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Saving NATO's Foundation

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TRANSATLANTIC DEFENSE-INDUSTRY COOPERATION

TRANSATLANTIC defense cooperation is a little like the weather: everybody talks about it, but nothing much seems to happen. Meanwhile, Europe is building a separate “European” defense industry, based in part on shortsighted, if not downright misguided, calculations of self-interest. For its part, the United States is tentative at best and ambivalent at worst about greater cooperation. But as the United States and Europe dither, the effectiveness of the NATO alliance—and ultimately its future—is increasingly at risk.

The costs of inaction mount daily. Declining defense budgets, already stretched too thin, are denied the efficiencies that greater transatlantic cooperation could yield. Both Europe and the United States have therefore had to delay the modernization of their military forces and thus have been slow to take advantage of advances in technology—notably information technology that applies to command, control, communication, and intelligence. The air war in Kosovo

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demonstrated a potentially more worrisome consequence: the gap between U.S. and European military capabilities is growing, undermining both NATO's ability to undertake joint operations and the European allies' hopes to participate on an equal footing with America. At the same time, taxpayers in Europe and the United States are paying more than necessary. Most important, the industrial bases of American and European defense are growing increasingly separate, which could undermine the political basis of the alliance itself.

The stability of the Atlantic alliance is built on three mutually supporting principles: political and cultural community, common military defense, and shared burdens and risks. For many decades, improved cooperation between European and U.S. military and related aerospace industries has been seen as central to these principles; such cooperation strengthens NATO by giving it more effective armed forces that are both better equipped and interoperable. But for a variety of reasons on both sides of the Atlantic, industrial cooperation on defense has proved an elusive goal.

In the past, U.S. industry profited from selling sophisticated equipment to NATO countries without sharing much work or technology. An excellent example was the sale of AWACS, an airborne warning-and-control aircraft developed and produced in the United States, to NATO in the 1970s. Another is the acquisition of F-16 fighters by many of our NATO allies. At the same time, the U.S. defense market was largely closed to Europeans, ostensibly on the grounds that European systems were consistently inferior to their American competitors but actually in response to strong domestic political and business interests—reflected in various “buy America” legislation—which have no interest in “exporting” defense-budget dollars or jobs to Europe.

Increasingly, our European allies have been producing their own hardware—even when it is more costly and less advanced than what they could buy from the United States. A good example is the European Fighter Aircraft, which is being developed (principally by the Germans and the British) at significantly greater cost than that of better U.S. aircraft already available. The reasons for what seems irrational if not irresponsible European behavior are the perceived political and economic benefits (if not imperatives) of preserving an independent defense industrial base.

The deep European commitment to creating a “European” defense industry has several sources. First, like a common currency, an independent defense industry is deemed an essential feature of an integrated Europe, which requires its own political, economic, and military infrastructures to become an independent and coequal partner with the United States. Second, and relatedly, some Europeans believe Europe

The drive for a European defense industry eats away at NATO’s political base.

should be able to take military action without U.S. support and participation. Third, European defense consolidation is considered a necessary precondition to successfully competing, much less cooperating, with the handful of U.S. companies that have emerged from the U.S. defense industry’s own process of consolidation. For all these thoroughly

understandable reasons, Europe seems determined to have a separate defense-industry base, duplicating technological and production capabilities already expensively acquired by the United States.

Europe’s course, however, poses real political and security risks. It also harms economic efficiency and military effectiveness. There are twin, mutually reinforcing, political pitfalls at work here. One is the danger that a preoccupation with creating a “European” defense identity will eat away at the political base on which the support of European publics for NATO rests. The other is the danger that such a preoccupation will strengthen the forces of unilateralism and isolationism in the United States, which in turn will undermine the American political consensus on which the transatlantic link depends. Put simply, NATO in the post-Cold War world—perhaps even more than during the Cold War itself—needs its forces and capabilities to grow closer, not grow apart.

Likewise, defense-industrial cooperation remains crucial for NATO’s future. Having the leading defense companies in Europe and the United States work together for their mutual benefit would improve both NATO’s military effectiveness and its political cohesion. Conversely, if defense companies on opposite sides of the Atlantic are pitted against each other in a bitter struggle for slices of a progressively smaller pie, the inevitable spillover into the political arena will undermine the alliance.

But there has been an important change. For a generation, NATO governments mouthed the rhetoric of the “two-way street” in defense procurement and made hollow gestures in the form of politically dictated acquisitions from allies that made little economic or military sense. Not surprisingly, these were exercises in frustration. But now, for perhaps the first time in our lifetimes, defense and aerospace companies on both sides of the Atlantic have genuine incentives to form joint ventures, strategic alliances, and even mergers. All that remains is for governments to remove the unnecessary obstacles to such cooperation and then for the politicians to get out of the way.

FORTRESS EUROPE?

PURELY FROM the perspective of efficiency and effectiveness, the need for transatlantic cooperation in the defense industry is greater today than ever before because of two imperatives: economics and technology.

Although the post-Cold War world remains a dangerous place where security still requires cutting-edge military capabilities, the political basis for large defense budgets evaporated with the Soviet Union. Procurement budgets have fallen dramatically on both sides of the Atlantic. One inescapable consequence is that no one country can go it alone in developing the defense capabilities it needs. Another is that neither America nor Europe can afford to maintain its past industrial base. For example, the U.S. defense investment account—research and development (R&D) plus procurement—has fallen by 60 percent since 1990. (Recent pushes to increase these accounts will not make up much of the cuts.) But even at this sharply reduced level, the U.S. investment in advanced military and space technology and rate of expenditures thereon exceeds all of Europe’s combined—by about a factor of two.

One might think that these circumstances would lead governments and companies on both sides of the Atlantic to recognize that they were moving into an era of mutual dependence and to seek a consolidated transatlantic architecture that is smaller (and therefore cheaper) while retaining enough competition to ensure efficiency. In particular, one would expect that European industry would work hard to take advantage of the immense preexisting U.S. investments on a range of systems—

advanced fighter aircraft, surveillance and military communications satellites, ballistic missile defense, and so on—through some mutually beneficial arrangement, rather than devote increasingly scarce resources to reproducing those technologies.

But that is not what has been happening.

The U.S. defense industry has responded to the end of the Cold War with massive consolidation. Today there are just three surviving system-defense contractors: Boeing, Lockheed Martin, and Raytheon.

But a combination of old habits and unchanged political and legal

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constraints have largely limited this consolidation process to mergers and acquisitions among American companies. The result is a smaller, more integrated U.S. defense industry, but one which European political—if not necessarily business—leaders view as an even more threatening competitor.

For a variety of reasons, Europe has responded more slowly to the same post-Cold War imperatives. First, consolidating Europe's defense industry requires cross-border deals; Europe's national markets are simply too small to be viable. But surrendering control over one's means of national security, a potent symbol of sovereignty, raises a host of difficult political and emotional issues—issues made even more complicated by the fact that European states often own large stakes in defense companies. Second and related, one major incentive to consolidate is realizing the economic benefits from shedding excess capacity and downsizing work forces. But the European political reluctance to reduce employment, reinforced by the role the state has in many European defense firms, has been a big barrier to consolidation and downsizing.

In the end, however, imperatives are imperatives, and European companies are now moving down their own consolidation path, guided by their political leaders' distinctive concerns. These political constraints, more than the business objectives of European defense companies, are defining the shape of European defense consolidation. France, for example, wants to be at least as influential as Germany in charting the future of the European Union (EU). The United Kingdom

wants to capitalize on its “special” relationship with the United States while picking up business in Europe. Everyone wants to protect jobs. And perhaps most important, all the leaders seem to believe that a European defense industry is both an essential feature of an EU that can hold its own politically with the United States and a necessary precondition to transatlantic cooperation with the U.S. defense giants.

The most ambitious proposal for European defense consolidation—championed much more by political than by business leaders—is to form a single European aerospace defense company (EADC) composed of France’s *Aerospatiale*, British Aerospace, Germany’s *DaimlerChrysler Aerospace*, Spain’s *CASA*, Sweden’s *Saab*, and Italy’s *Finmeccanica-Alenia* to produce military aircraft, helicopters, space systems, guided weapons, and other defense systems. But the recent merger of the two largest British defense firms, British Aerospace and the defense portion of the General Electric Company, has created both an intimidatingly large defense giant that other European companies fear will swallow its putative partners and an all-but-anointed winner of virtually every major British defense contract. The “New BAe” is, at the least, a serious setback to the EADC, which may be why British Prime Minister Tony Blair reportedly became livid when informed of the merger. But the process of European defense consolidation has not been standing still. The French aerospace industry was substantially consolidated by the creation of *Aerospatiale-Matra*, a new enterprise with a distinctively French large state role. The recently announced merger between *DaimlerChrysler’s* aerospace arm and the Spanish aerospace company *CASA* was a smaller but still important step toward European defense integration.

What is emerging, then, at the level of first-tier European defense contractors is not all that different from what has transpired in the United States: the consolidation of the industry into three or so dominant companies that usually compete, sometimes cooperate, and jointly rely on an overlapping network of lower-tier suppliers who have even more complicated relationships among themselves. But the outcome of this emerging ad hoc approach to defense consolidation in Europe is still unclear. It may amount to little more than the emergence of national champions for each of the three major contenders for the mantle of European leadership, or it may lead to a de

facto EADC. The consolidation may actually ease transatlantic defense cooperation by creating both more viable, attractive potential associates in Europe and more opportunities for U.S.-European partnerships.

In brief, the Western alliance may be at a propitious moment but surely is at a critical one. Europe is clearly moving from the question of “whether” to consolidate to “how,” “when,” and “with whom.” How these questions get answered—in an exclusively European way or in one that also has a substantial transatlantic component—will make all the difference. The starting point must be a recognition that rationalizing the European defense industry should not be seen as synonymous with a “Europe-first” or a “Europe-only” approach to defense consolidation—a realization that is dawning on European defense companies faster than on their political leaders.

Given the above factors—including the ongoing downward slide in defense spending, the often less advanced technology of European enterprises, and a continuing large state role in defense companies everywhere in Europe—whether Europe can mount a competitive industry by itself remains a real question. If it cannot, the result could be a gradual slide toward a Soviet-style arsenal system based on inefficient state direction, increased protectionism, and a growing gap—already in embarrassing evidence in Kosovo—between increasingly sophisticated U.S. military prowess and lagging European systems. But even if Europe establishes something like an EADC, the resulting competition between “Fortress Europe” and “Fortress America” would be a body blow to NATO’s political unity and military effectiveness.

THE NEW WARFARE

IF THE FIRST imperative for transatlantic defense-industry integration is economics, the second is the technological revolution in warfare. As first the Gulf War and more recently Kosovo showed, Western military commanders can now have near real-time information available about their foes. If this intelligence is coupled with modern precision weapons, victory can be achieved much faster and with far fewer casualties to soldiers and civilians than ever before. This formula has become increasingly important to Western publics, especially in peacekeeping operations.

The new military fundamentally relies on information technology—the ability to collect vast amounts of data using optical and electronic sensors on satellites and planes, exploit this information, and get it to the appropriate field commanders. The emphasis has shifted from “platforms”—ships, aircraft, and armored vehicles—to information systems that support command, control, communications, and intelligence (C³I) for military forces. Thus defense cooperation is especially valuable in these areas.

These C³I technologies make possible sweeping air superiority, successful combined air-and-land attacks, and effective naval power projection. The most vital element in the “out of area” missions NATO may confront is C³I—and to work, C³I must be interoperable among all of NATO’s forces. Its importance to effective warmaking goes well beyond the classic logistics-based arguments for standardization, such as the usefulness of common types of ammunition or spare parts. Quite simply, C³I—along with strategic lift, or the ability to rapidly move forces over large distances—is today the key to superiority in conventional warfare. C³I is the brain of modern warfare, so to say that the United States, NATO, and Europe will have separate C³I structures is a bit like saying one healthy body can have one, two, or three heads. In principle, one can imagine three different systems communicating seamlessly in combined wartime operations, but in the real world, it would probably be ineffective, cumbersome, and expensive.

U.S. defense industries, supported for decades by generous defense budgets, are now preeminent in developing and integrating these information systems. European industry is relatively weaker, both because fewer resources have been devoted to developing C³I and because modern C³I technologies are based on advances in commercial information technologies—communications, computers, software, and the like—where the United States also has a considerable advantage (but by no means a monopoly) over Europe.

So Europe is doubly disadvantaged in this key area—something that should argue for more, not less, transatlantic defense-industry cooperation. But today, European governments are first consolidating the defense industry in Europe so that it can compete effectively with the United States and only then (if even then) cooperate with U.S. industry. Because it is such patently bad business, cooperation is

not even contemplated in other areas, such as biotechnology and commercial information technology, where the hand of the state is not so visible or strong. Instead, in these fields, firms on both sides of the ocean seek arrangements that permit the most efficient use of technology and capital.

Realistically, could a European strategy of developing technologies internally ever compete with the United States? Probably not, although certainly not because Europeans are less intelligent or imaginative than Americans. In part, the reason is that the United States devotes more resources to high-tech than all of Europe combined. But even more important are the differences between the European and American ways of technology innovation.

The United States is enjoying a tremendous burst of productivity in applying new information-based technology to all industries, including defense. This innovation's hallmark has been an unprecedented level of industry attention to the implementation of new technology. Creativity has also been stimulated by agile venture capital and new R&D partnerships between universities, firms, and government.

There is no comparable wave of innovation in Europe. Although European firms are technically outstanding in many particular areas, Europe's innovation generally lags behind America's, especially in key information technologies. Defense and aerospace integration offer an attractive way for Europe to catch up to the United States and adopt techniques that make sense for the European environment.

In sum, then, three technological reasons clearly argue that Europe should favor transatlantic integration over going it alone: the size of America's past R&D investment, the relative U.S. strength in core technologies, and the greater vigor of U.S. innovation in underlying commercial information technologies.

HAPPY TOGETHER

ANOTHER MODEL for cooperation makes far greater political, military, and economic sense than a single-minded drive toward European defense consolidation: an immediate move toward transatlantic partnering in parallel with European consolidation. This should be an industry-led effort, not one spawned by greater

cooperation among governments; after all, 30 years of trying the latter approach has failed.

The NATO mechanism of defense cooperation proceeds through the Committee of National Armaments Directors (CNAD). This group has occasionally taken initiatives on worthy joint projects, such as theater ballistic-missile defense and military communications satellites. Currently the CNAD is devoting considerable attention to an airborne moving-target radar, a system comparable to the Pentagon's Joint Surveillance Tracking and Radar System (JSTARS). But the CNAD is doomed to move slowly because its armament directors need to compromise simultaneously with their governments, industry interests, and potential partners. Defense budgets in both Europe and the United States are constrained, and the combined market is steadily shrinking. Defense companies therefore have a growing business incentive to move toward consolidation and other forms of partnering that cross not only national borders but also the Atlantic. So company-led efforts, particularly if encouraged by governments, are likely to produce a smaller, more competitive industry structure that strengthens rather than undermines NATO cohesion.

Merging major European and U.S. firms is one but not the only way this consolidation can occur. American and European firms should pursue flexible, even experimental, approaches on the presumption that there is no one right model and that everything therefore need not be determined once and for all. For example, mergers among second-tier companies—the key suppliers to the first-tier defense giants—not only ease transatlantic defense cooperation but also face far fewer political and business obstacles. European component and subsystem manufacturers are frequently as technically advanced and efficient as their U.S. counterparts, making for attractive merger or acquisition opportunities. European defense and aerospace prime contractors, which are relatively weaker in information technology, will also seek to acquire second-tier U.S. firms in areas such as defense electronics, information warfare, and reconnaissance—a welcome trend.

The alliance's defense industries need a merger along the lines of Daimler-Benz and Chrysler's.

U.S. and European firms also can form joint enterprises in some important segments of the defense industry, such as surveillance satellites or large transport aircraft—sort of like multiple transatlantic Airbus consortia. Ventures where two companies combine to address one project are less desirable because the cooperation is intentionally temporary and often hard to manage because of the lack of long-term common interest.

“Big-bang” transatlantic consolidation is not impossible; just look at the pharmaceutical, oil, and automobile industries. What is needed is a merger with the scope and imagination of the recent Daimler-Benz and Chrysler merger. Successful transatlantic defense consolidation will require a determined effort on both sides of the Atlantic to change past practices—and the prejudices these practices have bred. This means major changes in policy and attitudes by both U.S. and European governments and industry.

On the U.S. side, the principal barrier stems from the desire to protect advanced technology. In the past, America refused to share technology for fear that it would find its way into Soviet hands. Today, Washington fears that the Europeans will be more willing than the United States to incorporate this technology into weapons sold to third countries, to say nothing of rogue states, to whom Washington would never sell. Europe suspects—perhaps with some justification—that behind these apparently principled reasons also lurks a U.S. desire to maintain market advantage.

Europeans find the U.S. practice of giving a security classification to equipment and technology particularly vexing. Classification is justified when the technology in question (for example, an electronic warfare device) could render U.S. forces vulnerable or strengthen their potential adversaries. But classification is not an appropriate way to maintain a technological edge or a commercial advantage, and Washington must take special care not to abuse this key instrument of national security.

More generally, Washington must change its attitude and rules governing the transfer of technology to NATO. The important test is whether a technology transfer to NATO in the context of transatlantic cooperation would do more to enhance U.S. security interests than it would harm U.S. security if the technology were inappropriately

retransferred to third parties. Real-world answers to this test require a tough balancing act. On the one hand, having advanced weapons fall into the hands of hostile states or terrorist groups poses real risks. On the other, current European technology is already sophisticated enough to attract most of the world market and pose many of the same kinds of risks and costs. These facts of international life mean that even a draconian U.S. policy on technology transfer to its NATO allies will not make much difference if that policy clashes dramatically with European practices. The right balance for U.S. policy is to simultaneously share more technology with NATO but crack down more effectively on the sale of advanced weapons systems by any NATO member to third parties.

Specifically, what should be done? First, Washington should state that its policy is to encourage and ease cooperation between U.S. and NATO defense entities, consistent with the applicable antitrust laws. That Europe should be spending more on defense has become an American refrain—the un-said implication being that much of the spending would be with U.S. firms. A wiser new refrain would call for greater funding for NATO projects awarded to the transatlantic defense firms with the best bids.

As a matter of weapons-acquisition policy, Washington should declare and demonstrate that the American defense market is wide open to any European company that can out-compete its U.S. counterparts, provided that there is clear and convincing evidence that European markets are just as open to U.S. defense firms. Such a policy will require not only changing various “buy America” provisions scattered throughout U.S. statutes but also making reluctant politicians and bureaucrats overcome their strong predilections to favor home-grown alternatives.

Second, the Pentagon should highlight programs where NATO cooperation is considered especially valuable. “Buy transatlantic” provisions might even be attached to a few of these to show that Washington means business. Examples might include large military transports, advanced air-to-air missiles, air- and space-based radar reconnaissance satellites, or theater missile defense systems. The fact

Europe's leaders must adjust their vision of the future of the European defense industry.

that Europe has already substantially consolidated the latter two areas may reassure European companies that they will not be dominated by their American counterparts—and thus may be particularly promising areas for early initiatives.

Third, the Pentagon should work to convince European defense ministries and firms that the United States will be a reliable partner in defense-technology projects. This will require the United States to revise its policy for sharing advanced technology with European companies along the lines described above, including an overhaul of the criteria and practice for security classification of equipment provided to Europe. The long-time U.S. practice of maintaining a special technological relationship with the United Kingdom should be broadened immediately to include other key NATO allies—and, eventually, all of NATO. The new U.S. policy also needs to take account of the fact that European defense entities are increasingly multinational, which makes an ally-by-ally approach increasingly unrealistic.

With this wiser U.S. government policy in place, U.S. firms will be able to proceed in several directions. Some U.S. companies—especially within the second tier—will explore mergers and acquisitions with European firms. Others will establish operations in Europe, both on the continent and in the United Kingdom, that show their commitment to a long-term presence in Europe. Likewise, European defense companies will probably increase their presence in the United States, which also would be a plus. Several large U.S. and European firms will form strategic alliances to pursue common business objectives. Over time, two or three transatlantic enterprises could form to compete for the widest range of defense and aerospace business—an objective that is in America and Europe's combined political, security, and economic interest.

Tough decisions will have to be made on America's side of the Atlantic for this vision to be realized. But the same is also true for Europe. Whatever form consolidation takes, European political leaders must be willing to make the difficult calls necessary to reap the benefits in efficiency that consolidation offers, and that entails closing facilities and firing workers. More fundamentally, Europeans must be willing to adjust their vision for the future of the European

defense industry. That future must be inclusive rather than exclusive—based on the proven success of the Atlantic alliance, rooted in cooperation across the Atlantic rather than the juxtaposition of “Fortress Europe” and “Fortress America.” If Europe tries to go it alone instead, the inevitable outcome will be inefficient defense companies, squandered defense resources, a growing gap between American and European military capabilities, and a fatal weakening of the alliance.

The major challenge, then, facing both U.S. and European governments is making transatlantic cooperation at least as attractive as continued consolidation within Europe and the United States. They should then leave it to the defense companies themselves to determine which alliances, mergers, and partnerships make the most business sense. Economic incentives and technological imperatives would then probably produce a form of transatlantic cooperation that best serves NATO's security needs and political interests. In any event, high-tech advances and financial windfalls will most likely prove irresistible enough to defeat obstructionist political leaders. What persuasive and intelligent political leadership can do is to encourage industry to take the ambitious actions that will lead to a stronger NATO. 🌐