BAE-EADS merger fails due to mounting antagonisms between major powers

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The proposed merger between Britain's BAE and EADS, the Franco-German civil aviation corporation, has collapsed. The merger of Europe's largest defence corporation with the civil aviation corporation that manufactures the Airbus was shipwrecked by the competing national interests of the three main European governments, which are either part owners of the companies or have veto rights over any merger or takeover.

The collapse of the projected "European champion" testifies to the sharp and deep-seated antagonisms surrounding political, economic and military cooperation in Europe, the competing interests of the US and Europe, and the parlous state of Britain's manufacturing base.

If successful, the €35 ($45) billion mega-merger, first leaked in mid-September following nine months of secret talks, would have split the new entity 60/40 between EADS and BAE shareholders. By creating an aerospace-defence giant with up to €72 billion in annual sales and an international workforce of 220,000 employees, it would have displaced Boeing, the American corporation, as the world's biggest civil and defence aviation manufacturer.

For BAE, the deal would have provided a way out of its dependence on the shrinking defence budgets of its main customers, the British and US governments, and a return to the civil aviation industry it left in 2006 when it sold its share in EADS. With US defence spending, which accounts for 40 percent of BAE's sales, set to fall by $600 billion over the next 10 years, BAE has already slashed costs, having shed 22,000 jobs in the last three years.

For EADS, the merger offered some cushion against the cyclical civil aviation industry, the possibility of expanding into the US market and possibly freedom from the political interference and rows between the French and German governments that had dogged the corporation since it was set up in 2000.

The two companies had hoped to eliminate any government holding in the new entity and limit them to a "golden share" that could veto mergers and takeovers. As well as securing the support of Germany and France, however, the deal also needed approval from Washington and London. While it was always going to be a tall order, the viability of the European civil and defence aviation industry depended upon it.

The deal would have sparked a wave of mergers among Europe's smaller defence firms. Instead, the merger fell apart hours before the deadline set by Britain's Take-Over Panel to decide whether to proceed to formal negotiations. The companies had insisted that they would only ask for an extension to the deadline if there was broad agreement at governmental level, an agreement that was not forthcoming.

One of the key issues was the size of the governments' stakes. The US, opposed to awarding defence contracts to corporations controlled by foreign governments, had stipulated that the upper limit for state ownership by the French and Germans would be nine percent. France's stake would at least reflect the value of its existing 15 percent stake in EADS. Germany holds no shares in EADS, but has a stake in EADS' shareholders via its holdings in Daimler and a consortium of public and private sector banks. It made it clear that it would demand a nine percent stake so as to balance that of France. The Spanish government currently holds a 5.45 percent stake in EADS.

Britain, which despite owning no shares in BAE can veto any merger, insisted that neither Paris not Berlin could increase their stake at some future date, so as not to jeopardise BAE/EADS' ability to win contracts in the US. France refused to give any such commitment.

Boeing, fearing the emergence of a stronger rival for defence contracts, opposed the European tie-up and called for the US authorities to examine the deal. In civil aviation, Boeing and Airbus have long been rivals, with each accusing the other of receiving government aid.

There were also differences over the number of jobs, the sites for manufacturing, the nationality of the chief executive, and the degree of corporate control that would remain within their countries. Berlin feared that civil aviation centred around Airbus' base in Toulouse in France and defence based in Britain would leave Germany without its own sphere of influence. It demanded that the new corporation have its headquarters, or at least a major division, in Germany, and sought assurances about jobs. Britain insisted that the chief executive of the defence division should be based in the UK and be a British national.

EADS, which had sought to limit government involvement in the company, refused to locate any part of the business on purely political grounds. It had already announced its intention of manufacturing its Airbus airliner in the US, a decision which it hoped would smooth the path to US regulatory approval.

In the event, it was Germany's Chancellor Angela Merkel who vetoed the deal that was seen as favouring the French and British. According to an advisor in Merkel's office, the chancellor refused to agree to the tie up with BAE because she was opposed to EADS' merger with a defence corporation and was concerned about the prospect of German job losses.

The German veto led to bitter recriminations from Britain and France. Germany's relationship with Britain is already fraught due to Prime Minister David Cameron's refusal to contribute to the eurozone's rescue efforts, his veto against eurozone integration and his constant exhortations to its members to do more to resolve the crisis.

The future for BAE, Britain's most important manufacturer and private sector employer, is bleak. It was only in 2006 that BAE sold its 20 percent stake in Airbus at a knock-down price to focus on defence and the US market, neither of which can sustain the company. Utterly parasitic, BAE used much of the proceeds in share buybacks, leaving it with a weak balance sheet that makes diversification into new businesses impossible.

BAE now faces the prospect of being broken up or sold to one of the US prime defence contractors, in the unlikely event that one can be persuaded to take on BAE's £4.7 billion pension fund deficit, the largest of any British corporation. Neither proposition is viewed favourably by either BAE or the British government, which could use its "golden share" to veto any deal that would leave it with less influence than that offered by the merger with EADS.

Apart from its defence contracts with the British and American governments, its main customers are Australia, India and Saudi Arabia. But the £4 billion trade with Saudi Arabia and the £11 billion joint investments are in jeopardy following the House of Commons Foreign Affairs Committee (FAC) announcement that it would open a wide-ranging review into Britain's relations with Saudi Arabia and Bahrain following Riyadh's suppression of the democracy movement in Bahrain.

The German government, for its part, is withholding a €600 million loan to fund the development of the Airbus 350 in an attempt to ensure that future production takes place in Germany. Earlier this year, EADS announced that it would move some Airbus operations to Toulouse in France. The loan is the second tranche of up to €1 billion promised by the government for the A350.

Ian Waddell, national officer of the Unite union, which has more than 30,000 members across the two companies, had welcomed the deal and wanted Britain to follow France and Germany's lead in taking shares in the company. He reacted to its failure by urging a nationalist response from the Conservative-led government. "There was an industrial logic to the merger, but national and political interests proved to be the stumbling block," he said. "The UK government now needs to strengthen its 'golden share' and send a powerful message that it backs British manufacturing and BAE Systems."