Cross Border EU Defence Industry Consolidation between Globalization and Europeanization

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Introduction

European integration has evolved from being predominantly market driven to encompass foreign, security and defence policy. While the market for defence equipment has been exempt from the EU treaties – and indeed the WTO regime – cross-national collaboration has characterized R&D and production of major weapon systems in Western Europe since the sixties.

Hence since 1965 the UK has developed only one indigenous front line combat jet airplane – the Jump Jet Harrier – but has been a core contributor to three joint European endeavours – the SEPECAT Jaguar, the PANAVIA Tornado and the Eurofighter Typhoon.

Yet mergers and acquisitions (M&A) involving defence companies from at least two different EU member states have been few. This is particular the case when looking at M&A’s involving key players in the major Western European member states.

Four high profiled deals involving key companies in the major EU powers have been recorded since 1999. The first was the merger of DaimlerChrysler Aerospace AG (DASA) of Germany and Aérospatiale-Matra of France in July 2000 forming EADS (European Aeronautics Defence and Space). The second was the acquisition of Racal plc of the UK by the Thales Group – formerly Thomson-CSF – of France. The third instance was the December 2001 creation of MBDA which consolidated the vast majority of Western Europe’s missile industry. It brought together the missile units of EADS of Germany and France, BAE of the UK and Finmeccanica of Italy. Finally Finmeccanica of Italy in 2004 purchased all shares of AgustaWestland securing the company full control of the UK helicopter industry.

Hence high tech industries of Aerospace and Electronics dominate cross-border M&A. Only minor cross-border consolidation has been recorded in the sectors producing Naval and Land systems.

From this limited set of observations it seems that the UK is more permissive in allowing foreign firms to acquire national defence companies – this tolerance is also extended towards US companies making inroads in the British defence industry. On the balance it should be noted the BAE has been a very active investor in the US. In short the UK Defence industry seems to be subjected to Globalization.

Secondly it seems continental consolidation proceeds as ‘mergers of equal’ leaving owners in the constituent companies in control – a corporate equivalent to ‘pooled sovereignty’! Accordingly developments in France and Germany to some extend mimic the dynamics of European integration.

In this paper we shall seek to explain these patterns by identifying and gauging the effect of domestic mediating institutions in France, Britain and Germany.
Analytical Framework

The inquiry departs from the Europeanization literature which asserts that uniform pressures often produce diverse responses. Accordingly the existence of unambiguous cohesive stimuli in the form of binding EU legislation does not necessarily bring about institutional convergence in the member states.

Following Claudio Radaelli: “Europeanization consists of processes of a) construction, b) diffusion and c) institutionalisation of formal and informal rules, procedures, policy paradigms, styles, ‘ways of doing things’ and shared beliefs and norms which are first defined and consolidated in the EU policy process and then incorporated in the logic of domestic discourse, political structures and public policies (Radaelli, 2004).”

The extent to which European initiatives produce domestic institutional response, depends on the degree to which EU stimuli is perceived at odds with existing rules, practices and arrangements. The Europeanization literature assumes that adaptation pressures increase when the EU issue specified rules. Accordingly, national systems often undergo change due to European integration – ‘levels of fit’ determine how strong a pressure for change individual states face.

Together with the unique legal hierarchy of the EU aquis, this has constituted a challenge when aspiring to gauge the relative impacts of Globalization and Europeanization. Given the fairly unified legal structure and binding nature of numerous EU instruments, global stimuli by contrast often appear more diffuse, abstract and indirect.

Knill’s 2001 study of Europeanization of national administrative practices employed a distinction between impacts stemming from very explicit hard law institutional requirements. A case in point could be the separation of regulators, rail track operators and train operators introduced by EU legislation in the domain of transport. Another impact mechanism rely on changing opportunity structures by e.g. providing access for hitherto excluded groups to particular policy processes. Finally, policies “directed at changing domestic beliefs and expectations” may result in Europeanization as practices are eventually adapted (Knill, 2001). The latter impact has been identified as the most relevant in relation to foreign policy.

In the domain of European defence industry consolidation, we have little amounting to binding legislation on the part of the EU and other regional bodies. While few and far between, the studies that have aspired to apply the Europeanization perspective on defence industry issues have concluded that European-wide Defence Markets have emerged framed by soft law, institutional adaptation, ideational change and the creation of the European Defence Agency (see e.g. Britz 2004, Mörth 2003, Mörth 2004).

Hence mechanisms in both the realm of Europeanization and Globalization are operating at a levelled playing field. For the purpose of the present study, the basic mechanisms through which Europeanization and Globalization push for domestic institutional change are considered identical. Consequently the chief difference between the two concerns their origin – i.e. is a stimulus originating from European or Global (North American) venues?

Globalization may be seen as fuelling, being mediated by or competing with European integration. In this inquiry focus is on the role of domestic mediating institutions in affecting institutional change initiated by respectively Europeanization and Globalization. While it is recognized that
European integration in itself sparks globalization (see e.g. Abdelal, 2006) and European integration can be a response to globalization (Moravcsik, 1998), this paper will treat both Globalization and Europeanization as independent variables.

**Varieties of Capitalism**

Europeanization departs from institutionalism and recognizes the variation in domestic political and economic systems found in the member states of the European Union. The ‘varieties of capitalism’ literature is concerned with the diversity in the institutional configuration of the advanced political-economies. According to Hall & Soskice (Hall & Soskice 2001 & 2003), five spheres in particular frame domestic systems. They are 1) the industrial relations systems, 2) the vocational training and education system, 3) the corporate governance system crucially including the financial and capital market systems, 4) the inter-firm relation systems and 5) practices and norms of information and knowledge sharing within organizations.

The ‘varieties of capitalism’ literature, makes a case for institutional rigidity contending that well entrenched national models of capitalism can either withstand or adapt to Globalization and Europeanization pressures in manners enabling them to maintain their distinctiveness (Hall & David Soskice 2001 P. 56). To this end the five spheres listed above form mediating institutions which may both constitute ‘points of misfit’ and harnessing devices ensuring sufficient domestic capacity of adaptation in response to external pressures for change.

In this inquiry, we shall concentrate on the last three institutional spheres as cross border acquisitions, mergers and operations are fundamentally affected by corporate governance, inter-firm relationships and knowledge sharing within organizations.

Emphasis will be on ownership patterns in relation to corporate governance and inter-firm relations. Aspects of inter-firm relations dealing with knowhow and knowledge sharing within organizations will be addressed by analysing national innovation system institutions.

Defence industries represent institutional islands which have evaded regulatory congruence as the activities of the sector are exempted from the EU and WTO treaties. The sheltered character of the defence industry makes it an archaeological excavation site unveiling preserved properties of national institutional models prior to the changes instigated by Europeanization and Globalization. But what characterized this institutionally lost world conserved by the defence industries? How has it been reflected in ownership patterns?

Ownership patterns are framed by institutions defining state-market and finance-industry relations.

Britain invented arms-length government vis-à-vis the market and epitomised the virtues of liberal statehood until the two world wars forced the country to experiment with new forms of regulation in order to mobilise the resources required for the war-efforts. The British State has first and foremost presided over a market needing transparent enforcement of basic rules (Dunleavy & O’Leary, 1987).

France invented the Developmentalist State. Colbert’s early approach to national development by means of state-led industrialisation left an imprint on the institutions of the French state, which have been challenged briefly but never eradicated. The French State has first and foremost presided over a territory needing cultural and legalistic cohesion (Shonfield, 1969).
Germany invented corporatism. Although subjected to authoritarian rule a number of times, Germany has consistently enlisted civic organisations (often economic interest groups) in the governance process – at times more so then political parties. The German State has first and foremost presided over a nation needing aggregating structure (by no means always democratically exercised).

With regards to the development of the financial system, differences also seem striking. It is through the financial system that the market for firms is structured. Hence a system relying on banks to meet the financing requirement for businesses is likely less transparent and open in its approach to ownership transfer then a system relying on public, tradable, listings.

Germany’s financial system is optimised for privately – often family – owned firms. The country’s so-called ‘mittelstand’ consist of SME’s which have developed close relations to their preferred bank which cater for their financing needs as ‘housebanks’. The larger corporations are even more intimately linked to one of the major four banks through the latter’s sizable holdings of stocks. At times around 35-40% of shares in German corporate undertakings have been controlled by the big four banks. The banks in turn appoint board member to the major industrial groups and assume responsibility in assuring access to ‘patient’ capital and loans when needed (Zysman 1983).

Great Britain by contrast stands out as an example of a capital market driven system. The overall capitalization of the London Stock Exchange exceeds that of Paris, Frankfurt and Milan combined. British firms turn to the stock market to secure working capital – even though the banking market is well developed. Intimate trust which is vital in the German system can be replaced by valuation and enforceable contracts in the UK system. This in turn makes the market for firms and the ability to achieve consolidation much easier than in the rest of Europe (Zysman 1983).

That is with the possible exception of France. In this country national consolidation in any priority industry can be achieved through acts of government. The French have a much stronger tradition for state participation in the corporate sector then in Germany and Britain. When not directly involved through ownership, the French state has previously used grants and sectoral interest rate fixing to assure that private sector development went according to the desires of national planners (Schmidt, Vivian 2002 and 2003).

National Innovation Systems
Innovation Systems, denotes the structural and institutional factors affecting the manner in which technological and organisational knowledge is created, implemented, applied and diffused in the economy (E.g. Lundvall 1992).

Innovation Systems both contain tangible and intangible elements. A company’s innovative capacity is thus in part determined by its access to tangible factors such as suitable sources of e.g. knowledge, managerial skills, publicly sanctioned patenting regimes and finance.

But in addition ‘soft’ intangible features such as social rules, inherited norms and attitudes which are shaped through history and rooted in national culture, also constitute part of the system. A basic distinction is made between Mission Oriented Innovation Systems and Diffusion Oriented Innovation Systems.
Mission Oriented systems are grand scale constructs designed to solve fairly specific tasks such as enhancing a country’s military technology capability. But the ‘Mission Orientation’ often extends to other sectors in such countries.

Complex coordination and project management mechanisms sustain Mission Oriented systems which exhibit a bias towards breaking down projects to multiple inhouse R&D endeavours based upon and connected through proprietary standards.

A case in point is France where the Mission Orientation is evident in her approach to infrastructure build-up. The French State thus mobilised significant resources to enable the development and national deployment of the Minitel pre-Internet technology. Other French examples are found in transport such as the high-speed TGV trains, the Airbus passenger jet, the Concorde supersonic jet and the Ariane Space launcher. The French National Innovation System is one of the clearest examples of a Mission Oriented model. The market demand for these products has been created via politically dictated public procurement and sold abroad through the involvement of the French state in political deals. Major parts of French technology policy have been biased towards France’s biggest companies, her biggest R&D institutions and “grand projects”.

In countries with predominately Diffusion Oriented Innovation Systems, the generation of new technologies takes place in a range of institutions that need not be subject to a high level of co-ordination. Moreover, countries with ‘Diffusion Oriented’ Innovation Systems willingly import technologies.

Public, semi-public and private technology organisations subsequently assist and enable industry by diffusing these technologies. Moreover the above organisations are equally concerned with helping firms to apply new technologies in their production process.

Germany’s National Innovation System is predominantly a diffusion oriented (Ergas 1986). Technological cooperation among firms is encouraged by the government but the government is not an active match-maker. The German state has altered over time from a developmental Entrepreneur with a strong ‘Listian’ orientation towards a provider of collaborative infrastructure such as the elaborate system of Research and Technology Organizations (Kluth & Andersen 1997).

The United Kingdom is also diffusion oriented, albeit the key mechanism in this country is the markets place. Due to the character of the financial system with its emphasis on capital markets, British corporations tend to be bigger than in continental Europe. This allows for some firm driven ‘grand projects’. This has been particular paramount in the defence industry, although state sponsorship still dominates here and past Government interference in the restructuring of the sector has been pervasive. But UK chiefly exhibits a market driven diffusion orientation. The private market for technology through patents and technology service firms has traditionally been larger then in comparable continental economies (Kluth & Andersen 1997). This is complemented by a somewhat patchier network of Research and Technology Organizations which tend to rely less on public funding then their European counterparts. The striking feature of the British system is, accordingly, its contractual nature. Technology is much more of a commodity then in Germany and France. This could ease cross-border mergers in the R&D intensive Defence industry as its technological assets are either in-house – an thus disconnected from coordinated Mission Oriented networks and associated proprietary dependencies – of sourced on a commercial basis.
Hence in market based Diffusion Oriented innovation systems technology is a commodity traded using elaborate patenting practices and licensing. Given the more volatile market for firms in the UK owing to the nature of the financial system, technology is also obtained through company acquisitions.

Domestic institutions predisposing companies towards either making or buying technology; partaking in developing proprietary technologies or employing standards using licensed patents; and relying on either centralized complex project managements mechanisms, public-private diffusion networks or the market place in framing knowledge flows, have a strong mediating impact on both global and European pressures for cross-border consolidation.

**Foreign Policy Identities**

Pure political mediating institutions relate to dominant thinking on national security. Exclusive access to technologically superior equipment and an endogenous manufacturing base has been a prime concern for security strategists. Domestic perceptions of how ceding or pooling control of the national defence industrial and technological base are informed by perceptions of how national security relate to European and Global security. But what is the applicability of the Europeanization literature to the ‘high politics’ field?

Hix and Goetz forward a widely shared understanding that the EPC (European Political Cooperation) and consequently the CFSP (Common Foreign and Security Policy) due to the intergovernmental nature of foreign policy collaboration were unsuitable areas of inquiry for Europeanization research (Hix and Goetz, 2000).

The growing body of research which is nonetheless conducted along this route stresses the learning mechanisms of expanded interaction in foreign policy communities. Hence some scholars point out that member states adapt to EU policies such as when formally neutral countries participate in “EU Battle Groups” and approve a “Solidarity Clause” in the EU treaties (Smith, 2000 & 2004). Others have advanced the view that foreign policy Europeanization for some countries entails using the EU as a power multiplier’ (Wong, 2006).

In its most pervasive form, students of EU foreign policy highlight the emergence of a common identity in the foreign policy domain enabling Europe to act as a global normative power. Adrian Hyde-Price observe “[A] ‘European identity’ is associated with values such as liberal-democracy, social market economies and peaceful resolution of disputes” (Hyde-Price 2004 P. 108). This enables the EU to act as a global normative power stressing the aspiration of changing the locus of international relations from state security to individual security (see e.g. Manner, Ian 2002 and Manners, Ian and Whitman, Richard 2003).

The counter position holds that identities and strategic cultures exhibit considerable resilience. As it is historically rooted and internalised through national identity, there are limits to congruence in this domain within a foreseeable time frame.

A literature has emerged highlighting the role of norms and identities in affecting foreign policy behaviour (e.g. Aggestam 1999, Wolf 2004). A related strand of research revolves around the notion of ‘Strategic Culture’ (Snyder 1977, Katzenstein 1996). The latter has been defined as:
“Broadly speaking, strategic culture focuses on the domestic sources of security policy and attempts to identify how the past impacts and shapes contemporary policy behaviour. In contrast to some of the more traditional approaches in security studies, the strategic culture approach is interested in the subjective, nationally specific, aspects of security and defence policy and the ways in which collective historical experiences, channelled through pervading values and norms, play a role in defining interests and thus shaping policy choices.” (Longhurst 2004 P. 1).

Work on Foreign Policy Identities emanates from Constructivism. Identity can broadly be defined as “images of individuality and distinctiveness (‘selfhood’) held and projected by an actor and formed (and modified over time) through relations with significant ‘others’” (Jepperson, Wendt and Katzenstein 1996 P. 59).

In its discursive connotation, identity is concerned with the justification of foreign policy rather than its causation (Hansen 2002 P. 8). As such it is considered the deepest discursive layer providing the foundation of argumentative legitimations of foreign policy.

Departing from these perspectives we can note that: 1) Historical patterns of rivalry, distrust and antagonism between states, are not easily eradicated. 2) National foreign policy identities inform national preferences on the national origin of M&A partners and differentiated levels of tolerance with regards to the national origins of companies to which national control of domestic defence firms may be pooled or ceded.

In sum four significant mediating institutions have been identified. They are: state-finance and state-market relationships, knowledge flows and foreign policy perceptions. Each of them significantly affects domestic responses to cross border defence industry consolidation in the major West European powers.

**Domestic Mediating Institutions: Varieties in State-Market, Finance-Industry Relations and Innovation Systems**

Western Europe have subscribed to capitalism as a system since the end of WWII. But the practices and balances between market and state made for tremendous diversity. This diversity in turn provided shelter for special regimes relating to national defence industries. Special relationships could be identified in a host of industries including utilities, telecommunications and transport. Yet with the Internal Market scheme only defence initially withheld pressures for a more uniform market economic regime across different sectors and national boundaries.

These special defence industry regimes have become institutional islands facing various pressures for mainstreaming. One factor challenging the sustainability of special defence industry regimes is the dual use nature of numerous defence products. While largely absent in e.g. missile manufacturing, it is salient in relation to other products in high demand following the capability transformation of major European powers (Reppy, 2000).

Hence the growing emphasis on mobility has boosted procurement of logistical assets such as transport and tanker planes for the air forces, landing dock and transport vessels for the navies, helicopters and trucks for the armies etc. Even units representing traditional capabilities such as warships are increasingly build according to commercial specifications using modular construction techniques by civilian ship yards! Some weapon classes are predominantly dual use. This is e.g. true for helicopters where only dedicated attack helicopters such as the European Tiger and the
Apache of the US do not find civilian applications. Defence electronics represent a less tidy but equally intertwined relationship between civilian and military technology application.

It is accordingly difficult to maintain a distinction between defence and civilian industry in most domains of aerospace and the naval sector. As market conditions, including provisions for state aid, for merchant vessels and commercial airplanes have been mainstreamed, companies operating in both the civilian and the defence domain have to comply with contradicting regulatory regimes.

In addition the defence industry regulatory regime has undergone change. For a start the EU established the European Defence Agency in summer 2004. Crucially, rules for procurement have been subjected to Europeanization challenging privileged relations between domestic defence departments and national champions. The creation of Organisme conjoint de coopération en matière d’armement (OCCAR) in 1996 serving as programme office for collaborative projects has instigated a renunciation of the principles of *juste retour* on an individual programme basis. Hence the allocation of contracts is to be based on competition and governments have vowed to assess national returns up against best value and over several projects over many years. (Reda, 1999 P. 83).

This has been compounded by collaborative shifts in capabilities within both the EU and Nato responding to the demise of the Cold War, the war on terror and a rise in overseas operations stemming from state failures and demands for humanitarian interventions.

This has challenged the manufacturing and technology capability of domestic industry players in the Western European powers. As the immediate post cold war period also saw a decline in order books as politicians sought to reap the ‘Peace dividend’ and a massive consolidation of US industry, numerous call was made for ‘European solutions’ to the restructuring of the sector (e.g. Anthony & Wolf 1991, Scherpenberg, 1997, Rohde & James, 2004).

**Domestic Ownership Patterns: Mediating Finance-Industry & State-Market Institutions**

Different forms of ownership constitute a key factor determining patterns of cross-border consolidation. Ownership arrangements are in turn framed by the mediating institutions of Finance-Industry and State-Market relations.

In France and Italy the Government has retained dominant shares in the major defence players. Thales and Finmeccanica have embarked on aggressive acquisition sprees in foreign markets – particularly the UK where regulators do not seem to mind! They are inaccessible as targets themselves due to state control.

Besides state ownership, a number of European defence firms are publicly listed companies. This applies to the major British players such as BAE Systems and Rolls Royce in addition to Franco-German EADS – although the French state has retained a sizable holding in the latter. Likewise the UK government retain ‘Golden Shares’ in both BAE and Rolls Royce. They remain rather passive shareholders maintaining the limited stake solely as a safeguard against undesirable hostile takeovers.

Another form of ownership which has been widespread in the European defence industry is corporate affiliation – typically in a conglomerate. National conglomerates have often developed close ties to governments and maintaining some defence related capability can be a means to ensure
political favours – particularly if the national market is limited and export prospects modest. German naval yards HDW, Nordseewerke and Blohm & Voss are thus owned by ThyssenKrupp.

A fourth form of ownership seen in both Germany and France is private ownership. In Germany the highly successful armoured vehicle industry is controlled by two families. Hence the Röchling family owns a 42 per cent stake in Rheinmetall and the Bode family controls 51% of KMW. In France Serge Dassault still dominates Jet fighter manufacturer Dassault Aviation.

A novel inclusion to the listed types of ownership is that of Equity Fund control. This form of ownership is typically of limited duration but often serves as a stopover towards consolidation. A case in point is the 75% stake in German naval yard HDW formerly held by One Equity Partners (OEP). Another example is the forays made by the infamous US-based Carlyle Group. The latter has acquired a 31% stake in the former UK MoD research labs now named QinetiQ.

Domestic responses to such institutionally alien foreign ‘intrusions’ are indicative of how both State-Market and Finance-Industry mediating institutions are brought to bear.

In the case of the Carlyle Group they were invited by the UK government to invest in its privatised military research labs! By contrast, the ThyssenKrupp acquisition of HDW was nationally applauded. OEP and equity funds in general constitute an alien component in the German business system which has not fully recovered from the shocks caused by the hostilities surrounding the Thyssen-Krupp merger and in particular the hostile take-over of Mannesmann by Vodaphone. It was of fear for the temptations presented to the Röchling and Bode families from such investment vehicles that prompted the German government to introduce legislation which could block foreign takeovers.

In tune with the general model, Germany is institutionally inclined for negotiated deals in both the domestic realm of M&A and in relation to cross-border consolidation. The negotiating partners may include the state as facilitator, the rather autonomous board of the directors in the affected companies and key shareholders often with banks in a key position and other stakeholders such as Trade Unions.

France is equally disposed towards negotiated deals, albeit with the state in the driver seat dealing with the affair as an intergovernmental pursue.

This contrasts Great Britain where the Government has taken a rather lax attitude to foreign defence industry involvement. Moreover British firms are ‘easy’ takeover targets due to their listing and often spread ownership.

Underlining the difference, the UK MoD introduced a new procurement system in the eighties, ten years before the formation of OCCAR, aiming to deal with the near domestic monopoly in supplying a wide range of weapon systems. Based on the idea of ‘contested markets’, national monopolies are challenged by foreign suppliers who are routinely invited to tender in order to establish benchmark prices.

The invitation of the Carlyle group to invest in QinetiQ and the awarding of major contracts to e.g. Thales following the acquisition of Racal, further underscore the different character of state-market relations.
**Domestic Patterns of Knowledge Flows – Mediating National Innovation Institutions**

In view of the importance of technology in the Defence industry where R&D activities account for 35 – 40% of turnover in certain segments, the manner in which companies are ‘plugged in’ to national innovation systems constitute and important mediating institution in relation to cross-border consolidation.

Hence a transfer of ownership may imply a loss of privileged access to publicly sponsored basic and applied research. Moreover, different national innovation institutions may inhibit successful integration of a merged company. A company well plugged into a Mission Oriented system may find it difficult to maintain its technological strengths if taken over by a company well enmeshed into a market based Diffusion Oriented system.

Collaborative European procurement, development and production projects such as the Tornado Combat Aircraft, the Eurofighter and the A400M transport plane have an inherent Mission Oriented bias. Lead partners consist of a coalition of firms representing the sponsoring countries and they require complex project management mechanisms encompassing procurement agencies, the group of lead companies and second tier suppliers. They need to balance political aspirations to build upon established national technological strengths and deliver products which are truly European. This implies proprietary solutions and a high level of in-house R&D among the often pre-selected participating companies.

By contrast major US Defence system development have been managed by a single lead company selecting partners on the basis of more commercial criterions such as cost and technological expertise. Although the US Defence market is highly protected, American companies have on occasion sourced on the global technology market.

Hence the Abrams Main Battle Tank of the US army has a German Rheinmetall 120 mm gun as its main armament and its crew is protected by Burlington ceramic armour developed by and licensed from the British Tank research centre at Chobham Common.

While difference between the US and continental Europe are evident, signs of systemic changes can be observed on both sides of the Atlantic.

Hence the formation of EADS brought together the main partners of the ‘Mission Oriented’ civilian Airbus Consortium and a number of equally coordinated cross-national military projects such as the Tiger Attack Helicopter and the aforementioned Tornado. This allowed French, German, Spanish and Dutch Defence projects to be hosted in a single company along American lines.

European collaborative ventures have combined with the rapidly expanding Technology Policy of the European Union and general coordination endeavours in relation to public sector management reform. This has affected funding mechanisms in e.g. public research institutes. Privatised national champions have experienced a re-casting of privileged relations with public knowledge providers in more contractual terms. EU’s framework programmes have also affected knowledge flows across and within borders as projects drawing on partners from several member states and the traditional institutional divides were given priority.
Likewise the Joint Strike Fighter initiated by the US reflects a move towards international collaborative military development, production and procurement. Yet a US based clear lead partner has been signed up and only BAE of the UK has been granted first tier status. For the remaining non-US suppliers, standards and licensing are key parameters of project management.

In spite of these instances of transatlantic congruence, national innovation institutions retain important mediating capacities. Hence in the case of France, specific studies of the defence technology sub-system suggest it has maintained numerous distinctive elements (Serfati, Claude 2000 and 2007). Yet, the model defining character of the French National Innovation System identified by Francois Chesnais (Chesnais, François, 1993) would seem to have instigated a shift away from its core Colbertian properties with the growing utilization of outsourcing of R&D on contract terms. This is in part attributed to pressures of congruence and convergence emanating from Europeanization and Globalization (See e.g. Mason, Geoff, Beltramob, Jean-Paul and Paul, Jean-Jacques, 2004 and Mustar, Philippe and Larédo, Philippe, 2002).

Yet national patterns of knowledge flows remain intact although the mechanisms regulating them have altered (Daffix, Sylvain and Jacquin, Yves, 2009). In this light the defence sub-system finds some shelter in the Mission oriented predisposition of the national system at large.

Studies specifically on the German defence innovation system are rare. Investigations in other sectors suggest a re-configuration has taken place (e.g. Kaiser & Prange, 2004). In essence the German network centric Diffusion model has opened up due to participation in the EU framework programmes and the gradual development of European and global technology service markets. Its inherent openness has been expanded further by growing reliance on standards, contracting and patents. It is not becoming a market based Diffusion system although it embraces certain elements as in the case of France. The collaboration institutions and network ideals of interaction make it very receptive for intrusion by actors willing to commit themselves by investing time and wholeheartedly subscribing to associated epistemic communities.

These mechanisms hovering between state and market has offered an opportunity for concerted participation by members of the highly coordinated French ‘Grand Projects’ which had already engaged in re-inventing their mode of interaction through less hierarchical means.

Evidence from UK suggest the weak traces of a Mission Oriented system has evaporated due to the pull-out of the state as active owners of defence industrial enterprises, an extreme level of consolidation and the growing reliance of major UK defence firms on the US market and the often pervasive alliances they have concluded with American companies.

On aggregate recorded R&D levels have declined and the industry increasingly buys access to key technological insight on the transatlantic market place (Hall, Peter and James, Andrew, 2009). BAE’s acquisition spree in the US has partly been a move to secure access to the world’s most lucrative market for Defence products and partly to obtain access to critical technologies. Hence the UK has amplified it market based Diffusion features in the realm of the defence technology sub-system suggesting congruence towards the US rather than the EU.

**Domestic Mediating Institutions: Foreign Policy Identities**

The break-down of the Cold War order fuelled claims that security threat perceptions changed among the major European powers. In the post cold war environment no powers challenge the...
souvereignty of European states thus diminishing the need for autonomous supply channels in the domain of military hardware.

In an Europeanization perspective, the Common Foreign and Security Policy (CFSP) of the European Union can be seen as institutionalized Franco-German reconciliation and mended Anglo-French rivalry. Pooled regional sovereignty replaces national sovereignty. Regional capabilities suffice and even the most protective European governments increasingly favour efficiency over autarky.

This suggests we are en-route from one world order to another as proposed by George Sørensen (Sørensen, George 2006). Although we may still be in an interregnum period, such a shift entailing new interpretations of sovereignty is indeed feasible from a liberal perspective.

Other indicators of such a transition has been the prominence accorded to humanitarian intervention – sanctioned by appropriate international authorities – and the entailed shift in emphasis from national to human security (See e.g. Finnemore, Martha 2003).

Evidently, such a shift could facilitate cross-border consolidation in ‘sovereignty sensitive’ industries. By contrast Realist analysis emphasise that the cessation of external pressure such as the Soviet threat enhance tension and rivalry among major European powers. Diminishing cohesion was evident in relation to e.g. the US-led Iraqi invasion which brought the major powers of the European Union on collision course.

Similar antagonism had surfaced in relation to the Balkan war where Germany had been quick to grant recognition to Slovenia and Croatia while both Britain and France during the Bosnia conflict were seen as aiding the Serbs by both Germany and the US. In relation to the Middle East Germany adopts a cautious stand vis-á-vis Israel while France on occasion has come out vocally in support of the Arabs and the Palestine cause.

In ideational terms, the demise of a shared threat perception has accentuated previously partially suppressed notions among each of the major three Western European powers depicting the remaining two as the ‘constitutive other’.

An Ideational take on mediating institutions centres on the observation that notions of the character and desirable direction of European integration, rooted in domestic foreign policy identities, differs tremendously and have a rub-off effect on the extent to which the major Western European powers embrace changing perceptions of sovereignty and thus their willingness to share their defence industrial and technological base with each other.

Mediating Ideational Institutions – Divergent Foreign Policy Identities and Strategic Cultures

Germany’s present restraint-based foreign policy identity dates back to the ‘Stunde null’ assertion that Longhurst identifies as a key historical rupture in German foreign policy. From this followed that the use of force in foreign policy was no longer a justifiable tool. Instead the country has sought to advance regional stability through consensus and institution building (Duffield,1998). Moreover militarism and the pride associated to soldiering have been defamed as has indeed the notion of nationalism and statism (Longhurst 2004 P. 46).
Yet, according to Stahl et. al. (Stahl et. al. 2004), there are opposing identity elements in the contemporary German foreign policy discourse. While all framed by the above general identity template, they carry important implications for more tangible Foreign Policy Standpoints. One of the identity elements is denoted ‘Restraint’ and the other ‘Normalization’ (Stahl et. al. 2004 P. 433).

The ‘Restraint’ discourse cautions policy makers to observe the memories of World War II militarism in neighbouring countries prompting a low key foreign policy precluding muscle flexing. The ‘Normalization’ discourse, likewise embedded in multilateralism, institution and consensus building in addition to other civilian power virtues, does allow room for Germany to partake in international corporation in a manner enabling the country to pursue a national interest and to contribute with military capabilities in joint operations (Reinhard, 2004).

The wider template of French External Sovereignty is rooted in a shared domestic belief portraying the country as a great power which has engaged in Europe to counter-balance super-power domination. This self-image has also emphasised the role of the state in retaining territorial integrity and national cohesion. This ‘patrie-état-nation’ element hovers between External and Internal Sovereignty, but it is quite illustrative of the role of the state in French society. It has furthermore been extended to former parts of the empire seeking secession in part explaining the particular ferocity of French colonial wars.

As in the case of Germany, France harbours contending identity elements which are all embedded in the above template. Stahl et. al. identifies three positions: a rather weak Idealist stance and the stronger Realist-Autonomous and Realist-European positions. The Idealist position sees Europe as France’s destiny and generally advocates an image of ‘European France’. By contrast the Realist-Autonomous discourse calls for France to pursue it fortunes and engage in European collaboration only when its serves to expand the influence of the country. The in between Realist-European position considers Europe as the only viable channel through which US hegemony can be balanced (Stahl et. al. 2004 P. 437-38). It is thus most likely to provide legitimacy for hard security policy collaboration including an Europeanization of the Defence-Industrial base.

Great Britain resides on islands cut off from continental Europe. This has contributed to the country’s External Sovereignty perception. Hence the wider framework of this aspect of Strategic Culture emphasise Britain’s Global role and commitment to keeping trade lanes open, the special relationship with the USA and a scepticism towards Franco-German security initiatives. In the Europeanist-Atlanticist debacle, Britain is clearly learning towards the former (Miskimmon 2004).

This has indeed also been defined as the nexus around which contending UK foreign policy identities evolve. Writing during Operation Desert Storm, William Wallace identified an ‘Anglo-Saxon exceptionalism’ position and a ‘European’ position (Wallace 1991). The ‘Myth of Anglo-Saxondom, according to Wallace, was nourished by the Civil War and threats of Catholic absolutism from France and Spain producing an image of the free Britain opposed to the unfree continent (Wallace 1991 P. 70). Vis-à-vis Europe Britain should choose ‘Splendid Isolation’ while blessing the remainder of the Globe, in unison with the US, with morally superior institutions such as the civil liberties of the Magna Charta, the doctrine of Common Law and Parliamentary Sovereignty.

A European position, however, can also be observed. It departs from a sense of semblance with Protestant Northern Europe and a growing recognition of the imbalanced and no longer that special-
relationship with the US. Prominent proponents of this view in British policy circles included former defence minister Michael Hesseltine who resigned his post when Helicopter manufacturer Westland was sold to American Sikovsky rather than joining a European consortium. On balance, however, the ‘Anglo-Saxon exceptionalism’ would seem far more embedded in British policy circles then the European perspective although the presence of the latter occasionally can be observed as was the case of the St. Malo summit and the resultant declarations.

How may these identities/strategic cultures serve as mediating institutions in relation to Defence industry consolidation? Starting with Germany her Strategic Culture – or foreign policy identity – offers little in the way of political support for retaining or developing an indigenous military industrial base. The ‘Normalization’ discourse could, however, make a case for retaining national control over the Defence Industry.

In a French context the Strategic Culture would either support a full Europeanization of the industry when assessed from the somewhat marginal idealist view or creating balanced entities leaving equitable amounts of national control to all contributors when viewed from the Realist-European perspective. The Realist-Autonomous perspective could see cross-border consolidation as a means to achieve industrial domination. Hence France should contribute to common industrial entities only when the country assumes a disproportional high level of control.

In Britain the Anglo-Saxon exceptionalism discourse makes state orchestrated endeavours to further European consolidation unlikely. For a start the state is biased towards an arms-length approach to industrial restructuring. Secondly the current process is perceived as a Franco-German led initiative. Moreover, the transatlantic disposition of UK industry which benefits from navigating in a North American business system more akin to their domestic realm then conditions in continental Europe may be viewed favourably by Whitehall as it confirms the special relationship myth which is indeed underlined by the privileged access to the US defence market of BAE and Rolls Royce. Occasionally, however, a European theme cracks this pattern as was the case with the Westland affair in the eighties and British political commitments in St. Malo and onwards.

Conclusions
This paper started by observing that the UK is more permissive in allowing foreign firms to acquire national defence companies – this tolerance also extends to US companies. At the same time BAE has been a very active investor in the US. By contrast continental consolidation has proceeded as ‘mergers of equal’ – a corporate equivalent to ‘pooled sovereignty’!

These different domestic responses to Globalization and Europeanization have been attributed to the effects of domestic mediating institutions. Three sets of mediating institutions have been investigated. They are: ownership patterns, innovation systems and foreign policy identities.

Different dominant ownership patterns predispose continental firms to create ‘mergers of equals’. Germany’s negotiated approach to M&A and French state involvement in the sector has paved the way for e.g. the formation of the EADS.

British firms may partake in the cross-border consolidation process mainly as targets for acquisitions. Second tier UK defence companies are fairly easy to acquire for continental firms as they are usually publicly listed. Major UK Defence companies are barred from entering state dominated continental entities such as Thales and EADS.
Domestic innovation institutions predispose companies towards either: making or buying technology; partaking in developing proprietary technologies or employing standards using licensed patents; and relying on either centralized complex project managements mechanisms, public-private diffusion networks or the market place in framing knowledge flows.

A partial mainstreaming of military innovation sub-systems can be observed. The French system appears increasingly compatible with the German system combining networked diffusion mechanisms with Mission Oriented traits. By contrast the UK system is leaning towards the US amplifying its market based Diffusion Orientation. This may help explain the high occurrence of consolidation in the very R&D intensive aerospace sector involving French and German firms.

In linking foreign policy identities with domestic responses to cross-border consolidation, findings for Germany suggest little in the way of political support for retaining or developing an indigenous military industrial base. The ‘Normalization’ discourse could, however, make a case for retaining some control of the industry. France either supports a full Europeanization of the industry when assessed from the somewhat marginal idealist view or creating balanced entities leaving equitable amounts of national control to all contributors when viewed from the Realist-European perspective.

The Realist-Autonomous perspective could see cross-border consolidation as a means to achieve industrial domination. Hence France should contribute to common industrial entities only when the country assumes a disproportional high level of control. Combining this with the German Restraint identity may help explain the enduring momentum of Franco-German collaboration.

In Britain Anglo-Saxon exceptionalism makes state efforts to further European consolidation unlikely. The transatlantic disposition of the UK confirms the special relationship myth which is indeed underlined by the privileged access to the US defence market of BAE and Rolls Royce.
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