

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES
POLICY DEPARTMENT



**The extra-EU defence
exports' effects on
European armaments
cooperation**

SEDE



STUDY

The extra-EU defence exports' effects on European armaments cooperation

ABSTRACT

Are exports made to countries outside of the European Union (EU) impeding European cooperation in armaments? Although the numbers vary significantly from one country to another, the European Defence Technological and Industrial Base (EDTIB) now collectively derives an important share of its collective turnover from extra-EU export sales. Accordingly, EU Member states devote important political, financial and administrative resources to support and promote their national producers in major competition overseas. The current scarcity of common European programmes, and the limited impacts of recently introduced legislation designed to harmonize national defence procurement rules and to facilitate intra-EU transfers, could indicate that extra-EU exports are detrimental to European cooperation on weapons projects. This negative effect would primarily come from introducing greater levels of competition between European companies creating greater tensions, which are not conducive to cooperation on the EU level. The study finds that there is indeed a correlation between competition for major foreign markets and difficulties of intra-EU cooperation but makes the analysis that extra-EU exports are more a symptom of structural constraints faced by major suppliers, such as the weakness of defence spending in European countries, and the persistence of fragmentation and duplication of production capabilities.

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Authors: Lucie BERAUD-SUDREAU, Associate Researcher, Arms and Military Expenditure Programme, SIPRI, SWEDEN

Official Responsible: Ulrich KAROCK

Editorial Assistant: Aysegul UNAL and Elina STERGATOU

Feedback of all kind is welcome. Please write to the author: ulrich.karock@europarl.europa.eu.

To obtain copies, please send a request to: poldep-expo@europarl.europa.eu

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List of acronyms

- **COARM:** Conventional Arms Exports Working Group
- **CP:** Common position
- **CSDP:** Common Security and Defence Policy
- **DI:** Direction du développement international
- **DSO:** Defence Support Organisation
- **EC:** European Commission
- **EDA:** European Defence Agency
- **ECS:** Export Credit Agencies
- **EDITB/DITB:** European Defence Industrial and Technological Base
- **EU:** European Union
- **FXM:** Försvarsexportmyndigheten
- **G2G:** Government to Government
- **LoI:** Letter of Intent
- **MoD:** Ministry of Defence
- **MRO:** Maintenance, Repair and Overhaul
- **NATO:** North Atlantic Treaty Organisation
- **OCCAR:** Organisation conjointe de coopération en matière d'armement
- **OFICAEX:** Oficina de Apoyo Exterior
- **pMS:** Participating Member states
- **R&D:** Research and Development
- **UAE:** United Arab Emirates
- **UK:** United Kingdom
- **UKTI:** United Kingdom Trade and Investment

Executive summary

The impact of extra-EU exports on European armaments cooperation

The interrogation at the heart of this study is whether the importance of the European defence industrial and technological base (EDTIB) extra-EU exports in its turnover has consequences on European cooperation in armaments. The EDTIB derives a significant share of its collective turnover from export sales and EU Member states devote important political, financial and administrative resources to support and promote their national producers in major competition overseas.

This situation has led to the proposition that competition between Member States to gain market shares overseas and have become a handicap in establishing an integrated European defence market. Implied here is that this dynamic leads Member States to prioritize the international markets at the expense of European joint initiatives.

Approach to evaluating the consequences of extra-EU exports on European armaments cooperation

In order to assess the importance of extra-EU exports in the European DTIB turnover, the study first investigates the origin of the turnovers of the 6 countries of the Letter of Intent (LoI), namely France, Germany, Italy, Spain, Sweden and the United Kingdom, to which Poland, as an emerging European supplier, was added. It is largely recognized that the LoI countries concentrate the core of European defence production capabilities expressed both in quantitative (turnover) and qualitative (range and diversity of defence specific capacities) terms. It demonstrates the importance of extra-EU exports varies between 18% (Germany, Poland) and 43% (Italy) for the year 2012, and that sales to markets outside of the EU represent a significant share of their turnover.

Second, the study presents the support and guidance mechanisms implemented by the LoI countries plus Poland to support their companies' extra-EU export efforts. This part shows that Member States devote significant financial, administrative and political resources to help their 'national defence champions' win major sales abroad. Considering the fact that some of these countries are involved in cooperation programmes, States are sometimes faced with the choice of either supporting a domestic made system, or one produced in cooperation. In other cases, promotion resources help a multinational company compete with itself on a foreign market by supporting a national subsidiary of a company based in another country.

A third part of the report explores the ineffectiveness of the European Common Position (CP) on arms exports in harmonising export rules and guidance at the European level. Using the recent debate surrounding the sale of Mistral command and power projection ship to Russia, it demonstrates that one of the main goals of the CP – to create a more level-playing field by eliminating differences of restrictiveness in national export legislation – was not achieved.

The relationship between extra-EU exports and cooperation

There are indications of a strong correlation between, on the one hand, the importance of extra-EU exports for EU Member States and especially for LoI countries and on the other hand, difficulties of European cooperation between companies and between Member States. Competitions for extra-EU markets often involve several European suppliers, which are supported in different ways by their states in these contests. Multiple examples presented in the report indeed show that this rivalry fosters tensions and hostility between European actors, which, in turn, has a negative impact on European cooperation in the field of armament.

However, this report did not uncover evidence to support the idea that extra-EU defence exports are actually causing the challenges currently displayed by European defence production cooperation.

Examination of past armament collaborations or competitions suggest that there is no automatic link between frictions and mistrust among suppliers with either exports or cooperation. Therefore, the importance of foreign sales may be a symptom of deeper-seated features of the European defence market.

The structural drivers of extra-EU exports

The domination of national logic in European defence and the weakness of European defence spending would explain both the 'race to export' by individual countries and the reluctance to engage in cooperation programmes. The general weakness of European defence expenditures over the past 15 years contrasts starkly with the general growth observed in the rest of the world. This has led both companies and Member States to turn to these extra-EU markets to counteract weaker domestic sales. Since the issue of the fragmentation and duplication of defence production capabilities across European countries remain, competition between European producers in foreign market seems inevitable. In turn, the high stakes and intensity of these competitions warrant significant Member States support.

1 INTRODUCTION

1.1 Background

The objective of developing a single, integrated European arms market and industry, considered a necessary condition of a Common Security and Defence Policy (CSDP), has been a recurrent issue since the creation of the European Economic Community. At the European Union (EU) and Member States levels, recent integration of directives on offsets and intra-community transfers ⁽¹⁾, as well as the achievement of a common position on arms exports in 2008 ⁽²⁾ are largely considered significant steps in attaining these goals. On the industry's side, phases of consolidation of varying importance since have also occurred taken place since the late 1990's at the European level and, to a lesser extent, at the transatlantic level.

Despite these inroads, worries about the progression of this project as well as concerns about the willingness of Member States to give up some of their national prerogatives in defence policy and defence economy are surfacing ⁽³⁾. Indeed, although most Member States have integrated the new directives in their legislations, several observers consider the emergence of an integrated European arms market both from demand side (government requirements and procurement) and supply side (industry) slow to materialize ⁽⁴⁾.

One factor that is often cited as influencing or even curbing European cooperation in defence is the impact of Member States approaches to the international market, understood here as sales made outside of the EU. Two interrelated observations support this proposition. First, efforts made by Member States to assist their national arms producers when they are competing for markets overseas, which are perceived as creating tensions between countries and companies both outside the EU and within. Second, the fact that the European defence industrial and technological base (EDTIB) is thought to derive a significant share of its collective turnover from export sales, which reinforces decisions to secure these sales in order to maintain domestic arms production capabilities ⁽⁵⁾. Implied here is that this dynamic leads Member States to prioritize the international market at the expense of European joint initiatives.

This situation has led to the proposition that competition between Member States to gain market shares overseas and the means used to make those gains have become a handicap in establishing an integrated European defence market as competing for foreign sales is not conducive to greater cooperation at the European level. Recent reports of one Member State forbidding another to transfer a weapon system that included a component controlled by its national arms export rules, although denied by the country thought to have blocked the sale, have fed into this hypothesis ⁽⁶⁾.

¹ Commonly referred to as the 'defence package', composed of Directive 2009/43/EC on intra-EU transfers of defence products and Directive 2009/81/EC on Defence and security procurement.

² 'Council Common Position 2008/944/CFSP of 8 December 2008 defining common rules governing control of exports of military technology and equipment', Official Journal of the European Union:
<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:335:0099:0103:EN:PDF>

³ Mampey L. et al. Study on the implementation of Directive 200943EC on transfers of defence-related products – 14 August 2014.

⁴ Fiott, D., 'More competitive, more efficient? The 2013 European Commission Defence Communication' Security Policy Brief no 49, Egmont Institute, September 2013.

⁵ European Commission, 'Towards a more competitive and efficient defence and security sector' Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, 24 July 2013.

⁶ This refers to a reported incident between France and Germany, which is discussed further in part four on intra-European cooperation.

However, it is important to note that this proposition is rarely supported by empirical evidence and systematic analysis. Therefore, there is a need to confirm the reality of the problem arising from Member States and industry prioritizing and promoting sales outside the EU on European defence cooperation, as well as its the scope and needs to be approached in a more methodical fashion.

1.2 The mandate

The overarching objective of the study is to evaluate the impacts of '*defence exports outside the [European] internal market on the DTIB, on the cooperation among DTIB entities inside and outside Europe and on the effects of measures by Member States seeking to support the national DTIB on the global defence market back to internal market*'. For clarity and structure, this goal is broken down in two main components, with a major subcomponent for each:

- Investigating and assessing the share of defence exports outside the EU in the turnover of the European DTIB;
 - Assessing the share of cooperative programmes in Member States defence exports;
- Presenting and analysing methods implemented by Member States for promoting national defence exports;
 - Assess the effects of national defence export support and promotion policies aimed at the international market on European armament cooperation and also in the light of relevant EU legislation.

These objectives necessitate both quantitative (estimating the share of exports in turnovers) and qualitative analysis (assessing impact of export support and promotion policies on cooperation).

1.3 Understanding of the mandate

The interrogation at the heart of this study is whether the EDTIB extra-EU exports' importance in its collective defence turnover has consequences on European cooperation in armaments. The underlying hypothesis of the request for this study is that the share of foreign sales in total defence turnover may have become significant enough to lead EU Member States to prioritize export markets in their defence industrial policies, a priority which translates into a strengthening and widening their support and guidance to national companies engaged in major international competitions. Considering the fact that there is significant duplication of arms production capabilities across Europe, and therefore different European versions of certain categories of weapons, competition abroad between European suppliers is frequent. Consequences of this competition overseas then come back into the EU as enduring tensions and hostility between national companies.

In this context, both the increased export reliance of European arms producers and the establishment of national-centric promotion policies and mechanisms are thought to foster friction between major arms producers and to hamper cooperation efforts. Indeed, few new programmes developed in cooperation have been initiated in recent years. Notable exceptions are North Atlantic Treaty Organization (NATO) Air-Ground Surveillance System programme and Multinational, Multirole Tanker Transport Fleet.

1.4 The structure of the study

The study is divided in four 6 parts:

- The first part delineates the field of investigation. It provides clarification on the methodology adopted to assess European DTIB dependence to export outside the EU, explains the reasons for selecting a sample of countries and presents definitions of key concepts used in the report.

- The second part investigates levels of dependency on sales outside the EU made by selected countries by using three main indicators: a) the national share of turnover from domestic sales; b) the national share of turnover from sales to other EU countries; c) the national share of turnover from sales outside the EU. It then proceeds to the data. A sub-section of this part also evaluates the share of export sales assignable to weapons systems made in cooperation.
- The third part presents an overview of selected countries export support policies and mechanisms. It identifies major characteristics, preferred mechanisms and similarities between Member States approaches to national export promotion.
- The fourth part presents and analyses export promotion efforts enacted by Member States, showing significant administrative and financial resources are allocated to supporting national export efforts.
- The fifth part explores different dimensions of intra-EU competition. It also highlights the fact that this competition sometimes happens in the framework of cooperation.
- The sixth part reviews the role of the EU Common Position on export and highlights its ineffectiveness in both harmonizing and restricting EU Member States export controls.
- The seventh part analyses how extra-EU exports may or may not influence European cooperation on armament in light of elements provided in previous parts. It makes the observation that establishing a causal link between export and cooperation is difficult and explains why. It then proceeds to suggest an alternative way of looking at the relationship between extra-EU exports and European armament cooperation.

2 Demarcating the field of investigation: approach and method

This section presents key methodologies for both the quantitative and the qualitative analysis required by the mandate.

2.1 Unit of analysis and selection of the country sample

Data and analysis from European institutions recognizes that the core of European arms production capabilities, expressed both in quantitative (turnover) and qualitative (range and diversity of defence specific capacities) terms is located in the signatories the 2001 Letter of Intent (LoI) ⁽⁷⁾. Historical choices made by these states during the early Cold War explain this concentration of the European defence industry in a handful of countries. These choices include maintaining autonomy of supply in support of independent decision-making and being prepared for a conflict with the Warsaw Pact (or in the case of Sweden, supporting the country's neutral posture). The establishment of national defence industrial bases was essentially made possible by significant state investments in military research and development (R&D) and production with the aim of building a high-degree of national self-sufficiency in defence.

Post-Cold war spending trajectories tend to indicate that although changes have occurred in levels of spending, distribution at the European level has not drastically changed. Except for Sweden, which was overtaken by Poland in the recent years in terms of military expenditure, other LoI countries are still, by far, the largest European defence spenders (as discussed in more details in section 2.2 below).

⁷ France, Germany, Italy, Spain, Sweden and the United Kingdom.

Considering this concentration of both spending and arms production capabilities, using the Lol signatories and adding Poland, a country largely seen as an emerging supplier in Europe, captures the majority of the EDTIB turnover in Euro value.

2.2 Data

Assessing the share of the European DITB exports outside the EU in the combined European defence turnover is a challenge. With the exception of the €96 billion figure cited by the 2013 European Commission Communication ⁽⁸⁾, no data exists on total and/or Member State defence turnover, which means this data has to be collected. Approaching this task from the perspective of the supply-side would not only be time-consuming considering the number of firms that are involved in the defence market, it also raises several difficulties. For instance, many companies do not provide a breakdown of their sales between defence and non-defence categories and some of them use a defence and security aggregate that could be misleading. In other cases, companies do not classify their exports between EU countries and extra-EU countries. Finally, some privately owned companies, such as Germany's KMW, simply do not report their sales publicly.

In light of these difficulties, SIPRI has chosen an alternative method for estimating total national arms industry turnover and its three components (domestic sales, intra-EU exports, extra-EU exports) for Lol countries using data provided by Member States. This method seeks to estimate total national defence turnover by adding domestic defence spending on equipment, to which export revenues are added, but imports are subtracted.

$$\text{Total turnover} = \text{National defence equipment spending} + (\text{estimated}) \text{ Exports} - (\text{estimated}) \text{ Imports.}$$

Although more achievable, this approach is not without problems. Since defence largely remains a national prerogative in the EU context, no common method has been adopted by all the Member States to report foreign sales made by their defence companies. For instance, Germany has a narrower definition of 'weapons of war' than France. Another example of different approaches is the fact that some European countries record the value of export licences granted, and others the value of actual deliveries of the goods. However, to assess the extra-EU export share of a country's total defence turnover, the figure that counts is that of sales. Moreover, in most cases countries do not break down their own arms procurement between domestic procurement and imports.

For clarity and transparency, we provide below more specifics on the data collected and methods used for estimations:

- The UK Defence Statistics provide spending by the MOD with UK industry, broken down by industrial classification. Thus, for the UK, we take total turnover for the arms industry as spending by the MOD on UK manufacturing industry, plus (estimated) exports. There is no need to deduct imports as the figures already exclude spending by the MOD with overseas industry.
- For national defence equipment spending for all other Lol countries and Poland, we use EDA figures for Total Defence Investment (procurement + R&D)⁽⁹⁾.

⁸ European Commission 2013, op.cit.

⁹ We include R&D as much of this will be related to the development of weapon systems by industry. This methodology may therefore give an overestimate in that some R&D is conducted 'in house' by MODs. However, this definition excludes most or all

- For exports, for France, Italy, Spain and Sweden, we use the reported figures for arms export deliveries given in the EU Annual Report on arms exports. These countries provide figures in that report for both export licenses and deliveries.
- For Germany and Poland, who only provide figures for export licences in the EU report, we estimate deliveries as 43% of export licences for the year in question, based on a close analysis of figures for licences and deliveries for those countries providing data for both ⁽¹⁰⁾. It has been observed in the past ⁽¹¹⁾ that the total value of licences granted is systematically higher than the value of actual sales. In the case of Germany, this was considered to give a more comparable estimate than the (lower) figure provided in Germany's national reporting for exports of 'weapons of war'.
- In the case of Germany, export licences are divided into two categories: first of all, the regular export licenses that are included in the EU Report. Secondly, a separate category of export licenses that relate specifically to collaborative programmes with other European producers. These are of roughly equal magnitude for the year in question. We include 43% of each of these in the estimate for Germany's total exports. The licenses for collaborative programmes are counted entirely towards intra-EU sales; while some may be for equipment to be included in systems ultimately sold outside the EU, the immediate recipient is an EU partner nation.
- For the UK, which also has not provided figures on arms export deliveries since 2008, we used figures for export orders provided by the UK Defence Statistics for the *previous* year, based on an analysis of figures for orders and deliveries for the years when both were provided ⁽¹²⁾.
- To estimate imports, we have first added up imports (or estimated imports) by each of the seven countries from as many available sources as possible, i.e. for countries that report a breakdown of their arms exports by recipient. We have then supplemented this by a proportionate estimate for other countries, based on imports from these countries measured by SIPRI's 'Trend Indicator Value' for transfers of major conventional weapons ⁽¹³⁾.
 - The countries included in the total for identified imports are:
 - All other EU Member States, through the EU Annual Report (using the 43% estimate for countries only reporting licenses, or in Germany's case the figures for exports of 'weapons of war');
 - The USA, using data from the DOD Defense Security Co-operation Agency; and
 - Canada, Norway and Switzerland, using their annual reports on arms exports.

The data collected and used to investigate the share of turnover per selected countries covers the year 2012 ⁽¹⁴⁾. It is the last year for which the European Defence Agency (EDA) provides statistical data for Member States. It is also the reference year used by the European Commission in its 2013

spending with industry on Maintenance, Repair and Overhaul (MRO), which would generally be classed under Operations & Maintenance spending.

¹⁰ This ratio was obtained by applying linear regression analysis, i.e. by regressing exports on licences for years for which we have available data and constraining the intercept to be zero. Analysis showed that actual deliveries were much more closely related to licences issued in the same year, as opposed to the previous year, despite possible time lags between issuance and use of licences.

¹¹ SIPRI transfers database and Grimmer, Richard F. 'Conventional Arms Transfers to Developing Nations' Congressional Research Service Reports, from 1973 to 2012.

¹² Using the same method of 43% of licenses for the UK would give a far lower figure for exports. It is possible that some UK arms exports under government-to-government projects such as with Saudi Arabia are not included in the licence figures.

¹³ The TIV value is used only as a supplementary source of estimates and not as a primary source, as it is not a financial measure, see SIPRI Yearbook 2013, p.239-240.

¹⁴ UK domestic procurement figures are for the financial year 2012-13.

Communication to the European Parliament. Considering important variations in reporting by Member States, the figures presented in this report must be considered estimates. They are based on official statistical and data sources of Member States and EU institutions and agencies.

Lastly, the status of the European market needs to be clarified for the purpose of this study. Two different approaches to the EU market emerge from the literature. The European Union and the European Commission (EC) tend to consider the EU defence market as an internal market while Member States report sales to European countries as exports, alongside those made to Asia or the Middle East, for instance. For the purpose of this study, only sales outside the EU will be considered as exports and indirectly as a measure of reliance to foreign sales, but the share of 'exports' to the EU will be indicated as a reference.

Therefore, in order to provide a complete picture, shares of turnovers for selected states – as far as they are available — are broken down into domestic sales, European sales and international (rest of the world sales).

2.3 Selected countries export support and promotion approaches

The review of export support policies implemented by Member States selected for this study primarily relies on official state publication, relevant governmental and non-governmental agencies publications as well as on interviews with officials involved in arms exports promotion at the national level. A literature review of think tank reports and more academic oriented articles is also used to support this section.

2.4 Evaluating the significance of the export share of national defence turnovers and its impacts

Linking the share of exports in total defence turnover to greater efforts made by national authorities to promote domestically made weapons overseas implies that these shares are significant enough to warrant mobilizing state support and resources to secure major export contracts in a highly competitive global market. From the outset, this assumption raises the question of a 'tipping point', as the European Commission qualifies it in its 2013 Communication. This is a point at which consequences of loosing the competition for a major contract may affect national arms producers in a way that would be judged damaging, for instance by leading to the loss of strategic production capabilities and critical skills, or, from a demand side standpoint, by questioning the financial feasibility of a programme by limiting the anticipated number of units produced and therefore increasing unit costs.

However, this tipping point in the ratio of exports to total national turnover has, to our knowledge, not been identified, at least in available sources ⁽¹⁵⁾. Therefore, this requires making a judgment. We suggest that a 20% share of national turnover coming from arms sales overseas would indicate that export are important to a country and that losing a large market share may have negative impact on the companies involved (rationalisation leading to loss of skills) and on costs (lesser units meaning higher unit costs), but would not be existential. A 50% share would indicate a very high dependence where the loss significant markets overseas may have severe consequences on the survival of production capabilities domestically.

¹⁵ Micro economics literature on post-Cold war adaptation did suggest thresholds in order to appreciate firm dependency to defence contracts — generally estimated at 50% of a company's revenues — but this approach is not suited to a country estimate, which involves a much larger aggregate.

3 Investigation and assessment of the share of export in total turnover

The first part of the mandate requires an assessment of European reliance on exports in European total turnover. Unfortunately, total EU defence turnover figures are not publicly available. For instance, the EDA does not publish collective or per country turnover figures for its participating Member States (pMS). The only official reference we could collect for the EU level comes from the 2013 European Commission Communication to the European Parliament which mentions a European total turnover of €96 billion ⁽¹⁶⁾. Sources and method used to reach this estimate are not described in the Communication.

Based on SIPRI data on national defence turnovers for Lol countries plus Poland, the States selected to investigate the share of export in turnover, €96 billion represents a very high figure. Combined estimated total defence turnovers of Lol countries and Poland (see figure 1) represent a total of €50 billion. Based on EDA figures for defence investment and export figures from the EU Annual Report, ignoring imports and assuming a rather higher ratio of exports to licences for other countries not providing export data, we obtain an upper estimate of around €57 billion for total EU arms industry turnover. This is considerably lower than the EC estimate (about 40% lower). The share of the total represented by the Lol 6 plus Poland implied by our estimate (i.e.89%) reflects the structural realities of the European defence economy, in particular the fact that defence spending in the EU is concentrated in a handful of states. Indeed, using SIPRI military expenditure data for 2012, Lol countries plus Poland account for 80% of all EU countries defence spending. EDA data gives a slightly higher share of total EDA pMS plus Poland defence spending ⁽¹⁷⁾ for 2012 with an 80.9% figure ⁽¹⁸⁾. Looking more specifically at investment spending (procurement and R&D) using EDA data, the share of Lol states plus Poland climbs up to 90.6% of total pMS spending.

3.1 The Lol countries plus Poland sample turnovers

This section examines more closely the share of extra-EU exports in total turnover for Lol countries plus Poland for the year 2012. Except Poland, Lol countries rank highest in Europe in terms of national defence spending, procurement and R&D spending. They also have significant arms production capabilities and are regularly ranked in the top ten arms suppliers according to SIPRI data.

The charts (figures 1 and 2 below) present data per state in three categories: a) domestic sales; b) EU sales and c) exports ⁽¹⁹⁾. They also illustrate the share of the selected countries in the €57 billion estimate of European turnover and proceed to rank them according to the share of exports, from highest to lowest.

This is only a sample for one year. Although the figures roughly reflect levels of spending, especially in investments, they cannot be considered a trend. For instance, a major delivery by one of the member country companies can boost sale for the year. No such significant event occurred for the selected countries in 2012.

Key observations from figures 1 and 2:

- The share of extra-EU exports varies significantly between countries. The lowest share is Poland with extra-EU exports accounting for 18% of turnover. The highest share is Italy with 43% extra-EU exports. The average is 29.7%;

¹⁶ European Commission Communication, op.cit. 2013.

¹⁷ Denmark is not an EDA pMS and is not included in 2012 EDA data.

¹⁸ This can be explained by different definitions of military expenditure.

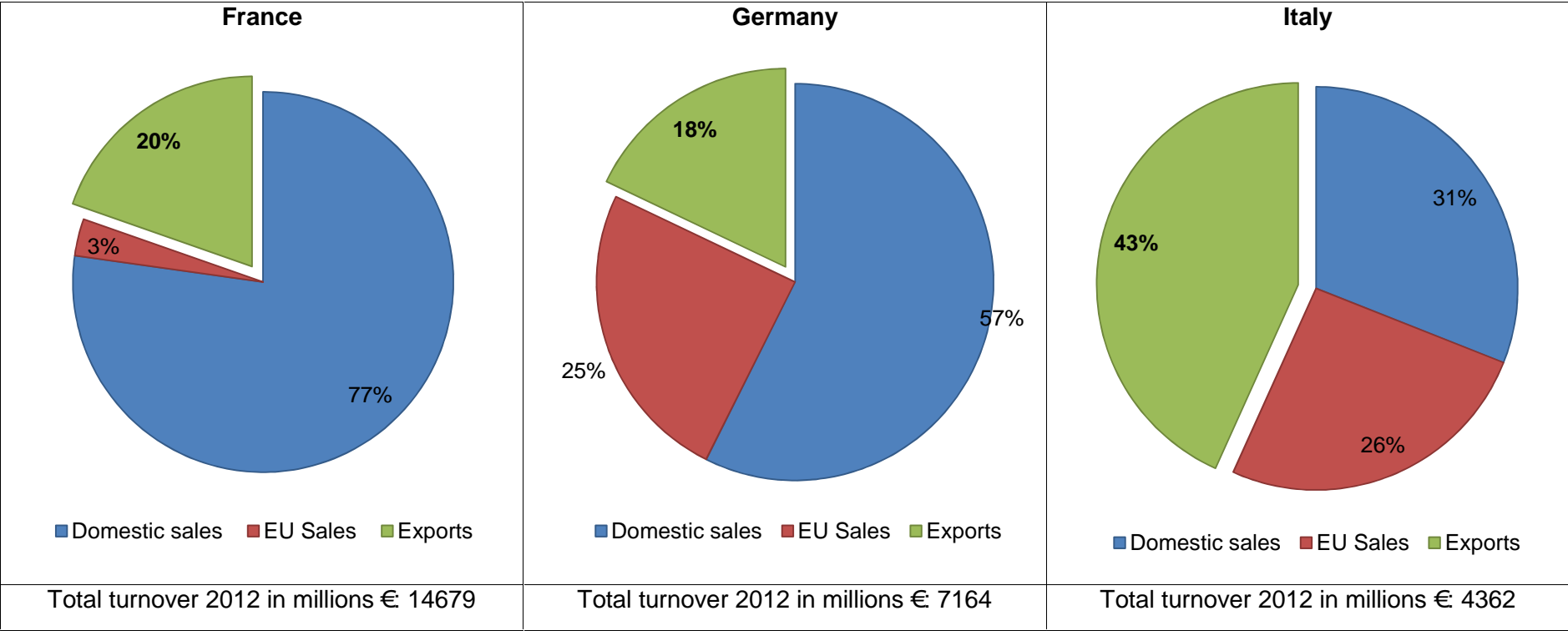
¹⁹ In calculating domestic procurement, we have subtracted all of the imports figures from national defence investment. This might somewhat underestimate domestic procurement, as some imports are for inclusion in systems that are then exported.

- Total estimated extra-EU exports account for 26.4% of the combined turnover of Lol countries + Poland;
- With the notable exception of Italy and Sweden, where international sales are higher than domestic sales, domestic sales still represent more than half of national turnovers;
- Shares of sales to EU are relatively low compared to extra-EU exports, with a share of turnover of 7.1%; the countries showing the highest levels of export sales (Italy, Spain and Sweden) also show greater EU sales;
- The relatively high share of extra-EU exports for the UK may exaggerate the importance of these sales in comparison to the domestic market, due to the very high level of military spending, primarily in the Operations & Maintenance category, which is outsourced to the UK defence industry. This amounted to €10 billion in 2012, according to EDA data. Some of this amount may be covered in the figure on spending with UK manufacturing industry, but we estimate that most of it is not as it falls under a 'services' category ⁽²⁰⁾. Thus, the domestic revenue base for UK companies is much higher than the figures presented ⁽²¹⁾.

²⁰ Since a) much of this spending is not with manufacturing industry, but services, and b) given available MOD data for pure equipment procurement spending plus EDA data for 'outsourced' spending, which gives a total much higher than the spending with manufacturing.

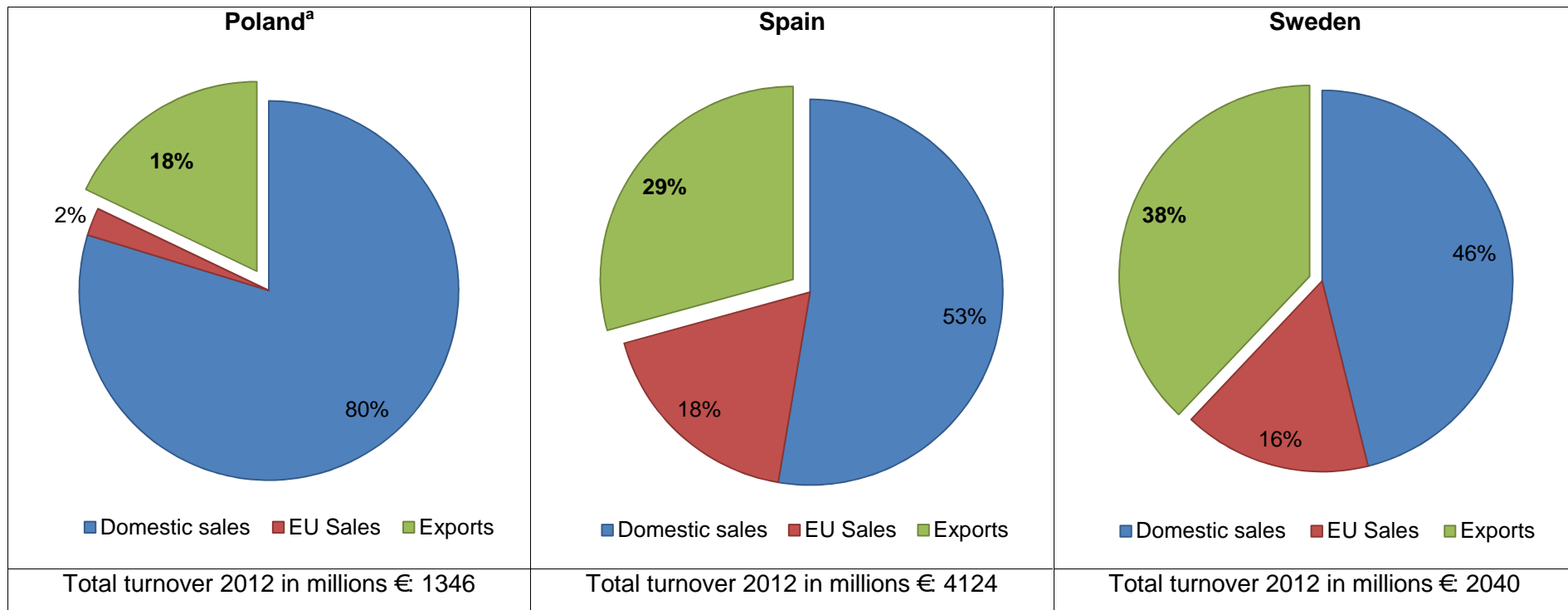
²¹ The breakdown of MOD spending on UK service industries provided by the UK Defence Statistics is not sufficiently fine-grained to distinguish between spending on military services and spending on general services with companies that are not in any sense part of the UK DTIB.

Figure 1. Lol countries plus Poland distribution of sales by destination as shares of turnover



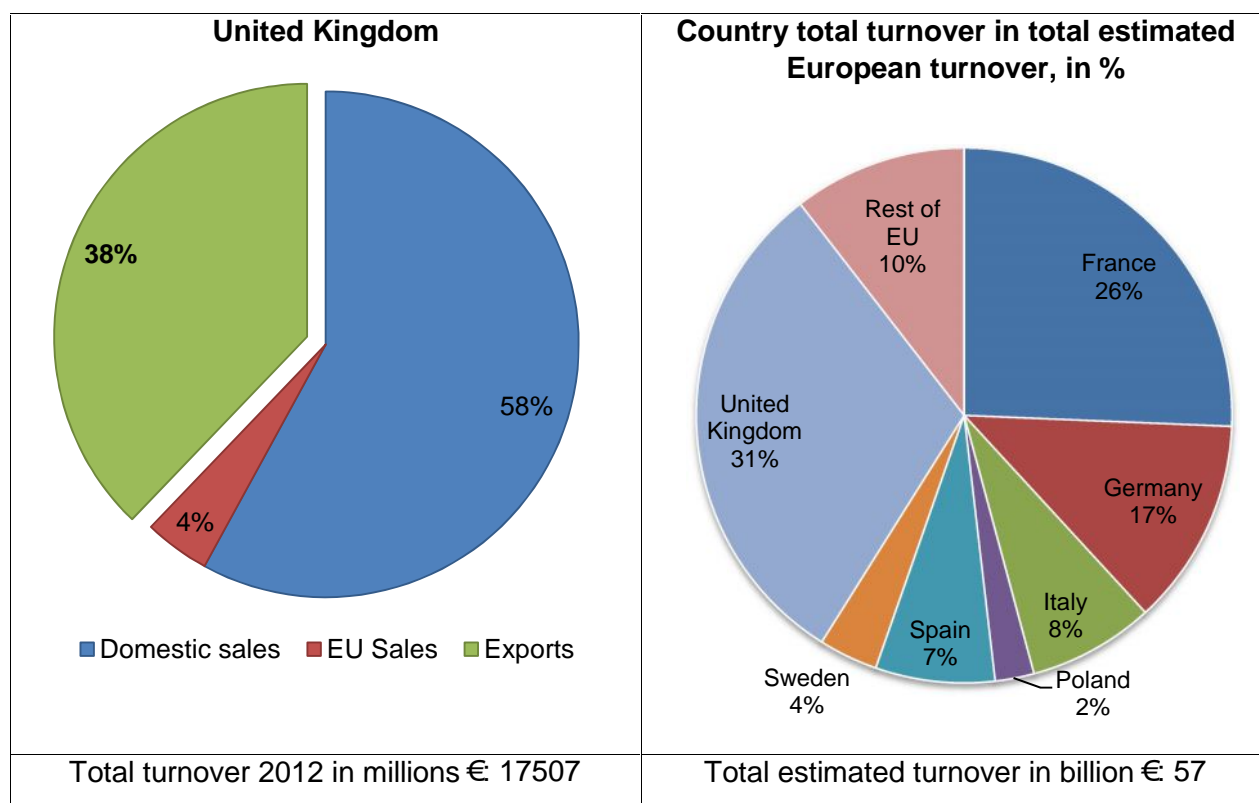
Source: SIPRI

Figure 2: Lol countries plus Poland distribution of sales by destination as shares of turnover (continued)



Source: SIPRI

Figure 3: Lol countries plus Poland distribution of sales by destination as shares of turnover (continued)



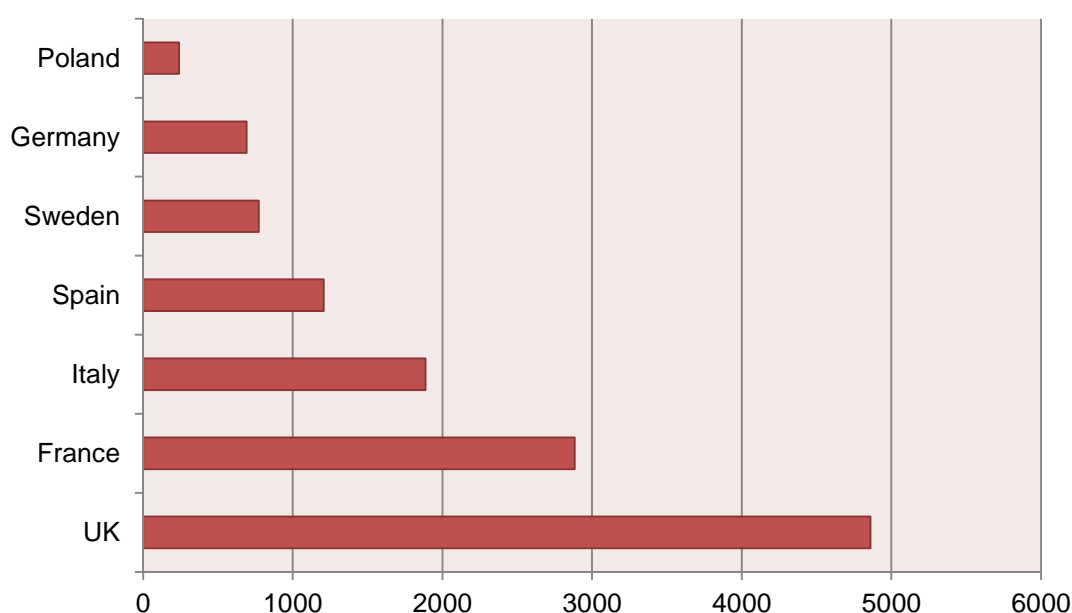
Source: SIPRI

a: The margin of error for estimating the UK, Germany and Poland's exports is wider than for the other countries as we are using figures for export orders or export licenses as a basis for estimation, rather than direct export figures. The share of extra-EU exports on turnover should be considered a low estimate.

b: Conversion from SEK to Euros was made using ECB average exchange rate for the year 2012.

c: Conversion from GBP to Euros was made using ECB average exchange rate for the year 2012.

Figure 4: Ranking of Lol countries plus Poland according to their estimated extra-EU exports figures, 2012, in millions of Euros



Source: SIPRI estimates

Considering the ranges of 20% to 50% of national turnover as indicators of medium to very high dependence on extra-EU exports, it would seem that industry levels of reliance in Lol countries are quite high. This is less true for Poland, which is largely considered an emerging supplier. It may also be because Polish companies do not have an international footprint as important as traditional suppliers from the Lol countries.

Domestic sales remain a central feature of total national turnover, and makes up the major part of it for five out of the seven Member States. The very low share of domestic sales for Italy may indicate the impact austerity policy on defence minister targeting investments. 2012 was still a difficult year in terms of GDP growth and several governments have used this category of spending to decrease state spending⁽²²⁾. In the case of Sweden, which has not undergone general austerity reduction programmes, continuing military expenditure cuts and downsizing of the armed forces since the end of the Cold War have left the country with a disproportionately large arms industry given the country's size and military spending levels.

3.1.1 Estimating share of cooperation programme in export shares of turnover of the EDTIB: A discussion

Government initiated cooperation programmes aimed at developing weapons systems are limited in number. Current cases are the Typhoon combat aircraft, the NH-90 helicopter, the EC-665 Tiger Combat helicopter, the FREMM and Horizon frigates, the Scorpene submarine and the Boxer armoured vehicle.

For the companies involved in these programmes, it can be assumed that they represent a significant part of their turnover in the defence sector, even though data on the share of defence cooperation programmes revenues in total revenue is not made available. For instance, considering the cost of the platform and its general success on the market, the Typhoon programme is certainly a significant part of

²² The same consideration goes to some extent for Spain, and while investment spending recovered considerably in 2012, such spending was at a much lower level in 2011.

the activities of BAE systems and of the Defence and Security division within the Airbus Group. Nevertheless, the absence of data make estimating the export share of these programmes in a company or in a country turnover even more challenging than estimating national defence turnovers.

Figures on deliveries of major weapons, produced in cooperation, by destination can give an order of magnitude of the importance of exports for a cooperative programme.

Table 1. Orders and deliveries of weapons produced within selected cooperative arms programmes between EU member states

Programme	Participating Member States	Nb of units ordered or delivered to producing countries	Nb of units delivered to other EU countries	Nb of units delivered non-EU countries
Typhoon Combat Aircraft	Germany, Italy, Spain and UK	472	30	88
Horizon Air Defence Frigate	France and Italy	4	0	0
FREMM Multirole Frigate	France and Italy	18	0	1
Scorpene Conventional Attack Submarine	France and Spain	0	0	10
Boxer Infantry Fighting Vehicle	Germany and the Netherlands	747	0	0
EC-665 Tiger Combat Helicopter	France and Germany	138	102	97
NH-90 Multirole Helicopter	France, Germany, Italy and Netherlands	331	102	97

Source: SIPRI Arms Transfers Database

As shown in Table 1, the Typhoon combat aircraft has been primarily been bought by states directly involved in the production. The total number of Typhoon aircrafts delivered to states outside Europe between 2005-2014 represents less than 15% of the number supplied to the cooperating states. In contrast, the total number of the NH-90 helicopters delivered to clients outside Europe constitutes about 60% of the number supplied to states cooperating in the programme. In that case, export sales, including intra and extra European exports, exceed the number bought by cooperating states. Finally, the Scorpene submarine was developed by Spain and France, but was never procured by these countries. It has only been build for export.

Winning a major international market, whether it is for a national, multi-country or multi-company produced defence equipment, can completely reshuffle shares of turnover coming from domestic, EU and extra-EU sales for a company. The best example to illustrate this is the Indian Medium Multi-Role Combat Aircraft Programme, a project valued at \$13 billion USD. All three European made combat aircraft were presented to the competition. French company Dassault Aviation was the bidder selected to enter into exclusive negotiations with the Indian MoD. If they are successful, French aircraft manufacturer Dassault Aviation will see its share of turnover coming from export sales grow steeply in the coming years

Available data is insufficient to be able to assess more precisely the share of cooperation programmes in extra-EU export shares of turnover of the EDTIB. Table 1 tends to indicate that except for two cases – the Scorpene attack submarine and the Tiger Combat helicopter - sales to countries involved in the production outweigh export sales (including those made to other EU states), which falls in line with the dominant trend observed in figure 1, the importance of domestic orders.

4 Export support and promotion in Lol countries and Poland: actors and resources

4.1 Governmental export promotion actors

European governments devote significant administrative and political resources for arms export promotion. Most Lol countries have agencies or ministerial departments dedicated to arms export support. In France (Direction du développement international, DI), Spain (Oficina de Apoyo Exterior, OFICAEX) and Sweden (Försvarsexportmyndigheten, FXM), these departments and agencies are attached to the ministries of defence. In the UK, the Defence and Security Organisation (DSO) is attached to the trade department, the UK Trade & Investment department (UKTI). In Italy and Poland, arms export support is taken up by personnel within the ministries of Foreign Affairs (Direzione generale per la promozione del sistema Paese and Departament Polityki Bezpieczeństwa respectively). Their roles cover three main tasks: governmental coordination; promotion per se; and after-sales services (see table 2 below). Germany does not have a national defence export support agency, but German government representatives do engage in export promotion through other actors.

These others actors include most significantly the Armed Forces, who undertake materiel demonstrations and share users' experiences with the Armed Forces of potential client states. Defence attaches also help defence companies identify key local decision-makers and facilitate contact between local authorities and the exporting company. They can also create or report market opportunities. Political actors are also key in arms export promotion and contract negotiations, ranging from ambassadors, to heads of government and states, as well as parliamentarians. In France, there are also companies under state supervisions that engage in arms export promotion (Défense Conseil International, ODAS notably).

Over recent years, the trend has been to reinforce export promotion actors and their resources. In 2013, a committee was created to strengthen inter-ministerial coordination in France (Comité ministériel des exportations de défense). The French Defence ministry is also considering leasing weapon systems, a project that could be implemented thanks to 'special purpose vehicles' (²³). In the UK, there are on-going plans to strengthen DSO personnel. In 2013, the British Government also created a ministerial working group on defence and security exports. A study originally launched to investigate FMS-type agreements was later refocused towards Canadian export promotion and to providing a 'handbook' for defence export support. Under Angela Merkel's leadership, the German Government developed what *Der Spiegel* called in 2012 the 'Merkel doctrine', which implies that arms exports are now considered as a foreign policy tool and part of defence partnerships with foreign partners. The Spanish and Swedish governments launched their dedicated arms export support agencies respectively in 2012 and 2010, respectively.

²³ Special purpose vehicles (SPVs- are companies partly state-financed, which in this case will be able to buy military equipment from the French Armed Forces and lease them to the ministry of Defence. This project is due mainly to budgetary concerns, but SPVs would also be used to offer client states to lease French materiel.

Table 2. Summary of major actors supporting state export promotion policy

ACTORS		ROLES	EXAMPLES
Administrative actors	Dedicated arms export support department/agencies (Fra, Swe, UK, Spa); or MFA resources (Ita, Pol). -- Germany does not have a dedicated department but other types of actors are involved.	Coordination: main contact points for the defence industry; prioritizing industry requests	<ul style="list-style-type: none"> FXM (Swedish defence export support agency) has an annual plan for export support priorities, regarding markets or companies in need of support.
		Promotion: representing the state in bilateral visits; meetings between firms and potential clients; trade shows. This role aims mostly at ensuring the credibility of the exporting firm. It also includes traditional representational function.	<ul style="list-style-type: none"> British UKTI DSO enabled a defence firm to secure contracts in South Korea, through an invitation to a joint UK-South Korean summit, and an introduction to the South Korean procurement agency, as well as the South Korean embassy in the UK. DSO also provided advice such as market intelligence to the company. Dec. 2014: The head of Spain's OFICAEX, attended the United Arab Emirates National Day in their Madrid embassy.
		After-sales: Supervise on-going contracts – notably in case of government-to-government agreements but not only.	<ul style="list-style-type: none"> French DGA/DI has personnel in charge of supervising existing deals, ensuring that deliveries are on schedule and that the technical performances of the products meet expectations. They act as communication channel between the client government and the industry.
Military actors	Armed Forces	Demonstrations	<ul style="list-style-type: none"> July 2012: an officer from the German Bundeswehr assisted the test of Leopard-2 tanks in Saudi Arabia.
		Share user's experience: promote domestic weapon systems to the armed forces of potential client states	<ul style="list-style-type: none"> Nov. 2013: the Spanish Navy showed the Cantabria supply ship to the Indonesian Navy in Jakarta.

	Defence attachés	Communication channels; market opportunities	<ul style="list-style-type: none"> -French armament attaches regularly organize conferences for French delegations in their assigned country, inviting host country procurement authorities to participate, for instance.
Political actors	High-level government executives (ministries, heads of government, heads of state)	Promotion	<ul style="list-style-type: none"> - In 2010, Swedish King Carl XVI Johan travelled to Brazil to support the JAS-39 Gripen bid in the Brazilian combat aircraft competition. - Polish President Bronislaw Komorowski gave the opening speech for the Polish defence industry trade show in 2013 (International Defence Industry Exhibition MSPO, in Kielce).
	Parliamentarians	Representation	
	Special envoys	Create market opportunities	
	Ambassadors		
Dedicated companies	Government-supervised companies with arms export promotion activities (France)	Défense Conseil International (DCI) (49.9% state-owned): specialized in transferring French military know-how, as part of defence export sales	<ul style="list-style-type: none"> - DCI was in charge of training the Russian crew on the Mistral-class amphibious assault ships, before the planned delivery. This includes how to sail the ship, how to use the communication system, the propulsion system, maintenance, etc.

4.2 Other government tools to win arms export deals

4.2.1 Export credit agency (ECA)

Arms deals involve high financial stakes. Most buying countries do not pay the full amount of the contract right away. Payment is instead made through financial deals over the long-term, which also involve interest rates over the reimbursement period. These lead client states and exporting firms to rely on state-backed export credits, where the private market (banks) will not support the risk by themselves. Export credits provided by supplier states' Export Credit Agencies (ECA) not only act as a guarantee for the exporting firm, but are also a tool to attract customers. Indeed, conditions attached to the loan provided by ECAs can become a key argument in negotiations. Often, the ECA guarantees enable the commercial bank to offer preferential interest rates over long-term loans. Overall, the export credits transfer the financial risk from the defence company to the supplying states' budget and can help win export deals thanks to preferential financial arrangements.

German export credit insurances, called 'Hermes Bonds', were valued at around €3.3 billion in 2012. In France, between 2010 and 2014, 25% of the French ECA's outstanding loans covered military sales. For the British ECA, export credits for military goods in 2007-08 represented 57% of its outstanding loans, but only 1% in 2008-09. The figure rose again in 2012-13 up to 47%. In 2007, a NGO report estimated that 'between twenty and thirty percent of all export credits issued or underwritten by European governments are military-related' ⁽²⁴⁾.

4.2.2 State guidance with offsets arrangements

Offset is a general term used to designate industrial and technological compensations for states buying a major and expensive weapons system from a foreign supplier. They are presented as ensuring some 'return on investment' for the importing state by requiring that the supplier reinvest a share of the cost of the programme (most often a 100%) in the economy of the client country's defence or other civilian industrial sectors. In this respect, a supplier's offset proposition is often an important criterion to winning a contract.

Offsets have been part of the defence market since the start of the Cold War, but the practice has experienced a significant increase in popularity in the 2000s. Several regions have experienced impressive GDP growth in this period and several countries in those regions, such as Brazil, India, and Indonesia, have sought to use available resources to modernize their arsenals and to acquire some national defence production capabilities. Therefore, offsets requirements have not only multiplied, but have also become generally more demanding. This is made easier by the fact that flat markets in Europe are putting pressure on European suppliers to conclude sales abroad.

Offsets deals are very opaque and are difficult to negotiate by the supplier, especially if technology and know how transfers are involved in order to help create indigenous capabilities. These scenarios often lead to the supplying company seeking government's involvement in order to protect its interest (preserving most sensitive know how and technology) and to help identify potential key partners in their offset offers.

4.3 Other promotion tools

Offsets and technology transfers are increasingly being negotiated through government-to-government (G2G) agreements, which further strengthens the need of state involvement in export promotion and

²⁴ European Network Against Arms Trade, 'European Export Credit Agencies and the financing of arms trade', 2007, p.12.

negotiations. G2G agreements provide the client state with reassurance as to the outcome of the deal and the fulfilment of technology transfers obligations. Indeed, in the framework of G2Gs, the supplying state is legally engaged in fulfilling contract obligations – instead of a conventional contract between the defence firm and the purchasing government. G2G agreements also open the possibility to avoiding a tender process and directly enter in bilateral negotiations. Because client states increasingly request this kind of contracts, the supplier government's involvement is also automatically increased.

Other tools that are available involve supplying surplus weapon systems in addition to the new weapon system being purchased. For example, French surplus exports are often related to the tentative sales of new weapons. France leased the Agosta-class submarine 'Quessant' to Malaysia, for training purposes in advance of acquiring two Scorpene submarines. The Quessant was decommissioned in 2001 and leased to Malaysia between 2005 and 2009. Yet another example would be the sale of 12 second-hand Mirage-2000 aircraft to Brazil, a deal that can be perceived from the French side as a means to facilitate a Rafale choice in the F-X2 competition.

Eventually, exporting governments can also use political and diplomatic tools to win over potential clients. To take another French example, an antenna of the Louvre museum was opened in Abu Dhabi, reportedly to convince the UAE to purchase the Rafale fighter aircraft.

4.4 States and multi-layered intra-European competition

The perceived necessity for European defence firms to win export markets to sustain their national defence production activities and the co-existence of national and multinational European weapon systems seem to compound intra-European competition. Indeed, considering the overlap of cooperative and national programmes in several sectors, States are sometimes faced with the choice of either supporting a domestic made system and one produced in cooperation. In other cases, its promotion resources help a multinational company compete with itself by supporting the national subsidiary.

4.4.1 Different forms of intra-European competition

In its most common form, intra-European competition occurs when defence firms from different European countries contend for the same market, inside or outside the EU. The best known case is that of the French Rafale combat aircraft, the Swedish Gripen and the jointly produced Eurofighter (UK, Germany, Spain and Italy) repeated competitions against one another on international markets (India, Brazil) as well on the European one (Greece).

In some cases, competition can take place within a trans-European firm. A good example of such a case is Swedish submarine builder Kockums, which was acquired in 1999 by HDW, the German shipbuilding company, which in turn was acquired by ThyssenKrupp in 2005. Consequently, within ThyssenKrupp Marine Systems (TKMS) there were two companies, a Swedish one (Kockums) and a German one (HDW), which competed for the same export markets. The parent company TKMS eventually prevented its subsidiary Kockums from competing in two major submarine markets: Singapore and Australia. German and Swedish firms were again competing against another European submarine producer, French DCNS²⁵.

Another type of intra-European competition comes about when companies who are jointly producing a weapon system, are also domestically producing a competing product. For instance, Eurocopter and AgustaWestland jointly produced the NH90, but at the same time, AgustaWestland developed the EH101, a competing helicopter. The company and its home government again prefer to support the product that is wholly or primarily nationally produced. There are also cases where a jointly produced system leads to

²⁵ Cabirol M., 'Sous-marins à Singapour: comment l'allemand TKMS veut torpiller sa filiale suédoise Kockums', La Tribune, 8 November 2013.

intra-European competition, if each company offers its own version on global markets, for example with Scorpene submarines (France/Spain) ⁽²⁶⁾.

4.4.2 Cooperation on export promotion for joint weapon systems remains national-centric

Although, export promotion is undertaken most often on a national basis, in the case of some joint European systems, export promotion will be divided among producing countries according to diplomatic criteria. The Typhoon case is a good illustration of the national focus of exports in the framework of multinational programmes. An export success story, the combat aircraft was developed and is produced and upgraded by a consortium consisting of companies in the UK, accounting for 33 per cent of the work share, Germany, 33 per cent work share, Italy, 21 per cent work share and Spain, 13 work share. Even though firms from each of these countries contribute components to the production of each Typhoon, the export marketing strategy for the aircraft divides up areas of responsibility for sales between the partners. For example the UK partner is responsible for the sale of Typhoons to Saudi Arabia, Italy for marketing to Kuwait and Germany for marketing to India and Austria, for instance.

It is also worth noting that European institutions dedicated to promoting cooperation on defence programmes and procurement, such as the Organisation conjointe de coopération en matière d'armement (OCCAR) or the European Defence Agency, were not given authority on export promotion that could strengthen pan-European cooperation on external markets.

5 The loud absence of the Common Position

The Council Common Position 2008/944/CFSP of 8 December 2008 defining common rules governing control of exports of military technology and equipment (hereafter: CP), is today the main instrument for EU-wide cooperation on arms export controls. The CP, like its predecessor the 1998 Code of Conduct on arms exports (hereafter: Code), has had weak effects on EU Member States' arms exports. Today, EU Member States appear reluctant to appeal to the CP to criticize each other's arms exports.

5.1 The mixed goals of the CP

The CP takes up the 8 criteria identified in the Code, which Member States are required to use when assessing industry requests for export licences. The CP also includes consultation and information exchange mechanisms. One of the key aims was to achieve harmonization of EU Member States' arms export policies. However, this harmonization goal encompassed various objectives from different actors. The will for harmonization was the result of four main causes:

- Scandals resulting from arms exports to Iraq, which came under public scrutiny during the First Gulf War;
- NGOs advocating restriction of arms exports to states violating human rights;
- Calls from the defence industry for a level playing field; and ⁽²⁷⁾

²⁶ French and Spanish shipyards DCNS and Navantia joined forces in the 1990s to produce a new class of conventional attack submarine, the Scorpene. Plans were for Spain to procure the weapon system, as France had made the decision earlier to use only nuclear submarines. The Spanish Government bowed out of the programme and decided to go with a purely nationally produced submarine, the S-80. France criticized its ex-partner for using know-how acquired during the development of the Scorpene and also to present a competitor, the S-80, on the international market. See Mer & Marine. 'Scorpene: la fin du litige entre DCNS et Navantia' 12 November 2011:

<http://www.meretmarine.com/fr/content/scorpene-fin-du-litige-entre-dcns-et-navantia>

- Governments' concerns towards the risk of 'licence shopping', whereby corporations would relocate defence production in states with less restrictive export controls.

However, despite the common interest in harmonization, several reports ⁽²⁸⁾ have shown that the twin aims of increased restrictiveness and a level-playing field have failed to materialise.

5.2 The failure of the CP: Neither increased restrictiveness and nor harmonization

Quantitative studies on EU-wide arms exports as well as qualitative studies either on several exporters or on particular recipients, reached similar conclusions: there has been neither increased harmonization nor tighter controls since the adoption of the Code and the CP. The lack of harmonization is due mainly to the fact that the implementation of the CP rests on the authority of Member States, which entails divergence in the interpretation of the CP criteria. As a result, the human rights, democracy or conflict criteria do not appear to restrict European arms transfers, and some studies²⁹ even suggest that the Code and the CP actually weakened common standards.

Recent examples related to cases of jointly produced weapon systems show the lack of common interpretation of arms export control criteria. The German Government was recently reported to have blocked French exports, for systems partly produced in Germany³⁰. This occurred for missile producer MBDA which was prevented from exporting Milan-ER missiles to Qatar; land and artillery systems producer Nexter for armed vehicles Aravis to Saudi Arabia; and aerospace producer Airbus Helicopters for Cougar helicopters to Uzbekistan. Military vehicle producer Renault Trucks Defense also reportedly had the export of its VAB Mark3 to a 'Middle east' country blocked. Another example of differing interpretations of arms export policies is the British pre-emptive refusal to grant licences for Sweden's export of Gripen combat aircraft to Argentina – as the new Gripen-NG includes parts produced in the UK.

Not only do these examples show the divergences in European Member States' arms export policies, but they also demonstrate that governments do not publicly appeal to CP criteria to when in disagreement over granting arms export licences.

²⁷ The logic in the level playing field rationale was that common export control norms would reduce competitive disadvantages through subjecting European manufacturers to equally stringent rules in the contracting and competitive post-cold war armaments market', in Hansen S.T. and Marsh N. (2014), 'Normative power and organized hypocrisy: European Union Member States' arms export to Libya', *European Security*, p.5.

²⁸ Bromley, M. and Brzoska, M., 'Towards a common, restrictive EU arms export policy? The EU Code of Conduct on major conventional arms exports', *European Foreign Affairs Review*, vol. 13, no. 2, 2008; Erickson J.L., 'Market imperative meets normative power: Human rights and European arms transfer policy', *European Journal of International Relations*, 19(2), 2013, p.209-234; Bromley M., 'The Europeanisation of Arms Export Policy in the Czech Republic, Slovakia, and Poland', *European Security*, 16:2, 2007, p.203-224; Bromley M., 'The Impact on Domestic Policy of the EU Code of Conduct on Arms Exports', SIPRI Policy Paper No. 21, SIPRI, May 2008; Hansen S.T., and Marsh N., 'Normative power and organized hypocrisy: European Union member states' arms export to Libya', *European Security*, 2014; Bromley M., 'The Review of the EU Common Position on Arms Exports: Prospects for Strengthened Controls', EU Non-Proliferation Consortium, Non-Proliferation Papers, No.7, Jan. 2012.

²⁹ Holm, K., 'Europeanising export controls: the impact of the European Union Code of Conduct on Arms Exports in Belgium, Germany and Italy', *European Security*, vol. 15, no. 2 (June 2006), pp. 213-34; Duquet N., 'Business as usual? Assessing the impact of the Arab Spring on European arms export control policies', Flemish Peace Institute, Brussels, 2014

³⁰ These reports were denied by Germany.

5.3 Deliberately avoiding the CP: a symptom of the lack of a common market

The absence of the CP in public discourses has been highlighted by a recent joint Saferworld/GRIP study on the Mistral deal between France and Russia ⁽³¹⁾. In 2010-11, when France negotiated the sale of four Mistral-class ships to Russia, these discussions were strongly opposed by EU allies. The deal was nonetheless signed, but the conflict in Ukraine 'returned the Mistral sale to the spotlight', all the more so given that the delivery of the first ship was scheduled for October 2014. This widened further the number of allies criticizing France. However, the authors of the study underline that none of the criticisms relied on the CP criteria. According to the authors, 'this is all the more remarkable given that the contract raises concerns to a varying extent under at least six of the Common Position's eight criteria, most notably criteria 4, 5, and 7'. The only occurrence of the CP within the debate on the Mistral sale that the authors identify came from the Ukrainian ambassador to the EU, from a Ukrainian think tank; and within the EU from the Lithuanian Defence Minister.

The reluctance of EU governments to publicly appeal to the CP can firstly be explained by the differing interpretations of CP criteria by the Member States. This may prevent a common understanding and therefore the possibility to resort to the EU CP to publicly criticize another EU Member States' export decision. Secondly, as the authors of the Saferworld/GRIP study point out, 'decision-makers and political figures prefer not to draw attention to the Common Position, in the expectation that they may themselves in future approve problematic arms sales on the basis of economic or perceived foreign policy advantage'. This means that EU governments deliberately avoid appealing to the EU CP, in order to not implement it in a specific case – so that, over the longer run, they themselves in turn cannot be held accountable against the criteria of the CP. A public and specific use of the CP could indeed lead to its actual implementation, whereas its current absence from public debate amounts to its almost non-existence. Specific deals are nonetheless likely to be mentioned within COARM discussions, but these are confidential ⁽³²⁾. An alternative but complementary explanation is the reluctance of Lol Member States to resort to the CP. Officials in charge of arms exports in Lol Member States consider that they have a stronger legitimacy to discuss arms export controls than other EU Member States with a small or no defence industry. Such a perception could lead to reluctance from Lol states to refer to the CP, which applies to the entire community of EU Member States. These states would instead focus on intra-Lol agreements on export controls.

This 'loud absence' of the EU CP can be considered as a manifestation of the lack of common EU defence market. Although one of its main goals was to create a level-playing field, this was not achieved insofar as States have not mentioned the CP in the Mistral issue. Like export promotion activities, export controls remain in the hands of national decision-making processes.

6 Are extra-EU exports impeding European cooperation?

This report has first shown, in part 3 that shares of extra-EU exports in defence turnovers at the country level are collectively significant for the EU's major arms suppliers based in Lol countries, although there are differences in their magnitude. It has also demonstrated, in part 4, that Member States mobilize important administrative and financial resources to support their companies' attempts to win foreign markets outside the EU, which sometimes puts them in conflicting situations in terms of which actor to support. Part 5 has also highlighted the virtual ineffectiveness of the European Common Position on

³¹ Quéau Y. and Isbister Roy, 'An ill wind. How the sale of Mistral warships to Russia is undermining EU arms transfer controls', Saferworld/GRIP, Briefing, Nov. 2014.

³² COARM: Conventional Arms Exports Working Group.

exports as a way to harmonize EU member states export controls by providing a common export framework, which would eliminate the impression that some companies unduly benefit from less restrictive export controls.

Combined, these elements do indicate a strong correlation between, on the one hand, the importance of extra-EU exports for EU Member States and especially for LDC countries and on the other hand, difficulties of European cooperation between companies and between Member States. Competitions for extra-EU markets often involve several European suppliers, which are supported in different ways by their states in these contests. Multiple examples show that this rivalry fosters tensions and hostility between European actors, which, in turn, has a negative impact on European cooperation in the field of armament.

However, this report did not uncover evidence to support the idea that extra-EU defence exports are actually causing the challenges currently displayed by European defence production cooperation. Examination of past armament collaborations or competitions suggest that there is no mechanistic link between frictions and mistrust among suppliers with either exports or cooperation. Indeed, several European cooperation programmes are well known to have created enduring tensions between both companies and countries ⁽³³⁾. From another standpoint, being competitors does not seem to be a barrier to cooperation for Finmeccanica (which owns helicopter producer AgustaWestland) with Airbus Helicopters on the NH90 consortium. Interestingly, this observation is also true at the national level. Germany's two land systems producers, KMW and Rheinmetall are simultaneously competitors in some market segments and collaborators in others.

This suggests that extra-EU defence sales by themselves may not be the issue at stake. Indeed, the 'race to export' could be a reflection of deeper, structural problems, such as the stagnation of European procurement spending and the persistence of the domination of national logics and prerogatives in the defence policy areas.

6.1 Impact of exports and European cooperation: An elusive relationship

The relationship between the importance of exports in national defence turnovers and levels of European cooperation is far from obvious. As mentioned above, one possible link between extra-EU exports and European cooperation is the consequences of rivalry on foreign markets on relations between suppliers. It implies that methods used by industry with the support of the state to win international markets, such as generous offsets proposals or offers of financial assistance to the client, aggravate tensions between companies within the EU and create a situation where they weaken incentives to cooperate at the European level.

Contrarily, competition on the international stage could also be seen as a driver for combining forces at the European level. In principle, it would reduce the number of competitors, increasing the chances of a single European supplier winning a major contract against actors from the United States, Russia, Israel and some emerging suppliers such as South Korea. Moreover, high stake competitions are also both risky and costly to undertake. Preparing bids for major, long-term markets abroad requires significant resources, as indicated in chapter 4, and there is often uncertainty about how long evaluation of the tenders and negotiations to sign the contract will take. On top of this, there is always a possibility of a cancellation ⁽³⁴⁾. Submitting a joint tender may help mitigate these concerns by spreading both the risks

³³ This case of the Scorpene submarine mentioned in section 5 is telling on this issue.

³⁴ A good example is that of the Canadian Combat Vehicle (CCV) programme, which was suspended and restarted four times over the course of 5 years. Each new round of competition requested bidders to submit a new tender, which also had to include a detailed offset proposal as per the Canadian Industrial and Regional Benefits (IRB) policy. After the fourth round, the Canadian Government decided to cancel the CCV programme. One tenderer, French land systems company Nexter, requested that the

and the costs between partners. From another standpoint, the importance of extra-EU's share of turnovers presented in part 3 could lead suppliers dependent on extra-EU export sales to seek to reduce this reliance by engaging in a cooperation programme with other EU Member States, which would, in principle, increase the EU share of their exports.

It should also be mentioned that collaborative programmes might, by themselves, embody serious obstacles to European cooperation. Over the years, major programmes led in multinational cooperation have developed a somewhat negative reputation. They are considered difficult to manage, time consuming, and they too frequently fail to meet expectations in terms of costs savings ⁽³⁵⁾. To the usual obstacles generally associated with major procurement projects, such as costs overruns, delays, long lead times and repeated changes to technical requirements, multinational cooperative programmes add a lack of requirements harmonization as well as additional inefficiencies assignable to national 'juste-retour' work shares arrangements, which are an indirect way of seeking to preserve national production capabilities in a multinational framework.

The virtual ineffectiveness of the European Common Position on exports in harmonizing extra-EU arms transfers confirms the prevalence of state logic. European countries continue to favour their national legislations on defence exports over the common position and, in some instances, are believed to use national regulations to block a competitor sale to a third country ⁽³⁶⁾. Whether or not intentions motivating these actions are based on a desire to interfere with a competitor, they highlight major differences in national legislations on arms transfers, which sustain tensions at the European level.

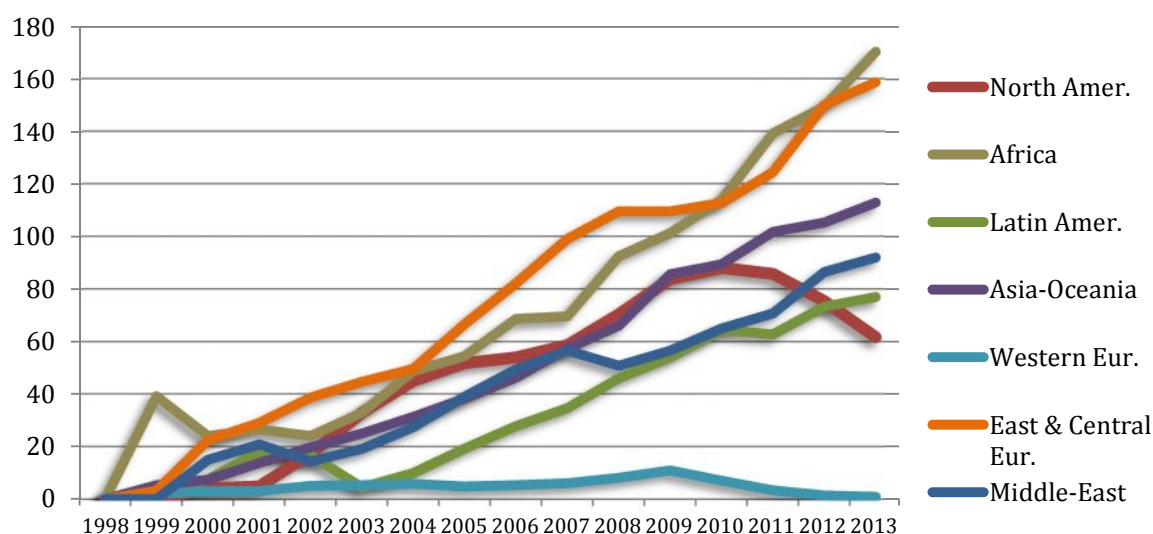
6.2 The influence of enduring characteristic of the European defence economy: stagnation of defence spending and the enduring domination of national logic

Exports by themselves may not be the central variable when addressing the issue of European armament cooperation and its difficulties. It can be seen more as a symptom of two enduring structural features of the European market: a) the persistence of national logic at the European level, which leads states to prioritize national production capabilities within the EU context and on international markets and b) the relatively weak growth of European countries' defence spending since the end of the Cold War.

Canadian government compensate the industry bidders for the costs of their bids'. See Nexter, Press Release, *Nexter Comments on Government's Decision to Cancel the CCV*, December 20th, 2013: <http://www.nexter-group.fr/en/press-releases/632-reactions-de-nexter-suite-a-lannonce-du-canada-darreter-le-programme-ccv>.

³⁵ France, Cour des comptes, 'La conduite des programmes d'armement' Rapport annuel, 2010, pp.33-73.

³⁶ See chapter 6.

Figure 5. Evolution of military spending by region, 1998 to 2013, base 100, in percentages

Source: SIPRI Military Expenditure database.

Increased competition for international contracts is partially caused by the fact that drivers of military expenditure growth have partially moved away from the Western world, but especially from Western Europe, in the past 20 years. As shown by figure 3, military expenditure has been characterized by significant growth in all regions of the world except Western Europe since the late 1990s. Although in absolute terms, Western European countries remain high spenders, their share of the world total military expenditure has decreased over the past 20 years, from 33.1% in 1993 to 17.1% in 2013.

To counteract the impacts of almost flat defence procurement spending growth over the past decade, and the uneven successes in European integration and cooperation, states with significant arms producing capabilities have individually made the choice to turn to extra-EU export markets.

6.3 Offsets and impacts on the competition/cooperation dynamics in Europe

As mentioned in section 4.1.2 of this report, offsets are not a new phenomenon in the defence market. They became an accepted practice in the context of the budding Cold War rivalry between the United States and the Soviet Union. They were first implemented through NATO to facilitate European rearmament, and were seen by the US as a way to recoup some of the Second World War costs by selling major weapons to allies ⁽³⁷⁾. To a certain extent, they have contributed to the establishment of a defence industry in Europe. Since then, the practice of offsets has spread and morphed. As national defence markets are not subjected to World Trade Organization regulations, they have become an important tool of industrial policy for an increasing number of countries.

Indeed, since the mid-2000s, the significant relative growth in military investments accounts outside the Western world (see section 6.2 above) has been accompanied with what IHS Jane's calls a 'proliferation' of offset policies that are widely considered as increasingly demanding by suppliers. These policies vary greatly from one State to another and often pursue different sets of objectives. Some countries leverage their imports by requesting offsets to support general goals of industrial policy (i.e. supporting industrial and technological sectors not necessarily associated to the weapon being bought), which are called

³⁷ Hoyos, Carola, Katie Carnie and Tom Pearson, 'The history of defence offsets' Financial Times, 9 October 2013.

'indirect offsets'. Some actors use compensations to create national defence production capabilities, often linked to the specific contract being tendered, such as supplying landing gear for an the aircraft being acquired, which are named 'direct offsets'. Offsets can vary greatly in their form: they can range from integrating national companies in the winning prime contractor supply chain to building naval yards and support R&D in universities, or creating a joint-venture with a national company and transferring know-how. Indeed, as the US Department of Commerce notes in its annual report on defence offsets, they are usually seen as a good way to attract research and development as well as capital investments in the country.

6.3.1 What are the impacts in Europe?

As is the case for exports in general, the relationship between offsets and the current situation in Europe with regards to defence cooperation and integration is difficult to assess. The literature on offsets is primarily preoccupied with a) market distortion effects of the practice in recipient countries; b) offsets impacts on a national industrial sector growth or performance or c) exploring the link between offsets and corruption. We are not aware of open source reports or articles that have investigated compensations' possible consequences on cooperation between companies or countries, or their distorting effects in the domestic markets of exporting companies.

In a tentative fashion, three levels of consequences of offsets on European cooperation could be identified. First, at the competition phase, it can be expected that every European defence company that sells major weapons systems overseas have to comply with offsets demands, as they are a selection criterion for winning a major export contract. Simply put, they form an integral part of the competition along with price and technical requirements/performance of equipment. Importers have a vested interest in maintaining a high level of rivalry between potential suppliers in order to get the best possible deal, and this includes the offsets proposal. In itself, this is not conducive to greater cooperation between European suppliers and partially explains the support provided by states for their competing companies overseas. Moreover, offsets proposals are a decisive factor in the selection of a supplier. They contain sensitive information about capabilities and strategies of the bidding companies, which consider these proposals as proprietary information. European companies that are regularly facing each other in different extra-EU export competition may not be inclined to share information about their offset strategies in the context of a cooperation effort if they remain competitors for other markets requiring offsets.

Second, once the competition is over, offsets also entail long-term commitments with the recipient country for a winning company. They involve the creation of relationships between a foreign prime contractor and local suppliers, which, in some cases, can outlive the duration of the contract ⁽³⁸⁾. One possible hypothesis that can be suggested, but that would need to be tested, is that a foreign company that has a long term presence in a recipient country because it had won a major contract in the past may have built an advantage over newcomers for future programmes by already having a presence in the country, a national suppliers base and better knowledge of the national policies and practices. This situation also makes it even more difficult for newcomers to enter the market.

Third, in a more general sense, offsets influence the strategies of the larger European defence firms by shaping their supply chains in a way that is very specific to the constraints imposed by offset demands. It pushes them into an internationalisation process, parts of which they may not have chosen without compensations required in order to win a contract. One can wonder to what extent European defence

³⁸ This is the case of the Canadian based landing gear manufacturer Heroux Devtek, which was inserted into Lockheed Martin's supply chain in the 1980s for the C-130 tactical transport aircraft programme.

companies' presence overseas induced by offsets requirement can be an obstacle to more cooperation within Europe.

Finally, as is mentioned in a report on the future of the European land systems industry ⁽³⁹⁾, a possible line of investigation on impacts of offsets on producers' domestic market concerns longer-term corporate strategies. It could be thought that major European producers, faced with modest domestic investment budgets, have chosen to secure contracts overseas in order to sustain their activities. In turn, this would position them favourably in a hypothetical future European consolidation process, which would lead to elimination of redundant capabilities.

6.4 Difficulties and ambivalence surrounding defence integration

The limited influence shown so far by the 'defence package' directives and the Common Position on exports not only highlight the domination of state logic, it is also a manifestation of the major difficulties in building an integrated defence market. As it has been demonstrated numerous times, cooperation in a resources-constrained environment makes sense from an economic standpoint. From the EU point of view, it is an essential pillar of the CSDP. But from a national government point of view, using public funds to support a foreign company defence production and sales is difficult to justify. This divergence may be the cause of ambivalence shown by Member States toward demand-side initiatives (procurement policies) such as those promoted by the European Commission in the European defence market.

Indeed, even though the starting point of this report is the share of exports in the EDTIB turnover, very little elements address the supply-side (industry) of the market 'equation'. Industry consolidation is identified as a condition of the construction of a truly integrated European defence economy, but so far, measures aimed at harmonizing the demand-side have failed to create the condition of greater defence production capabilities rationalisation across Europe. In this respect, cooperation programmes, simply by reducing the number of companies that involved in a competition abroad, would necessarily improve the possibilities of winning, as long as the tender is competitive. Indeed, whether the bid is submitted by one company or by a consortium, the major issue is to convince the client that the offer presented is the best. In this, EU support to export on third markets could be seen as a way of encouraging common proposals, but this comes at the end of the process, when a weapon system is ready to be exported. How much EU support to common initiatives on third market would have weight in convincing producers to cooperate would need to be assessed more thoroughly.

To conclude, we explore here two, interrelated lines of thought linked to European defence cooperation for future investigation. Firstly, section 6.2 of this report discusses how global changes to world demand are currently reshaping the global defence economy dynamics. Section 6.3.1 indicates that this has led the supply-side to engage into an internationalisation process. One of the questions that emerge is whether this internationalisation process is creating structural impediments to both greater European cooperation and supply-side restructuring at the continental level, as major producers are now forming long-term partnerships with companies located outside Europe.

Secondly, there are increasing worries about investments efforts made by European countries and their companies in science & technology and research & development to prepare the next generation of armaments. Fragmentation of research projects along national lines is an issue, as scarce resources are possibly allocated to develop potentially overlapping capabilities, and smaller national investments reduce the scope of the projects undertaken. These concerns could be compounded by the 2016 US defence budget submission, which openly prioritizes investing in R&D following five years of cuts in this

³⁹ Fleurant, A-E and Yannick Quéau, 'Quelles perspectives pour l'industrie européenne des armements terrestres ? ', Focus stratégique, n°50, March 2014 - IFRI, Paris.

spending category. If the US Congress sanctions this budget, commentators believe that a new generation of American weapons will be ready in 25 to 30 years. Considering the costs associated with developing a new armament generation, the current situation of investment spending in Europe makes it difficult for producers to match the US effort. In a forward-looking fashion, creating European R&D budget may help overcome this challenge, but some European suppliers are also looking to countries outside Europe as partners for co-developing weapons and technologies, which may also act as an obstacle to cooperation in Europe.

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