

Eugene Kogan

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



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**Eugene Kogan**

**The European Union  
Defence Industry and the  
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*Der Autor gibt in dieser Studie ausschließlich seine persönliche Meinung wieder.*

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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)<sup>1</sup>, 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

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<sup>1</sup> 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”<sup>2</sup>, 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,

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<sup>2</sup> 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."<sup>3</sup>

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 Ompol 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

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<sup>3</sup> Defense News, 28 February 2005, 6.



domestic and international pressure, particularly by the United States.<sup>4</sup> 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.<sup>5</sup> 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.<sup>6</sup> The 2002 level of export licences to China shows a “slight” rise from that of 2001.<sup>7</sup> *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”.<sup>8</sup> Based on the figures mentioned above, one could predict that the value of EU licences to sell arms to China would

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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,<sup>9</sup> 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.<sup>10</sup>

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

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<sup>9</sup> '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.

<sup>10</sup> '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.<sup>11</sup> 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.<sup>12</sup> 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.<sup>13</sup> 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

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<sup>11</sup> 25 October 2004, 82.

<sup>12</sup> 5 October 2004.

<sup>13</sup> J. Kreutz, 'Reviewing'; 46.

China.<sup>14</sup> 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.<sup>15</sup>

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.<sup>16</sup>

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.<sup>17</sup>

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

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

<sup>15</sup> 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.

<sup>16</sup> 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.

<sup>17</sup> 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.<sup>18</sup>

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.<sup>19</sup> 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.<sup>20</sup> France is reluctant to provide more details on arms export licences it grants, but instead just cites those it rejects.<sup>21</sup> 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.

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<sup>18</sup> 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.

<sup>19</sup> Financial Times, 1 October 2004.

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

<sup>21</sup> 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.<sup>22</sup> 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.<sup>23</sup>

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;

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<sup>22</sup> 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.

<sup>23</sup> *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 examples<sup>24</sup> 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.<sup>25</sup>

### 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.

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<sup>24</sup> R. Grimmett, European Union's ; CRS-6-CRS-7.

<sup>25</sup> 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.<sup>26</sup>

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

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<sup>26</sup> R. Grimmett, ‘European Union’s’; CRS-7-CRS-8.



equipment developed in an EU member state though produced elsewhere.<sup>27</sup>

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.<sup>28</sup>

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.<sup>29</sup> So far, the draft amendments are not finalised.

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<sup>27</sup> 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>>.

<sup>28</sup> Europe (Bruxelles), 15 April 2004.

<sup>29</sup> <<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.<sup>30</sup>

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.<sup>31</sup> 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 significantly<sup>32</sup>, 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.

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<sup>30</sup> <<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>>.

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

<sup>32</sup> *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.”<sup>33</sup>

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.<sup>34</sup> 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

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<sup>33</sup> Idem; 9 March 2005.

<sup>34</sup> 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.<sup>35</sup>

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.<sup>36</sup>

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.<sup>37</sup>

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

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<sup>35</sup> R. Grimmert, 'European Union's'; CRS-7.

<sup>36</sup> 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>>.

<sup>37</sup> 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.<sup>38</sup> (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.<sup>39</sup> 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.<sup>40</sup>

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.<sup>41</sup> 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.<sup>42</sup> In early

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<sup>38</sup> 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...](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.

<sup>39</sup> 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.

<sup>40</sup> Aviation Week and Space Technology, 21 February 2005, 30.

<sup>41</sup> Idem; 21 June 2004, 46.

<sup>42</sup> 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.<sup>43</sup>

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.<sup>44</sup> 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.<sup>45</sup> However, in early December 2004 China signed a \$US1.3 billion Airbus deal.<sup>46</sup> 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.<sup>47</sup> Laurent Rouaud, Airbus vice president for market research and forecasts, estimates that China may buy between 100 and 125 of the aircraft.<sup>48</sup> 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.<sup>49</sup>

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.<sup>50</sup> 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

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<sup>43</sup> *Idem*; 21 June 2004, 46.

<sup>44</sup> *Aviation Week and Space Technology*, 18 October 2004, 35.

<sup>45</sup> *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.

<sup>46</sup> *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>>.

<sup>47</sup> *Aviation Week and Space Technology*, 21 June 2004, 46.

<sup>48</sup> *Idem*; 7 March 2005, 21.

<sup>49</sup> *Flight International*, 15-21 March 2005, 5.

<sup>50</sup> *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’.<sup>51</sup> 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.<sup>52</sup>

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.<sup>53</sup> In October 2004, Eurocopter concluded a long-term agreement with AVIC 2 covering the joint development and production of an all-

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<sup>51</sup> 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.

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

<sup>53</sup> Aviation Week and Space Technology, 18 October 2004, 35.

new utility helicopter, scheduled to enter service in 2010.<sup>54</sup>

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.<sup>55</sup>

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.<sup>56</sup>

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.

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<sup>54</sup> *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.

<sup>55</sup> *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.

<sup>56</sup> 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.<sup>57</sup> 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.<sup>58</sup>

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".<sup>59</sup> 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.<sup>60</sup>

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<sup>57</sup> 21 June 2004, 46.

<sup>58</sup> *Aviation Week and Space Technology*, 13 December 2004, 38.

<sup>59</sup> *Space News International*, 18 November 2002, 1.

<sup>60</sup> 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.

Siemens of Germany and Huawei Technologies of China said that they have started a venture to build a high-speed mobile-phone network in China, as the government prepares to issue licences for fast wireless services.<sup>61</sup>

### **2.3. Sales of Nuclear Power Plants and High-Speed Rail Systems and Their Economic Value**

Opportunities worth billions of euros loom in China's push for building up its nuclear energy capacity. As centrepiece of the strategy, aimed at moving away from coal and oil in order to meet the economy's exploding energy demand, China wants to build thirty-two nuclear reactors until 2020. Electricite de France (EDF), France's state-owned utility, assisted in the construction of the Daya Bay reactor in 1994. Also, in a joint venture with Germany's Siemens, the French nuclear company Areva has built eight of China's eleven reactors.<sup>62</sup>

In early December 2004, China laid the cornerstone for a Daimler Chrysler factory in Beijing and signed contracts, totalling nearly \$US800 million for railway locomotives and power generation equipment from Siemens.<sup>63</sup> An additional important milestone in Germany's investment policy in China was the construction of the first commercial high-speed train link from Pudong International Airport to the Shanghai Business Centre, which was officially inaugurated on 31 December 2002. The technical planning and construction was carried out by the Thyssen-Krupp/Siemens, the so-called Consortium Transrapid International.<sup>64</sup> This undoubtedly reflects Chancellor Gerhard Schroeder's conviction that his country's economic interests come first, leading him to believe that the Tiananmen Square events were a thing of the past.

## **3. Current Arms Export Licences and Their Potential Future**

According to internet sources, Europe's arms manufacturers and their governments consider China – and certainly entire Asia-Pacific – to be just another market. It is, in fact, an increasingly critical market for the European defence industry which

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<sup>61</sup> For a complete article, see International Herald Tribune, 21 March 2005.

<sup>62</sup> International Herald Tribune, 5 October 2004. For sales of high-speed rail systems, see note 12.

<sup>63</sup> Financial Times, 8 December 2004.

<sup>64</sup> U. Reisach, 'Deutsch-chinesische Wirtschaftszusammenarbeit – das beispiel Siemens', Strukturwandel in den deutsch-chinesischen beziehungun. Analysen und Praxisberichte in M. Schüller (Hrsg.). Institut für Asienkunde. Hamburg: IFA, 2003, 141.

depends on exports for the bulk of its income. UK's British Aerospace (BAE) Systems, for example, typically does between 70 and 75 per cent of its business outside the United Kingdom, as does Thales of France. Overseas sales bring in nearly half the income of the Swedish defence company Saab. Also the Franco-German-Spanish EADS depends heavily on exports. Eurocopter, a subsidiary of EADS, for instance, exports more than two-thirds of its output.<sup>65</sup>

### **3.1. Arms Export Licences With the Embargo in Place: Efficiency or Loss of Control?**

While the Europeans balked at selling China complete weapons systems during the 1990s, their arms embargo was honoured more in the breach than in the observance. Between 1993 and 2002, France sold over \$US122 million in defence goods to China. The United Kingdom sold China Racal/Thales Skymaster airborne early warning radar systems and Spey aero-engines for Chinese JH-7 fighter-bombers. The University of Surrey (i.e. Surrey-based Satellite Technology Limited (SSTL)) co-operated in China's micro-satellite development, a technology, the Chinese acknowledge will be used in 'parasitic' anti-satellite weapons.<sup>66</sup> At sea, German and French marine diesel engines power new Chinese submarine and surface combatants. Germany's MTU is co-producing marine diesel in China to power China's new Song A-class submarines. French-designed Semt Pielstick marine diesels power the new very stealthy Chinese 054-class frigate.<sup>67</sup>

According to Gregory Suchan, a US State Department official, responsible for political-military affairs, France, Italy and the UK continue to export arms to China,

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<sup>65</sup> R. Bitzinger, 'A prisoner's', see <[http://jamestown.org/publications\\_details.php?volume\\_id=39...>](http://jamestown.org/publications_details.php?volume_id=39...).

<sup>66</sup> J. J. Tkacik, Jr. 'Washington must head off European arms sales to China', Backgrounder, 1739 (18 March 2004), 4. Part of Tkacik's article relating to the EU member states' sales to China was translated into German and published in *Sueddeutsche Zeitung* on 9 December 2004. Tkacik's information relating to the French sales is not correct. For instance, France granted €05 million of licences for arms sales to China in 2002 alone. John Hill article 'Europe' (55) specified that, for instance, Rolls-Royce was granted export licence for between 80 to 90 Spey aero-engines. The UK government annual report on strategic export controls, covering 2002, details 177 exports licences for China worth £50 million (\$US89 million); Space News International, 14 February 2005, 19. The Wall Street Journal noted that the most recent UK report covering 2003 showed that export licences for equipment valued at £76.5 million (€15 million) had been granted for sales to China. The list of items licensed for sale by the UK is long and includes military aircraft communications systems, ballistic test equipment, components for military utility helicopters, military helmets and military cargo vehicles. 6 August 2004; Far Eastern Economic Review, 12 August 2004, 27.

<sup>67</sup> Space News International, 14 February 2005, 19.

although other EU states interpret the embargo more strictly.<sup>68</sup>

Even with the embargo in place, Suchan asserts that EU members sold about €210 million (\$US262 million) worth of military equipment to China in 2002, led by France, Italy and the UK. The 2002-level shows a slight rise (which, in the opinion of the author was a steep rise!) from 2001 and US officials are closely following what the 2003 figures will be (see below). The sales do not include lethal equipment or major platforms, but US officials are concerned that they could allow China to quickly overcome niche capability shortfalls in night-vision, command and control, sensors and other systems – areas considered to be just as sensitive.<sup>69</sup> (For niche products and their importance, see Chapter 3.2.)

Between 2002 and 2003, the European Union almost doubled its arms export licences for China, raising questions about its insistence on having no intention of increasing its sales, once it lifts its arms embargo on China. The EU annual report on arms exports shows that the value of EU licences for selling arms to China totalled €416 million (\$US544 million) in 2003 compared to €210 million in 2002.

In December 2004 EU leaders endorsed plans to lift the embargo during the first half of 2005, but “underlined that the result of any decision should not be an increase of arms exports from EU member states to China”. However, according to the information in the EU Official Journal issued in December 2004, France granted €171 million worth of licences for arms sales to China in 2003, Italy €127 million, and the UK €112 million, showing all figures well above the €210 million level of 2002.<sup>70</sup>

Richard Grimmett noted that the largest share of French licence approvals for China in 2003 were in the categories Military List (ML)11 – electronic military equipment (€98.5 million), ML10 – aircraft and related equipment (€45.4 million), and ML15 – imaging or countermeasure military equipment (€24.1 million). As for Germany, the largest share of its 2003 licence approvals for China were in

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<sup>68</sup> Financial Times, 7 October 2004; Jane’s Defence Weekly, 2 March 2005, 21.

<sup>69</sup> Aviation Week and Space Technology, 25 October 2004, 82. According to the Financial Times (6 December 2004) France accounted for half of the total, with licences worth €105 million. For the sales in 2001, see note 6.

<sup>70</sup> Financial Times, 18 January 2005. According to Internet sources <[http://www.redstar.ru/2005/01/26\\_01/n.html](http://www.redstar.ru/2005/01/26_01/n.html)>, French share of licences increased from €105 million in 2002 to €171 million in 2003, while British share increased from €79 million in 2002 to €112 million in 2003. The source did not provide any information for the Italian share increase. Grimmett CRS report noted that Italy granted €22 million of licences for arms sales to China in 2002. CRS-8, see <[www.fas.org/sgp/crs/row/RL32785.pdf](http://www.fas.org/sgp/crs/row/RL32785.pdf)>. For the British share, see also The Wall Street Journal, 6 August 2004; Financial Times, 19 January 2005 and note 66. For the total sales from EU to China, see <<http://www.defensenews.com/story.php?F=608586&C=America>>; Europe (Bruxelles), 21 January 2005; Financial Times, 22 January 2005; Jane’s Defence Weekly, 2 March 2005, 21.

categories ML14 – specialised military training equipment or simulators (€528 thousand), ML11 – electronic military equipment (€433.1 thousand), and ML21 – software for items controlled in the EU Common Military List (€134.4 million).<sup>71</sup>

Given the amount of military technology Europe has sold to China under the embargo, there is simply no assurance that an EU Code of Conduct will prevent military technology sales<sup>72</sup> to China and thereby contribute to the arms race in the Asia-Pacific region. No less important, the Chinese funds for social development will probably decline and the money be diverted to procure weapons systems.

To conclude, it is evident that even with the embargo in place, the licences for arms sales to China granted by EU member states have increased rather than decreased. Thus, the EU arms embargo on China has proved to be inefficient and particularly France has seized the opportunity to substantially increase its licence approvals (see notes 69-70). (For the share of French licence approvals, see note 71.)

### 3.2. Niche Products and Their Importance

Although it is assumed that China is willing and able to purchase large amounts of high-tech weaponry, the prospects have been overestimated. China is interested in acquiring specific niche technologies and minor weapons systems, such as radar, air-to-air missiles (AAMs), sonar equipment, torpedoes and other important force multipliers. It also aims at increasing the fighting capabilities of, both its old and new weapon systems, improving its command and control, communications, computers, intelligence, surveillance and reconnaissance (C4ISR) and raising its military capabilities for asymmetric warfare operations, in order to prepare for a potential conflict with the United States over Taiwan.<sup>73</sup>

Lifting the arms embargo is unlikely to result in Beijing buying German submarines or French fighter jets. However, Europe might be able to sell components or subsystems that could substantially contribute to modernising the People's Liberation Army (PLA) and filling critical technology gaps, particularly in areas, such as command and control, communications and sensors. However, the EU does not need to lift its arms embargo in order to export these items to China.<sup>74</sup> The author disagrees with Bitzinger's argument because particularly

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<sup>71</sup> 'European Union's', CRS-9; Jane's Defence Weekly, 2 March 2005, 21.

<sup>72</sup> Space News International, 14 February 2005, 19.

<sup>73</sup> F. Umbach, 'EU's links', 45; Idem; 'Will the EU', see <<http://www.tp.org.tw/eletter/print.htm?id=2002484>>.

<sup>74</sup> R. Bitzinger, 'A prisoner's', see <[http://jamestown.org/publications\\_details.php?volume\\_id=39...>](http://jamestown.org/publications_details.php?volume_id=39...>); Aviation Week and Space Technology, 7 March 2005, 22.

crucial technologies, such as C4ISR have not been sold to China under the embargo. Yet, other military items, such as aero-engines, radar systems and satellite technology have been sold (see Chapter 3.1). The author's argument is supported by an internet article (see note 75).

According to internet sources, the Chinese can find top quality fighters, diesel submarines, destroyers, and surface-to-air missiles (SAMs) in Russia, but they may not be able to find the C4ISR systems needed to become more effective. The EU may just be the source to provide such systems<sup>75</sup>, as Russia does not have them. In fact, Russia would be willing to sell such systems, as the constraints on selling advanced weapons systems to China were lifted a decade ago and the US leverage on Russia, not to sell such systems to China, no longer works.

In keeping with its strategy on non-military businesses, China would probably seek to form joint development projects with the Europeans. This would give China faster access to Western technology, which is precisely what US Department of Defense (DoD) strategic planners fear most.<sup>76</sup>

Aforementioned niche technologies, approved by EU member states and delivered to China, are most likely to be as crucial as, for instance, military aircraft, helicopters and submarines sold by Russia. The combination of both and the creation of hybrid systems, namely of niche technologies and major battle platforms or niche technologies integrated into major battle platforms would give China an edge in the Asia-Pacific region – not only in making its stand vis-à-vis Taiwan. (For further discussion of the issue, see next chapter).

### **3.3. Arms Export Licences If the Embargo is Lifted: Expectations vis-à-vis Reality**

According to Jean-Pierre Cabestan of the French National Centre for Scientific Research, particularly France and Germany are pushing for lifting the arms embargo on China: France, because the government is under pressure from the defence industry to resume arms sales; Germany, because it wants to maintain good and close relations with Beijing. Both EADS and the French electronics company Thales told *Jane's Intelligence Review* that, although they currently do not

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<sup>75</sup> <<http://www.heritage.org/Research/AsiaandthePacific/wm672.cfm>>. A shorter version of the same Internet article was published in the Space News International, 14 March 2005, 19. For details relating to the Russian sales to China, see Jane's Defence Weekly, 16 March 2005, 23.

<sup>76</sup> International Herald Tribune, 24 February 2005.

export military equipment to China, they are monitoring the situation.<sup>77</sup> In a time of shrinking European defence budgets, China might become a vital customer for companies, such as Thales and EADS.<sup>78</sup>

China's annual defence budget is estimated to be the world's third largest at \$US50 billion to \$US70 billion and China has expressed interest in weapons ranging from aircraft carriers and early warning aircraft to radar and C4I systems.<sup>79</sup> (For niche products and their importance, see Chapter 3.2.)

Lifting the embargo might have security-related as well as political consequences. The first would depend on the equipment sold. Major battle platforms such as quiet submarines and advance fighter aircraft could have a destabilising effect and might not be approved but the so-called non-lethal transfers, like information technology (IT) adapted for military command and control, sensing and precise strike could prove most dangerous. Those technologies transformed the US military and could change China's calculus as to the effectiveness of a military option across the Taiwan Strait.<sup>80</sup>

Some commentators believe that if China confines its arms orders to Russia, it will remain decades behind the US in high-technology weaponry. According to Peter La Franchi, associate defence editor of the British-based *Flight International*, China, if it wants to reach anything like parity with the United States, let alone become a military power in its own right, will have to move beyond the Russians and find alternative sources of cutting-edge technology. For China, Europe has plenty to offer.<sup>81</sup>

According to Dick Pawloski, Professional Staff Member, Committee on Armed Forces, US House of Representatives, a PLA shopping list for EU technology will inevitably be centred in large intelligence, surveillance and reconnaissance (ISR) sensors, forward looking infrared (FLIR)/laser targeting pods, electronic warfare equipment, electronic intelligence (ELINT)/signal intelligence (SIGINT) receivers, active phased array modules, commercial off-the-shelf (COTS) embedded computers, helmet mounted displays (HMDs), inertial navigation equipment, jam-resistant secure spread spectrum comms and digital networking equipment. On the Chinese market, the EU will have

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<sup>77</sup> J. Hill, 'Europe'; 54. The first signs of EADS interests towards Chinese market were expressed in early February 2004, see FAZ, 5 April 2004. In early February 2005 EADS announced its intention to increase its marketing to China should the embargo be lifted, see International Herald Tribune, 9 February 2005. For Eurocopter's envisioned co-operation in China, see note 53.

<sup>78</sup> The Wall Street Journal, 6 August 2004.

<sup>79</sup> Defense News, 4 October 2004, 8.

<sup>80</sup> International Herald Tribune, 9 February 2005.

<sup>81</sup> Far Eastern Economic Review, 12 August 2004, 27.

no significant competitors as it will occupy the niches the Russians cannot cover, and vice versa. Where there is an overlap the PLA will play the EU and the Russians off against each other to gain better prices and exert pressure for access to products otherwise denied.<sup>82</sup>

Furthermore, active EU aerospace and defence industry participation in the Chinese project would be very welcome by the Chinese. EU technology transfer is likely to pose a serious threat to the Asia-Pacific region. EU governments and their defence industry managements are well aware of this being a potential risk. In addition, as *Jane's Defence Weekly* reported China's reputation for reverse engineering and its poor record in preserving intellectual property rights makes many manufacturers afraid that their technology could be copied. Those copies would then compete within China and on export markets.<sup>83</sup>

At the same time, the Chinese leadership is getting less and less interested in Israel's participation in its projects, as Tel Aviv would need a green light from Washington, which might turn out to become a nightmare for Israel and a great disappointment for China.

Since Chancellor Schroeder and President Chirac initiated their political arm-twist on EU member states to lift the arms embargo on China, Russia's President Vladimir Putin has not issued any comment. However, according to internet sources, President Putin recently broke his silence and explicitly stated that Russia is not interested in the appearance of new competitors (the EU member states) on the Chinese market. He continued, "As less competitors on this market, so is better for us". At the same time he mentioned that Russia is considering the possibility of working with the EU on the Chinese market.<sup>84</sup>

Internet sources cited Alexander Mikheyev, the expert on naval aviation issues at the Russian arms trade company Rosoboronexport, who sees the fierce competition between Russia and the EU on the Chinese market in the delivery of naval craft and helicopters. There are also prospects of such a competition with regard to commercial and transport aircraft and helicopters for special purposes (fire-fighting, police, and medical use).<sup>85</sup> There is, however, one important military item that only Russia can deliver, namely the long-range bomber aircraft Tu-22M Backfire. In his article Carlo Kopp was the first to point out China's

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<sup>82</sup> E-mail of 28 February 2005.

<sup>83</sup> 2 March 2005, 21.

<sup>84</sup> <<http://www.strana.ru/stories/01/12/04/2157/243189.html>>.

<sup>85</sup> <<http://izvestia.ru/armia2/article693860>>.



interest in acquiring this long-range bomber.<sup>86</sup> Russia is going to take part in military exercises with China during the second half of 2005, as part of an effort to promote Tu-22 aircraft sales. The Russian Air Force Commander-in-Chief (CINC) General Vladimir Mikhailov cautiously stated that selling Tu-22 and Tu-95 strategic bomber aircraft would be possible.<sup>87</sup>

Times have changed since the 1990s and today such sales are no longer considered taboo. The Russian decision to sell long-range bomber aircraft to China has absolutely nothing to do with the forthcoming EU decision on the arms embargo – a claim that has occasionally been made but is inaccurate and misleading.

Although the Chinese indigenous military-industrial complex (MIC) is lagging some twenty or more years behind in the manufacture of cutting-edge weapons systems,<sup>88</sup> it is continually improving. The author disagrees with David Shambaugh's assessment that "whatever modern conventional weapons China's military bought from Russia, is not manufactured in China" – China most certainly manufactured under licence, as, for instance, the Su-27 military aircraft. In addition, the Chinese are also enhancing their designs and development of own military aircraft, partly based on the Russian systems.<sup>89</sup>

Finally, as Eugene Kogan noted in his article, there are at least five Chinese aerospace industry objectives Beijing would be able to achieve without Russian participation. These are: increased investment in aerospace industry infrastructure; enhancement of the Russian-built air fleet inventory, using Western/South African avionics and Israeli components; procurement of AWACS; enhancement of domestic development and manufacture as well as procurement of advanced unmanned aerial vehicles and unmanned combat aerial vehicles (UCAVs); and continued investment in space, with the emphasis being on military space.

The sixth objective would be to design and manufacture a new military transport aircraft. An additional aspect underlined by Kogan is that China has increasingly become interested in technology transfers rather than in direct defence purchases, in order to be self-sufficient.<sup>90</sup>

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<sup>86</sup> 'Backfires approaching', Asia-Pacific Defence Reporter (September 2004), 6. For a complete article, see 6-8.

<sup>87</sup> Jane's Defence Weekly, 26 January 2005, 17; <<http://www.defensenews.com/story.php?F=598327&...>>; <<http://www.defensenews.com/story.php?F=598412&C=europe>>.

<sup>88</sup> International Herald Tribune, 23 February 2005.

<sup>89</sup> For further information, see E. Kogan, 'Russo-Chinese aerospace industry on the up', Interavia, 669:58 (January-February 2003), 17. For a complete article, see 17-19.

<sup>90</sup> For a complete article, see 'Russia-China aerospace industries; From co-operation to disengagement', The Jamestown Foundation, 4:19 (30 September 2004), see <[http://www.jamestown.org/publications\\_details.php?volume\\_id=39](http://www.jamestown.org/publications_details.php?volume_id=39)>.

To conclude, the Chinese shopping list is long and full of crucially important defence items. Whether they will be delivered to China or not remains to be seen. What is evident, however, is that miscalculations on behalf of the Chinese leadership, like passing a Taiwan anti-secession law, may have given EU member states an excuse to delay an embargo lift. In other words, a domestic political error of that kind may turn out to be expensive when it plays a crucial role in world politics.

## Conclusions

Over the last sixteen months, since the EU summit meeting in October 2003, the political pressure President Chirac and Chancellor Schroeder have been putting on the governments of the EU member states has started to bear fruit. If EU member state governments had felt lukewarm about the French and German initiative to lift the partial arms embargo on China, they now appear to be more inclined to go along. However, only time will tell how long EU member states will continue to resist the initiative of lifting the arms embargo. It appears to be a matter of months rather than years.

When analysing the 2001-2003 EU data on approved licences for selling for military equipment to China, it becomes more than obvious that the arms embargo is ineffective and inefficient and there is no sense in discussing the issue, as long as it is not adequately enforced. It can only be effective under three conditions:

1. If the embargo is imposed and enforced under UN auspices, i.e. as a UN arms embargo. The case of Libya mentioned below is a point in case.
2. If the exporting countries follow a strict policy of keeping the embargo in place. This means that the country under embargo cannot circumvent it and import necessary equipment, technology and components for its military. It also requires well-concerted long-term policies of all exporting countries, which currently do not exist. The embargo on China revealed that Russia is still the major arms exporter to China. Israel also played a role that should not be overestimated. The suggestion of British Foreign Secretary Jack Straw to outline a proposal for an international arms trade treaty is a non-starter, because there will always be a country, as for instance Russia, that is interested in selling arms, whatever the circumstances. It should be emphasised that arms exports are closely intertwined with the countries' domestic defence industry interests and arms export organisations will keep pushing their interests.
3. If the country under an arms embargo has no extensive defence industry infrastructure and, therefore, is incapable of developing and

manufacturing its own military equipment. Two countries under embargo, that managed to withstand it, are Iran and China. Both countries are building up extensive defence industry infrastructure. The only example of a country where an arms embargo was successfully imposed and enforced was Libya. The embargo was agreed by the UN, its policy was strict, and the country had no defence industry infrastructure.

It should be stressed that even a tightened Code of Conduct may not hinder sales of niche technologies to China. Even the best intentions of the EU member states to lift the embargo may turn out to be useless, which could be politically challenging for President Chirac and Chancellor Schroeder. After all, they have invested a good deal of time and effort in persuading the other heads of state to go along and, therewith, put their reputation on line. As a result, I cannot see any way out for them – they have ‘crossed the Rubicon’.

It is important to point out that EU commercial interests in China are often overlooked but will certainly continue to play a crucial role in President Chirac’s and Chancellor Schroeder’s overall strategies. EU commercial business in China constitutes more than 60 per cent of the total commercial and defence business, and this ratio is likely to remain over the next fifteen to twenty years.

Finally, perhaps the European Union can lift the arms embargo under the explicit condition that the suspension will be reassessed annually in the overall context of China’s progress. If there is insufficient progress, the embargo can be re-imposed. The Chinese leadership is unlikely to appreciate such a decision and the strings attached to it. However, China might be pragmatic enough to understand the worries of EU member states and may accept. There is much at stake for both sides. Though it appears that the EU has more to gain than China, China’s potential gains are, in fact, equally as great.

## Acronyms and Abbreviations

AAM	air-to-air missile
AI	Amnesty International
AVIC	China Aviation Industry Corporation
AWACS	airborne early-warning and control system
BAE Systems	British Aerospace Systems
C4ISR	command, control, communications, computers, intelligence, surveillance and reconnaissance
CFSP	Common Foreign and Security Policy
CINC	Commander-in-Chief
COHC	Citic Offshore Helicopter Corporation
COTS	commercial off-the-shelf
CRS	Congressional Research Service
CSA	China Southern Airlines
CSIS	Centre for Strategic and International Studies
DoD	Department of Defense
EADS	European Aeronautic Defence and Space Company
EC	European Commission
EDF	Electricite de France
ELINT	electronic intelligence
EU	European Union
EW	electronic warfare
FAZ	Frankfurter Allgemeine Zeitung
FLIR	forward looking infrared
FSU	Former Soviet Union
GDP	gross domestic product
GJU	Galileo Joint Undertaking
HMD	helmet mounted display
ICE	Inter City Express
ISR	intelligence, surveillance and reconnaissance
IT	information technology
MEP	Members of the European Parliament

MIC	military-industrial complex
ML	Military List
MoU	memorandum of understanding
NGO	non-governmental organisation
OSCE	Organisation for Security and Co-operation in Europe
PLA	People's Liberation Army
PRC	People's Republic of China
PSS	passive surveillance system
SAM	surface-to-air missile
SIGINT	signal intelligence
SIPRI	Stockholm International Peace Research Institute
SSTL	Surrey Satellite Technology Limited
SWP	Stiftung Wissenschaft und Politik
TGV	Très Grand Vitesse/Very High Speed
UAV	unmanned aerial vehicle
UCAV	unmanned combat aerial vehicle
UK	United Kingdom
WTO	World Trade Organisation

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