European Security and Defence Assembly
Assembly of Western European Union

DOCUMENT A/2072 16 June 2010

FIFTY-EIGHTH SESSION

The transatlantic defence equipment market

REPORT

submitted on behalf of the Technological and Aerospace Committee
by Axel Fischer, Chairman and Rapporteur (Germany, EPP/CD Group)

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Report transmitted to: the President of the Council of WEU; the Secretary-General of the WEU; the President of the Council of the European Union; the High Representative of the Union for Foreign Affairs and Security Policy; the President of the European Commission; the EU Commissioner for institutional relations and communication strategy; the Presidents/Speakers and the Chairmen of the Foreign Affairs, Defence and European Affairs Committees of the 39 national parliaments represented in the Assembly; the Presidents of the Parliamentary Assembly of the Council of Europe, the NATO Parliamentary Assembly, the OSCE Parliamentary Assembly, the Baltic Assembly, the Nordic Council, the Parliamentary Assembly of the Black Sea Economic Cooperation, the CIS Parliamentary Assembly; the President of the European Parliament; the Secretaries General of the Parliamentary Assemblies of the Council of Europe, NATO and the OSCE.

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[1] Adopted by the Committee on 20 May 2010.

RECOMMENDATION 855[2]

on the transatlantic defence equipment market

The Assembly,

(i) Recalling Assembly Recommendation 849 of 3 December 2009, in which the Assembly considered that;

> " *(i)* (…) the European Union's Common Security and Defence Policy (CSDP) must be founded on a European Defence Technological and Industrial Base (EDTIB); (…)
>
> *(iii)* (…) a robust EDTIB is a prerequisite for autonomous European defence capabilities; (…)
>
> *(vii)* (...) while the European defence equipment market must be open and transparent internally, it must guard against distortion of competition from the outside; (…)
>
> *(xix)* (…) the development of the EDTIB also requires increased transatlantic and international cooperation, based on reciprocity and fair exchange in particular as regards technology transfers";

(ii) Considering that transatlantic relations in the field of security and defence remain one of the pillars of peace and stability in Europe;

(iii) Considering the importance of the economic dimension of transatlantic relations, in the form of the large volume of trade and reciprocal investment;

(iv) Stressing that the United States and Europe today remain the largest and most highly developed markets in terms of investment, spending, R&T, production and procurement;

(v) Noting the structural and budgetary imbalances that currently exist between the United States and the EU and NATO European member states in the field of defence technologies and equipment, as well as the technology gaps in certain sectors;

(vi) Noting the recent initiatives taken by the US Administration with a view to reforming the American technology transfer and defence equipment export control systems, and considering that while this will create opportunities for re-establishing a balance on the transatlantic market, it will also pose challenges for European firms;

(vii) Considering that it is first and foremost up to the European states to reorganise and reform the EDTIB in order to make it more effective and competitive in Europe and in the framework of transatlantic relations;

(viii) Supporting the efforts of European security and defence companies to establish themselves on the US market and participate in requests for proposals on the US security and defence market;

(ix) Considering that if the development of a balanced transatlantic market for defence technologies and equipment is an objective shared by the United States and the EU states, the latter should be able to protect themselves against distortions of competition and take measures to maintain the autonomy of European defence capabilities, much as the United States does in order to preserve its superiority in areas that it deems strategic;

(x) Considering that the European Defence Agency should play an active role, together with the participating member states and, where appropriate, the European Commission, in the guidance and development of the transatlantic market for defence equipment,

[2] Adopted by the Assembly on 16 June 2010 at the 2nd sitting.

RECOMMENDS THAT THE COUNCIL INVITE THE EUROPEAN UNION MEMBER STATES, AS MEMBERS OF THE EUROPEAN UNION, TO:

1. Pursue the efforts at national and multilateral level and within the European Defence Agency and NATO to strengthen the European defence technological and industrial base;

2. Endeavour in their bilateral relations with the United States and within the framework of NATO and of EU-US relations, to promote and defend the interests of European companies on the transatlantic defence market, just as the United States does for its companies;

3. Task the European Defence Agency with identifying sectors for cooperation between the participating member states and the United States in the fields of technology and defence equipment, in coordination with the relevant NATO agencies and committees.

EXPLANATORY MEMORANDUM

submitted by Axel Fischer, Chairman and Rapporteur (Germany, EPP/CD Group)

I. Summary

1. The strategic defence relationship between the United States and Europe, in particular those European states that are members of NATO and the European Union, is a fundamental part of today's international order. A relationship that was built up over the cold war years and pursued thereafter, it is central to the defence choices of a large number of European states, both large and small.

2. While NATO is the body that symbolises that relationship, it is not the only component. A transatlantic political and economic area, unparalleled in terms of coordination and integration in other parts of the world, is maintained and developed through bilateral defence cooperation agreements and commercial, social, educational and cultural exchanges.

3. This multifaceted relationship is not without its tensions and disagreements, but shared interests outweigh any differences which – where they do exist – are more a matter of form than of substance. While European support for American initiatives and action cannot automatically be taken for granted, there is a general consensus among European governments to go along with them, if only in an attempt to mitigate any potential adverse effects. Europe "from Venus" complements the United States "from Mars".

4. That has not hindered the emergence of a single European entity, embodied in the European Union, which aspires to change the balance of the transatlantic relationship. The United States would also like its European allies to take on a greater share of responsibility, so long as its leadership role in international affairs remains unaffected. While the United States has other allies and partners, Europeans are among the most loyal.

5. Europe and the United States have a history of cooperation spanning over 60 years. It is a cooperation that bears elements of competition however, particularly in the economic sphere. Europe is the United States' leading economic and financial partner. The extent of the relationship can be seen in the impact of the American subprime crisis on the European economy and the trade in certain products and financial assets/liabilities between the two sides of the Atlantic.

6. Nevertheless, Europe also has national and shared (in the EU) economic and industrial interests to protect, including the European security and defence technological and industrial base. There is no denying that the United States has provided Europe with a great deal of defence equipment, especially in the 1950s and 60s, and it is still the main external supplier of defence equipment to Europe. However, with the exception of a small amount of equipment, the majority of European needs could be met by European industries.

7. Of course turning to European firms might entail costs that are sometimes higher than simply buying "off the shelf" from the United States, but it is also a guarantee of operational autonomy. And beyond being a matter of protecting and developing national and European industrial and technological capacities and the economy, it is a source of prestige and influence in the international defence equipment market.

8. When it comes to defence equipment, the transatlantic relationship is based as much on cooperation as on competition and access to the Euro-Atlantic markets is two-way. Some American and European experts are in favour of establishing a more integrated transatlantic defence equipment market. It is a tempting proposition considering the benefits European firms might derive from easier access to the American defence market and the tens of billions of dollars it represents annually.

9. On the other hand, given the respective sizes, capacities, capital value and political clout of American and European firms in the defence sector, an open transatlantic market based on the model of the integrated European common market would most likely result in a proportionally similar division of labour as in the Euro-Atlantic strategic relationship: America leads, Europe plugs the gaps.

10. The transatlantic defence equipment market is still characterised by mutual attraction and cooperation on the one hand and by suspicion and competition on the other. The supplier-client relationship exists on both sides, but it is neither mutual nor balanced; there is an element of entrepreneurship with European and American firms investing and setting up in both the United States and Europe respectively, and cooperation on both a large and small scale in equipment and technological research and development (R&D).

11. On the R&D side, there is the somewhat sensitive issue of technology transfers, in particular from the United States to Europe. These exchanges are subject to legal and regulatory constraints, including ITAR (International Traffic in Arms Regulations) – a source of discord in Euro-Atlantic relations when it comes to cooperation in defence equipment and technology.

12. Notwithstanding the restrictions, tensions and legitimate protectionist impulses, the transatlantic defence equipment market is very dynamic and offers unique opportunities for return on investment. It is part and parcel of a strategic relationship which has been built up over more than half a century and which remains alive and well in an international context that is very different from the one that helped create it.

13. The transatlantic market has a major political dimension, characterised by a strong degree of interdependence. It is based on three pillars: the acquisition of equipment and technology, industrial aspects and cooperation/competition. The Technological and Aerospace Committee of the European Security and Defence Assembly has tasked its Chairman, Axel Fischer (Germany, EPP/CD Group), to examine this complex market and present recommendations with a view to redressing the balance in transatlantic relations in this field.

II. Introduction

14. The sum total of global defence spending in 2009 is estimated at over a thousand billion euros. The United States and Europe account for 70% of this figure (50% and 20% respectively). Between 2001 and 2009, the American defence budget increased by more than 75%, while European budgets remained stable.

15. The “Long War” against international terrorism and the wars in Afghanistan and Iraq have contributed towards the increase in American spending, including on major missile defence equipment and technology programmes, fighter planes, naval projection capabilities, UAVs (unmanned aerial vehicles), equipment and force protection, modernising ground forces and technological development.

16. The European allies – which have varying levels of commitment to American operations – are obliged to invest in the same areas, on the basis of national technological and financial choices and capacities, in order to ensure a modicum of interoperability with the United States. Some countries draw on the national or European (in cooperation) defence technological and industrial base to try and close the gaps, others buy off the shelf from the United States, while the bolder ones commit to transatlantic cooperation programmes.

17. In the latter instance, if a European partner wants to have any say in the way a programme is run, it has to make a significant financial and technological investment. The gap in political, financial, technological and human resources makes it difficult for a European state to play a key role in deciding on the strategic direction of a joint weapons programme.

18. There are numerous examples where the European states participating in joint programmes – the F-35 Lightning II jet fighter (Joint Strike Fighter), NATO’s missile defence or Alliance Ground Surveillance (AGS) programmes – have very little scope for influence and the ultimate decisions are solely American. It is also true that instead of taking a coordinated approach to their dealings with the United States, European countries favour bilateral relations.

19. The Euro-American defence relationship and the resulting transatlantic market are only minor aspects of a highly developed and sophisticated economic partnership. Trade in goods and services between the United States and the European Union has an estimated value of approximately 600 billion euros (in 2009), with the EU coming out on top. Direct investments between the two account

for over 2.5 billion euros (about half each) and according to the European Commission the "transatlantic" job market employs some 12 to 14 million people (directly or indirectly, again about half each).

20. The two markets – American and European – represent over 800 million people and two thirds of global GDP. The United States and the European Union/NATO states are home to the majority of large multinational defence firms and have a pool of tens of thousands of highly qualified staff and an extremely high combined spending capacity of over 700 billion euros (the United States has more than 500 billion for 2011). The European Union and the United States come first and second in the foreign direct investment (FDI) rankings, both inward and outward.

21. The transatlantic defence equipment market is thus underpinned by a globally dynamic and stable Euro-Atlantic market. Despite some very real trade conflicts over the dominance of some American firms and subsidies to the aeronautics and agricultural sectors, the more than 60-year-old strategic relationship stands firm and disputes are resolved through compromise and sometimes financial compensation. These economic disagreements have very few political consequences, contrary to what happens with other international actors.

22. This relationship is also maintained between firms. The European market is dynamic, relatively open and above all solvent. Of course, as there are a large number of participants (the EU states), American firms have to trade with each client (the armed forces) bilaterally and in what are essentially small quantities of equipment. Technology exchanges follow the same pattern and depend on how much trust is placed in the clients and their capacity to make use of the technology.

23. American firms are highly active in the European market. They go it alone, making direct sales in partnership with European firms or through subsidiaries they have bought, as is the case with General Dynamics Land Systems Europe. GDLSE owns four land vehicle firms in Germany, Austria, Spain and Switzerland. Each of these firms sells specific products at first developed for the local market and now available throughout Europe and on the international market.

24. It is more difficult for European companies to break into the American market, especially when it comes to major equipment programmes. Like BAE North America, they set up in the United States in order to have direct access to the centres of political (Congress, Government) and military (Department of Defense, branches of the armed forces) decision-making. They find themselves up against the big American companies that have been part of the military-industrial complex of the United States since the 1940s.

25. It would appear that forming partnerships is the logical solution for winning contracts in major programmes such as the F-35 Lightning II (Joint Strike Fighter), the VXX Presidential Helicopter Programme or the KC-X aerial tanker. In these three instances, BAE and other European firms (F-35), AgustaWestland (helicopter) and EADS (tanker) have the role of junior partners and are subordinate to the main coordinators: Lockheed Martin (F-35 and VXX) and Northrop Grumman (tanker).

26. Another approach is to buy out medium-sized American companies which have niche equipment and technology skills. The American authorities encourage such acquisitions thanks to which jobs and skills remain in the United States. It also presents an opportunity to transfer management methods and technologies from Europe to the United States, bringing innovation to and modernising the American military-industrial complex. There are fewer technology transfers in the other direction, from the United States to Europe, and they are kept under strict control.

27. It is clear that in the transatlantic market as it stands now European firms are seeking to procure orders from the Department of Defense. They are prepared to agree to the transfer of skills and know-how which once developed are unlikely to be transferred back and be of benefit to Europe. On the other hand, European firms will benefit from the skills of the local workforce and get a slice – albeit very small – of the American defence budget.

28. In practice it is mainly financial considerations – share values – that motivate European firms to invest in the United States. They are aware that they have limited access to the American defence market and in no way are they an instrument of European influence in the country. Even considering their combined efforts, European firms play a very small role in the major weapons programmes of the

United States – whether in the air, land, sea or space sector. What is more they tend to work bilaterally, making no effort to cooperate with each other on the spot.

29. For Europe one of the weak points in the transatlantic relationship is the lack of a coordinated approach which could change the trade balance in the world's leading weapons market (the United States together with the Europe of NATO and the EU). The same applies to European defence as a whole and the European security and defence technological and industrial base in particular, but that is another debate.

30. If the situation does not change in the transatlantic defence equipment market European industry is likely to get stuck with playing second fiddle or subcontracting on behalf of the big American players. And Europeans are likely to remain in a position of strategic dependence – even if it goes by the name of partnership – on the United States for a long time to come.

31. On 11 March 2010 the Assembly organised a seminar on this subject in Madrid in the context of the WEU/EU Spanish Presidency. The current report is a synthesis of the work of the seminar which dealt with the industrial and institutional aspects of the transatlantic defence equipment market and put forward proposals for bringing about improvements in the current position.

III. The transatlantic defence equipment market (TDEM): a major imbalance in structure and capacities

32. The first speaker, Admiral Alain Coldefy, Vice-President, Political Affairs, EADS, France, set out the position as regards the TDEM starting with the imbalances from which it suffered and the reasons for them. First of all there was the matter of the economic resources allocated to defence to which reference is made in the introduction to the present report.

33. By way of a rough comparison defence accounted for 23% of the US federal defence budget as against 7% for the United Kingdom, 11% for France and 9% for Germany, these being the three highest spenders on defence in Europe: 110 billion euros out of a total for Europe (European Union and NATO) of close to 200 billion per annum.

34. The crucial figures were those not for global spending but for spending on investment and defence research and technology:

– EU investment expenditure (at 51 billion euros) was three times less than for the United States (152 billion euros). The latter had grown by 22% since 2006-2007 as compared with 8.5% in Europe's case;

– the United States spent some 10% of its defence budget on research and development as against 4% for Europe as a whole; there was a pronounced discrepancy as regards research and technology, which averaged 2.5 billion euros for Europe as against an average for the United States of 7.3 billion euros.

35. However discussion of the figures was subject to some qualification. The major differences in defence budgets and, consequently, as far as the transatlantic equipment market was concerned were of a political and structural order. According to Admiral Coldefy, the United States, with its homogenous defence market, had a major advantage which Europe overall did not, its besetting problem being as always fragmentation and compartmentalisation of its defence effort.

36. European defence had always had a problem in defining common needs – notwithstanding its acute awareness of where its major deficiencies lay: interoperability, projection, mobility and C4ISR or C4ISTAR for example – and in agreeing common standards, an area further complicated by the need to take account of American standards, particularly in the case of the NATO working groups, and the difficulty of translating convergent needs and standards into common equipment programmes.

37. National defence, industrial and economic interests weigh heavily in this process and European countries often share the same analyses but are divided on how problems are to be resolved: by taking a national approach, through European cooperation, transatlantic cooperation, direct off-the-shelf

purchases, from the United States in particular, or through the Foreign Military Sales (FMS) procedure.

38. Admiral Coldefy drew attention to the trade imbalance between Europe and the United States, hardly surprising in view of the fact that Europe was not a single market. He made the point that the United States had exported US$5 billion worth of defence equipment to the EU against only US$2.2 billion worth of imports from Europe. The United States' major customers were the United Kingdom, Germany and Italy, with France in seventh place after the Netherlands (in 2007).

39. The reasons for this, he felt, were threefold: requirements, "national preference" and procedures relating to technology protection and security (in the wider sense of internal security). The first was a statement of fact and required little further explanation. The United States' defence policy had a global reach and formed the basis of a global strategy of primacy and superiority over its allies, partners and potential adversaries.

40. That strategy took in military capabilities, the military industrial complex, foreign policy and economic, social and cultural factors. As the Iraq war had shown, the United States could afford not to take any notice of allies that did not agree with it, in the same way as those opposed to it and seeking to restrict its power. Conversely, the allies and "the others" had to take account in any action they took of the US position or reaction.

41. He explained that for Europe the transatlantic relationship was founded on long-term strategic interests. Where it differed with the United States was on the choice of means, rather than on the fundamental analysis.

42. Besides, since 2001 and even before, the United States had been engaged in a war against radical Islamic terrorism, leading it to intervene directly in various theatres of operations connected with the problem: Afghanistan, Iraq, Pakistan, Yemen and Somalia. Where American forces were not directly engaged, the war was being waged though strikes launched remotely and making heavy use of armed unmanned aerial vehicles.

43. The American armed forces are structured for external operations, allowing as necessary for massive deployment of troops and equipment depending on whether the conflict is low- or high-intensity and whether adversaries with high technology means are involved. The US defence extends from the depths of the ocean to outer space, and into cyberspace.

44. Metaphorically speaking US defence meets the three tenets of the Olympic motto: "citius, altius, fortius" (faster, higher, stronger), while Europeans, even those with a substantial defence input in terms of capabilities and investment, aspire to only one or at most two of those criteria. Those qualities also explain US control of operations undertaken in coalition and the fact that notwithstanding consultations undertaken for form's sake, their strategic and tactical choices are the ones to prevail, with, as necessary, arrangements to accommodate one or other of its allies, without being dependent on any of them.

45. Coalitions are a means of boosting US power in a theatre of operations and help legitimate armed intervention – even if it is conducted outside the institutional framework of the United Nations or NATO. But the true power multipliers are the United States' human, technical and technological resources. The difference between Americans and Europeans is one of quality as well as scale, making it difficult for the latter to catch up.

46. This does not rule out responses to what are identified as common requirements – for example force projection and protection – but even then the solution must be geared as a priority to the most demanding requirements, namely those of the US standards. With the exception of one or two niche capabilities such as the C-27J Spartan aircraft (originally the Italian G222) used by the US Special Forces, Army and National Guard or the British Harrier used by the Marines, the US military-industrial complex is able to meet virtually all of the needs of the US armed forces and those of its allies.

47. Regarding the notion of "national preference", mechanisms exist on both sides of the Atlantic to protect the defence industrial and technological base. In the United States there are various regulations

– initiated principally by Congress – controlling access by foreign firms to the American defence market and, more importantly, their activity there.

48. Such mechanisms come under the direct control or supervision of the US Treasury Department, Department of Commerce or State Department. The Department of Defense is also involved in such structures but it is the supervisory department that has the final say, or even, in the event of a dispute, Congress or the President of the United States. The Government Accountability Office also plays an important part, as EADS discovered in the second round of bidding for the contract to replace the US refuelling aircraft fleet.

49. A key organisation is the Committee for Foreign Investment in the United States (CFIUS), set up in 1975 and now integrated into the Treasury Department's Office of Investment Security. The Treasury Secretary chairs the Committee composed of representatives of the Departments of Justice, Defense, Internal Security, State, Trade, the office of the US Trade Representative, the Department of Energy, and the Office of Science and Technology (under the President of the United States).

50. Other bodies are also represented, as required: in particular the National Security Council and the Homeland Security Council, the Director of National Intelligence and the US Secretary of Labor. (These last two have no right of vote.) This membership is indicative of the wide-ranging and multidisciplinary view that the American administration brings to bear on national security and defence matters.

51. CFIUS' principal task is to "review transactions that could result in control of a US business by a foreign person ("covered transactions") in order to determine the effect of such transactions on the national security of the United States". In practice, CFIUS must take account in its decision-making of the interests of the various parties involved.

52. As a result, and given the openness of the US economy and its foreign investment requirements, CFIUS' decisions are, except in a very limited number of instances, broadly speaking favourable to applicants, foreign public and private sector firms and investors.

53. Between 2006 and 2009, out of a total of 469 applications submitted for consideration, only 64 (13%) were withdrawn, either during the examination process or upon the launch of a more detailed investigation. The applicant normally withdraws voluntarily, particularly in cases which attract a considerable amount of media attention, like the takeover bid for the oil company Unocal by the China National Offshore Oil Corporation (CNOOC) in 2005, or the buy-back of US ports from a Dubai investment fund in 2006.

1. International Traffic in Arms Regulations (ITAR) and the F-35 Lightning II programme

54. The United States has a rigorous control mechanism covering technology transfers which is a source of discord with NATO's European allies and other states such as Israel, Japan and South Korea: the International Traffic in Arms Regulations, or ITAR, regime.

55. ITAR addresses two major concerns based on financial and national security considerations. The financial argument arises from the fact that some technologies have been developed in the United States and funded by the federal government and/or American firms or foreign companies based in the United States that work in the security and defence sector.

56. Technologies such as stealth and radar, certain system software codes, encrypted communication systems or military satellites, have to be protected from (industrial) competition. They also provide the American armed forces with a decisive edge in military operations that needs to be preserved.

57. The other argument is that even if sensitive technologies can and should be shared among allies, in some cases there is a risk that they will be passed on to third parties who were not meant to have access to them.

58. The ITAR regime implements the Arms Export Control Act (AECA) and is described in Title 22 (Foreign Relations), Chapter 39 (Arms Export Control), Subchapter M of the United States Code. It is enforced by the US Department of State.

59. The goal of ITAR is to safeguard the security of defence equipment and technology transfers from the United States to its allies and partners, in line with the general code of the AECA, the first section (2751) of which is aptly entitled "The Need for International Defense Cooperation and Military Export Controls".

60. At the Department of State, licences and waivers are granted by the office of the Deputy Assistant Secretary for Defense Trade Controls and the Managing Director of Defense Trade Controls, Bureau of Political-Military Affairs. Administrative responsibility for ITAR does not end there, because the Under Secretary of State for Arms Control and International Security and the Assistant Secretary of State for Political-Military Affairs are (in some cases) also involved.

61. The Bureau of Political-Military Affairs is the central body in this structure and includes the Directorate of Defense Trade Controls which consists of four departments with the following areas of competence:

– Defense Trade Controls Management;

– Defense Trade Controls Licensing;

– Defense Trade Controls Compliance; and

– Defense Trade Controls Policy.

62. This Department of State monopoly of export controls in the field of defence equipment and technology does not make it easy for the United States' partners, whose contact for military cooperation purposes is the Department of Defense and its various agencies. Even though the Defense Secretary or the DoD staff in charge of these matters listen to requests from allies or try to reduce restrictions on cooperation, the final decision is not theirs to take.

63. European allies can therefore get caught up in a bureaucratic system over which they have no control, where decisions are sometimes the result of the power struggle between the Department of State (generally very jealous of its prerogatives) and the Department of Defense. This administrative and technical system, in which (internal) political considerations also play a part, is a regular subject of criticism and reform proposals, even at the highest US decision-making levels.

64. One example that highlights the potential difficulties generated by the ITAR regime is that of the constraints imposed on the European and other states participating in the F-35 Lightning II (Joint Strike Fighter, JSF) programme. The European participant countries (listed in order of status and size of investment: the United Kingdom, Italy, the Netherlands, Turkey, Denmark and Norway) bring with them the know-how, experience, materials, processes and technology, paid for by their companies and taxpayers, and from which all parties benefit.

65. This works well in terms of the flow from Europe to the United States: it demonstrates the value of what Europe has to offer and opens the US market up to other by-products of European R&T, both in the civilian and particularly the military sector, the hardest market to penetrate. When it comes to transfers in the other direction, European countries invariably run up against a major stumbling block in the form of ITAR, despite measures introduced in order to reduce the obstacles to technology transfers in the framework of this project:

– the JSF Program Office directed the prime contractor (Lockheed Martin) to develop an international industrial plan to anticipate timeframes for national disclosure and technology transfer decisions;

– agencies involved in the export-licensing process are administering a pre-screening process for the transfer of low technology and non-sensitive items and allowing addendums to be attached to licence applications;

– the JSF prime contractor and agency officials have applied a less rigorous regime, Global Project Authorization (GPA) and an exemption procedure for foreign contractor bids. The GPA allows for technology transfer decisions regarding certain technologies to be made in five days or less; however, its use has been limited. Use of the bid and proposal exemptions is intended to avoid delays by providing foreign contractors with information needed to compete for contracts without first obtaining an export licence;

– issues related to the releasability of classified information, technology, or systems to foreign partners are addressed as they arise in the JSF programme because of the involvement of international partners in the early design phase of the programme.

66. These measures address some of the complaints made by European countries, particularly with regard to receiving the detailed information needed to respond to calls for tender for the various components of the F-35 Lightning II (JSF). However, as the programme has progressed, the technology transfer debate has shifted from individual components to the finished product, in other words, the weapons system that this aircraft represents. It is in this area that the United Kingdom, the lead European partner in the programme, has expressed dissatisfaction with the restrictions in place.

67. Having invested nearly US$ 4 billion in the System Design and Development (SDD) phase, the British authorities want freer access to the most sensitive technology and equipment in order, if need be, to adapt them to the needs of British forces. This would also enable the United Kingdom to be less dependent on its US suppliers (avionics, communications, command and control, weapons, modifications, upgrades, repairs and improvements).

68. Furthermore, the supposedly close political, military and industrial ties between the two countries is another argument put forward by the United Kingdom in favour of greater flexibility in the area of bilateral technology transfers. In 2005, the United Kingdom (and Australia, another partner in the programme) benefited from a more flexible application of the ITAR mechanism through the addition of a new section (126.15) to the existing regulations.

69. In practice, however, this did not result in any real progress which in turn led to a minor crisis between the two countries, with the British threatening to withdraw from the subsequent development and test phases of the programme. In June 2007 the two governments signed the UK-US Defence Trade Cooperation Treaty which goes beyond the F-35 Lightning II programme.

70. According to a UK House of Commons report on the state of bilateral relations between the United States and the United Kingdom, the treaty "would end the need for a separate US export licence for each item of defence equipment and technology sent to the UK. [Its objectives] are to improve interoperability between the UK and US armed forces, support combined military or counter-terrorism operations, and reduce the current barriers to the exchange of defence goods, services, technical data and the sharing of classified information in support of co-operative defence research, development and production and in certain defence and security projects where the UK or the US is the end-user".

71. The treaty was ratified by the United Kingdom in 2008 and is still awaiting ratification by the United States Senate. The political and economic situation in the United States, where Congress is particularly concerned about protecting national interests and economic advantages, has blocked progress in this area which is not deemed to be a priority. With regard to the F-35 Lightning II programme, the Department of Defense confirmed its opposition to the transfer of system source codes to any partner in the programme, regardless of status or level of involvement.

72. More recently, in April 2010, Italy made public its dissatisfaction with the return on investment from its billion-euro participation in the programme and at the same time highlighted the problems encountered in the area of technology transfers. The Italian Government has considered delaying work on building the assembly and maintenance facility for the "European" F-35 Lightning II planned to be built in the Cameri air base in the north of Italy.

73. Here we have an example of the extent to which the United States, in its defence relations with Europe, can manoeuvre and ignore its partners with no other consequences than mild diplomatic protests. The appeal of the American defence market and the prospects it holds for European firms, not to mention the strategic interests of some European states vis-à-vis the United States, acts as a de facto deterrent to any form of effective retaliation.

74. The Obama administration has decided to review the defence equipment and technology export control system. Previous administrations had already attempted such reform and the Department of Defense and the American defence industry are in favour of seeing it through. A bill should be submitted to Congress by the end of 2010.

75. According to statements from the administration and, in particular, from Defense Secretary Robert Gates, the idea is to overhaul the list of sensitive and strategically important technologies and defence equipment which are subject to extremely tight controls and to set up a single agency to administer export authorisations. This would streamline the current system where the decision-making centres are scattered among a variety of different departments and agencies.

76. In line with proposals from the Coalition for Security and Competitiveness, an initiative launched on 6 March 2007 by America's leading security and defence industry associations, and in the same spirit as the reforms put forward by the Bush administration in 2008, the reform is based on four points:[3]

- "A single, tiered export control list, instead of 2 major (State's USML & Commerce's CCL [Munitions List and Commerce Control List] and some minor lists, which do not really differentiate. It will feature "higher fences around fewer items," and allow items to progressively move down the tiered list as technologies become more widespread;
- A single, newly-created export licensing agency, instead of 3 or more;
- A single agency to coordinate enforcement instead of several;
- A single unified IT system. It would replace the current mix of newer IT systems (Defense), older systems (Commerce, built in 1987 and not modified much), and mostly paper-based systems (State Department)".

77. The different administrative departments which intend to hold on to their prerogatives need to be convinced of the need for reform and, above all, it requires the support of the majority in Congress – something which cannot be taken for granted, for reasons of protectionism, limiting the action of the federal state (a new agency would be set up) and internal politics. The United States is to hold midterm elections in November 2010 when there is likely to be a change in party majority in Congress or a narrower gap between the number of Democrats and Republicans (there are currently 75 more Democrat than Republican Representatives and 18 more Senators).

78. Republicans, and some Democrats, will not hesitate to protest that such a reform will provide the opportunity for sensitive American technologies and equipment to be exported, directly or indirectly, to potential enemy states, such as China and Russia. Such criticism has been voiced recently by members of Congress as well as inside the administration with regard to France's intention to sell Mistral-class projection and command ships to Russia.

79. If the attempted reform meets with even partial success, transatlantic cooperation will be made easier, but the European market will become more dependent on the United States. Indeed, the search for European solutions to meet European needs is partly due to the difficulty of accessing certain American technologies and equipment, either because of restrictions or because of costs.

80. Loosening controls, if only for allied countries, would enable American firms to cut development and production costs incurred as a result of current regulations that aim to protect sensitive technologies and equipment. It would also facilitate participation in cooperation programmes. These are the arguments put forward by American firms and associations such as the Aerospace Industries Association (AIA).

81. European firms would then be in open competition with American firms on both the European and international market. An argument often used by those in the United States who advocate easing the

[3] US Department of Defense, Office of the Assistant Secretary of Defense (Public Affairs), News transcript, DOD Background Briefing with Senior Defense Officials from the Pentagon, 19 April 2010, http://www.defense.gov, and "USA Moves to Improve Arms Export Regulation Process", Defense Industry Daily, 21 April 2010. http://www.defenseindustrydaily.com

current regime is that European companies have the edge in a system which favours technology and equipment transfers that do not require American licences and authorisations.

82. Pending further details, the proposed American reform offers good prospects for European firms (and purchasing governments), but the European defence technological and industrial base (EDTIB) needs to be well prepared and indeed should be strengthened in those sectors that have not already been so, such as land and maritime defence equipment and technology. In the aeronautic and space sector, however, Europe already has the wherewithal to redress the balance in transatlantic relations.

2. The KC-X programme, the tanker aircraft affair

83. For the majority of European states belonging to NATO and the EU, gaining access to the US defence market and seeking opportunities for cooperation with the United States is a national priority, even when conditions are unfavourable to European strategic interests with regard to freedom of action or preserving and developing the EDTIB in support of the Common Security and Defence Policy.

84. Yet, apart from generating profits and dividends for shareholders in European firms in the security and defence sector, the hoped-for benefits have not materialised. The most recent example is the contract to replace the United States' fleet of refuelling aircraft – a subject which raises so many questions regarding political and financial considerations and the general state of transatlantic relations in the defence sector that it deserves a whole report by itself.

85. The United States has the largest fleet of aerial refuelling tankers in the world, with around 540 aircraft spread between the Air Force, the Air Force Reserve and the Air National Guard. The majority – approximately 480 – of these aircraft are KC-135 Stratotankers, built by Boeing and brought into service in 1957. Some 800 or more KC-135s have been built in total since 1956 when the aircraft made its maiden flight.

86. The remainder of the tanker fleet is made up of KC-10s, built by McDonnell Douglas, of which some 60 are in the Air Mobility Command inventory. Brought into service in 1981, the KC-10 is the most recent model of tanker.

87. There are several variants of both aircraft – including refuelling, cargo and troop transport versions – which have been adapted and updated to meet the changing requirements of the US Air Force and accommodate new equipment. The tanker fleet plays a key role in maintaining air superiority, particularly in the context of external operations throughout the world. The global war against terrorism, whose main theatre is Afghanistan, has seen a growing number of such operations since 2001.

88. At the end of the 20th century, the decision was made to begin gradually replacing the KC-135 fleet. Operation and maintenance costs, as well as the need to update the equipment to adapt it to the new F-22 and F-35 fighter jets and possibly for refuelling drones, were too much even for the American budget to bear.

89. In 2002 Boeing was selected to provide a replacement for the KC-135. The new tanker was to be based on Boeing's commercial 767 aircraft and was designated the KC-767A ("A" for advanced). The US Air Force initially opted to lease 100 aircraft which were to enter into service in 2012.

90. The plan to lease drew criticism in Congress, especially from Senator John McCain, and from the Government Accountability Office. Indeed, the entire selection procedure came in for criticism as those who had selected the KC-135 replacement aircraft had shown a clear bias for the 767 over the military A330 then proposed by EADS North America/Airbus.

91. The latter is to be the basis for the new European tanker and transport aircraft, the MRTT (Multirole Transport and Tanker). To date in Europe only the United Kingdom has contracted to purchase the MRTT, though France also intends to do so and will be followed by other European states. Outside Europe, Australia, Saudi Arabia and the United Arab Emirates are in the process of purchasing the MRTT (a total of 28 aircraft have been ordered, including 14 for the United Kingdom).

92. A compromise was finally reached in 2003 whereby the US Air Force was "obliged" to buy 80 KC-767A and lease just 20 for the sum total of 20 billion dollars – not in itself a major contract, but replacing the entire fleet of KC-135 in the long term would potentially bring in hundreds of billions of dollars.

93. This arrangement was to be cancelled in 2004, following an investigation into influence-peddling between Boeing and civil and military officials in the Department of Defense responsible for selecting and overseeing the KC-135 replacements. One person was arrested and a number of people resigned as a result of the investigation and the tanker fleet replacement process was temporarily brought to a halt.

94. In 2006, the Department of Defense issued a new request for proposals (RFP), involving a contract for the purchase of 179 aircraft for a total of 35 billion dollars. Once again the KC-X competition pitted Boeing against the EADS-Airbus/Northrop Grumman partnership: the former proposing a lighter version of the 777, later to be replaced by the 2002 proposal for the KC-767A, and the latter a version of the A-330, at first designated KC-30 and later renamed KC-45.

95. After a complex and eventful selection process – involving protests from both sides, a revision of the initial RFP and the technical and operational requirements, and political intervention from the administration and Congress on behalf of one or other of the competitors – the final contract was awarded to EADS/Northrop Grumman and the KC-45 in February 2008. Their success was short-lived however, as the whole process was disrupted by a major event in the United States: the 2008 presidential elections and the arrival of Barack Obama in the White House.

96. As soon as the contract was awarded to its competitors, Boeing appealed the decision and the Government Accountability Office (GAO) was asked to investigate whether the tanker selection process had been fair. The American system of checks and balances and the separation of powers – a symbol of American democracy which President Bush ran roughshod over during his first term in office in the interests of the global war on terrorism – played a key role in instigating the investigation.

97. A Democratic majority in Congress, an almost inevitable change in presidency and a serious economic crisis conspired to create a political environment that was largely in Boeing's favour. The GAO, which is part of Congress but recognised for its independence, concluded that the KC-X selection process had been biased in favour of EADS/Northrop Grumman. The outgoing administration was unable to take the matter any further and even Northrop Grumman did not want to embark on a costly and uncertain legal battle.

98. With only tepid support from the European states, in particular the "founding" states, EADS found itself alone in the face of the internal political and economic vagaries of the United States. In 2009 – Act Three in the continuing American tanker saga (after 2003 and 2008) – the Department of Defense announced that it was relaunching the tanker replacement programme after a lengthy review of the relevant procedures and criteria and in the wider framework of a general review of defence procurement programmes and procedures.

99. A major public relations and lobbying operation was launched by Boeing and EADS North America-NG in defence of their respective proposals. A pressure group with backing in Congress also took up again the idea of a split contract that had been advocated in previous years by the Democrat John Murtha, Chairman of the House of Representatives Defense Appropriations Subcommittee. John Murtha died in February 2010 leaving a vacuum that was filled by opponents of the idea of a split contract.

100. The Department of Defense had also opposed the idea, which brings to mind another controversy surrounding the second engine for the F-35 Lightning II. It was only in February 2010 that the final RFP was made public. This time Northrop Grumman decided to withdraw from the race and to end its partnership with EADS North America in the field of tanker aircraft for the US market. The deadline for responding to the RFP was set in May 2010, with the possibility of a three-month extension if another company should wish to submit a bid.

101. This withdrawal provoked a more active response from the European states, including at EU and Commission level. The World Trade Organisation (WTO) was also appealed to, although neither it nor indeed the Commission has competence for public defence procurement. The Commission is in

the process, via a directive, of acquiring direct competence in this area, but only for European contracts.

102. After a process of reflection and without even having found an American partner to be the prime contractor, as a means of gaining easier access to the more sensitive or confidential aspects of the programme – in particular everything falling under the ITAR regime – EADS-North America confirmed its decision to continue proposing the KC-45, this time as a prime contractor, possibly in cooperation with other US aeronautical companies.

103. That decision was not well received by Boeing and its political and military supporters, and there was much criticism in Congress and the press of a US firm that was a subsidiary of a European company participating in the tender. But the DoD agreed to extend the deadline for submission of a bid from May to July 2010.

104. However, that positive decision did not include a revision of the RFP. It is clear from the RFP document, in particular the annexes concerning the tanker characteristics, that the US Air Force is seeking above all a small moderately-priced aircraft. The idea is to replace a large ageing fleet by more modern aircraft, but not to make a major qualitative leap, contrary to what is happening with the F-22 and F-35 combat aircraft, for example.

105. Nonetheless, in the long run it will also be necessary to replace the more modern KC-10s. And it will probably be at this point in time that thought will be given to a new generation with more advanced characteristics in terms of size, range and payload.

106. For EADS North America to remain in the running, particularly as a prime contractor for a fairly small initial contract (179 aircraft worth 50 billion dollars, compared with more than 2 000 aircraft worth more than 300 billion dollars for the F-35 Lightning II programme, for example) is a tactical risk but an important strategic move. The risk is well known given the terms of the RFP and also the DoD's declarations in favour of an intermediate solution at a moderate cost.

107. In its declarations EADS North America claims to be participating in order to win, although in reality – due in large part to reasons of US domestic policy – the barriers to a non-native American choice are already in place. Boeing will not fail to appeal a decision against its own proposal and its supporters in Congress could get the contract cancelled, for it is Congress that decides and votes on the defence budgets submitted to it by the administration.

108. Moreover, as noted above, this is also an election year and a time of economic crisis. At the same time the US administration's attention in the foreign policy area is focused on Afghanistan, withdrawal from Iraq, Iran, and its relations with Russia and China. If the United States wants the support of its European allies in order to manage these issues, it will not be at the price of a pro-European choice for the tanker contract, and no European state would dare link the two issues.

109. The strategic aim behind EADS' participation is to prove that its north American subsidiary is sufficiently integrated in the United States to stand as prime contractor, a feat that even the European company that is the most firmly established in the US has failed to bring off so far: indeed, BAE North America, although it has managed to become a leading supplier to the DoD, does not have a prime contractor role in any major American defence equipment programme.

110. BAE North America accounts for more than 47 000 jobs in the United States, out of a total staff of 107 000 for the BAE group, and its sales amounted to more than 14 billion euros in 2009, out of a total for that market of 26 million euros (55%). BAE North America, the DoD's fourth supplier and world leader in 2010, has now gained a firm foothold on the US market, just as EADS North America is doing, by buying US firms, developing capabilities to meet the requirements of the US forces and becoming integrated with the US defence equipment market.

111. De facto BAE NA and EADS NA are American companies; they may be subsidiaries of European firms, but enjoy wide-ranging autonomy and are fully subject to US rules and regulations on the transfer of defence technologies and equipment. This is a good commercial operation but the only return on investment is the dividends to be shared and a positive balance sheet.

112. The technologies and innovations designed and developed in the United States remain in that country and are subject to transfer and export controls. At the same time, however, without the American market those companies, like many others in Europe, would be limited by the small size of their national markets and by the permanent paucity of investment budgets. In the United States budgets for large medium- and long-term programmes may be scarce, but for the immediate requirements of forces on operations they are increasing.

113. European companies are well placed in that market sector with competitive products incorporating advanced technologies. EADS is well positioned with its CN-235 aircraft and the Eurocopter EC-145 (UH-72 Lakota) helicopters, two examples that were highlighted by the participants in the Madrid seminar, in particular Mr Domingo Ureña-Raso, Chief Executive of Airbus Military.

114. Mr Ureña-Raso drew attention to a key feature of the US market that sets it apart from the European market: “United States defence requirements are large enough to sustain the economic feasibility of one program. An American [company] could make a business case with only the US domestic market. US market’s suppliers do not [need] additional export markets to survive [and] their products can [meet] the specifications of each American customer”.

115. This situation is to the advantage of the United States, with the European market divided into national entities with different priorities, non-coordinated interests and non-synchronised budgetary timetables and defence investment and programming cycles. Cooperation is the exception rather than the rule, and is inclined to concern those programmes, for example in the fields of space and strategic lift (A-400M), where a national effort on its own is not enough.

116. And even when there is cooperation it tends to be a matter of necessity or driven by political considerations, and to be limited to a small number of determined and willing states (the ones which are at the origin of and shoulder a large share of investments).

117. Mr Ureña-Raso pointed to the fact that although the US market is difficult it is not closed, and that there are opportunities, particularly in the area of homeland security. He mentioned as a case in point the sale of maritime patrol aircraft for the US Coast Guard in 2004, following no less than four years of negotiations. For this contract Airbus Military was in partnership (as a Tier 1 subcontractor) with the three main US firms active on that market: Boeing, Lockheed Martin and Northrop Grumman. Alenia Aeronautica and Lockheed Martin also presented a maritime version of the C-27J.

118. The contract, finally, was awarded to a joint venture formed by Lockheed Martin and Northrop Grumman. The CN-235 was adopted as the platform for the US Coast Guard maritime air surveillance system, and an order was placed for 36 aircraft that are still in the process of being delivered. The contract is worth the relatively modest sum of one billion dollars. There are also political reasons for the choice of a European platform: the CN-235 aircraft is produced by CASA, the Spanish component of EADS, and the Spanish Government at the time had supported and followed the United States during the invasion and occupation of Iraq.

119. It is also worth pointing out that although the platform is produced by EADS-CASA in Seville, the engines (General Electric), avionics (Rockwell Collins) and on-board systems (communications, sensors, produced by Lockheed Martin and Northrop Grumman) are American. The two European platforms in the running – the CN-235 and C-27J – correspond to a market niche not covered by US firms like Boeing (C-17) and Lockheed Martin (C-130, P-3 Orion and Poseidon P-8 family).

120. Moreover, an analysis of current Europe-US trade in the field of defence equipment and technologies reveals a stark imbalance in terms of quantities but above all quality. In a strategic area such as theatre or extended missile defence, for example, or even territorial defence, American choices and analyses are in the process of becoming the basis for a European missile defence, in particular through the NATO projects in this area.

121. As regards unmanned aerial systems, notwithstanding the European efforts in this area, American platforms that have been tried and tested in operational conditions are already being fielded by the armed forces of several major European states. Examples are the Global Hawk, known in its German version as Euro-Hawk (Northrop Grumman and EADS Germany), or the Predator that has

already been procured by the United Kingdom and Italy. Even after adaptation to the specifications of the client states, these systems contain cores (black boxes) that remain subject to the control of the country of origin (the United States).

122. Some countries such as Spain are in the process of acquiring Tomahawk submarine-launched missiles and AEGIS naval antimissile command and control systems. Norway is also interested in this system. Patriot missile batteries and soon also the MEADS system (United States, Germany and Italy) are present in Europe, although equivalent European products exist or are in the process of being developed and built, in particular by EADS' subsidiary, MBDA (missiles). To these we can add CH-47 Chinook (latest version) and enhanced CH-53 helicopters and possible increases to the fleet of C-130J and C-17 aircraft. And *the* radar aircraft remains the AWACS (Airborne Warning and Control System) on a Boeing 707 platform.

123. The arrival of the F-35 Lightning II aircraft will further strengthen the United States' presence on the European market for high-tech defence equipment and technologies and hence the political influence that comes with Europe's technological dependence on it. In exchange, as highlighted by the examples given, European states are selling aircraft and also land vehicles, albeit those produced by BAE NA for the force protection market niche.

124. If the efforts to reform the American technology transfer and defence equipment export control systems are successful in the years to come, US companies will become more active on the European market, either to sell their products or in the framework of cooperative programmes like the F-35 Lightning II. Given the technological gap between the US and European armed forces, it is not easy to pinpoint an area in which the Europeans have a competitive edge.

125. This situation is not without risk for the long-term maintenance of the European DTIB, with its fragmented, non-coordinated and non-synchronised market. Yet at political level there is no clear resolve to reduce dependence on the United States by increasing investment in European R&T and R&D, not on a country-by-country basis, but in the framework of a European approach under the guidance of the structures already in place: the European Defence Agency, OCCAR and the LoI-Framework Agreement, for example.

IV. The transatlantic market: industrial aspects and political considerations

126. European companies are getting organised in order to play a more active role on the transatlantic market, although here too the approaches vary. BAE, for example, has opted for total assimilation within the American defence industrial base, while EADS prefers to maintain its European identity; Thales has a major presence in the US but makes most of its profits in Europe, and other companies like Finmeccanica supply the US DoD and Department of Homeland Security in response to requests for proposals (RFPs), although Finmeccanica has also recently followed the BAE and EADS example of purchasing US firms.

127. A necessary step in order to gain access to the US market is to enter into a partnership with major local players like Boeing, Lockheed Martin, Northrop Grumman and Raytheon in order to respond to American RFPs: examples are the RFP for the tanker aircraft and the CN-235 coastguard aircraft. This gives US companies access to knowhow, processes, technologies and equipment that they may be lacking or no longer produce or do not produce themselves for reasons of priorities and funding.

128. For European companies, in addition to facilitating their access to the US market, this is also conducive to their integration within this market, giving them an inside perspective on trends and prospects and providing them where this is possible with access to processes and technologies they do not have. They can also benefit from others' experience as regards management and organisation methods and the procedures for implementing projects and programmes.

129. Generally speaking, therefore, this is a mutually beneficial relationship which may also have a "moralising" effect on company behaviour due to firms' alignment on a "common" code of business ethics. Without going into the details of a complex deal involving contracts for the sale of military equipment to Saudi Arabia and a number of other countries (South Africa, the Czech Republic,

Tanzania), we can quote the example of BAE which, although it had almost succeeded in escaping sanctions imposed by the UK's Serious Fraud Office chose instead to negotiate the payment of a 332 million euro fine following an inquiry conducted by the US Department of Justice into the same affair.

130. 290 million euros out of that sum was paid to the United States although the affair in question had taken place outside American jurisdiction and the company concerned was BAE UK and not BAE NA. In the words of BAE Chairman Richard Olver: "In 2000, the Company gave a commitment to the US Government that it would establish and comply with defined US regulatory requirements within a certain period and it subsequently failed to honour this commitment or to disclose its shortcomings". That act of contrition was also motivated by BAE NA's concern to maintain its image as a responsible supplier to the US DoD.

131. Without that of out-of-court settlement there would have been further investigations that would have had a very negative impact on the activities of BAE NA, which like EADS NA and other firms with a European parent company does not have the same political, economic and social leverage as its American counterparts.

132. In addition, American firms often argue that their competitors from EU and other countries have an unfair competitive advantage, either because they receive direct aid from the European governments – a case in point are the EADS subsidies currently under discussion within the World Trade Organisation (WTO) – or because European legislation or informal arrangements on offsets or simply on gifts that are assimilated with bribes are less strict than in the United States.

133. European firms point out, for example regarding the subsidies, that US companies also receive aid in the form of the multi-million dollar contracts that they are regularly awarded by the Departments of Defense (DoD) and Homeland Security (DHS). And as far as influence-peddling is concerned, both European and US companies are bound by international standards and agreements, in particular those drawn up under OECD and WTO auspices.

134. This trade war, which can be soft or hard, depending on the markets, does not prevent American companies from being very active in Europe, where they are the leading non-European supplier of defence technologies and equipment. In addition to the obvious historical and political explanations for this there is also a major economic argument: Europe is the world's second market after the United States and total defence spending by the European states exceeds that of Russia and China together.

135. The European market, while it may not be indispensable to US companies, is solvent, with an attractive and guaranteed return on investment. Relations at bilateral level and within NATO contribute to that cooperative and competitive environment in which the rules – on tenders, statistics, accounting and technical standards – are generally speaking similar and shared, if not common. US firms are also present on Europe's homeland security market.

136. Furthermore, Boeing and Lockheed Martin are very favourable to the creation of a more integrated transatlantic security and defence market. The reform of export controls, supported by the major American defence industry associations, will facilitate that effort. Europe is not a captive market for the American military-industrial complex, but it is its most predictable and stable market.

137. Indeed, cooperation on the transatlantic market was the angle taken by the US industry (Lockheed Martin and Boeing) representatives who attended the Madrid seminar. Mr Pedro Argüelles, Vice-Chairman of Boeing International (in charge of relations with Spain and Portugal), for example, highlighted the global nature of the security and defence industries.

138. This is true for both the United States and Europe, but not to the same degree. As stressed by Mr Ureña-Raso, mentioned above, the US market is almost self-sufficient, accounting for almost half of world defence spending. The European national markets, even the largest (the United Kingdom, France and Germany) or those of a respectable size (Italy, Spain, Sweden, the Netherlands, Turkey, Poland) are limited in terms of orders and investments, which the European companies are in need of.

139. It is essential for the survival of the EDTIB to seek other national markets in Europe as well as access to the international market outside the United States. As far as the European market is concerned, the European Commission and European Defence Agency are working to make it more

open and dynamic by putting in place a legal and regulatory framework that is more predictable, fairer and less subjected to the protectionist interests of individual states.

140. Better harmonisation of the European market rules also has advantages for US firms, as pointed out by Mr Argüelles, because that market can then be treated as a harmonised if not single area, with common or shared requirements. Currently American companies, in spite of their commercial clout (government support, attractive products and prices, technologies and equipment tested in theatres of operation) are obliged, like their European counterparts, to disperse their efforts in response to the diversity of European requirements.

141. Notwithstanding those shortcomings, the Boeing International Vice-Chairman observes that the transatlantic market, although not integrated, is becoming increasingly interconnected (which is not the same as interdependent). According to Mr Argüelles the factors contributing to that are:

- international [American and European] teams pursuing business opportunities;
- European companies buying and investing in the US;
- transatlantic cooperative programmes growing in number and importance;
- supply chains of both European and North American companies are increasingly globalised;
- North American defence companies have important investments in research and development and manufacturing in European Union member states.

142. All those aspects are a daily reality in transatlantic relations. However, looking at the details one realises that they remain imbalanced. Cooperation among companies on a given technology or product, in particular when the companies concerned are competing in several areas, is a delicate matter, particularly as regards intellectual property rights. A partner that wishes, for example, to modify or export equipment produced in cooperation has to get the other party's agreement.

143. In the case of Europe-US cooperation, that situation has already posed problems for the export of equipment. In 2006 the US administration blocked the sale by Spain of 10 CN-295 and two CN-235 aircraft to Venezuela on the grounds that the sale was detrimental to US interests in Latin America. Spain complied, because the aircraft contained American-made components the export of which was subject to approval by the United States, but above all because EADS-CASA did not want to lose access to the US market (the CN-235 coastguard aircraft contract).

144. Furthermore, European acquisitions and investments in the United States have produced mixed results. Experience shows that it is not by purchasing US firms that European companies necessarily get more DoD contracts (France's experience in the 1990s with Fairchild Aerospace-Orbital Science is a case in point: when the French firms withdrew, the award of DoD contracts resumed).

145. European acquisitions are often second or third tier firms. United Defense, one of BAE NA's flagship acquisitions (2005), still produces armoured vehicles including the Bradley tracked vehicle and other land and naval equipment (guns), but the more modern and more expensive equipment remains the responsibility of General Dynamics (e.g. the Stryker, as well as many other vehicles and land systems for the Future Combat Systems project, estimated at more than 100 billion US dollars).

146. Cooperative programmes such as the MEADS missile defence system (United States, Germany, Italy) and the F-35 Lightning II cost considerable sums for Europe, and lead to a transfer towards the US of knowhow and technologies that are lacking in Europe. Although the United States shoulders the biggest share of the costs (58% for MEADS and about 90% for the F-35 Lightning II – development costs) this also means that its partners are bound by American decisions concerning the design, technologies and equipment (sensors and weapons systems, for example).

147. In terms of supply chains it is true that European companies, like US firms, have a whole host of subcontractors all over the world, but concentrated mainly in three countries – China, Russia and India – in the aeronautics and IT sectors, for example. The United States and Europe are also engaged in a flourishing trade in subsystems and components, with, it is true, Europe importing more, due to the bigger production volumes in the United States.

148. Investment in local defence research and production activities also exists, up to a point. In the US there are export controls that limit the return to Europe of innovations made by the American subsidiaries of European firms. US firms in Europe are less affected by restrictions of that kind, although they do face certain barriers designed to protect technologies and capacities.

149. One of the American firms with the biggest presence in Europe is General Dynamics, with General Dynamics Europe Land Systems Europe (GDELS), which has four European land equipment companies in its portfolio – Santa Barbara (Spain), Steyr (Austria), Mowag (Switzerland) and the former EWK (Germany). GDELS-Germany is specialised in mobile bridge systems, but the three other companies produce similar armoured vehicles, the same ones as those produced before the takeovers (Pizarro, ASCOD, Pandur and Piranha).

150. Although in the United States GD is a major player in the field of land systems and the related R&T and R&D activities, GDELS European products do not seem to benefit from transfers of technologies or innovations from the parent company. These vehicles, which are relatively inexpensive, are less advanced in terms, for example, of systems, performance and protection, than the German, French, Italian or Finnish products.

151. Mr Argüelles made several suggestions for improving the defence market dimension of transatlantic relations:

- transatlantic defence industrial cooperation and transatlantic programmes that include US and European partners;
- innovative models for the future acquisition and management of important defence capabilities (C-17 SAC type);
- the right regulatory framework on both sides of the Atlantic;
- keeping adequate levels of defence investments in Europe.

152. All four points offer opportunities to both partners, but there are major obstacles to any decisive progress. These are: the general technology gap; capability requirements which despite 60 years of cooperation within NATO are still not expressed in a coordinated or synchronised fashion in terms of budgetary schedules, R&T cycles, acquisition cycles, updates, maintaining and modernising operational capacities and equipment lifecycles; and finally, tactical and strategic approaches to crises which vary according to how they are perceived to affect national interests.

153. As far as legislation and budgets are concerned, the EU states have only just started establishing a legal framework at European level, in the form of the voluntary codes of conduct drawn up in the European Defence Agency framework (public procurement, supply chain, offsets) and Commission Directives. European defence R&T will also be the subject of a specific chapter in the future EU Framework Programme for Research and Technology Development (FPRTD) for the period 2014-2020.

154. As regards budgets, Europe generally speaking maintains a level of defence spending commensurate with the Union’s ambitions, which are essentially regional in nature: stability within the EU area (Balkans) and on its borders (Mediterranean, Caucasus, Russia, Ukraine, Belarus).

155. The only exception at the present time is the EU NAVFOR Somalia-Atalanta naval operation in the Indian Ocean, Gulf of Aden and off the coast of Somalia, but it is clear that no European state is able to form a coalition for the stabilisation of Somalia and to bring together the tens of thousands of European soldiers and the logistics, assets and capabilities required for missions lasting as long as the NATO mission in Afghanistan or the United States and Coalition operation in Iraq (seven years in both cases).

156. Furthermore, defence spending in Europe is concentrated in half a dozen countries, with two countries – the United Kingdom and France – accounting for the bulk of expenditure. However, those two countries do not have the same relations with the United States. The United Kingdom and its industrial champion are trying to increase operational interoperability with the US by choosing American technologies and equipment or equipment with American components, or by adopting

American concepts such as the Cooperative Engagement Capability for the Royal Navy, for which the systems prime contractor is Lockheed Martin.

157. France for its part believes in developing a DTIB that meets its needs for autonomy and operational sovereignty (a concept put forward by the UK with respect to the F-35 Lightning II programme, but whose success is not guaranteed). It is trying to get the other states to endorse that approach but with limited success, because some countries are reluctant to develop a real defence industrial base that would be in competition with that of the United States, for fear that it could lead – as it has done in certain civilian areas such as the aeronautics sector – to crises in transatlantic relations.

158. The majority of European states within the EU and NATO seem content with the current strategic situation, with the United States playing its role of “first among equals” that dates back to the end of the second world war. The economic crisis in Europe, with the situation in Greece perhaps a warning of further upheaval to come and public opinion becoming wary of European forces participating in operations in which the United States is the lead player, may further aggravate the perception gap and differences of interests between European countries and the United States.

159. Indeed, Mr Argüelles covered those aspects at the end of his presentation when he referred to the dangers of failing to maintain a sufficient level of defence investment, which he suggested should be achieved through cooperation at European level rather than by means of a national effort alone in order to give the EU and the NATO European allies a weightier role in transatlantic relations:

- the European technology base is eroding and the potential for innovation and contribution to R&T that the industry can make will be severely limited;
- the industry will not be able to attract, develop and retain the skills needed by such a technology intensive industry;
- transatlantic cooperation will suffer as a result of the disproportionate size of the US and European markets;
- new protectionism will surge.

160. This may be considered as a piece of friendly advice, but for American and European experts on transatlantic cooperation and European security and defence issues it goes without saying.

161. Lockheed Martin was represented at the Madrid seminar by Mr Octavio Manduley, Director General (Spain and Portugal). Mr Manduley presented Lockheed Martin as a global company in terms of its size and reach, but with the advantage of having as its main customers the US Departments of Defense and Homeland Security (DoD and DHS), which together account for almost half of world spending in the security and defence area.

162. The DHS budget stands at 55 billion dollars in 2010 and 56 billion dollars has been requested for 2011. The DHS supervises several agencies in charge of air transport (TSA) and border controls, the Secret Service (certain activities for the Treasury, protection of the US President), the coastguard services, the Federal Emergency Management Agency (FEMA) dealing with natural and industrial disasters, and others.

163. The DHS does not supervise agencies such as the FBI (homeland security), the DEA (drugs), the ATF (Bureau of Alcohol, Tobacco, Firearms and Explosives) and a large number of other federal security and law-and-order structures that come under the authority of the States of the Union. All those budgets together, plus the American intelligence budget (more than 50 billion dollars in 2010), amount to hundreds of billions of dollars.

164. The DHS is also a source of funding for security R&T and R&D in particular in the field of infrastructure protection, border surveillance and controls, airports and cyber security. Since the 11 September 2001 terrorist attacks, a huge national and international market worth hundreds of billions of dollars each year has opened up; this is a market on which companies like Lockheed Martin, Boeing, EADS and Thales are highly present and active.

165. The security market is similar to the defence market: in Europe it is fragmented among the different states, and in the United States, despite the post 9/11 rationalisation of homeland security, there is still a whole host of different agencies at federal and state level, leading to a dispersal of investment, with Congress playing a major role in setting priorities and allocating resources.

166. As regards transatlantic cooperation in the field of defence technologies and equipment, Mr Manduley presented several examples of cooperation on international programmes as well as on programmes which for the moment are purely American, such as the US Navy's Littoral Combat Ship (LCS).

167. That programme, above and beyond the military capabilities it is seeking to develop, illustrates a major difference between the American approach, supported by a large budget, and that of all the European states. The DoD is co-funding, together with the firms competing in the bid, the production of two life-size demonstrators with an operational performance corresponding to that specified in the RFP.

168. The two primes are Lockheed Martin (USS Freedom, 2008) and General Dynamics (USS Independence, 2010, with a trimaran seaframe built by Austal). The two demonstrators have already been built and are currently in the test phase. Two other ships are expected in 2012 (Fort Worth, LCS-3, built by LM and the Coronado, LCS-4, built by GD). A total of 55 ships in this new category are planned, at a cost varying from over 10 to 30 billion dollars, depending on the different estimates (and delays).

169. In 2009, in a report produced by Northrop Grumman, it was estimated that seven LCS could conduct a counter-piracy mission (Indian Ocean, Gulf of Aden, Somalia) with the same effect as that achieved by 20 ships of the kind currently being deployed in this zone (10 to 11 000-tonne cruisers), for a quarter of the costs. The 3 000-tonne LCS is modular and can be adapted to a wide variety of missions (anti-submarine, anti-surface, reconnaissance, surveillance, for example). The cost of the first two demonstrators is estimated at 1.3 billion dollars (some one billion euros: 481 million for the Fort Worth and 530 million for the Independence).

170. By way of comparison, the FREMM Franco-Italian multi-role frigate programme (6 000 tonnes) will cost 6 billion euros for the production of 21 frigates up to 2022; construction only really started when the first firm orders were signed (in 2005, after three years of bilateral negotiations; the programme is being managed by the Joint Armament Cooperation Organisation OCCAR). The French frigates are being built by DCNS, in France, and the Italian frigates by Orrizonte Sistemi Navali (Finmeccanica).

171. In principle only one model will be selected for the LCS project, launched in 2004, although US observers and experts consider the two proposals to be more complementary than competing.

172. The LCS programme includes an international contribution but it is not an international programme like the F-35 Lightning II, another of LM's flagship programmes. Participants are Denmark, Germany (EADS Germany), Italy, Sweden, Switzerland and the United Kingdom, which are responsible for different systems and components. Unlike the F-35, the programme involves cooperation among companies, rather than governments. However, it is obvious that once the LCS is built there will also be a market for it in Europe, where it will be in competition with European platforms.

173. Mr Manduley presented LM's portfolio of defence activities, which cover practically the full range of defence requirements, from land equipment to space assets, as well as instruction and training. It should also be noted that LM worked in partnership with Finmeccanica/Agusta Westland for the presidential (naval) helicopter programme.

174. Under President Barack Obama's administration, however, the programme (VH-71/US 101) was reviewed and suspended in 2009. A new RFP was announced by the US Navy in 2010 (VXX) but this time LM decided to cooperate with Sikorski.

175. Unlike the Boeing representative, however, Mr Manduley did not elaborate on the question of the transatlantic market or put forward any precise proposals for its development. One must also bear

in mind that according to the global vision of companies like LM, the European states are partners like any others, such as Israel, Japan or South Korea.

176. In 2009, among LM's 15 leading clients in terms of sales, five were European countries: with the United Kingdom and Greece in first and second place, respectively, Norway and Turkey ninth and 10^{th}, and Spain in 13^{th} place.

177. Mr Fernandez Ramirez Balza, representing the Spanish firm INDRA (security, defence, space), wound up the panel of guest speakers with a presentation about the current state of the transatlantic market, with particular reference to the barriers that continue to confront European companies on the US market, issues covered also by Mr Enrique Navarro Gil from Portfolio IC2 (consultants) in a complementary presentation delivered during the first part of the seminar.

178. The speaker reiterated the aspects mentioned above: the budget gap, fragmentation of the European market and Europe's lack of political unity vis-à-vis the United States. On this last point, despite the efforts of some members of the US administration, President Obama is clearly keeping his distance from his European counterparts. It is also true that the President's career hinges on domestic issues of social policy (healthcare reform) and the economy.

179. On the major international issues – Iran, Afghanistan, the Middle East conflict, Russia, China and withdrawal from Iraq – Europe's voice does not stand out enough to attract much attention. As mentioned above, the European states have settled into the strategic status quo of the last 60 years and notwithstanding certain reservations expressed more in private than in public, Europe does not present a credible alternative in the eyes of the United States and other countries to the American positions, approaches and decisions.

180. Mr Navarro Gil compared the factors that support transatlantic cooperation on defence equipment and technologies with those that contribute to the gap between the two (unequal) partners. In the list of supporting factors he put:

– globalisation: an aspect stressed by the American speakers. The national market alone, even if it is the US market, is no longer enough to maintain and develop the DTIB in the long term;

– defence economics: it is true that the Europeans have much more limited resources, but the United States, with its major budget deficits, also faces restrictions. The 2010 review of priorities for the 2011 budget and the Quadriennal Defense Review (QDR) for the period 2010-2014 curb expenditure on long-term programmes and redirect investments to covering short- and medium-term requirements, in other words those relating to ongoing operations or likely to be necessary in the near future (three to five years). Cyber defence and cyber attack have also become major areas.

– changing military requirements and the need for interoperability in coalition operations: the two aspects are important and are interlinked, because if requirements are too different it is difficult to maintain interoperability in the long term; this applies on the optimistic assumption that the United States and Europe arrive at a minimum level of joint operability, which is not the case today. This would be a possible area of cooperation for the NATO technical agencies and the European Defence Agency, political conditions permitting;

– recourse to dual technologies and the threat from new or re-emerging competitors: competitors are more of a risk for European companies than for US firms. Russia, China and India have fewer financial resources and bigger armed forces still strongly geared to territorial defence, or regional operations. Moreover, from the technological standpoint, and with the exception of certain sectors in Russia (missiles, aerospace, nuclear weapons and certain types of land equipment), non-European competitors have not yet reached the same technological level as Europe, let alone that of the United States. There is a learning, instruction and training process that is essential, although it has been speeded up by the global spread of dual technologies.

181. In his presentation Mr Balza from INDRA gave a comparative review of the two markets (size, budgets, investments, programmes, R&T and R&D) as well as of the strategies adopted by European companies in order to penetrate the US market. Some companies opt for assimilation (BAE NA), others for cooperation, acting as subcontractor to an American prime (EADS NA for the KC-X)**.** There are even attempts to sell directly to the US market (the case of INDRA with its portable satellite communications terminal, a model which subsequently was copied and adapted by a competing American firm).

182. In order to better defend European interests on the transatlantic market Mr Balza made three suggestions:

- increase/rationalise R&T investment in the EU (long term);
- address, with the US, the barriers to trade (including ITAR restrictions);
- harmonise technology control policies (general licences).

183. The first point is essential for maintaining the EDTIB, failing achievement of the strategic objective of expanding it, in qualitative and quantitative terms. Consolidating and developing the EDTIB is a prerequisite for Europe to become a global player. To go from the role of junior partner to that of senior partner of the United States is a matter of resources, as much as of will.

184. While the latter appears still to be lacking, except in a small minority of EU and NATO member states, the development of assets and capabilities is continuing, albeit at a pace that may be deemed too slow. The fact is, however, that the EU and the European NATO member states have so far lived up to the challenges they set for themselves.

185. Notwithstanding the caveats, flagrant capability shortfalls and budgetary constraints, all the United States' European allies have been able to respond to calls for more troops and capabilities in Afghanistan, while at the same time, among other things, protecting maritime security in the Indian Ocean, Gulf of Aden and off the coast of Somalia, maintaining the territorial status quo in Lebanon (Lebanon-Israel), conducting ad hoc operations of variable duration in Africa (EUFOR Tchad/RCA lasting one year from 2008 to 2009), providing airspace surveillance assistance in the Baltic States, and maintaining a presence in the Balkans and Georgia (monitoring mission).

186. This does not stop some people in the United States from taking the moral high ground and criticising the European states for their alleged pacifism. The fact remains, however, that without the contribution of the European states, which maintain their capacities at the cost of a huge budgetary effort, and without the ongoing process of political-military-industrial cooperation which cannot be taken for granted, given the different levels, capabilities, political, economic and social situations, perceptions and interests of the European states, the United States would have to invest more in terms of financial resources, troops and equipment in order to play its role of "world policeman".

187. Europe for all its diversity, weaknesses, economic crises and crises of confidence will remain for the foreseeable future the United States' staunchest ally, particularly from the strategic standpoint. The two are bound not just by political and economic ties and their security and defence interests but also by social and cultural considerations. The United States remains a state of Europeans, or even, as written in 1995 by the then Assistant Secretary of State for European and Canadian Affairs, Richard Holbrooke, in the American magazine "Foreign Affairs", a "European power".

188. This does not prevent the two from having their differences, which is also a sign of maturity in a relationship that cannot continue to be one of "we lead" (the US) and "you follow" (the European and other allies). And the transatlantic market can only function on a sound and lasting basis if European companies with their knowhow and technology are sufficiently developed, but also protected, as US firms are. This is a task for the Europeans themselves; it is up to them to overcome their differences and look beyond purely national interests. The new transatlantic relationship – one that is shaped no longer by NATO but by a growing EU-US partnership, including on defence issues – will determine how the transatlantic market develops.

189. Cooperation, complementarity and competition form the basis for this relationship which must shift away from dependence towards interdependence. This will make for effective multilateralism

between Americans and Europeans, to the benefit of international security and the defence of democratic societies confronted with the challenges of an increasingly multipolar world that brings with it opportunities, but also major risks.

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