wars. In 1967, the separate executive commissions of the ECSC, EEC, and EURATOM merged into a single European Commission with the authority to enforce the treaties governing each respective agency and to issue decisions binding on the EC.² The Commission's actions often require the consent of the newly created single European Council, composed of foreign ministers of the 12 states.

The passage of time, however, has brought some less desired, though perhaps inevitable, changes. In 1948, the U.S. enjoyed economic predominance because it possessed the most extensive industrial base (and one of the few) left intact after the war. In these unusual circumstances, the U.S. experienced unusual trade surpluses. Recovery from the devastation of the Second World War did not come easily on the European side. It was a group of far-sighted thinkers who envisioned an integrated economy for Europe, building slowly upon successes of the ECSC, EURATOM, and the ECC. At this stage, cooperation for military purposes was

¹"Private Sector Perspective on the International Trade Issues of 1992," (Charlene Barsevsky, Steptow & Johnson) Washington, DC, ABA Pamphlet: *Doing Business with Europe*, 1989, p. 184.

²"Working Together—the Institutions of the European Parliament," (Emile Noel, EC Publication as reprinted in ABA Pamphlet, see footnote 1, 1988, p. 5.

consciously excluded from these arrangements, however, and was left to the exclusive province of the North Atlantic Treaty Organization.

The Single European Act (SEA) (signed in February 1986, and effective since July 1987) consolidated three separate entities, the Steel and Coal Community, the Atomic Energy Community, and the European Economic Community under one organization, appropriately referred to as the European Community (EC). Now, forty-one years after the creation of NATO, we have the logical progression of our earlier efforts: a strong, self-reliant, democratic Europe. President Bush, during his 28 May 89 speech in Brussels, referred to this development as a "European Renaissance."³ The success of Western Europe has in no small way influenced contemporary events in Eastern Europe.

EMERGENCE OF A NEW EUROPE

Over time, the Western European nations that had depended on U.S. aid to purchase U.S. military products, became exporters themselves. Spain, for example, is a most recent example of a nation no longer receiving grant aid that is enjoying relative success as an exporter of arms. Statistics show a decline of \$8B in U.S. foreign military sales since 1982, with world-wide agreements down from a high of \$22B in that same year. This decline corresponds to the drop in international oil prices and increasing Third World indebtedness. Less expensive military aircraft (oriented toward low intensity conflict) are now being purchased from Spain, Brazil, and others. Furthermore, Syria, Iraq, Iran, Brazil, Argentina, India, South Africa, China, and Israel, among others, have developed varying levels of munitions and missile production capabilities.⁴ The U.S. has responded to the decline of the market by eliminating asset use charges [on all FMS cases], and nonrecurring research, development, and production charges for MAP and FMS grant programs (i.e., the "Fair Pricing" legislation passed for FY 90). Cost, however, is not the sole cause of the decline.

Europeans have felt the pressure of increasing international competition. Noting a shift in world trade to Asia and the Pacific, many influential Europeans believed that unless action was taken, Europe would eventually be commercially dominated by Japan and other emerging Asian exporters. In order to compete more effectively (at home and abroad), internal European trade restrictions needed to be eliminated. According to EC studies, the national costs of separate customs administration, separate research and development, and other factors resulting from national boundary restrictions increase the cost of consumer goods by 10 percent and decrease business profits by \$30B per year.⁵

Under broader authority of the SEA, national laws judged by the European Court of Justice to be unreasonable restrictions on intra-European trade have been invalidated. For example, German beer "Purity Laws" were among the first national laws determined by the European Court to be a pretext to the restraint of trade rather than a valid health requirement. Danish environmental (automobile) emission standards are currently being reviewed by the Court for similar reasons.

Already the EC has shown itself to be a formidable trade bloc and a constructive force in dealing with extra-European protectionist trade measures, such as those of Japan. As such, the EC could be an effective force for maintaining free trade in the world.⁶

³Department of State Bulletin. Vol 89, No. 2149, August 1989, p. 15.

⁴"Reshaping of the Defense Industry," *Jane's Defense Weekly*, 25 November 1989, p. 1155.

⁵"Europe 1992: A Basic Guide," *Barrister*, (A Brotman & Y. Quintin) Fall 89, p. 42.

⁶"Fortress Europe: Seizing the Opportunities," (Paul Mifsud) Washington DC, ABA Pamphlet: *Doing Business with Europe*, 1989, p. 379.

CHANGES TO BE EXPECTED WITH EUROPE 92

The European Commission White Paper of June 1985 (*Completing the Internal Market*) outlined the concept of a single internal market and set target dates for implementation. Since the passage of the SEA, approximately 400 measures have been considered by the Commission, and 31 December 1992 has been set as the overall target implementation date, albeit an optimistic one. After adoption by the European Parliament, these measures require further implementation in national parliaments. In accordance with the stated policy to integrate markets, trade restrictions between borders are to be phased out by 31 December 1992. This includes over 300 national laws concerning health, environment, or other laws which serve as a pretext for restricting the "free movement of goods, persons, services, and capital." It is not yet clear whether this will mean a total dismantling of all border controls. Discussions continue, for instance, as to whether border guards will be maintained to prevent intra-European travel for terrorists, for drugs, or for other criminal purposes.

The value-added taxes of the European States will have to harmonize, though it is not clear whether the UK approach, 0% VAT, or the French approach, 38%, will prevail. (France depends on VAT for 40% of its revenues.)⁷ It is expected that a permissible range of perhaps 14 to 20% will be set.⁸ One must bear in mind that Europe 92 is not intended to make goods produced outside Europe more expensive, but rather to eliminate national trade barriers. An easier flow of goods will also be facilitated by the ultimate creation of a common European Currency Unit (ECU), which appears closer to reality with the UK belatedly accepting the inevitable.

The consequence of the elimination of national trade barriers is that the entry of a U.S. firm into operations in one European nation provides them tariff-free access to the entire market of 320 million Europeans, provided the requirements of "local content" and "rules of origin" are met. Proposals would give preference to offers with at least 50 percent European content in public procurement contracts (a European version of the "Buy American Act").⁹ It is highly unlikely that so-called "screwdriver assembly plants" (local assembly of foreign-made parts) or "shell corporations" will satisfy the requirements of these new rules. The U.S. semiconductor industry will possibly be adversely affected by local content provisions enacted recently which have been aimed mainly at Japan.¹⁰

The EC Broadcast Directive was a test case for the viability of a local content requirement contained in a proposed EC directive and an object lesson for how not to deal with the European Parliament. When U.S. television and movie industry lobbyists approached the Europeans in the Fall of 1989 to object to what was perceived as a heavy-handed European attitude on the subject of local content of television programs, U.S. interests were soundly rebuffed and limits were placed on the number of U.S. productions to be accepted. A more effective future negotiating approach on this subject may be to assert that the practice violates the requirements of the General Agreement on Tariffs and Trade (GATT).¹¹ Until there is an effective challenge to local content rules, the rush of businesses to establish production "footholds" in Europe will continue.

Many U.S. manufacturers (General Dynamics, Ford, General Motors, etc.) have had established operations in Europe for many years and have an advantage in meeting national content requirements. Certain high technology firms, such as IBM, will likely also benefit from established operations in Europe.

⁷Brotman/Quintin, *op. cit.*, p. 43.

⁸Brotman/Quintin, *op. cit.*, p. 43.

⁹Barshevsky, *op. cit.*, p. 200.

¹⁰*Ibid.*, p. 196.

¹¹*Ibid.*, p. 194.

Joint ventures may offer opportunities to participate in work with European firms, so long as they do not run afoul of Article 85 of the ECC Treaty. This provision, strictly applied by the European Commission, prohibits agreements or undertakings which "have as their object or effect the prevention, reduction, or distortion of competition within the common market."¹² This law, which in some ways resembles U.S. antitrust provisions, outlaws collusion in terms of price-fixing, production limits, and other areas restricting competition. American corporate "merger mania" has made Europeans even more leery of U.S. takeovers of European firms. Yet, the U.S. has been equally concerned about recent proposed European arrangements between KLM and Northwest Airlines, British Airways and United Air Lines, etc.¹³

One may anticipate that national "offsets" (direct or indirect) to funds paid pursuant to FMS or commercial programs, will receive continued emphasis. The Defense and Commerce Departments have generally resisted these provisions, yet they remain a part (in one form or another) of doing business in Europe.

Of equal concern is the future of export controls. The Single European Act loosened export control provisions of the Treaty of Rome. The future of the Coordinating Committee on Multilateral Export Control (COCOM) is in serious question with member nations (which include all NATO nations, except Ireland, and the U.S., Japan, and Australia), and especially the Federal Republic of Germany inveighing against the voluminous list of dual-use products, i.e., this with both industrial and military applications.¹⁴ With the varying stages of democratization in Eastern Europe and with rushes to increase trade with the East, COCOM seems increasingly unpopular. Recently, for example, the U.S. yielded its restrictive position on the export of small computers after much external pressure and convincing evidence that non-COCOM members would export the products anyway. Another complicating factor would be if (or when) the Eastern European nations apply for associate membership in the EC.

A benefit of Europe 92 could involve the standardization of products (including standards for safety, environmental, technical, certification and testing requirements, etc.). Though delineation of such standards and their implementation is expected to be a long, painful process, these rules will in many cases make it easier for U.S. exporters by providing a "one size fits all" marketplace, rather than 12 separate standards. At the same time, however, these rules can make the European arms manufacturers more efficient (making economies of scale production practical) and, consequently, more competitive. U.S. government and U.S. industry are attempting to play a role in the standard setting process, so as to avert subversion to protectionist interests.¹⁵

REORIENTATION OF EUROPE AND THE U.S. FOR THE NEXT CENTURY

Keeping in mind that Europe 92 is viewed by many on the other side of the Atlantic as a matter of survival, it should not be assumed that Europe will thereby close its markets to U.S. products.¹⁶ Regardless of how successful the proposed economic integration is, Europe will still need the U.S. for both trade and security reasons. The U.S. will continue to be important as a source of goods not available elsewhere (e.g., certain high technology military items). Furthermore, in other areas, the U.S. enjoys the advantage of economies of scale production in

¹²"The EC Commission's Application of Article 85 EEC Treaty to Joint Ventures," (Peter Verloop, Nautra van Haersolte, Amsterdam, The Netherlands), ABA Pamphlet: *Doing Business with Europe*, 1989, p. 255.

¹³Mifsud, *op. cit.*, p. 376.

¹⁴"EC '92 Promises Big Market, Big Competition for U.S. Defense Firms," *National Journal*, 13 May 89, p. 1171.

¹⁵Barshevsky, *op. cit.*, p. 190.

¹⁶*National Journal*, *op. cit.*, p. 1170.

some areas that will be difficult for European to equal, whether because of lack of resources or integrated industrial infrastructure.

For example, there are few fighter aircraft programs that compare with the world-wide sales of the F-16 (or previously, the F-5). There are grand hopes for the development of a "next generation" European Fighter Aircraft (EFA) by Britain, Italy, Spain, and West Germany, but the U.S. already has the proven technology base and mass production capability (without the cost overruns and the in-fighting currently plaguing EFA). Since the U.S. will have an exclusive hold on capabilities in these areas in the long-run, cooperation with the Europeans through the "EPG Group" (F-16 program with Belgium, Netherlands, Norway, Denmark, and the U.S.) may very well offer the most hopeful aspects in terms of cost savings and preserving a U.S. position in the European market.

The Europeans have much to gain in terms of cost-savings through cooperative programs, especially with U.S. participation in combined R&D and production efforts. Transcending EC product standardization is NATO standardization. Whereas previous efforts have been made through the Independent European Program Group (IEPG), there remains a military necessity for standardization between U.S. and European equipment. It is conceivable that EC standardization (and IEPG) efforts might help clear political obstacles that have hindered progress in military standardization in the past. Furthermore, cost saving for defense items have become a political necessity of late on both sides of the Atlantic.

The Nunn Amendment (FY 1986 codevelopment legislation) demonstrates Congressional interest in U.S. cost-savings, especially with NATO and other allies, by encouraging multinational cooperation in R&D and production. Programs such as those for Maverick, Stinger, and Penguin missiles, as well as V/STOL (Harrier) technology, have shown the success of coproduction. There are a total of 82 such programs, although U.S. enthusiasm has been muted of late.¹⁷ A contrary signal was sent when some members of Congress opposed proposals to share R&D costs with Japan for their FSX advance tactical fighter program, and for production costs with Korea in its FX program. Though President Bush vetoed legislation that would have severely restricted the FSX program, similar projects are expected to come under increasing scrutiny for allegedly "exporting jobs and technology." A countervailing concern is that a "U.S. go it alone" approach could result in isolating the U.S. industrially and politically, and missing the "Europe 92 boat." For this reason, cooperation through the EPG Group may be a significant mode of doing business in the future.

Because of NATO, the U.S. position for cooperation is significantly enhanced for R&D, mutual logistics support (NATO Mutual Support Act), and other matters. Thus, the U.S. (and to a lesser extent Canada) enjoy a rather unique and enviable relationship with Europe. For that reason (among others), recommendations to alter North Atlantic Treaty Alliance obligations should not be made outside of proper channels. Such channels include the Conventional Forces Europe (CFE) talks in Vienna and related consultations with allies. It is important to properly anticipate European reaction to potential U.S. moves along those lines and the probable consequences this will mean for U.S. trade and security relationships. Influential Europeans continue to see a U.S. commitment to Europe as important and would view a unilateral break/drawdown with disfavor. They recognize that the Alliance provides the stability needed to build the new EC. This sentiment is represented by concerns expressed recently by European officials (prior to the December 89 Malta Summit) about bilateral U.S.-Soviet arrangements without consultation of the allies (aka

¹⁷"USA Looks for Safer Nunn Projects," (Barbara Starr), *Jane's Defence Weekly*, 25 Nov 89, p. 1147.

Reykjavik).¹⁸ Conversely, a radical reversal of the U.S. military commitment to Europe could be perceived as a disincentive to offer favorable economic arrangements to the U.S.

It is also clear that the U.S. will remain a top market for the export of European goods. This explains the continuing, if not increased, interest of European firms in U.S. markets. Reciprocity has been the key focus in European world trade policy (e.g., as in the case of Japan, discussed earlier). Restrictive trade measures against European goods would engender similar counter-measures against U.S. goods. By the same token, our non-discriminatory treatment of European exports should theoretically encourage a reciprocal fair treatment of U.S. exports: in short, this should mean a two-way street for trans-Atlantic trade. There is some continuing concern, however, that "reciprocal" restrictive provisions aimed at Japan, such as those concerning the banking industry, might work against the U.S. as well.¹⁹

The commonality of economic and security interests of these North Atlantic nations is endemic in the "Atlanticist" view. As previously mentioned, influential Europeans are not all keen on any rapid or unilateral U.S. "decoupling" from Europe. President Bush is well attuned to this point, and he went out of his way to reassure the Allies prior to the 4 December 89 Malta Summit. His visit with EC President Jacques Delors immediately after the summit set the precedent for a positive partnership and consultation on matters of mutual concern. This further underscores the increasing relation of security issues with economic issues and the necessity for the EC to deal with both.

U.S. relations with Europe through the next century will be growing and dynamic. To meet this challenge, we must be conscious of European interests and actively work with our Allies to adapt our security and economic arrangements to a changing world. U.S. security assistance arrangements will not necessarily go away, but they must be adjusted to respond to these new circumstances.

CONCLUSION

The Atlanticist approach offers a basis for continued security and trade relationships with Europe. By emphasizing our mutuality of interests, we build on our advantageous position with Europe. As an important ally and a guarantor of European security, we enjoy a special relationship that is not available to other nations. Security assistance is an important instrument of foreign policy that can be used to reinforce this relationship.

Although U.S. exporters will not be happy with local content rules, many other aspects of Europe 92 may work in our favor. Requirements for product standardization may make it easier to export products to a broader market. Antiquated national trade barriers will be struck down by the European Court of Justice. Furthermore, interoperability within NATO will keep up the demand for certain U.S. defense products and services and will provide a way around local content rules.

If the implementation of Europe 92 is consistent with its established goal of encouraging free trade, it should serve as a boon, not an impediment, to trans-Atlantic mutuality. During the crucial implementation phase when the European Commission is developing its policies, we must work to foster a positive, cooperative relationship with the EC in order to best promote U.S. interests.

¹⁸"European Praising Baker Blueprint," (Thomas Friedman), *New York Times*, 14 Dec 89, p. 22, and also, David Lauter and John Broder, "Won't OK Troop Cuts at Malta, U.S. Assures Allies," *Los Angeles Times*, 29 November 89, p. 12.

¹⁹Barshevsky, *op. cit.*, p. 186.

See Also

1. "Europe's Internal Market," *The Economist*, 8 July 1989.
2. "U.S. Industry Must Look Overseas," *Jane's Defence Weekly*, 16 Sep 89.
3. "Europe 1992—A German View," *Armed Forces Journal International* (Rolf Roesler), Sept 89.
4. *Hearings before the Committee on Foreign Affairs, House of Representatives*, Testimony of Secretary of State Baker, p. 52.
5. For a less optimistic appraisal of Europe '92 see: Eric Stein, "European Foreign Affairs System and the Single Europe Act of 1986," *The International Lawyer*, Winter 89, Vol 23, No. 4, pp. 977-944.

ABOUT THE AUTHOR

Major Shotwell is assigned to the Security Assistance Management Division, Directorate of International Programs, on the Air Staff. He is an attorney and previously worked as a desk officer for issues involving Germany, Spain, Portugal, and Africa while in the International Negotiations Division HQ, U.S. Air Forces in Europe (USAFE) from 1985 to 1988.