

# ESA's Industrial Policy after the FINPOL Initiative



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*The medium-term strategy for the Agency, formulated in September 2003 by the Director General in his Agenda 2007 document, focuses on a series of fundamental changes in ESA's every day life that will strongly influence the Agency's future.*

The political and industrial landscape in which the Agency is operating is continuously in motion. The European Union is undergoing profound institutional changes, with enlargement to 25 Member States with new borders, new responsibilities, and new needs (narrowing the digital divide, increasing security, sustaining development, etc.), calling for a redistribution of resources. The recently finalised European Constitution foresees shared competencies in space matters, and a European security and defence policy. Additional sources of funding for the development of space systems are being identified, associated with specific sectorial policy demands and complementing the traditional sources of funding for ESA activities based on technological and industrial interests.

As far as European industry is concerned, in the medium term institutional programmes will rely on large and small system integrators. The restructuring process involving large system integrators will have come to an end, probably resulting in one (or a maximum of two) large telecommunications satellite manufacturer(s) in Europe and one large launcher prime

contractor. The equipment-supplier industry will have gone through a restructuring exercise leading to more specialised suppliers serving European and non-European primes. Alliances with non-European partners will also be in place.

The expected recovery in the commercial market in the next few years will be very low, and the levels of activity generated by this market in European industry will produce a workload only representing close to half the industrial production capabilities currently available in Europe. This trend, combined with the increasing importance over the years to come of the public space sector, linked mainly to the implementation of ESA and EU policies, will constitute a substantial challenge.

With an imminent future so different from the reality we know today, ESA had no choice but to adapt in anticipation of these events. The first step of the reforms referred to in Agenda 2007, including financial, budgetary, and industrial policy issues, was then proposed. Following the Council's decision of 18 December 2003, a Council Working Group known as FINPOL was set up, charged with studying the possible evolution of these issues. The Group's work was speedily completed, so

that a final report could be presented to Council in June this year, accompanied by a Resolution (ESA/C/CLXXI/Res. 2 (Final)), which was approved unanimously.

The new Resolution covers three domains:

- Co-ordination of the European programme with national programmes.
- Planning and budgetary policies.
- Industrial and procurement policies.

An overview of the conclusions is presented below, focussing particularly on the industrial and procurement issues.

## **Co-ordination of the European Programme with National Programmes**

This topic is mentioned in the ESA Convention, but is only partially implemented as of today.

Starting from an analysis of the effects of the existing *Technology Harmonisation Programme* (a process aimed at rationalising the various technology efforts in Europe, but mandatory neither for Member States nor for ESA programmes), it becomes evident that the future of this process calls for the enforcement by the Director General of the recommendations of the process itself within ESA programmes, where he has direct powers,

and for greater promotion of the conclusions of the said process within Member States and industry for their programmes, where that process can only be implemented on a voluntary basis. A first proposal for a modified process will be presented at the November 2004 meeting of the Agency's Industrial Policy Committee (IPC).

Total agreement was reached on the need for developing a *Strategic European Procurement Policy*, in order to ensure that such strategic areas as technologies, components and equipment remain under the control/leadership of European industry. As this falls within the mandate of the Director General, he can set up the necessary internal rules and responsibilities.

Concerning the proposal to '*foster the participation of European industry in national programmes*' (where participation of non-national European industry is rare, and the ESA and national programmes can become a source of duplication and inefficiency), the principle was supported by a large majority of States, with the understanding that it can only be implemented with the express agreement of those Member States involved, since it impinges on national prerogatives, and on a basis of reciprocity. Detailed rules will have to be worked out by the IPC, based on such industrial-policy criteria as non-distortion of competition, improvement of industrial specialisations, and the opening of new markets for competitive equipment suppliers, as well as on technology- and innovation-related criteria.

## Planning and Budgetary Policies

Council has also approved the introduction of a new *Long-Term Plan (LTP) concept*, which will be useful not only as a management tool for the Executive, but also for the Member States, as it contains the best estimate of budgetary requirements for the implementation of the decisions already taken on approved programmes, as well as forecasts for the budgetary requirements for future programmes. It also includes the best estimate of the forthcoming contributions from Member States. The Agency's Administrative and Finance Committee (AFC) began studying the details of the new approach in September.

The introduction of *flexibility for in-year budget execution*, in the frame of the new Long-Term Plan, is probably one of the most radical reforms, and one on which the AFC will be working intensively in the coming months.

## Industrial and Procurement Policies

Another profound change approved by Council is that relating to the *hierarchy of return rules*. The return constraints per State have been rendering ESA programmes almost unmanageable in recent years because of the multiple constraints that co-exist in terms of: overall return obligations (for a five-year period, counting all ESA programmes and activities together), return obligations per programme (on programme completion), return obligations for the mandatory programmes and activities (every five-year period), and return obligations per sub-envelope of a certain programme. The new approach foresees a pyramid-like hierarchical arrangement, in which greater flexibility is allowed for the return rules of individual programmes, a lesser degree of flexibility is set for the overall return (which supersedes any other return obligation), whilst the need to target the ideal return coefficient of one\* is maintained. Member States will have to decide on the minimum overall return coefficient (for the period 2000-2004 it was 0.90), and on the minimum return coefficient for programmes (on completion for optional programmes, and every five years for mandatory ones). For the latter, the Executive has proposed a value of 0.8. This major change will go hand in hand with the approval of new programmes in 2005.

The need for *mastering risks* for programmatic and procurement purposes has been recognised: some examples in the recent life of the Agency (Space Station and Launchers, for instance) demonstrate that this is a fundamental issue in a domain which, by definition, includes risky activities. It has been stressed that adequate funding has to be assured by

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\* The 'return coefficient' is the ratio between the sum of actual contractual commitments awarded to industry in a Member State for a particular programme, and the sum of ideal contractual commitments corresponding to that State's nominal contribution to the programme. If, for example, a State participates at a level of 10% in a given programme, its ideal return in terms of contractual commitments is 10% of the total overall commitments awarded to industry for that programme.

Member States within the programme envelopes for preparatory activities and the early phases of programmes, before embarking on the main development phase. In the procurement approach, it will be necessary to prepare a development dossier (in practical terms, a detailed risk analysis of what can happen during the development phase of a programme, and the means, technical and financial, to counteract those risks), before starting procurement for the development phase. The development-dossier concept will be analysed by the IPC in January 2005. An incremental approach to procurement when risks are deemed very high (e.g. in the case of interfaces not under the Agency's direct control) is also foreseen: this consists of procuring, within a given overall ceiling, only a share of the total development programme, in line with a practice in use in, for instance, the defence and nuclear fields.

The *Code of Best Practices*, which dictates the rules to be followed by the Prime Contractor in a competitive environment vis-à-vis its subcontractors, will be revised and presented to the IPC for approval in early 2005. It will be complemented by the '*Make or Buy*' Plan, which on the one side establishes the boundaries of the activities of the Prime Contractor and of its subcontractors, whilst on the other maximising the opportunities for competition. Furthermore, the *return requirements approach* (based on return figures per State imposed on the Prime as a performance requirement, like the mass or the power for a satellite) will become the basis for the achievement of competitive offers within a given return constraint.

The set of detailed rules will be put before the IPC in January 2005.

## Conclusion

With the FINPOL-based decisions, and the subsequent detailed rules and procedures that will be in force towards the middle of 2005, the Agency will change its way of operating in the world of finance and procurement, resulting in improved flexibility at all levels. r