

Eugene Kogan

The European Union Defence Industry and the Appeal of the Chinese Market



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Defence Industry and the
Appeal of the Chinese Market**

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Vorwort

Die Europäische Union hält sich nicht so streng, wie sie vorgibt, an das Waffenembargo gegen die Volksrepublik China, das die EU am 26. Juni 1989 aus Protest gegen das Vorgehen der chinesischen Führung am 4. Juni gegen Anhänger der chinesischen Demokratiebewegung am Platz des himmlischen Friedens verhängt hatte. Eugene Kogan will mit dieser Analyse dokumentieren, dass das Embargo nicht überprüft und durchgesetzt wird.

Die Rüstungsexporteure liefern keine ganzen Waffensysteme, sondern Dual-use-Technik oder nicht-letale Rüstungsgüter wie etwa Radarsysteme, Flugzeugtriebwerke, Kommunikationssysteme oder Satellitentechnologie. Elektronische Ausrüstung des Westens ist für die chinesische Luftfahrt- und Verteidigungsindustrie von großem Nutzen, weil China gerade hier große Defizite hat. Diese Komponenten können von China dann für eigene Zwecke genutzt und verbessert werden.

In Zeiten sinkender Verteidigungsbudgets wird der chinesische Markt für die europäische Rüstungsindustrie immer interessanter. Darüber hinaus bemüht sich auch die kommerzielle europäische Luftfahrtindustrie um China, das der größte Markt für diese Produkte zu werden verspricht. Frankreich und Deutschland werden auf die damit verbundenen Chancen nicht verzichten wollen und die anderen EU-Mitgliedsstaaten weiter drängen, das Rüstungsembargo zu beenden. Welche Konsequenzen eine Aufhebung des Embargos für die Länder der asiatisch-pazifischen Region, insbesondere für jene an der Straße von Taiwan hätte, wäre noch gesondert zu untersuchen. Eine entsprechende Expertise des Büros für Sicherheitspolitik wird demnächst veröffentlicht.

Bei all dem geht es aber nicht nur um das Exportgeschäft. Wie Willem van der Geest, Direktor des Brüsseler European Institute for Asian Studies betonte, sind die Bemühungen, das Embargo zu beenden, jenseits der kommerziellen Ambitionen zu einem Symbol für die Anstrengungen der EU geworden, ihre Beziehungen zu China, das sie als einen „strategischen Partner“ betrachtet, zu vertiefen. Jeder Rückschritt in dieser Frage wäre ein Rückschlag für die unionseuropäisch-chinesischen Beziehungen. Das hätten die europäischen Staatschefs verstanden und auch stillschweigend akzeptiert.

Walter Matyas

Key Points

- The European Union's (EU) arms embargo on China is not adhered to as rigorously as the EU likes to make it out. The embargo as such has not been enforced and the EU official data for the years 2001-2003 cited in this report prove this to be true.
- There is no doubt that, despite the EU partial arms embargo, France, Italy and the United Kingdom (UK) remained the champions of arms exports to China under special licences. Although EU member states have agreed to provide data on both export licences and actual arms exports, the data cited in this report only refer to values of arms export licences to China, as approved by named EU countries. It has to be emphasised that the newspapers cited in the report tend, incorrectly so, to cite the data as coming from both sources, whereas the available data concern the values of arms export licences only.
- Though the proponents of arms export licences to China did not deliver major weapons systems, such as advanced fighter aircraft and submarines, they did deliver some of the niche products (also called dual-use technology goods or non-lethal defence goods)¹, such as radar systems, aero-engines, communications systems and even satellite technology. Obtaining Western electronic equipment is a real boon for the Chinese aerospace and defence industry, because it allows it to get a good look at equipment the country is still lacking. Furthermore, once the equipment is delivered, aerospace and defence industry workers can take it apart (reverse engineer it) and enhance its quality. In this respect the reactions of the Chinese aerospace and defence industry work force is similar to that of the work force in the Former Soviet Union (FSU). It aims at understanding the nature of the electronic equipment and subsequently enhancing it by inserting components built in China. In addition, for the Chinese armed forces every bit of sophisticated Western electronic equipment is important, because it increases China's military power.
- At a time of shrinking European defence budgets that are unlikely to increase over the next five years, the Chinese market is becoming increasingly appealing. In addition, Western prognoses for commercial aviation are focusing primarily on China to become the largest market ever. The commercial and military opportunities for European companies in China are huge. As a result, neither

¹ The author is using all three definitions throughout the report.

the French government nor the German government, in particular, will let such an opportunity slip away. The governments of both countries will continue to pursue their case and put pressure on the governments of the other EU member states to get a unanimous agreement on lifting the arms embargo.

- There is, however, much more at stake with such a decision than whether or not to sell French fighter craft or German submarines to China – namely, creating broader commercial ties and establishing genuine diplomacy. In the words of Willem van der Geest, the director of the Brussels-based European Institute for Asian Studies, “beyond commerce, lifting the embargo had become a symbol of the European Union’s effort to deepen its relationship with China, which it views as a strategic partner”. He added that “going back on this would be a major setback to EU-China relations”², which is something that EU heads of state clearly understand and tacitly approve of.
- Although the consequences of lifting the arms embargo on countries in the Asia-Pacific region and, in particular, the Taiwan Strait are not addressed here, it should be emphasised that that issue, by and large, overshadows all other issues. A study of it would need to be carefully balanced and analysed in the broader context of lifting the arms embargo, but that would require a separate study.

Introduction

This report deals exclusively with the European Union and the People’s Republic of China (PRC, also known as China) and not with a broader range of issues, such as, for instance, the impact of an embargo lift on the Asia-Pacific balance of power or on the Trans-Atlantic relations. The concerns of countries, such as Australia, Japan, South Korea and, undoubtedly, Taiwan are a very important issue. However, this report sets out to deal exclusively with the EU-China issue. Nevertheless, one can say that, for instance, the delivery of the airborne early-warning and control system (AWACS) to China would considerably change the balance of power in the Asia-Pacific region and exacerbate already strained Trans-Atlantic relations. The US will face the serious dilemma of how to deal with the EU over such deliveries to China, since the EU is their partner and not a subordinate as Israel is, for instance.

Israel and Russia are likely to be immediately affected by an embargo lift, since both countries have been, and still are, the main exporters of military hardware to China. Russia, at least will be dealt with indirectly in this report,

² International Herald Tribune, 24 February 2005.

since China is likely to play the EU and Russia off against each other, in order to reduce costs. Israel is important, but it is a fairly minor player compared to both the EU and Russia. Furthermore, Israel would need the approval of Washington for a potential delivery of, for instance, electronic warfare (EW) equipment to China. This is something that the Chinese leadership has already learned the hard way from Israel's failed attempt to export the Israeli-manufactured Phalcon AWACS to China. As a result, the Chinese leadership will not repeat the mistake of ordering EW equipment from Israel.

At the same time, the single-minded focus on the issue of arms exports and lifting the arms embargo on China overshadows the importance of other issues related to the relationship between the EU and China. EU policies regarding China need to be carefully balanced and analysed in the broader context of supplying China with a large variety of commercial goods, dual-use technology products and military hardware. In addition, the participation of EU member states in tendering for infrastructure projects, such as high-speed trains, civil engineering projects, and the construction of nuclear power plants is part and parcel of EU's long-term programme. The present paper will attempt to deal with a variety of complex issues EU member states have been pursuing since they initiated the arms embargo on China in summer 1989, with particular emphasis on EU defence industry interests, both commercial and military. The issue of the so-called EU Code of Conduct on Arms Exports (also known as the Code of Conduct) will be dealt with extensively but not exclusively. The Code of Conduct is full of contradictions, open to a variety of interpretations, and not legally binding. According to an arms policy official from one of EU's smaller member states, "the Code of Conduct remains a far cry from enforceable law". He adds, „talk to ten different EU-law experts and you get ten different opinions about whether the code can be made binding". "And not one of them says unequivocally: Yes."³

It is important to emphasise that selling arms to China is not exclusively an issue of three of the six leading EU arms producers, namely France, Italy and the United Kingdom. Spain and Sweden, unlike these three, have refrained from selling arms to China. On the other hand, Austria and Germany have granted small arms licence approvals. In April 2004 the import-export company Omnipol of the Czech Republic (which joined the EU on 1 May 2004) tried to sell Vera-E passive surveillance systems (PSSs) to China, which failed, as a result of intense

³ Defense News, 28 February 2005, 6.

domestic and international pressure, particularly by the United States.⁴ This paper will examine the niche products that the EU member states have delivered and/or are going to deliver to China, when the embargo is lifted. As the editorial in *Defense News* noted, France, Italy and the UK are leading in Europe in exporting small quantities of ‘non-lethal’ defence goods, such as radar and electronic warfare systems, radios and the like. Although radar and electronic warfare systems do not of themselves blow things up, they certainly make it easier for Chinese troops to do that.⁵ And, in case of a possible conflict in the Taiwan Strait, such ‘non-lethal’ defence goods are likely to be as crucial as, for instance, military aircraft, helicopters, and submarines.

There is a common line of defence put forward by EU countries that advocate lifting the arms embargo, arguing that lifting the embargo would not per se lead to a radical change in the strategic balance in the Asia-Pacific region, because arms exports would still be barred under a separate Code of Conduct and national regulations. The regulations in Germany, for instance, are stricter than those in France and the United Kingdom. Such an assertion is not based on substantial arguments, however, and, therefore, needs to be taken with scepticism. What if the arms export licences for China substantially increase once the embargo is lifted? A scenario like that is very realistic, because the arms embargo has, in fact, proved to be ineffectual and inefficient (see below.)

The 2001 export licences approved for China totalled €54.4 million.⁶ The 2002 level of export licences to China shows a “slight” rise from that of 2001.⁷ *It was certainly a steep rise from €54.4 million to €210 million* (author’s emphasis). However, the EU almost doubled its arms export licences approved for China between 2002 and 2003. The EU’s own annual report on arms exports shows that the value of EU licences to sell arms to China totalled €416 million in 2003 as opposed to €210 million in 2002. The main arms exporters that were listed in the EU report included France, Italy and the UK. As a result, questions can be raised about EU’s insistence that it has no intention of increasing these sales once it lifts its arms embargo on China. A EU diplomat admitted that, “it is difficult to say that we will lift the embargo but not increase sales”.⁸ Based on the figures mentioned above, one could predict that the value of EU licences to sell arms to China would

4 Jane’s Defence Weekly, 28 April 2004, 20-21; <<http://www.defensenews.com/story.php?F=2937448&C=Europe>>; Flight International, 1-7 June 2004, 15; 28 September-4 October 2004, 18; European Voice, 7 October 2004; Jane’s Defence Weekly, 20 October 2004, 28.

5 12 July 2004, 42.

6 Süddeutsche Zeitung, 8 February 2005.

7 Aviation Week and Space Technology, 25 October 2004, 82.

8 Financial Times, 19 January 2005.

increase to something between €500 million and €600 million in 2004.

Although the will of the governments will ultimately determine whether the partial embargo is lifted or retained, it is nonetheless important to underline that in all EU member states the political oppositions of whatever political affiliation were, and still are, against this process. In addition, various EU institutions, such as the European Parliament, the European Commission (EC), non-governmental organisations (NGOs) and Human Rights in China have been trying to prevent that the embargo is lifted and have sharply criticised the Code of Conduct. There is no consensus within the European institutions with regard to lifting the embargo and the efficacy of the EU Code of Conduct. Furthermore, any decision to lift the arms embargo would need the unanimous agreement of all EU member states. Yet, as Robin Niblett, the executive vice president of the Washington-based Centre for Strategic and International Studies (CSIS) and director of the CSIS Europe Programme noted, if a critical mass of EU members publicly starts campaigning for lifting the embargo, only few of the remaining members will want to stick out as active opponents. Once that critical mass starts to speak out, a decision could be arrived at quickly,⁹ as was envisioned and hoped for by President Jacques Chirac and Chancellor Gerhard Schroeder. So far, this has not happened, but it certainly will, and sooner rather than later.

In addition to the opinion of the critical mass, domestic pressure from EU's six leading defence industries to lift the embargo has been growing. EU arms producers have been feeling the pressure of the limitations of export opportunities, as a result of shrinking arms markets and Russia's unrestricted arms sales to China. They are tired of watching Russia take advantage of Europe's reticence. As Joakim Kreutz noted in his article, several French companies tied to the Galileo satellite navigation project, such as the Snecma group and the European Aeronautic Defence and Space Company (EADS), lobbied for the removal of the arms embargo, on the grounds that it could complicate relations with a partner (namely China) within the project. Most outspoken was Philippe Camus, co-chief executive of EADS, who claimed that the embargo was "a remnant of the Cold War" and complained that the previous successes of Franco-Chinese aerospace co-operation in the 1980s had been ruined by the embargo.¹⁰

Aviation Week and Space Technology reported that European industry officials estimated that, in the short term, China could need over €10 billion worth of

⁹ 'The United States, the European Union, and lifting the arms embargo on China', *Euro-Focus*, 10:3 (30 September 2004), 2; *International Herald Tribune*, 18 March 2005.

¹⁰ 'Reviewing the EU arms embargo on China: the clash between value and rationale in the European security strategy', *Perspectives*, 22 (Summer 2004), 48.

defence hardware, primarily in the area of communications, automation and information systems. However, other niche requirements, such as unmanned aerial vehicles (UAVs), trainers and light combat/utility helicopters, could also be required.¹¹ Since 1989 the EU has lost its military sales to Russia, as a result of its arms embargo, but it is not likely to be willing to lose again this time.

The *International Herald Tribune* reported that the Chinese government is deliberating whether to buy a French, German or Japanese high-speed train for its new Beijing-Shanghai link. If Alstom's Très Grand Vitesse (TGV) train wins out against Germany's Inter City Express (ICE) and Japan's Shinkansen, it would not only mean a contract worth as much as €12 billion, but also the prospect of more lucrative deals in the future. According to the French Trade Minister Francois Loos "the Chinese government plans to build 20,000 kilometres worth of rail tracks in coming decades". Thus, the stakes in China are high, to say the least.¹² Although it was announced in early 2005 that Japan was the winner, there is public resistance to that decision in China. The Ministry of the Railroad argues that the Japanese technology is tested and reliable, but there is a growing political rift between both countries, which is likely to affect the final decision.

1. The European Union's Arms Embargo on China

1.1. Background of the Imposition of the Arms Embargo

On 6 June 1989, the twelve members of the EU jointly condemned China, and some other countries imposed bilateral sanctions. Belgium, Germany and Italy suspended aid, grants, and loans *but did not impose an arms embargo* (author's emphasis), while the United Kingdom did. At the next European Council meeting in Madrid on 27 June 1989, the Ministers agreed to impose a number of EU-wide diplomatic and economic sanctions, including an arms embargo.¹³ The EU embargo is somewhat vague on what is included and, as a result, it has been interpreted differently by individual EU member states. The EU Declaration on China, the European Council document issued in the wake of the violence in Tiananmen Square, only called for an "interruption" of military co-operation and an embargo on trade in arms with

¹¹ 25 October 2004, 82.

¹² 5 October 2004.

¹³ J. Kreutz, 'Reviewing', 46.

China.¹⁴ The declaration does not define the meaning of the term “military co-operation” nor does it contain a list of arms within the scope of the phrase “trade in arms”. Nor does it contain exceptions or review clauses.

Since the arms embargo against China was imposed it has not been interpreted uniformly by the EU member states. This has been attributed to several factors, including the lack of specificity in the political declaration, the absence of a legally binding document, such as a Common Position, as is the case with subsequent embargoes imposed on other countries and, more importantly, the existing loopholes and weak points in the EU arms control system.¹⁵

Because there was no common list of embargoed goods, the embargo never became EU coherent in its implementation and scope, especially in relation to arms agreements that were already in place. This led to a *de facto* continuation of arms sales from EU member states to China, but the political impact of the embargo led to a general restraint with regard to signing new contracts.¹⁶

For instance, in 1995, the British government made it explicit that according to its interpretation, what was banned included: lethal weapons, such as machine guns, large calibre weapons, bombs, torpedoes, rockets and missiles; specially designed components of the above, and ammunition; military aircraft and helicopters, vessels of war, armoured fighting vehicles and other such weapons platforms, and any equipment which is likely to be used for internal repression.¹⁷

Any decision to lift the arms embargo would need the unanimous agreement of all EU member states. The process itself could take place at the European Council, a

¹⁴ J. Hill, ‘Europe considers ending Chinese arms embargo’, *Jane’s Intelligence Review* (June 2004), 54.

¹⁵ R. Grimmert, ‘European Union’s arms control regime and arms exports to China: Background and legal analysis’, CRS Report for Congress, 1 March 2005, CRS-4, see <<http://www.fas.org/sgp/crs/row/RL32785.pdf>>. An EU Common Position was discussed during the 2004 EU Code of Conduct on Arms Exports review.

¹⁶ J. Kreutz, ‘Reviewing’, 46-47. *Frankfurter Allgemeine Zeitung* (FAZ), 10 May 2004. Kreutz statement is not accurate. For information on arms exports licences with the embargo in place, see Chapter 3.1.

¹⁷ J. Hill, ‘Europe’, 54-55. For the British arms exports licences for China, see Chapter 3.1 and particularly note 66.

meeting of EU heads of state, or at the monthly meetings of the foreign ministers.¹⁸

The suggestion by embargo opponents, that lifting it would not necessarily lead to European arms sales to China, is simply disingenuous. It is true that some, perhaps even most, European countries would continue to hesitate to sell weapons to such a regime, in the spirit of the EU Code of Conduct on Arms Exports. Unfortunately, it is equally clear that certain EU governments are eager to begin sales immediately, which will surely prompt arms makers in other countries to lobby in their governments to follow suit.¹⁹ Although this explanation may sound simplistic, it is accurate.

Another EU policy that would influence possible arms trades with China and be likely to replace the partial arms embargo is the 1998 Code of Conduct on Arms Exports. Reviews of the latter were started in early 2004 and are still ongoing. The EU has promised not to lift the embargo until it has strengthened its Code of Conduct on Arms Exports and introduced a transitional regime for recently embargoed nations.²⁰ France is reluctant to provide more details on arms export licences it grants, but instead just cites those it rejects.²¹ The French reservations are well known and they are likely to pose a serious problem to arms exports to China under licences, even under stricter Code regulations. (For current arms exports to China under licence, see Chapter 3.1.)

Hopefully the arms embargo's inherent problems will not be repeated in a stricter Code of Conduct, though there is, currently, no way of telling, as it is still under review.

¹⁸ J. Hill, 'Europe', 55. <<http://www.defensenews.com/story.php?F=3070863&C=Europe>>; International Herald Tribune, 4 August 2004. There is an interesting nuance related to the EU arms embargo on China. According to Joakim Kreutz, the arms embargo on China is based on the Joint Statement of 1989 and, as a result, this suggests that there is no EU arms embargo in place against China, but rather an EU-wide set of national arms embargoes. These are implemented unilaterally to different extents, meaning that the key actors in decisions regarding the embargo are the individual member states. In practice, however, the member states have officially concluded that the removal of the embargo must be done as a common EU-wide action. 'Reviewing', 45.

¹⁹ Financial Times, 1 October 2004.

²⁰ Idem; 22 January 2005; <<http://www.defensenews.com/story.php?F=648609&C=Europe>>.

²¹ Idem; 5 December 2004; <<http://www.kommersant.ru/index-news.html?ext=news&id=84965&newsrubric=0&page...>>; Space News International, 14 February 2005, 19.

1.2. The EU Code of Conduct on Arms Exports

The Stockholm International Peace Research Institute (SIPRI) Yearbook 1999 noted that on 25 May 1998 the EU member states adopted a common Code of Conduct on Arms Exports, outlining general principles and guidelines for future exports of military equipment.²² Although the final version of the code is not much more than a restatement of the Common Criteria agreed upon in 1991 and 1992, there are a couple of differences. The most obvious is that the Code asks EU members to notify each other of export refusals. A second difference is that it is clearly intended to be a first step in a process towards the creation of common export regulations. In addition to eight criteria for arms exports, there are several “operative provisions” for further developing the code. The most important of these is that all EU members will provide an annual report on their arms exports and the national implementation of the Code. These reports will be discussed at an annual meeting within the framework of the EU Common Foreign and Security Policy (CFSP). During these meetings the development of the Code will also be on the agenda, thereby creating an institutionalised process of review and discussion, instead of ad hoc initiatives. The Code also specifically mentions the need for a “common list of military equipment” to which it would apply.²³

The eight criteria of the Code, which are to be applied by EU members when reviewing licence requests and making decisions as to whether or not to effect an arms export can briefly be summarised as follows:

- (1) consistency of export with the exporter’s international commitments arising from UN, EU, or Organisation for Security and Co-operation in Europe (OSCE) arms embargoes;
- (2) risk that export would be used for internal repression or where the recipient country has engaged in serious violations of human rights;
- (3) risk that export would provoke or prolong armed conflicts;
- (4) risk of recipient using export to undermine regional peace and stability;
- (5) effect of export on defence and national security interests of friends and allies;
- (6) commitment of purchaser to fight terrorism and uphold international law;

²² SIPRI Yearbook 1999: Armaments, Disarmament and International Security. Oxford: Oxford University Press, 1999, 439. For earlier drafts discussion, see *Ibid.* For the complete text of the EU Code of Conduct on Arms Exports, see *Idem*; Appendix 11D, 503-505.

²³ *Ibid.*; 440. For further clarification of the mentioned above distinctions, see R. Grimmett, ‘European Union’s’; CRS-7-CRS-8.

- (7) risk of diversion to third parties or to a terrorist organisation;
- (8) risk that export would undermine the sustainable development of the recipient country.

It is important to emphasise that these eight criteria, and the EU Code of Conduct on Arms Exports in its entirety, are political statements by the European Union, and *not legally binding* for the member states of the EU. No matter how strong the language of purpose and intent of the Code's eight criteria, the twelve Operative Provisions of the Code – those sections that set out the manner in which the Code is to be carried out – contain significant loopholes that militate against it as a strong regime for the control of conventional arms exports from EU member states. This circumstance is illustrated by the examples²⁴ presented in the following chapter.

Despite clearly articulated reservations related to the Code of Conduct, it is important as it specifies eight criteria that EU member states should take into account before authorising arms export licences, several of which are relevant for exports to China. These include the use of arms by the recipient country for internal repression and the respect for human rights (2); the danger that the sale might negatively affect regional peace and stability (4); the risk that the export might negatively affect the security of allied and friendly countries (5); and the likelihood that the buyer re-exports the product (7). The criteria relevant for exports to China that are emphasised here differ from the criteria underlined by Gudrun Wacker from the Stiftung Wissenschaft und Politik (SWP). Wacker anticipates that the second and fourth criterion (human rights and regional stability) would be of special relevance if the embargo on China were to be lifted.²⁵

1.3. Difficulties and Challenges Ahead

1. While each EU member state is to review export licence applications on a case-by-case basis, weighed against the eight specific criteria of the EU Code of Conduct, Operative Provision 3 of the Code expressly states that, “The decision to transfer or deny the transfer of any item of military equipment will remain at the national discretion of each Member State.” Thus, each EU member state is free to effect an arms sale based on its own judgement of whether or not it is appropriate.

²⁴ R. Grimm, *European Union's*; CRS-6-CRS-7.

²⁵ G. Wacker, *Should the EU arms embargo against China be lifted?*, SWP Comments 4 (April 2004), 5.

2. Operative Provision 10 provides additional guidance to member states for applying the EU Code of Conduct. It states, “It is recognised that Member States, where appropriate, may also take into account the effect of proposed exports on their economic, social, commercial and industrial interests, but that these factors will not affect the application of the above criteria”. A literal interpretation of this could mean that adopters of the EU Code of Conduct recognised that national economic or commercial interests would weigh heavily in the decision-making process regarding any given arms sale, and may even trump the broader EU-wide interest in restricting problematic arms exports. Yet in the same sentence the provision states that, while own national economic interests may compel a member state to sell, it is expected not to do so, in order to remain true to the principles of the EU Code of Conduct.
3. Broader oversight within the Code is provided by Operative Provision 8, which requires that a *confidential* annual report dealing with defence exports and the implementation of the Code of Conduct be circulated by each EU member state to the other EU member states. These reports are to be discussed at an annual meeting, where the Code is reviewed and recommendations for “improvements” can be submitted to the EU Council. Subsequently, a report based on the individual reports of the EU members is published. This report does, however, not contain all details of *actual arms exports* made by EU member states, although the published annual reports made pursuant to Operative Provision 8 of the Code do provide values of arms export licences issued and the values of the deliveries made. A supplier list is also provided, indicating the total of sales denials without *specifying them* nor indicating to whom they were denied. Individual states are free to provide as many details in their national reports as they choose. Most have taken a minimalist approach.²⁶

While a number of gaps are directly addressed in the operative provisions, other problems will have to be negotiated at the annual meetings or elsewhere. The issue of what to do, if one EU country wants to grant an export licence to a country to which another EU country has already refused permission, has been a bone of contention and remains unresolved. The Code also fails to address the problem of ‘post-delivery controls’ by means of verifying end-user certificates, controlling the actual use of the delivered equipment, or issuing licences for the production of

²⁶ R. Grimmett, ‘European Union’s’; CRS-7-CRS-8.

equipment developed in an EU member state though produced elsewhere.²⁷

Amnesty International (AI) considers it essential to tighten the Code. While several EU member states are of the opinion that the Code will serve as a 'safeguard' if the embargo is lifted, AI believes that, as things stand now, it falls short of providing sufficient guarantees. Robert Parker of AI pinpointed the shortcomings of the Code: Its criteria are too vague and subject to different interpretations by EU member states, its scope is too restricted, there is not enough transparency and it is not legally binding. According to Parker, several member states, notably Austria, Finland, France, Germany, Italy, Spain and the UK would continue to export arms to China, despite the embargo.²⁸

The newly published report, prepared by the European Parliament Committee on Foreign Affairs, argues for tightening the six-year old EU Code of Conduct on Arms Exports and clamping down on European arms brokers who operate through third countries. The report calls on the European Council to tighten the code's language in order to avoid misinterpretation by national governments. The Code's current wording "is leading to diverging interpretations" and its export criteria demand clarification "to ensure [that] they fully reflect" the responsibilities of EU member countries under international law.

In recent years, the Code has come under increasing criticism by Members of the European Parliament (MEPs), European Commission officials and non-governmental organisations, because its pan-EU export-licence notification rules are voluntary and allow too many arms exports to escape notification. The European Council wants to have the Code amended by the end of December 2004.

During the committee meeting a number of MEPs argued for making the Code legally binding but their amendment suggestions were rejected, in view of the deep split between the national governments over whether they would act the same way. The issue of making the Code legally binding, however, could surface in December 2004, when the Council's draft changes are finished.²⁹ So far, the draft amendments are not finalised.

²⁷ SIPRI Yearbook; 440. For the proposed changes in the EU Code of Conduct on Arms Exports, see S. Bauer and M. Bromley, 'The European Union Code of Conduct on Arms Exports: Improving the Annual Report'. SIPRI Policy Paper, 8 (November 2004). See in particular section 4: Recommendations, 32-33, and pay particular attention to paragraphs 4 and 6. See <<http://www.sipri.org/contents/armstrad/PP8>>.

²⁸ Europe (Bruxelles), 15 April 2004.

²⁹ <<http://www.defensenews.com/story.php?F=448162&C=Europe>>; <<http://www.defensenews.com/story.php?F=508851&C=Europe>>; International Herald Tribune, 8 October 2004; <<http://www.defensenews.com/story.php?F=507633&C=asiapac>>; Europe (Bruxelles), 19 November 2004; Financial Times, 23 November 2004; Frankfurter Rundschau, 7 December 2004.

According to internet sources, the Dutch Minister of Foreign Affairs, Bernard Bot, said that the EU needs more time to strengthen its Code of Conduct on Arms Exports. Adherence to the Code is optional and based on each member state's willingness to inform all other members before exporting weapons or components to a specified country. Bot further said that the twenty-five governments are reviewing means of applying the Code to countries such as China, where the ban may be lifted. The Hague wants to accelerate the work to enable EU leaders to discuss the weapons ban on China in December 2004.³⁰

According to EU sources, the changes will include clearer rules on arms brokering and notification of weapons trans-shipments as well as new guidelines for assessing the political and economic impact of arms exports to developing countries. However, EU officials said that the optional Code would not become a legally binding document in the foreseeable future, despite pressure from the European Parliament and NGOs.

In a separate, but related, review by the Council of Ministers, new guidelines on Criterion 8, which concern arms exports to developing and unstable regions, are due to be finalised in December 2004. The new Criterion 8 guidelines set forth a two-stage filter system to identify arms export requests from developing countries. They also define a set of macro-economic variables, or development indicators, to assess whether the request is justified. They also look at the gross domestic product (GDP), state control over arms imports, and the risk of having the imported weapons end up in other hands.³¹ So far, the new guidelines have not been finalised.

The new Code of Conduct would require transparency in arms sales, so that EU members, the EU itself, or other countries concerned would have the opportunity to object to a potential sale. It would oblige EU member states to take human rights, the potential impact of a sale on regional security, and the potential of technology re-export into account, before authorising export licences and to certify in writing that all these conditions have been met. It would also oblige them not to sell weapons systems to China, not to provide the technologies to upgrade its military capabilities significantly³², and not to provide dual-use technologies with significant military application. The latter point is not only crucial but imperative and will be discussed in Chapters 3.2 and 3.3.

³⁰ <<http://www.defensenews.com/story.php?F=445968&C=Europe>>. The issue of strengthening the Code of Conduct was earlier discussed by Frank Umbach, 'EU's links with China pose new threat to transatlantic relations', *European Affairs*, 5:2 (Spring 2004), 45; <<http://www.defensenews.com/story.php?F=2972855&C=America>>.

³¹ *Defense News*, 15 November 2004, 23; <<http://www.defensenews.com/php.story?F=507633&C=Europe>>; *International Herald Tribune*, 26-27 February 2005.

³² *International Herald Tribune*, 18 March 2005.

A tighter Code of Conduct could prevent different interpretations and reduce weapons sales. Security experts say that despite months of negotiations among the member states over how to improve the Code, it is still open to different interpretations as to how it can be applied. Also annual reporting is regarded as insufficiently rigorous and transparent. Mark Bromley, arms transfer expert at SIPRI noted that the Code of Conduct is based on the principle that you should share information with other member states when you deny an export licence to a company and added that “the information on when a positive decision is given is not very detailed.” Tomas Valasek, director of the Brussels-based independent Centre for Defence Information said, “If the Code of Conduct is to have any real value in limiting and checking arms exports to China, then it is crucial to close the leaks in the code as far as possible. This means putting in place a system that requires maximum accountability and transparency by all member states – not only how they report to each other but also to their parliaments.” Bromley, however, said some EU countries, such as France, were hesitant about sharing very detailed information when a positive decision was made, partly because of company confidentiality. British officials conceded that it would be difficult to close all the loopholes. One official, however, said that “we should use the leverage of lifting the arms embargo, so as to get long-term and significant improvements to the code.”³³

It is far from certain whether the EU Code of Conduct will be sufficiently robust to prevent sales of weapons and sensitive technologies to China. EU member states may disagree on how to interpret and enforce the Code and the possibility of one or more countries breaking out and selling arms to China unilaterally cannot be ruled out.³⁴ This argument will remain on the agenda for a while, even after the introduction of a tighter Code of Conduct. Only a real test of whether it prevents sales of sensitive technology to China will show how robust it is. In theory the Code would prevent any high-tech weapon transfers to China, but in practice it remains to be seen.

1.4. Problems Related to Dual-Use Technology Goods within the Code of Conduct

Operative Provision 6 of the EU Code of Conduct states that the criteria of the Code and the consultation procedures provided for in the Code shall apply to “dual-use technology goods as specified in Annex 1 of Council Decision 94/942/CFSP as

³³ Idem; 9 March 2005.

³⁴ The Asian Wall Street Journal, 9 March 2004.

amended, where there are grounds for believing that the end-user of such goods will be the armed forces or internal security forces or similar entities in the recipient country". As with the sale of military equipment, the decision of granting a sale licence for dual-use technology goods is left for each EU nation to decide for itself.³⁵

The EU member states, however, have not really addressed the question of whether the Code of Conduct can effectively prevent the export not only of major weapons systems but also of increasingly important dual-use technologies. These often do not meet the criteria of being 'lethal', for the purpose of export prevention. They, nonetheless, significantly augment China's military modernisation and its ability to project power.³⁶

The Dutch Ambassador to the US, Boudewijn J. van Eenennaam, noted that the EU is devising a 'toolbox' to govern what technologies will be exportable to China. Moreover, the toolbox will also aim to control the export of dual-use technology.³⁷

To conclude, it remains to be seen, whether a renewed and significantly tightened Code of Conduct will affect the arms sales to China under licence, whether and to what extent the value of EU licences to sell arms to China will decrease in the future or remain constant, rather than increase. If there were an increase in arms sales to China under licence, the EU debate and the current review of the Code would be in vain. However, beyond the issues of lifting the partial arms embargo and the revised Code of Conduct, there is the issue of commercial projects. This is quite often overlooked by the mass media, but, nevertheless, hi on the agenda of Chancellor Schroeder and President Chirac who are the main advocates of lifting the arms embargo.

2. Commercial Projects and Their Importance for the EU and China

What will the EU possibly gain from lifting the arms embargo? In fact, Europe's large commercial enterprises stand a far better chance of benefiting than its defence sectors. Lifting the arms ban would basically amount to a political rehabilitation of

³⁵ R. Grimmert, 'European Union's'; CRS-7.

³⁶ F. Umbach, 'EU's links'; 45; Idem; 'Will the EU arms embargo towards PR China be lifted? Perspectives and implications', Taiwan Perspective e-Paper, issue 29, 23 June 2004, see <<http://www.tp.org.tw/eletter/print.htm?id=2002484>>.

³⁷ Aviation Week and Space Technology, 13 December 2004, 38; <<http://www.defensenews.com/story.php?F=560498&C=Europe>>.

China, in return for which Beijing could reward Europe by buying more passenger craft from Airbus, satellites from Astrium, or telecommunication systems from Alcatel, Ericsson or Nokia. China might also turn to Europe in the future for nuclear power plants or high-speed rail systems.³⁸ (For sales of satellites and telecommunication systems, see Chapter 2.2. For sales of nuclear power plants and high-speed rail systems, see Chapter 2.3.)

Among the EU member states, Germany has taken the lead in investing and establishing joint ventures in China, though it did not sell a plutonium plant it was supposed to sell.³⁹ The other kinds of joint ventures Germany was supposed to establish in China were not elaborated on by the *Financial Times*.

2.1. European Aeronautic Defence and Space Company Participation via Airbus and Eurocopter in the Delivery of Civilian Craft and Helicopters, Both Now and in the Future

According to Paris-based analysts at A. T. Kearney Consultants, it is a very important issue for the aerospace industry how to deal with the Asian market and how the anticipated turf war over China will develop. Western companies need to factor China into their long-term strategies, not just for growth but also to generate needed cost reductions.⁴⁰

Undoubtedly, the European aerospace industry is, slowly but surely, gaining solid foothold in China – and the implications are great. Such a trend could also strengthen moves within the European Union to lift the partial military embargo on China.⁴¹ For instance, in 2003, EADS linked orders in China, valued at €2.1 billion (\$US2.8 billion). Airbus chief operating officer Gustav Humbert noted that Airbus considers China to be a strategic and very important market.⁴² In early

³⁸ R. Bitzinger, 'A prisoner's dilemma: the EU's China arms embargo', The Jamestown Foundation, 4:13 (24 June 2004), see <http://jamestown.org/publications_details.php?volume_id=39...>; Far Eastern Economic Review, 26 August 2004, 22. R. Niblett, 'The United States', 5; International Herald Tribune, 5 October 2004. This suggestion regarding French support for lifting the embargo due to economic interests: the sale of nuclear power plants and Airbus craft to China was further reinforced by Chih-Chung Wu, secretary-general of the European Union Study Association-Taiwan. Defense News, 25 October 2004, 44; International Herald Tribune, 7 March 2005.

³⁹ Financial Times, 13 December 2003. For confirmation that the Hanau-based plutonium plant was not transferred to China, see Asia Times, 30 April 2004; Handelsblatt, 5 May 2004; FAZ, 10 May 2004.

⁴⁰ Aviation Week and Space Technology, 21 February 2005, 30.

⁴¹ Idem; 21 June 2004, 46.

⁴² Idem; 13 December 2004, 38.

June 2004, Airbus disclosed the terms of a \$US100 million subcontracting arrangement with the China Aviation Industry Corporation (AVIC) 1, involving the A380 aircraft. AVIC 1 will produce A380 nose landing gear bays. The A330/340-series' forward cargo doors will be manufactured in China under a similar scheme, with Eurocopter's Aerostructures Division subcontracting the work package to the new Chinese partners.⁴³

As French President Jacques Chirac returned from a state visit to Beijing, European aerospace managers found themselves holding little more than some new orders for existing Airbus aircraft models and a joint effort to develop a medium-lift helicopter.⁴⁴ During Jacques Chirac's visit to China in October 2004, he was led to believe that a deal for an unknown number of A380s was in the offing, but he left Beijing without a new contract.⁴⁵ However, in early December 2004 China signed a \$US1.3 billion Airbus deal.⁴⁶ Airbus chief executive Noel Forgeard stressed that, in the next twenty years, China will grow to 10 per cent of the world's market in terms of commercial craft and he acknowledged that selling A380s is a key objective for the programme's managers.⁴⁷ Laurent Rouaud, Airbus vice president for market research and forecasts, estimates that China may buy between 100 and 125 of the aircraft.⁴⁸ In early March 2005 an Airbus official said that, by 2023, China is expected to need 1,790 new aircraft seating more than one hundred passengers, tripling the size of its passenger fleet.⁴⁹

Randy Tinseth, Boeing Commercial Airplanes product and services marketing director, says the company sees Chinese carriers adding 2,300 aircraft to their fleets by 2025, at a cost of about \$US183 billion.⁵⁰ It is certainly a staggering amount, yet there is one potential problem. There is no doubt that if China's economic conditions are robust, aviation expenditures, whether for civil or military purposes, will remain on top of Beijing's agenda for the next twenty years. Under a less robust economy, or

⁴³ *Idem*; 21 June 2004, 46.

⁴⁴ *Aviation Week and Space Technology*, 18 October 2004, 35.

⁴⁵ *The Wall Street Journal*, 8 December 2004. *Aviation Week and Space Technology* (31 January 2005, 34) and *Flight International* (1-7 February 2005, 5) noted later that while China Southern Airlines (CSA) is to take the five purchased A380s from Airbus, Air China is also in talks to lease two A380s through International Lease Finance. The CSA contract was signed in late January 2005.

⁴⁶ *Financial Times*, 8 December 2004. *The Wall Street Journal* further noted that a \$US1.3 billion deal was for twenty-three aircraft between Airbus and China Aviation Supplies Import and Export Group. 8 December 2004; <<http://www.strana.ru/stories/02/11/14/3205/235172.html>>.

⁴⁷ *Aviation Week and Space Technology*, 21 June 2004, 46.

⁴⁸ *Idem*; 7 March 2005, 21.

⁴⁹ *Flight International*, 15-21 March 2005, 5.

⁵⁰ *Aviation Week and Space Technology*, 8 November 2004, 34.

under fiscal constraints, aviation expenditures might suffer and Western predictions would not hold true. There is also clear evidence of a battle of the giants – Airbus versus Boeing – for China’s commercial aviation market. And the stakes are very high. The Chinese leadership is well aware of that and knows that for Chancellor Schroeder and President Chirac commercial business is of utmost importance. However, and it is important to point that out, the commercial opportunities in China are connected to lifting the arms embargo and accepting China as an equal and fully rehabilitated strategic partner, although the Chinese leadership has not explicitly stated that.

Chinese commercial aerospace industry leaders are interested in developing their own commercial craft. Setting up joint ventures with European companies is one way of developing the industry and obtaining the necessary know-how from the West.

There are, at least, two known Eurocopter helicopter projects in progress, while the third one is currently under discussion. The third project is important, because it includes, both civil and *military* (author’s emphasis) versions.

The assembly of the EC120 Colibri light helicopter (in China known as HC120) in China began in 2004 and Eurocopter is planning to open a Chinese subsidiary ‘in the near future’.⁵¹ When exactly is not yet known.

Eurocopter also concluded an agreement with the Citic Offshore Helicopter Corporation (COHC) of Hong Kong for the delivery of an undisclosed number of EC155 and EC225 Super Puma helicopters. In early December 2004, Eurocopter formed a joint subsidiary with the COHC and agreed to acquire a 10 per cent stake in the COHC.⁵²

Speaking on 29 September 2004 before the Defence Committee of the French National Assembly, Fabrice Bregier, Eurocopter chairman and chief executive, remarked that China has an urgent need for helicopters in the 7-tonne range, both civil and *military* (author’s emphasis), and said that Eurocopter is already envisioning co-operation in both areas, based on the assumption that the arms embargo will soon be lifted.⁵³ In October 2004, Eurocopter concluded a long-term agreement with AVIC 2 covering the joint development and production of an all-

⁵¹ Flight International, 1-7 February 2005, 37. Aviation Week and Space Technology (21 June 2004, 46) reported that Eurocopter completed an industrial arrangement to assemble EC120 helicopters in Harbin.

⁵² Aviation Week and Space Technology, 18 October 2004, 35; 13 December 2004, 38; Wehrtechnik, 4(2004), 85.

⁵³ Aviation Week and Space Technology, 18 October 2004, 35.

new utility helicopter, scheduled to enter service in 2010.⁵⁴

Another source reported, however, that Eurocopter is in talks with Chinese manufacturers to co-develop a new medium to heavy twin-turbine helicopter, dubbed the EC175. The proposed helicopter will be positioned between the Eurocopter-built AS365/EC155 Dauphin/Panther and the EC225/EC725 Super Puma and Cougar families' *military* (author's emphasis) helicopters.⁵⁵

Even if there are no major weapons sales immediately after the embargo is lifted, a new European-Chinese military-technological axis is quickly forming. For instance, in 2003 EADS purchased a stake in the Chinese military consortium AVIC 2 and similar alliances are probably waiting in the wings.⁵⁶

To conclude, the commercial opportunities for EADS and Eurocopter in China are immense, under robust Chinese economic conditions. As a result, neither the French nor the German governments will let such an opportunity slip away. We can foresee both governments increasing their pressure on the governments of the EU member states to lift the arms embargo on China. At the same time the Chinese leadership is interested in developing and further enhancing its commercial aviation infrastructure and Western assistance is certainly important to achieve that.

⁵⁴ *Idem*; 13 December 2004, 38; FAZ, 26 January 2005. In the latter issue of *Aviation Week and Space Technology* (7 February 2005, 62) Fabrice Bregier noted that Eurocopter signed a memorandum of understanding (MoU) with AVIC 2 to jointly develop a 6 to 7-tonne range helicopter dubbed the EC175, which is scheduled to enter service in 2010. This means that some time between October 2004 and February 2005 a long-term agreement was transformed into a MoU. So far, the author has not seen confirmation related to the signature of a MoU in other defence-related journals. Furthermore, as we will see below, it was reported that Eurocopter is in talks. Thus, we have to take this information with a pinch of salt. Although the author twice e-mailed (18 and 25 February 2005) Mrs Frances Fiorino, the author of the article published in the *Aviation Week and Space Technology*, to confirm the information regarding the signature of a MoU, he received no reply. In addition, an all-new utility helicopter was clearly defined as a 6 to 7-tonne range helicopter, both in civil and military versions.

⁵⁵ *Flight International*, 15-21 February 2005, 23. According to Craig Hoyle, defence editor of the British-based *Flight International*, 'a new medium to heavy-turbine helicopter' was just a style used by the author. He further added that the article spoke about one helicopter to be jointly developed with China. The new helicopter will be positioned between the AS365 Dauphin/EC155 and the EC225/EC725 Super Puma and Cougar families' helicopters. E-mail of 18 April 2005.

⁵⁶ For a complete article, see *Space News International*, 14 February 2005, 19-20. In the fourth quarter of 2003, executives of EADS, Eurocopter's parent company, signed the agreement to acquire a 5 per cent stake in AVIC 2 to symbolically strengthen long-term business links. *Aviation Week and Space Technology*, 21 June 2004, 46; *Wehrtechnik*, 4 (2004), 85.

2.2. Sales of Satellites and Telecommunication Systems

Aviation Week and Space Technology reported that Alcatel Space secured an order for a direct broadcasting satellite, dubbed Chinasat 9, which will be placed into orbit by a Chinese-built Long March launcher.⁵⁷ On 6 December 2004 ChinaSatcom and Turin-based Skylogic, Eutelsat's broadband affiliate, signed a far-reaching accord, covering a two-way network to connect Italian and Chinese businesses as well as trade and government agencies.⁵⁸

Shao Liqin, director of the department of high technology and new technology of the Chinese Ministry of Science and Technology, said that the Chinese government had expressed interest in becoming a full participant in the European Galileo satellite-navigation project. He added that "[...] our investment would be the same as that of the average [large] European government".⁵⁹ According to European government officials (over the last two years) China's role in financing the Galileo project has shrunk and will be limited almost exclusively to in-kind contributions by Chinese companies, investing in ground hardware to be deployed in China. The idea that China would invest €200 million in cash (discussed at an early stage) is gone. China is now expected to make a cash payment of €5 million to the Galileo Joint Undertaking (GJU) in return for an equity stake of well below 1 per cent. China has agreed to make additional payments totalling €65 million over three years towards Galileo's development, but this payment will probably be for ground installations in China, which will serve to communicate with the 30-satellite Galileo constellation. Once Galileo's ownership is transferred to an industrial consortium, which is planned for 2006, China will make a further investment equivalent to €130 million. This will probably be in the form of developing Galileo terminals for the Chinese market. Notwithstanding, even such a Chinese investment in the Galileo Joint Undertaking has caused some European industry officials to be concerned that this will only be the thin end of a wedge and that China will use its position to gain access to Galileo's intellectual property rights and compete with European companies in offering Galileo equipment worldwide.⁶⁰

⁵⁷ 21 June 2004, 46.

⁵⁸ *Aviation Week and Space Technology*, 13 December 2004, 38.

⁵⁹ *Space News International*, 18 November 2002, 1.

⁶⁰ For a complete article, see *Space News International*, 7 June 2004, 6; *Flight International*, 22-28 March 2005, 31. According to Galileo Joint Undertaking officials, Chinese firms are intended mainly to drive local demand, but they could also supply non-critical Galileo components. *Aviation Week and Space Technology*, 31 January 2005, 26. For the issue of intellectual property rights, see note 83.

