
The United States: Partnerships with Europe

By

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For nearly half a century following World War II, American and West European military establishments spent most of their energy and resources preparing for a massive war with the Soviet Union, in the hopes that credible preparation would prevent such a cataclysmic event from actually occurring. As allied forces prepared for war, particularly with respect to the Central European theater, it became fairly obvious that the logistics of conducting such warfare would be enormously simplified if forces fighting side by side could use the same type of fuel, ammunition, and even parts. As weapons systems grew more costly and complex, it also became apparent that greater economies of scale could be obtained from longer production runs, which argued for common weapons systems among allies.

The notion of reducing logistics problems and unit costs by cooperating in the development and production of common military hardware is blindingly obvious to the outsider. Yet with a few notable exceptions, over the past four and a half decades the actual accomplishments related to weapons cooperation between the U.S. and its European partners have been extremely limited.

This chapter will argue that governments are torn between the attractiveness of national weapons programs (providing political independence and expenditure of taxpayers funds and jobs at home) and where necessary bilateral programs (which are relatively simple), versus focusing on increased multilateral arms development, production, and even acquisition (which may provide more weapons at cheaper prices, but are more complex to administer and may result in increased expenditures off shore). The greater the external threat, and the tighter the domestic budgets, the more governments may turn to multilateral solutions; the weaker the external threat, and the more ample the domestic defense budgets, the greater the tendency to look to national solutions and to insure that expenditures are politically, as well as economically, rewarding.

Similarly defense companies prefer to produce products on their own and sell them “off the shelf” to foreign customers. They become involved in international cooperative activity only if they see real advantages related to increasing market access, reducing risk, obtaining capital at better rates, and gaining technology without having to pay development costs.

To date, the large U.S. defense market and companies, contrasted to the small individual European defense markets and companies, has made it difficult for American government institutions and private firms to work up much enthusiasm for cooperative programs. On the other hand, the small individual European defense markets, combined with a common external military threat (Soviets) and economic threat (U.S., Japan), has encouraged greater intra-European cooperation in both the civilian and military arenas.

This chapter will briefly review the efforts at weapons cooperation between the U.S. and European allies, the factors inhibiting success of such efforts, and suggest a few approaches which might improve chances of obtaining the basic objectives of more efficient weapons production and standardization. Note that this chapter is not intended to provide a comprehensive history of arms cooperation between the U.S. and Europe. Rather historical examples are raised primarily to highlight specific policy themes which must be recognized in addressing the arms cooperation issue.

RESTORATION OF EUROPEAN DEFENSE INDUSTRIES

Following World War II, only the UK was still left with a defense industry that was relatively intact and operating. The French had the professional talent and most of the industrial infrastructure, and simply needed time and resources to revive. The Germans, Italians, and smaller industrialized European countries had professional talent, but much of the industrial infrastructure was destroyed. Thus U.S. policy with respect to European countries varied somewhat from one country to the other.

At the outset, as the Soviet threat emerged, U.S. cooperation in weapons systems with allies and former enemies was quite simple—the government made U.S. weapons available to them out of inventory, or from current production. In some cases the weapons were provided on a grant basis through the Military Assistance Program, in others the recipients paid. The driving force for such weapons transfers was also quite straight forward—we wanted those countries to have the weapons necessary to help provide a credible deterrent to any expansionist Soviet intentions in Western Europe.

The U.S. was also interested in encouraging the restoration of European industries, including defense industries. Obviously so were the Europeans. Hence it was not surprising that by the late fifties a shift began from transfers of military equipment to European countries, to licensed production of American defense products in those countries. Early examples included production of the F-86 and F-104 fighter jets, the M113 Armored Personnel Carrier, and various utility helicopters.¹

Such licensed production transactions served the purpose of helping European countries provide for their own defense and of restoring their defense industries. This period, however, was also to have other long lasting implications for the United States. The Defense Department administered the program through an office reporting to the Under Secretary for International Security Affairs, known first as the Office of Programming and Control, and later the Office of Military Assistance. In 1971 this office became the current Defense Security Assistance Agency.² Its mandate was to provide hardware for allied countries, and later to assist in arrangements for licensed production. To that agency, the client was the recipient government and military establishment, not the U.S. company which produced the military hardware. Put another way, its mission was to help the foreign country obtain and/or produce weapons for its own defense, not to sell American products.

Similarly, the U.S. defense industry personnel involved in selling or supporting U.S. weapons systems in Europe, or in licensing production programs, saw their role as assisting the Europeans to assimilate U.S. weapons and technology. The U.S. provided the teachers, the Europeans the pupils. This mind-set became rather fixed in the U.S. corporate outlook towards Europe.

Finally, these programs were bilateral in nature, and helped individual European countries restore their respective militaries and defense industries. They did not encourage collective European activity *per se*, and in fact by supplying different weapons systems and helping individual national arms industries, may well have had the opposite effect.

ADVENT OF OFFSETS

A new phenomena in U. S.-European defense trade relations arose in the late 1960s when European governments began to demand offsets from the U.S. as a condition for purchasing American weapons systems, or even when they produced a U.S. system under license in their own countries. This practice, now widespread around the world, requires that the vendor of the defense hardware agree to purchase goods from the customer country. Increasingly such goods must themselves be in the defense or other high tech sectors. Often the vendor country must agree to transfer technology to the customer country in order for the customer to undertake the offset activity.

The U.S. government became involved in helping to perform some of the early offset programs, such as those involving the F-5 program in Switzerland, and the European countries (Belgium, Denmark, the Netherlands, and Norway) which coproduced the F-16. It soon found, however, that trying to fulfill offset obligations involved DoD in a variety of economic and political problems, both with the customer country and at home. Consequently, in the 1975 "Duncan Memorandum" DoD declared that in the future offsets would generally be an issue between the U.S. company selling a product, and the foreign purchasing government.³ That position was reaffirmed by President Bush in a policy statement on offsets issued on April 16, 1990.⁴

Offsets are also a nuisance to American business. Given a choice, companies would clearly prefer to sell "off the shelf" with no offsets or licensed production. Companies participate in such programs because they have become a necessary condition of doing business with most countries. Furthermore, given the enormous U.S. domestic commercial and defense markets, American firms have a comparative advantage in performing offsets as compared to companies based in smaller European or other country markets.⁵

In limited cases offsets can have one positive impact, which is to force American companies to look at European or other countries as the possible source of components for defense products, and in the case of horizontally integrated companies, for their civilian products as well. In some instances companies have found sources of components which, even without an offset incentive, are competitive in quality and price, and hence the relationship has withstood the passing of the offset requirement. In this case, offsets, rather than being market distorting, actually serve to increase information and hence make the international market more transparent; such examples, however, are probably the exception, rather than the rule.

MULTIPLICATION OF WEAPONS SYSTEM TYPES

As European national defense industries reestablished themselves in the 1950s and 1960s, they once again began to design and produce weapons for their own needs and for export. It soon became apparent that such independent production was leading to an increasing proliferation of

The second subdebate concerns technology. Defense research and development, it is argued, are important to design new weapons systems, and to have an idea of what an adversary might also have discovered, so as to prepare countermeasures. Furthermore, defense technology can have important spin-offs into the commercial world. Thus if a country relies on foreign suppliers for defense technology, it loses its research and development capacity, which in turn both makes it more vulnerable from a defense aspect to foreign developments, and it may sacrifice commercial advantage as well.

There is of course some truth to those arguments, although perhaps not as much as in earlier post war years. No European country can come close to matching U.S. or Soviet levels of spending on research and development, and hence their national efforts can at best rival U.S. work in limited niche areas. Defense related research no longer drives commercial research in most fields. Indeed, some have argued that concentrating on research and development of commercial products has helped a country such as Japan dominate many civilian areas of technology.

JOBS

The second issue related to the trade balance in armaments is, put simply, jobs, or more precisely, jobs funded by taxpayers funds. It is not unusual to hear U.S. defense industrialists comment privately, and at times publicly, that Europe doesn't have a defense procurement policy, it has a defense jobs policy. Of course, when lobbying a major weapons system in Congress, these same industrialists are quick to point out how many suppliers and related workers will stand to benefit in each state and Congressional district.

The clear fact is that in industrial democracies, politicians believe it is necessary to justify weapons systems to their voters not just in terms of getting the best defense product for their money, but also in terms of jobs and other benefits as well. In fact, it is quite evident that politicians are willing to sacrifice both quality of a system and its price if there is a real or perceived increase in employment.

In Europe this has not only meant protecting defense procurement, but public expenditures on other capital goods as well. It is noteworthy that it took only ten years from the founding of the European Community in 1958 to the removal of all internal tariffs on private sector trade in 1965 (although it is true that a number of non-tariff barriers such as national standards are only now being dismantled as part of the Europe 1992 exercise. However, "buy national" barriers with respect to public procurement in the so-called excluded sectors—transport, communications, water, and power generation—will only be removed in 1992, 34 years after the entry into force of the Treaty of Rome.

It will be even more difficult to remove buy national barriers in the defense arena, where arguments of national security carry greater weight. When European countries have purchased defense products from each other or worked together in joint projects, they have long adhered to the principle of *juste retour*, which is the basic concept that there should be a rough equality between the amount of funds a country spends on defense procurement and the amount of defense work which is created in the country. Such a balance may be struck within a single large cooperative weapons program, or expanded to include an overall balance of defense trade between countries, over more than one weapons system and over more than one year. It is true that some of the more industrially advanced European countries have not in practice always found ways to implement the concept of *juste retour* for their less industrialized European counterparts. But certainly the stated goal is that work share should roughly equal purchase share.

As already noted, European and other countries demand offsets when they purchase a weapons system from a foreign supplier. Again, such offsets are basically designed to assure the purchasing country a level of domestic production and employment, whether directly related to the weapons system or not, in exchange for its taxpayers funds. The United States is not immune to this phenomenon, even with respect to domestic purchases. Our states are not sovereign, and hence cannot withhold funds from the defense budget when a weapons project of particular importance is not funded. However, state delegations can make cancelling a favored project very difficult, and as noted, prime contractors make a point of spreading subcontracts widely about the country, a sort of domestic offset policy, to assure that taxpayers dollars flow back to as many districts and states as possible. Congressionally mandated small business and minority business set-asides are an additional form of domestic offset, which while undoubtedly increasing the costs of weapons systems, make them more politically attractive.

When it comes to purchases of weapons systems from offshore, which the U.S. has done on only rare occasions, it has generally demanded a "warm production line" in the U.S. Examples include the Harrier jump jet, the T-45 trainer, 9 mm handgun, multiple subscriber system, and bridge erector boat. While the official rationale given for such demands is related to security, not jobs, to the Europeans from whom we have purchased these systems our practice is hard to differentiate from an offset demand.

EUROPEAN INTEGRATION

The Europeans have long wrestled with the problem that companies which are limited to serving their small domestic markets—for both civilian and military products—may have difficulty in competing in a global market, particularly with respect to companies based in the U.S. and Japan, which has the benefit of large internal markets. In order for European companies to gain the necessary economies of scale, in 1985 the European Commission drafted a White Paper which outlined 300 measures necessary to create a single internal market with freedom of movement for goods, services, people, and capital by the end of 1992. The European Community adopted the Single European Act in December of 1985, which allowed the EC's Council of Minister[s] to make most decisions by qualified majority, eliminating the possibility of one country vetoing even minor changes. While some EC goals will not be met by the 1992 deadline, it is likely most will.

On the defense side, the Europeans have also tried to come to grips with the problem of the dominant size of the U.S. defense establishment relative to any single European country. Traditionally, their defense companies have tried to offset the small size of their protected domestic market by seeking export markets, primarily in the developing countries. In some countries, 60-70 percent of total defense production has been exported, much of it to Third World countries. But this reliance on Third World markets has become questionable as weapons needed to confront the Soviet threat became too complex and too expensive for such many such buyers. Examples include air superiority fighters, main battle tanks, large surface naval vessels, and complex electronic systems and related counter measures.

The Europeans have long been aware of the need to collaborate in order to match the American defense industry. In 1969 the European NATO ministers (absent France and Portugal) formed Eurogroup, with the basic intent of encouraging greater collaboration among the European countries in identifying weapons needs, developing and producing such weapons, or even purchasing them from other sources.¹³ In 1976 the Independent European Program Group (IEPG) was established, with France now a member. It had much the same mandate as the Eurogroup, but with perhaps a bit more independence from NATO itself¹⁴

The IEPG was not notably effective during its first decade of existence. In 1984, however, the British Defense Secretary, Michael Heseltine, with the support of the Dutch Minister of Defense, Jan van Houwelingen (who chaired the IEPG at the time) pressed to revitalize the organization. Its governance was elevated from armaments directors to defense ministers. By 1987 the IEPG issued a report entitled "Towards a Stronger Europe"¹⁵ which in turn led to an Action Plan that was approved in November 1988 at a Ministerial meeting. The plan urges:

- the creation of an open, transnational European defense market.
- a stronger European defense R&D effort
- development of viable defense industries in less developed member nations.

It is surely not coincidental that the resurgence of interest in the IEPG came during the same time frame as the period leading up to the passage of the Single European Act by the European Community. As in the civilian arena, the defense ministers recognized that the only way European defense industries could hold their own against the United States was through consolidation and larger, European wide markets. Ironically, the American economic threat appeared to play a more important role in the drive towards more rational defense equipment design and procurement in Europe than the threat posed by the common military enemy, the Soviet Union—and this of course was prior to the sudden decline in East-West tensions. And as with the Europe 1992 exercise, Europeans were quick to argue with the U.S. that the IEPG effort was not so much aimed at keeping the U.S. out of their markets, as it was to enable European defense industries to be truly competitive with their American counterparts.

The IEPG has been making progress on two of its major objectives.¹⁶ By the end of 1990 all countries except Luxembourg (which was excused) and Portugal were in some fashion publishing their procurement requirements so that other IEPG countries could bid on them. It should also be noted that the IEPG program included not only the concept of helping defense industries in less developed member countries, but also of *juste retour*, to assure that an open competitive procurement process would be modified to guarantee a rough distribution of contracts proportionate to funds spent. Thus any European open procurement defense program will be modified to produce "equitable" as opposed to efficient results, at least for a "transitional period." Traffic flow on European two-way streets is to be equal roughly in all lanes.

In theory, given the bilateral procurement MOUs the U.S. has with most IEPG members, U.S. companies should be able to bid on these published national defense requirements. It is the stated policy of the IEPG that this is the case. It remains to be seen whether in practice this will happen, however, particularly given the *juste retour* policy of the member countries.

The program known as the European Cooperation for the Long-Term in Defense (EUCLID), which is to facilitate cooperative R&D efforts on particular projects, also now appears about to get underway. It is similar to a number of European programs in the civilian sector such as BRITE, RACE, and ESPRITE, all of which are intended to combine national resources to help Europe stay competitive in high technology industries with respect to the U.S. and Japan.

EUCLID had been delayed in part because countries were unable to agree on how to handle ownership of intellectual property emerging from such research. With Ministers having passed this hurdle in November of 1990, there are hopes that contracts on joint research projects can be let by mid-1991. There are those in Europe that hope EUCLID can eventually move from being a facilitator of voluntary cooperation among countries on specific projects, to a truly central pool of

European money which can be spent on projects agreed to collectively—sort of a European DARPA.

During this rejuvenation period, the IEPG has almost certainly served as a catalyst for action by the private sector, just as the EC-92 program has triggered major restructuring in manufacturing and service sectors in the community even before new EC regulations are in place. Similarly, in the past two years there has been a major consolidation of defense companies within European countries.

Most notable has been the establishment by Daimler-Benz of its Deutsche Aerospace (DASA) Division, which absorbed the previously independent aerospace companies of MBB, Dornier, Telefunken Systemtechnik and MTU, and the acquisition by British Aerospace of Royal Ordnance. The UK's General Electric Company (GEC) and West Germany's Siemens collectively acquired Britain's Plessey, and divided most of the pieces among the two. GEC later took over Ferranti International's radar division. France's Thompson-CSF and Aerospatiale have combined their avionics activities into a single joint venture.¹⁷

It should be noted that if one of the European objectives was to create defense companies of a size to compete head on with American rivals, that objective is being met. For example, DASA, with aerospace sales of \$6 billion in 1988, and British Aerospace, with sales of \$7 billion in the same period, compare favorably with such American giants as General Dynamics (1988 sales of \$5 billion) and McDonnell Douglas (\$13 billion).

European companies have also begun to create cross national joint ventures, companies, and cross holding of stock in each others companies. For example, France's Thomson-CSF and British Aerospace intend to merge their missile and guidance system divisions into a new company called Eurodynamics. Similarly, DASA's MBB and Aerospatiale are forming Eurocopter to jointly design and produce military helicopters.

European companies have, of course, worked together in government sponsored project-specific consortium for some time. Examples include the British-French Jaguar fighter aircraft, and French-German Alphajet trainer, the British, German, and Italian Tornado fighter/attack aircraft, and the British, German, Italian and Spanish next generation European Fighter Aircraft (EFA). In all these cases governments identified a common requirement, projected individual country purchases, and divided up the work share in rough proportion. While there may be competition at the subcontracting and component level, work at the prime contracting level has been a political, rather than a market decision.

THE U.S. AND NATO WEAPONS INTEGRATION

As already noted, the NATO alliance has tried some of the same approaches recently embraced by the IEPG. Beginning thirty years ago with the unsuccessful NBMR, NATO later established the Conference of National Armament Directors (CNAD), which is the primary policy-making body in NATO for procurement. It is intended to encourage greater standardization and interoperability of weapons systems, and to stimulate joint programs for research, development, and production of weapons systems. In 1987 the CNAD approved a trial program known as the Conventional Armaments Planning System (CAPS), which would provide NATO members a forum to outline their anticipated research, development, and procurement plans and to compare them with other members. The program was adopted by NATO ministers in 1989 as a permanent part of the NATO planning machinery. It is hoped that CAPS may lead to common programs among members.¹⁸

Congress has on occasion given a positive push to such NATO weapons collaboration. In 1975 it passed the Culver-Nunn amendment which encouraged the U.S. Department of Defense to engage in cooperative activities with NATO countries. In 1979 it began the Foreign Weapons Evaluation program, which included funding, to stimulate the Services to examine whether existing foreign weapons systems might meet U.S. mission requirements.¹⁹ In 1985 the Nunn-Warner and Quayle [Quayle] amendments were passed. The former provided funds for codevelopment programs with NATO allies, and the latter removed a number of legislative obstacles to cooperation with and procurement from our allies.

Yet the same Congresses consistently passed Buy America legislation which sends an opposite signal to industry, the U.S. services, and our allies. The basic Buy America law of 1933 requires federal procurement officers to add 6 percent to the price of foreign bidders on defense contracts in comparing their bids to American firms. DOD has by policy increased the preferential margin to 50 percent. This preference, however, has been waived for essentially all NATO countries under the provisions of our bilateral reciprocal procurement MOUs. The Congress has also added product specific Buy America provisions which cannot be waived, ranging from specialty metals (since repealed), stainless steel flatware, anchor chain, textiles, and naval vessels. As recently as September of 1990 the House passed an extension of the Defense Production Act which encourages the President to purchase all military hardware and components from U.S. sources within five years (the provision was dropped in conference).

The executive branch in general, and the Department of Defense (DoD) in particular, also send mixed signals to European allies and U.S. industry as to its enthusiasm for cooperative undertakings. On the one hand there has been a long series of supportive policies and statements from Presidents, Secretaries of Defense, and U.S. Ambassadors to NATO on cooperative programs. As recently as March 15, 1990, the U.S. Ambassador to NATO William Taft, IV, made a speech endorsing defense industrial cooperation, early agreement among NATO partners on future military requirements, a definition of our industrial base to include NATO countries, and a mechanism to expand intra-NATO trade in defense products (a "NATO GATT").²⁰

But the executive branch and the services have also thrown numerous obstacles into the path of cooperative programs. The services have always preferred equipment which is tailor made for their own requirements—requirements which often are more specialized for a specific mission and more generalized to cope with a variety of external conditions than our NATO allies need or can afford. Cooperative programs have often been seen as requiring compromises to service requirements, and as adding time, cost, and complexity to the management of a program.

It is not surprising therefore that the services have historically not been enthusiastic about cooperative programs, except in rare instances when they didn't see any other way to obtain a desired piece of equipment (such as the Harrier jump jet). The Nunn program, for which the Congress earmarked specific funding levels, attracted the services as long as the costs associated with the program were covered by Nunn funds, rather than the services' own resources. But the U.S. dropped out of several of these programs when, after two years, service money had to replace the Nunn funds, and when the services perceived that the Office of the Secretary of Defense had lost some of its earlier enthusiasm for such programs.

THE TECHNOLOGY TRANSFER PROBLEM

The offices charged with watching over the transfer of U.S. technology, both in the services and in DoD (the Defense Technology Security Administration, or DTSA), have also been less supportive of collaboration than the sponsors of these programs. There is considerable apprehension that if U.S. companies are allowed to bring their best technology to a cooperative

program, the technology itself might be compromised, or knowledge of our capabilities might become known to potential adversaries. As a consequence, restrictions on technology transfer for cooperative programs can make U.S. technology unattractive to potential partners, who are often capable of providing their own technology at the level we are allowed to transfer. However, if only second best technology is available for a cooperative program, then both the U.S. service and alliance partners will quickly lose interest in the product. Thus all too often U.S. technology transfer policy results in our closest allies producing less capable equipment at higher unit costs than would be possible if U.S. technology were made available.

Similarly, the U.S., both through legislative statute and administrative oversight, has insisted on stringent controls over the export of products containing U.S. technology, even when produced in other countries. Even when the U.S. government agrees in advance to designating a set of countries to which sales might be made, it still withholds the right to unilaterally change the eligibility of a given country. As already noted, most European defense products must be exported if production runs are to be at all efficient. Hence Europeans are understandably reluctant to compromise their ability to export a defense product because it contains some U.S. technology.

The technology issue has been further complicated in the past two years as some in Congress and in the executive branch, particularly in the Commerce Department, have regarded cooperative defense programs as a conduit whereby U.S. technology may be transferred to countries which are our military allies, but commercial competitors. The recent efforts by Congress and the Department of Commerce to become more involved in establishing offset policy and to review product and procurement MOUs, plus the Congressional hostility to the FSX codevelopment program with Japan, are dramatic evidence of these concerns.

THE EMPTY STREET

The net result of these mixed signals is, not surprisingly, rather limited cooperation between the U.S. and Europe in weapons design, production, and trade. There have been stellar examples of such programs. Often noted are the F-16 fighter program; the Multiple Launch Rocket System (MLRS), with the U.S., UK, France, Germany and Italy; the Sea Sparrow, which included Belgium, Canada, Denmark, Germany, Greece, the Netherlands, Norway, Portugal, Turkey and the U.S.; the AV8-B attack aircraft, with the U.S. and UK; and the X-31, involving Germany and the U.S. But these have been the exceptions, rather than the rule.

Currently the U.S. procures roughly \$3 billion a year from off shore out of a defense procurement budget of approximately \$80 billion. This 4 percent of the market compares to European imports of roughly \$5 billion from the U.S., out of a procurement budget of around \$40 billion, or about 12 percent of its expenditures. As recently as the mid 1980s, Europeans complained that the ratio of European imports of defense equipment from the U.S. was about eight times that of U.S. imports from Europe. Today that ratio is about 1.4 to 1. However, the ratio has changed more because European imports from the U.S. have dropped sharply than because of increased U.S. imports from Europe, which are rising at a steady but slow rate. The two-way street is becoming more evenly traveled, but traffic is decreasing.

By way of comparison, it is noteworthy that in the United States about 29 percent of our automotive market is served by foreign producers (both imports and U.S. based foreign companies). In civil aviation, the U.S. imports about 38 percent of its demand, Europe around 77 percent. These figures would indicate that were open trade in defense products possible, it is likely there would be a considerably higher percentage of procurement accounted for by imports or foreign owned domestic production on both sides of the Atlantic.²¹

THE GOVERNMENT'S PERSPECTIVE: WHERE YOU STAND DEPENDS ON WHERE YOU SIT

So why have nearly three decades of initiatives to bring about greater arms cooperation between Europe and the U.S. produced such meager results? The reasons lie with both governments and industry. From the government standpoint, cooperation seems to have foundered on the inability of governments to find an appropriate balance between three sets of contradictory objectives:

Independence versus Interdependence: Individuals, bureaucracies, and nations all prefer to maintain their freedom of action. In the defense arena, this has meant that services want to obtain equipment designed for their particular mission requirements. Politicians and military planners want as autonomous an industrial base and research and development capacity as possible. International relations practitioners want wide latitude to conduct foreign policy, including the ability to impose trade sanctions. Cooperative arms programs, while hopefully increasing the total military power available to the NATO alliance, will generally reduce the individual freedom of action of each participant. For the U.S., with its huge domestic defense market, cooperation has historically not been an economic necessity to produce our own systems, but rather something we wanted others to do in order to increase their military effectiveness. We wanted it both ways—to maintain our own independence of action with respect to the design and production of weapons systems, while encouraging European interdependence (which is to say dependence) with the U.S.

Efficiency versus Equity: Put crudely, most economically efficient systems force individuals and organizations to compete against each other, with the least efficient losing jobs and business. Governments traditionally set the rules within which such competition occurs, and often feel impelled to intervene in the results of such competition in order to bring about “equitable” results. In democratic systems, this often means results in which the desires of politically active groups must be offset against the common welfare. In the case of defense cooperation, this means the proponents of “two way streets” and “open defense markets” must deal with the political requirements of “offsets,” *juste retour*, and “pork barrel” politics.

Multilateral versus Bilateral: The more participants there are in a program, the more compromises are necessary in arriving at a common policy, and the less satisfied each party will likely be with the decision. Hence it is easier to conduct bilateral programs than multilateral ones. The U.S. deals with European countries, not Europe, in most instances, as witness the individual bilateral reciprocal procurement MOUs. Since there is as yet no European defense procurement agency or industry, U.S. government and industry must deal with European countries and companies on an individual basis. But bilateral programs, while increasing standardization and (hopefully) efficiency between two countries, by no means resolve the problem of the U.S.-European alliance as a whole.

Multilateral programs, while being more complex, also allow a wider dispersal of costs and risk. The more partners, the longer the production runs, and hopefully the lower the unit costs. Furthermore, the greater the number of participants, the wider the spread of standardization around a single system. Finally, broadly based multilateral programs may be less vulnerable to the departure of any one partner from the program.

For individuals in European and U.S. governments, the more a government official has been preoccupied with fighting the Russians, the more oriented he is likely to be towards interdependence, efficiency, and multilateral solutions. Hence most initiatives for cooperative programs have come from NATO officials and representatives to the organization, Ministries of Defense, senior legislators on armed services committees, and scholars. Conversely, the more one is focused on getting reelected, maintaining the strength of a uniformed service, or keeping foreign

policy options open on a global basis, the more skepticism an individual may have towards arms cooperation, and the more sympathetic he may be with arguments centering on independence, equity and bilateral relations.

THE INDUSTRY VIEW: WHAT DOES THE CUSTOMER WANT?

The other player in the cooperation arena is industry. While the defense industry faces a peculiar customer base—essentially a limited number of governments—it acts in many respects as any other industry. In particular, it will participate in international cooperative activity for four basic reasons:

Gain Market Access: It is always useful to be close to your customer. Having a foreign partner, or an investment in the customer country, can help accomplish that objective. As the customers for defense products are governments, a foreign partner, production in the customer country, or purchases from that country may be a political or legal necessity. U.S. companies thus may have little choice but to seek licensed production or that with foreign business offset agreements. A European company bidding on a large contract with the U.S. must have a domestic partner and/or a U.S. subsidiary to have a reasonable chance of winning a competition; hence the recent direct investment by European defense companies.

Once again, the asymmetry between the U.S. market (about 50 percent of the Western defense market), and the European national markets, comes into play. It is quite obvious to European defense companies that buying into the U.S. market is a sensible investment. It is by no means as obvious to U.S. companies that entering into a relationship with a single company in one European country provides enough market access to make such a deal attractive. Ironically, one major advantage for a U.S. company of establishing a relationship with a European company might well be in Third World markets, where Europeans may have better access, strong political and financial support for exports from their own governments, and less of the political and legal restrictions which impede U.S. companies from selling directly to Third World countries.

Share the Risks: For U.S. aerospace companies, it is conventional wisdom that launching a new civil aircraft or engine involves “betting the company.” In recent years companies have spread the risk by taking on foreign partners. In the defense industry, the risk has historically been less as the government has generally covered most development costs. As DoD in recent years shifted towards requiring more risk capital by the defense companies, the firms responded by forming teaming arrangements with American partners. Over time, U.S. firms may seek foreign partners or will if the defense project has potential in both U.S. and foreign markets.

Raise Capital: Related to the above, launching increasingly complex and expensive civil projects requires large amounts of capital. International partnerships can help raise such funds in different capital markets. In the international arms cooperation arena, it is governments that generally fund such projects, and the increasing cost which drives them to work collectively, particularly within the European market.

Obtain Technology: Companies in the defense industry have long taken advantage of technology from off shore through buying components or obtaining production licenses. As technology development becomes increasingly complex and expensive, companies will find it attractive to search out partners for product development which have complimentary technologies—both basic and production—so as to minimize the up-front costs. This can only happen across borders, of course, if government controls on technology transfer do not preclude such arrangements.

For companies, as for governments, international cooperation is often harder than going it alone. This is particularly true in the defense industry. Most companies have excess capacity, and it makes little economic sense to establish a new production line outside of the home country. This observation is not necessarily true in the case where a European product is being considered by the U.S., as a single buy from DoD may be a multiple of the domestic European country market, and hence domestic production facilities might well not be adequate to produce for a large U.S. purchase. Security regulations make cooperation with foreign nationals complex. Thus barring incentives of the types noted above, defense companies will prefer to avoid cooperative undertakings.

In general the primary customers for defense companies are the uniformed services, and to a lesser degree the parliamentary bodies (particularly in the case of the U.S.) which must approve military budgets. These customers generally regard cooperative programs as an annoyance, and enter into them only under duress or with a strong enticement (such as free Nunn money in the case of the U.S.). In Europe, small national markets and increasingly expensive weapon systems are slowly forcing customers to overcome their antipathy to cooperative programs, as the only alternative to such programs is buying offshore or doing without. In turn, companies have responded by forming system specific, and more recently, product specific alliances.

SO WHAT HAPPENS NOW?

As defense budgets in Western Europe and the U.S. decline, the procurement of weapons systems on a national basis will mean each country will have to reduce the variety of systems it can produce, and to pay higher unit costs for those weapons which are purchased. Thus the economic arguments of cooperation and the larger production runs and lower unit costs associated with such cooperation become even stronger. Europeans may be driven to accelerate the efforts of the IEPG, and NATO may see arms cooperation as one of the areas for increasing activity in an institution looking for new directions.

At the same time, the receding Soviet threat which has precipitated those budget declines in turn will reduce the political and military pressure on Western democracies to make the perceived sacrifices needed to increase cooperation. European governments may well become preoccupied with absorbing Eastern Europe, while the U.S. becomes increasingly concerned with regional instability outside the European theater. The Europeans may well cancel a number of new systems, build and upgrade enough current systems to keep domestic defense industries alive, while the U.S. increasingly turns to development and procurement of equipment suited for force projection outside of Europe, such as airlift and sealift, lighter and more lethal weapons which can be readily transported, and equipment for light infantry combat.

As is usually the case with such dichotomies, the likelihood is that some of both will happen. Military services will increasingly find that diminished budgets and the tyranny of the linkage between unit costs and length of production runs will mean that they have to buy equipment from offshore (including the possibility of licensed production onshore) or engage in cooperative programs if they are to continue to purchase a variety of systems at anything resembling acceptable costs. At the same time, new systems in Europe and the U.S. are likely to be deferred or cancelled, and ways found to make do with current equipment or modifications of that equipment. European involvement in the war with Iraq is likely to remind the allies that they must be able to respond to events outside of the European Continent if they are to be credible as global players.

Proponents of cooperative programs should recognize political reality. Neither the U.S. nor Europe is likely to agree to any scheme wherein they go out of the business of designing and producing major defense equipment such as capital ships, fighter aircraft, or tanks. Here the best that can be hoped for is that European integration moves forward through cooperative programs so

that the Europeans at least reduce the number of models of such equipment they produce. While these systems may not compete against each other in home markets, they will do so in third country markets, which should help press the producers of both U.S. and European systems to design and manufacture quality products.

This function of Third World markets, by the way, is reduced when Congress refuses to allow sales of military hardware to certain countries without a similar boycott by European countries, or when European companies can use business methods, subsidized credits, or political pressure not available to their American competitors. In such cases, particularly in the Middle East, the Europeans have been able to attain markets even when their quality and price were not equal to that offered by American companies. This in turn encourages Euro-nationalists to produce parallel systems. The U.S. government and industry get the worst of all possible worlds in such a situation. The government loses influence over the customer country, U.S. industry loses sales which, and the Europeans get longer production runs.

With respect to such major weapons systems, the best role NATO might perform is to encourage greater standardization wherever possible, ranging from ammunition and fuel to other consumables (filters, treads, etc.) to subsystems and support equipment. Joint basic research projects, such as the X-31 enhanced fighter maneuverability program being undertaken by Rockwell and MBB might also be stimulated by NATO, future DARPA-EUCLID cooperation, or individual countries, thereby increasing common knowledge on which U.S. or European programs might be based.

With respect to medium sized systems, such as many missile programs, wheeled vehicles, communications gear, and infantry weapons, as well as for large subsystems on major weapons programs, a gradual increase in competition across the Atlantic would seem advisable. Here again, the emergence of a truly integrated European defense market may be a prior requirement for cross Atlantic cooperation to emerge. Only when the European market as a whole is of sufficient size to allow the Europeans some confidence in their ability to take on American companies will such two-way competition be practical. Without such market symmetry, European companies will continue to find it important to team with American companies or to purchase American subsidiaries in order to penetrate a market which is a multiple of any European country, while U.S. companies will primarily seek out export marketing opportunities (with associated offsets or licensing) for individual European and Third World national markets.

Even with such medium sized systems or major subsystems, neither Europe nor the U.S. is likely to be willing to see domestic capacity lost all together. Thus partnerships, licensing arrangements, or dual sourcing will almost certainly have to be employed in the immediate future to assure design and production capability on both sides of the Atlantic.

As to minor or highly specialized weapons systems, and components of all weapons systems, competition across the Atlantic should be allowed to the maximum extent possible. The total U.S. plus European market should be large enough to assure the survival of several firms for any given product, particularly if major weapons systems are designed to use standardized or compatible components to the maximum extent feasible.

On the European side, therefore, it is probably necessary for European integration to move forward rapidly if trans-Atlantic cooperation is to increase. On the U.S. side, perhaps the single major contribution the U.S. government could make would be to decrease controls on technology transfer. If U.S. companies cannot bring their best technology to the table, neither the Europeans nor the U.S. military services will have much interest in collaborative programs. If we insist on unilaterally dictating to which countries end items with even modest amounts of U.S. technology can be sold, Europeans will avoid using American technology will endeavor to create their own.

Overall, the best policy for governments to take is one that creates a framework which allows for maximum competition and cooperation among firms on both sides of the Atlantic. Given that customers are governments, such a framework will always have to take into account more political and security than commercial factors, and hence will never wholly emulate other product markets. The challenge is to take the most advantage of larger markets and the economies of scale a common defense market could provide, and to stimulate as much competitive behavior as is realistic among defense producers.

¹Thomas A Callaghan, Jr., *U.S./European Cooperation in Military and Civil Technology*, prepared for the Department of State by Ex-Im Tech, Inc., August 1974, p. 41.

²Defense Society Board, *Industry-to-Industry International Armaments Cooperation: Phase I-NATO Europe*, report to the Office of the Under Secretary of Defense for Research & Engineering, June 1983, p. 84.

³*International Coproduction/Industrial Participation Agreements*, report of the Department of Defense Task Group, August 15, 1983 (known as the Denoon Report, and its principal author, David B. H. Denoon), pp. 5-6.

⁴See Policy Statement and Fact Sheet released by the Office of the Press Secretary, The White House, April 16, 1990.

⁵For an example of industry attitudes towards offsets, see "Views of the Aerospace Industries Association on a U.S. Government Policy on Offsets Related to Military Sales"; submitted to the Office of Industrial Resource Administration, Bureau of Export Administration, U.S. Department of Commerce, January 30, 1990, in response to a request in the *Federal Register* of January 8 for public comment on offsets.

⁶Thomas A. Callaghan, Jr., *Pooling Allied and American Resources to Produce a Credible, Collective Conventional Deterrent*, prepared for the Department of Defense, August, 1988, p. 19.

⁷Callaghan, *U.S./European Economic Cooperation in Military and Civil Technology*, p. 40.

⁸*Ibid.*, p. 40.

⁹*Ibid.*, p. 41.

¹⁰Data from Research Center, Aerospace Industries Association, and the "Statement on Defense Estimates, 1990," a report to the Parliament by the Secretary of Defence, April, 1990.

¹¹Andrew Moravcsik, "1992 and the Future of the European Armaments Industry," Economic and National Security Program, John M. Olin Institute for Strategic Studies, Harvard University, September, 1989, p. 6.

¹²A number of recent studies on the industrial base have addressed this range of problems. See for example *Bolstering Defense Industrial Competitiveness*, report to the Secretary of Defense by the Under Secretary of Defense, Acquisition (known as the Costello Report), July 1988; *Industrial Base: Defense-Critical Industries*, a briefing report to the Honorable John Heinz by the U.S. General Accounting Office, August 1988; and *Lifeline in Danger: An Assessment of the United States Defense Industrial Base*, The Air Force Association, September 1988.

¹³Callaghan, *U.S./European Economic Cooperation in Military and Civil Technology*, p. 65.

¹⁴For a simple guide to the various institutions and programs related to Europe 1992 and European integration of the defense sector, see Aerospace Industries Association, *European Integration: Background and Definitions*, 1990.

¹⁵*Towards a Stronger Europe*, vol. 1, report by an independent study team established by Defense Ministers of Nations of the Independent European Programme Group, December 1986.

¹⁶See the "Copenhagen Communiqué" and accompanying "Policy Document on the European Defence Equipment Market" issued on November 16, 1990, by the IEPG Defence Ministers for more detail on procurement and EUCLID.

¹⁷Data from Aerospace Industries Association Research Center.

¹⁸Aerospace Industries Association, *European Integration: Background and Definitions*.

¹⁹Francis M. Cavasco, "The United States and Europe: State of the Future Relationship," *Revista Espanola de Defense*, 1990.

²⁰The Honorable William H. Taft, IV, "The Future of Defense and Industrial Collaboration in NATO," presented to the German Strategy Forum and the Institute for Foreign Policy Analysis, Bonn, FRG, March 15, 1990.

²¹Data from Aerospace Industries Association Research Center.