

A minefield of opportunity

Transatlantic defence cooperation in the Trump era

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For 70 years, NATO allies in Europe and North America have stood together to defend their territorial integrity and uphold a broad set of shared interests and values against common security threats. Yet, despite pledging in the North Atlantic Treaty to “seek to eliminate conflict in their international economic policies and ... encourage economic collaboration between any or all of them”, allies have largely gone their separate ways in their national defence industries.

With some political leaders on both sides of the Atlantic now questioning the relevance of the alliance, amid mutual accusations of deficient defence spending, failure to consult, protectionism and trade-distorting subsidies, the drive for industrial collaboration may seem less of an imperative.

But the need to be able to conduct operations together – whether through NATO, on UN missions or in ad hoc coalitions - as well as the search for economies of scale, will continue to provide a strong incentive for cooperation beyond current political frustrations.

Moreover, the emergence of cyber and hybrid forms of warfare that target civilian infrastructure, information networks, the media and democratic governance without overt military action, present a common challenge to densely interconnected Western democracies.

Governments, defence officials and experts on both sides of the Atlantic have long advocated greater cooperation in developing and manufacturing defence equipment to use budgets more efficiently, avoid duplication, harness the best technology and ensure interoperability among allied armed forces.

A rare exception has been France, which has pursued the goal of national – and more recently European – strategic autonomy, interpreted as avoiding as far as possible dependence on US or other non-European technologies, know-how and materials in a quest for freedom from external constraints. Even France, however, could not have conducted a campaign like the current Operation Barkhane against jihadist groups in the Sahel region without US intelligence, surveillance and reconnaissance, and allied assistance with airlift.

AN UNCOMMON MARKET

Defence has always been the most national of industries and the least amenable to the disciplines of the global market economy. That is partly because governments are the monopoly customers. Jobs, factories and politics as much as commercial factors drive the way they spend taxpayers' money. Defence companies are also often either monopolies or duopolies in their specialist fields, limiting competition. They know how to seduce politicians and use respected retired military commanders and diplomats as lobbyists.

Each nation wants to preserve security of supply of weapons, munitions and strategic minerals in crisis and wartime, guard its military technology from rivals and protect itself against espionage or sabotage. For the French and British, freedom to export to clients in the Middle East and Asia is key to the business model of their industries and reduces unit costs for their own armed forces.

NATO has implemented a small number of commonly funded programmes, mostly based on off-the-shelf US platforms, such as the Airborne Warning and Control System aircraft and the Allied Ground Surveillance based on the Global Hawk. But several allies are averse to common funding, so the alliance's budget is puny – barely 0.1% of combined defence spending.

The United States has prodded allies since the 1970s to pool capabilities around NATO priorities. More recently, the NATO Secretariat has tried to nudge groups of countries into cooperative efforts under the buzzword of 'Smart Defence'. It has had limited success, for example facilitating transfers of precision-guided munitions among allies.

12 NATO nations jointly own a fleet of C-17 strategic airlift planes based in Hungary, managed by the NATO Procurement and Supply Agency that operate on a time-share basis. The European Air Transport Command, established in the Netherlands in 2010, manages pooling and sharing of some 220 nationally-owned aerial refuelling and military transport aircraft of seven EU member states.

While the United States is a major supplier of equipment to European allies, especially in aerospace and missiles, seemingly insurmountable barriers remain to any sort of genuine common defence market. Put simply, the US is too strong and the Europeans too weak and divided to achieve a level playing field.

The transatlantic game is overwhelmingly played by US rules, notably the 1933 Buy American Act, and the 1941 Berry Amendment that requires the Defence Department to give preference to domestically-sourced products and materials. Moreover, the sweeping 1976 International Traffic in Arms Regulations (ITAR) controls and restricts the export of weapons, defence-related technology and know-how from the United States.

Washington does not treat all NATO allies equally in defence trade and regulatory policy.

The United States' three closest partners – the UK, Canada and non-NATO Australia – are officially designated as being part of the US National Technological and Industrial Base (NTIB), though not always treated as such in practice. Other allies, notably those that have individual Memorandums of Understanding on defence cooperation with Washington, may obtain discretionary, case-by-case waivers from ITAR and other constraints. Waivers may also be withheld without explanation. All allied companies face daunting compliance costs to compete in the US market.

European suppliers are almost never main contractors to the US Defence Department. UK-owned BAE Systems Inc. is the only foreign firm on the Pentagon's list of authorised prime contractors, but it acts mostly as a sub-contractor. Other European companies partner with US primes to become part of the supply chain. To operate in the US market, companies have to create a ring-fenced US subsidiary with an all-American proxy board and a Special Security Agreement (SSA) under which the foreign parent forfeits the right to use equipment or know-how developed in the United States in its home base or in exports, and has little insight into the activities of its US unit.

FRAGMENTED EUROPE

The fragmentation of the European defence sector has led to a grossly inefficient proliferation of weapons systems. The European Commission estimates that lack of cooperation among EU member states costs between €25bn and €100bn a year due to duplication, absence of competition and lack of economies of scale. The Europeans field 178 major weapons systems while the equivalent American figure is 30. They have 17 types of main battle tanks, compared to 1 in the US inventory, and 20 different types of combat aircraft whereas the US has only 6.

In 2009, the European Union made its first attempt to create conditions for a more integrated market by adopting two laws governing defence procurement and arms transfers among member states. However, the attempt to use regulatory tools to make the sector more transparent, competitive and efficient has had limited impact since the EU treaty allows governments to bypass EU tendering rules in awarding contracts by invoking essential national security interests.

In 2016, the EU adopted a Global Strategy enshrining the goal of “an appropriate level of strategic autonomy”. The following year, it launched a framework for closer defence cooperation among 25 member states, known as Permanent Structured Cooperation (PESCO).

This entails a series of binding commitments on defence spending and investment in equipment and in research and technology. It also calls for an annual defence review under peer pressure and a set of joint projects to generate missing capabilities involving coalitions of willing EU countries.

For the first time EU budget funds are being allocated to incentivise cross-border cooperative defence research and development, and eventual joint procurement. While the initial sums were small, the plan is to earmark €13bn euros for defence R&D in the 2021-27 budget, with additional money for military-related space projects and infrastructure improvements.

The EU's unprecedented venture into this field comes more than 60 years after a first attempt to create a European Defence Community failed. It was triggered partly by a heightened threat perception following Russia's 2014 seizure and annexation of Crimea and military destabilisation of eastern Ukraine, as well as a wave of jihadist terror attacks in western Europe and instability across Europe's southern periphery. For the first time since the end of the Cold War, European countries began to reverse the steep decline in their defence spending. Most have sustained increases for the last five years.

In parallel, NATO and the EU embarked on an unprecedented programme of cooperation and dialogue after decades of largely ignoring each other. Among the highlights are joint workstreams on cyber security, hybrid threats and so-called military mobility – facilitating rapid reinforcements by removing bureaucratic barriers to the cross-border movement of troops and materiel and upgrading roads, railways, air and sea ports and bridges for dual use with EU funds.

Another driver of closer EU defence cooperation has been the perception of a gradual, long-term US disengagement from Europe and its neighbourhood, predating the current administration. Washington has placed more policy attention and military resource on Asia. The political need to strengthen the EU in the aftermath of the UK's 2016 vote to leave the bloc was also a factor. The NATO-centric British had long been a brake on EU defence integration, although they now belatedly want to remain part of it.

Even the most enthusiastic advocates of European strategic autonomy acknowledge that it is a very long-term goal. The EU is not going to be a cohesive power capable of conducting more than modest external military interventions or of ensuring its own territorial defence without the United States for the foreseeable future.

THE TRUMP FACTOR

The election of President Donald Trump, who called NATO “obsolete” and initially declined to reaffirm its mutual defence clause, spurred the Europeans to step up their efforts. Trump accused European allies of owing the US billions in defence spending and branded the EU a “foe” in trade, imposing punitive tariffs on imports of European steel and aluminium in the name of national security. He also questioned whether America would come to the defence of Montenegro, which joined the alliance in 2017.

Trump's impetuous tweets, lack of consultation on strategic decisions, transactional approach to security, disdain for the EU and rough treatment of allies, especially Germany, raised doubts about his commitment to NATO. All this despite an increase in US spending and military presence in eastern Europe on his watch.

The United States has long urged Europeans to shoulder a fairer share of the defence burden and not free-ride on American protection. The Obama administration welcomed the plan to use EU taxpayers' money to help plug capability gaps identified by NATO and the European Defence Agency.

Trump preferred the stick to the carrot, demanding that allies finally meet their NATO commitment to spend 2% of GDP on defence, and pressing them to buy more American kit, implicitly to secure preferential US protection.

While Britain, Poland and the Baltic states meet the NATO spending guideline and France comes close, wealthy west European states such as Germany, Italy, Denmark and the Netherlands, spend less than 1.4% of GDP even after recent increases, and Belgium and Spain less than 1%.

In 2019 the Trump administration expressed deep concern at the way the EU was going about setting up its European Defence Fund (EDF) and Permanent Structured Cooperation (PESCO). A strongly worded letter from the State and Defence Departments complained that draft regulations governing the EDF and PESCO would discriminate against non-EU NATO allies and effectively shut American companies out of joint European projects.

The letter accused the Europeans of inserting "poison pills" in the rules to preclude firms from the US and other third countries participating, and hinted at possible retaliation. "It is clear that similar reciprocally imposed US restrictions would not be welcomed by our European partners and allies, and we would not relish having to consider them in the future," it said.

A wounded response from Brussels said the European market was and would remain significantly more open than the US market and called for "an open and transparent discussion with the US on access to our respective defence markets".

Washington objected chiefly to requirements that US-owned subsidiaries in Europe that want to join a consortium for an EDF project be bound to keep intellectual property arising from such EU-funded projects in Europe and subject to the arms export restrictions of their host country, and to rules that effectively bar the usage of items and technologies subject to US export controls.

Those terms closely mirror conditions that have long applied to European firms doing business with the US Department of Defence and its agencies, as the EU rejoinder noted.

Both sides accuse each other of protectionism. In interviews for this study, a senior US official voiced concern that for some EU countries – which he indicated included France and Germany – the EDF was "a trade policy masquerading as a defence policy", designed to shut US firms out. Another called it "an industrial policy masquerading as a defence policy".

For their part, some European officials have expressed dismay that Trump's drum-beating for higher European military spending carries an implied trade-off between US protection and buying American equipment.

"I am personally more concerned at the notion that the strength of NATO's solidarity might be made conditional on allies buying this or that equipment. The alliance should be unconditional, otherwise it is not an alliance. NATO's solidarity clause is called article V, not article F-35," French Defence Minister Florence Parly said in a reference to the US fighter aircraft.

Despite the US protests, the EDF regulation – key terms of which had already been agreed by EU governments and the European Parliament – is highly unlikely to be amended. It could, however, be clarified by implementation guidelines after a calmer transatlantic dialogue.

The EU is also considering allowing countries that "share European values" to participate in PESCO projects by invitation on a case-by-case basis. They would be open to selective US and UK participation, without giving China, or for that matter NATO ally Turkey, a right to take part. The US letter pointed out that such exceptional access would apply for a limited period and an extension would require unanimous approval by EU members. That would give any member state a veto at each stage.

It noted that "one member state" (France) has been blocking the opening of negotiations between the European Defence Agency and the United States on an administrative agreement setting a basis for cooperation since 2016.

LOPSIDED BALANCE

The balance in transatlantic arms trade is lopsided in favour of the United States. This is hardly surprising given that it has, by far, the world's largest military budget. It spends more than double EU countries' combined outlays and is home to the top five global defence companies - Lockheed Martin, Boeing, Raytheon, Northrop Grumman and General Dynamics. And its weapons systems have been battle-tested in multiple overseas operations in East Asia and the Middle East.

At the end of the Cold War, as Washington cut back military spending, the US defence sector underwent a sweeping, top-down consolidation triggered by a 1993 dinner hosted by then Deputy Defence Secretary William Perry that became known as the "last supper". Some past and present officials, including Perry himself, feel the wave of mergers and acquisitions went too far in reducing competition. The Pentagon has since encouraged European, Canadian and Australian companies to bid for US contracts in an effort to keep costs down and combat overcharging.

However, some EU players say they do not compete on a level playing field, citing the egregious case of a US Air Force refuelling tanker tender won in 2008 by pan-European aircraft manufacturer EADS (now called Airbus) in partnership with Northrop Grumman. The Defence Department overturned the decision after protests to Congress by Boeing, which won the re-run contest.

The fragmented European defence sector has yet to eat its last supper. Political discussions between the leaders of France and Germany in 1993 on a grand bargain involving joint fighter and tank projects that might have led to major cross-border consolidation foundered when the Gaullists returned to government in Paris. The “last breakfast” came to nought.

A generation later, the same fighter-for-tank trade-off is back on the Franco-German agenda but still faces political and industrial obstacles.

An industry-led attempt in 2012 to forge a European defence champion on the scale of the US Big Five by merging EADS with Britain’s BAE Systems collapsed due to German government opposition, dealing a severe blow to hopes of building a more integrated European defence industry. Despite the potential synergies, the deal failed chiefly due to political reluctance in Berlin.

While companies such as Airbus, Leonardo, MBDA and BAE Systems are cross-border players, procurement is run on strictly national lines and European cooperative projects are the exception rather than the rule. NATO and the EDA struggle to persuade defence ministries and armed forces to align their requirements, specifications, procurement timetables, testing and certification.

Some US majors, such as Lockheed Martin and Boeing, promote themselves as champions of transatlantic defence industrial cooperation, boasting of multinational supply chains with European subsidiaries and partners. Boeing has research centres in Madrid and Munich, while Lockheed Martin and Leonardo have an F-35 assembly line in Italy.

Despite EU efforts to outlaw so-called offsets as a distortion of competition and a source of corruption, promising work-share or other economic benefits as a lure for contracts is a mainstay of US defence sales, officially reported to Congress every year. French and British defence companies use similar techniques.

European governments often trust each other less than they trust the United States. Countries such as Poland and Romania on NATO’s eastern flank make no secret of their belief that by buying US weapons systems such as Patriot air defence missiles, they bind Washington more closely to their own defence, securing extra bilateral insurance against Russia that may be worth more than their NATO and EU membership.

According to official US figures, American companies won about 80% of international arms contracts in Europe in 2014-16. US defence imports from the EU amounted to less than 2% of US defence expenditure in 2016, while EU imports from the US amounted to almost 10% of member states’ defence outlays.

The vaunted two-way street is a five-lane highway with four of the lanes going in one direction.

PATH DEPENDENCE

Little of this is likely to change any time soon. This is not just because of President Trump's explicit "America first" priority, aggressive pursuit of exports or his suspicion of some key European allies, notably Germany but also France.

The president has issued orders that domestic US defence projects must include early planning for "exportability" and has tightened enforcement of Buy American rules. However, he is also keen to impose cost control on US defence contractors, leaving room for competition from European companies down the supply chain.

Signs of this were clear in the Defence Department's 2018 choices of a joint venture between Boeing and Sweden's Saab for the major T-7 training aircraft contract, and of the Leonardo-Boeing MH-139 helicopter to guard US nuclear silos.

There is a high degree of what social scientists call path dependence – doing what we've always done – in the behaviour of European states in the defence market. The US is most strongly present in the aerospace and missile sector in Europe, while Europeans mostly make their own armoured vehicles, artillery and ships.

Those such as Norway, Denmark, the Netherlands, Belgium and Greece that have long been part of the US military aerospace ecosystem are overwhelmingly likely to remain there because of industrial, economic, air force-to-air force and personal ties. Those such as France, Germany and Spain, that have historically been involved in European or national military aerospace programmes, are likely to continue to give precedence to European cooperation.

Most central European governments, grateful for US support for their NATO accession, bought F-16s to replace legacy Soviet fighters. But Hungary and the Czech Republic opted to lease Swedish Gripen fighters.

A couple of key swing states have participated in both US and European ventures – the UK and Italy. Both are now locked into the F-35, and this may well determine their path for decades to come, especially since the UK will be more politically dependent on the US once it leaves the EU.

Germany's decision to exclude the F-35 from its search for a successor to the Tornado multirole combat aircraft, which caused howls of outrage in Washington, was an example of the pattern.

Five NATO allies – Germany, the Netherlands, Belgium, Italy and Turkey – own strike aircraft modified to deliver US nuclear weapons stored on their territory under NATO's so-called nuclear sharing programme. Germany and Italy adapted the Tornado for this purpose. Italy is switching its nuclear-sharing capability to the F-35, but Germany has yet to decide how it will replace its Tornados, due to retire in 2024, for the nuclear role, which will require US agreement.

The French and the Germans – especially the French, who have been historically more ambivalent about NATO – consider it a matter of national technological and industrial sovereignty to maintain their own capability to build top-of-the-range military platforms.

THE TIMES THEY ARE A'CHANGING

This is not to say that more transatlantic defence industrial cooperation is impossible or unlikely.

The cost constraints of high-tech, high-end platforms are forcing the Europeans especially to look for partners, be it in Europe or across the Atlantic. No European nation is likely to produce a fighter aircraft or a main battle tank on its own again.

Even cross-border projects such as the Franco-German sixth generation Future Combat Air System (FCAS) and the rival Anglo-Italian Tempest project will face huge difficulty finding adequate funding. It would be unrealistic to expect two sixth generation European combat aircraft to emerge. The more likely number is one, or none.

While the EDF and PESCO may encourage collaboration in the European defence sector, without strong, top-down political leadership they are unlikely to be game-changers, given the limited funds involved. That would also require the Europeans to reconcile widely divergent national arms export restrictions, which are arguably as big a constraint as ITAR on joint projects.

One factor that is changing defence procurement is the extent to which the civilian tech sector has overtaken the military-industrial complex at the cutting edge of technology. This trend is accelerating in the fields of artificial intelligence, quantum computing, cyber warfare, autonomous vehicles, space and digital communications.

The United States is worried about Chinese telecoms equipment maker Huawei penetrating next generation Western mobile networks, partly because its own telecoms industry has fallen behind. This would create a security vulnerability. Ericsson of Sweden and Nokia of Finland are potential alternative 5G technology providers, which ought to give the Europeans some leverage.

The pace of innovation in the digital economy is making the lumbering 20-year development cycle for major weapons platforms look obsolescent. Increasingly, defence purchasers are looking for fast off-the-shelf solutions that can be bolted onto existing military platforms, or adapted and hardened for defence uses.

However, some in Silicon Valley and its European and Canadian counterparts are wary of working with the US Defence Department either for ethical and reputational reasons or because they fear having their know-how restricted from commercial use at home and abroad. If cutting-edge US tech companies insist on remaining "ITAR-free", the Pentagon has a problem.

Japanese officials say Tokyo developed its own space launch industry rather than submit to ITAR.

Such technological and commercial factors may well drive reform of the US restrictions on technology transfer and export controls more effectively than any pressure from European allies.

THE WAY AHEAD

Based on more than 40 interviews conducted in Europe and North America, the forthcoming Friends of Europe report examines the strategic context, obstacles to and opportunities for transatlantic defence cooperation on both sides of the Atlantic.

Without illusions of a major breakthrough, given the entrenched interests and toxic politics, it recommends modest measures that could create balanced, win-win outcomes.

Whatever its feelings about NATO, the United States will always turn to the allies when it needs partners to do heavy lifting – whether it be naval patrols in the Gulf, special forces in Syria or trainers in Afghanistan. The need for coalitions is a political as much as a military imperative. Remaining interoperable is thus strongly in Washington's interest since the US military would have to do everything alone if no one could talk to it or operate with it.

The United States should see EU defence cooperation, including in the industrial and research fields, as in the long-term interests of the Atlantic Alliance. US industry may miss out on a sale or access to a European capability project here or there, but in the big picture, NATO would be better served by a stronger, more coherent European defence industrial base.

The European Union should press ahead with the EDF and PESCO without being unduly swayed by US objections, which in part reflect industrial lobbying. It should continue to ensure that its projects are aligned with capability gaps identified by NATO.

A more constructive dialogue on regulatory barriers to transatlantic defence cooperation may become possible perhaps under a future US administration if the EU initiatives are successful in generating extra capabilities and innovative technology.

The United States and the EU should consider a joint challenge fund for transatlantic research and technology projects in artificial intelligence, cyber security, digital communications equipment and space vehicle protection. Such projects would have to benefit from a general, mutual waiver of technology transfer and export restrictions among participating countries.

The EU, for its part, should enable the EDA to conclude an administrative agreement with the United States to facilitate working on joint capability projects.

The long-term common interests of the United States and Europe continue to point towards the value of partnership and cooperation in defence. Each would be far poorer without the other.

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