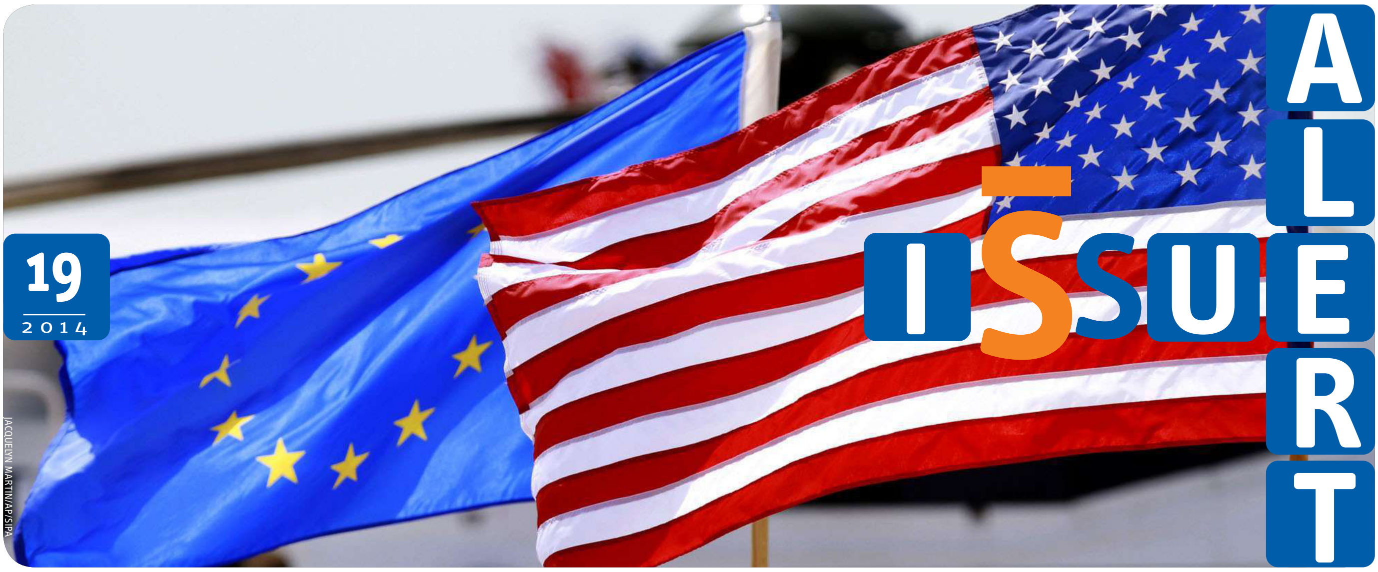

No TTIP-ing point for European defence?

by Daniel Fiott

The EU-US Summit on 26 March will mark eight months since the partners decided to formally launch negotiations on a Transatlantic Trade and Investment Partnership (TTIP). The aim of the TTIP – *if* finalised – is to remove tariffs, align regulatory standards and open up government procurement. Born out of the need to boost economic growth on both sides of the Atlantic and to respond to the rise of emerging markets, the Partnership will add an extra €120 billion to the EU economy annually, according to estimates by the European Commission. While President Obama's first visit to Brussels will likely be dominated by an agenda focusing on Ukraine and economic recovery, it is also worth thinking about some of the more sensitive areas involved in the TTIP discussions.

One such area relates to defence industry and markets. Back in June 2013, public procurement of defence and security goods was included in the Commission's negotiating mandate. Given the sensitive nature of defence procurement, however, both sides have, for the time being, agreed to drop a 'defence TTIP'. This situation is indicative of a broader negotiating environment that has seen a moratorium on including an investment chapter in the Partnership and other sectoral exclusions. Therefore, at first glance, the TTIP's overarching aims of abolishing tariffs, enhancing the compatibility of the EU and US regulatory environment and ensuring a greater flow of goods, services and investments in the transatlantic space will not apply to the defence sector. But is this necessarily the end of the story?

The dual-use conundrum

In today's defence markets it is no longer possible to speak of purely 'defence' goods and technologies, with dual-use goods and technologies increasingly blurring the lines between the defence and civilian sectors. In order for finished platforms (such as jet fighters, aircraft carriers and armoured vehicles) to function, componentry made in the civilian sector is essential. Accordingly, defence procurement contracts are just as likely to involve electronics firms as they are system integrators. The semantic confusion caused by this blurring may therefore still see, albeit indirectly, a number of defence-relevant goods and technologies fall under the provisions of a future TTIP. As just one example, while it is unlikely that attack helicopters will directly fall under the provisions of the TTIP, on-board technologies sourced from the civilian sector (such as sensor equipment and landing gear) may well be included.

Firms and governments may view the removal of tariffs on defence-related civilian goods and technologies as a positive outcome of the TTIP negotiations. However, the removal of tariffs would mean relatively little in the face of remaining non-tariff barriers. For example, despite recent moves by the US government to ease market entry for certain third-countries, the 'Buy America Act', the 'Berry Amendment', the Committee on Foreign Investment in the US and the International Traffic in Arms Regulations (ITAR) continue to serve as barriers to defence market access.

Based on the premise of national security, the ITAR in particular makes it difficult for US exporters to trade their defence products with third-countries. Yet, under the ITAR, the US government has the power to move goods that are presently classified under the 'munitions list' (USML) to the 'commercial list' (CCL). This process has already begun, with the US government relaxing ITAR controls on satellite components and technologies in 2012. While the USML items would not be covered by any future TTIP as it currently stands, items under the CCL could become subject to the TTIP provisions. Moving items from the munitions list to the commercial list could thus ease US exports to the EU and other countries around the globe.

What is more, while the US could ease export restrictions on their own firms, the country could still use its non-tariff barriers to hamper market access for third-countries. This is not to say that European firms are completely barred from the US market: through a Special Security Arrangement, European firms can operate in the US – albeit under strict conditions. There are also several examples of European firms breaking into the US market and making sizeable sales. For example, BAE Systems recently sold two naval gun systems worth $20 million to the US Navy and Coastguard. Despite such success stories, the TTIP in its present form will not remove existing regulatory barriers and European firms wishing to gain a foothold in the US market will continue to face familiar difficulties.

The situation outlined above could potentially affect the more than 1,350 small and medium-sized enterprises (SMEs) that operate in the European defence sector. These SMEs trade almost exclusively in dual-use goods and technologies. While a TTIP could make it easier for European SMEs to export defence-relevant civilian goods and technologies to the US market, US firms already have a competitive advantage over their European counterparts. For example, SIPRI calculates that between 2000 and 2012, ten EU member states exported a total of $4.4 billion worth of major conventional weapons to the US, whereas the US exported $21.8 billion to twenty-six EU member states. While European SMEs are good sources of innovation, they tend to lack the critical mass needed in terms of capital investment and R&D resources to be able to compete in the US market.

TTIP-ing the balance?

The TTIP may therefore have an indirect, if important, effect on the European defence industry. While tariffs may be removed on a host of defence-related civilian goods and technologies, non-tariff barriers may still be used to impede imports and facilitate exports. The term 'dual-use' may allow for sufficient flexibility to re-label 'defence' goods as 'civilian' and move them under the TTIP umbrella. This would allow the most valuable elements of the proposed TTIP to be retained, whilst also using the exclusion of defence from the TTIP negotiations to use non-tariff barriers in a strategic manner. The consequences of this scenario are still unclear for Europe's defence industry, and particularly for the mass of defence-relevant SMEs.

Whether or not the TTIP moves forward, and aside from the direct or indirect impact it could have on Europe's defence markets, the debate may reveal a more germane point about the state of defence-industrial policy in the EU today. Indeed, the increasing competition from the US and other emerging markets, and the depression in defence expenditure in Europe, beg some serious questions. One could begin by asking what the 'E' in the EDTIB (European Defence Technological and Industrial Base) actually represents.

If preserving and defending the EDTIB means boosting the competitiveness of Europe's defence firms through market openness, then it must be conceded that non-EU firms may also set foot and gain ground in the European market: would these firms then be part of the EDTIB? If the EDTIB is viewed as a means to sustain high-skilled employment in the Union and to promote European capability development programmes that have a positive knock-on effect on jobs, growth and R & D investment, the answer is likely to be yes. Conversely, if 'national' champions (or SMEs, for that matter) move business outside the EU – for whatever reason – would these still be considered part and parcel of the EDTIB?

At any rate, the prospect of a TTIP may force Europeans to finally address long-standing defence market fragmentation. The July 2012 Commission Communication and the December 2013 EU Council are steps in the right direction, but the uncertain effects of – and the potential opportunities contained in – the TTIP may yet serve as a further catalyst for progress.

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 | QN-AL-14-019-2A-N | ISSN 2315-1129