



BULLETIN

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The Polish Defence Sector and the Liberalised European Defence Equipment Market

Marcin Terlikowski

As a new public procurement law enters into force in Poland, the national system for obtaining defence equipment is—for the first time ever—subject to free competition rules, required under EU directive 2009/81. This will force the Polish defence sector, which is in many respects inferior to its European competitors, face market losses and fewer options for advancement. Poland can, however, formulate new economic policy towards the sector in which it would actively use existing legal options to ensure both the development of its technological base and the security of supply.

New Public Procurement Law. On 20 February 2013, a new public procurement law enters into force in Poland, reforming the system for obtaining defence-related equipment: weapons, ammunition, components and parts of weapons systems, and other direct military equipment, as well as services and work provided specifically for military purposes. In line with the regulations, all contract award processes in this specific domain are subject to pre-defined procedures, guaranteeing non-discrimination of bidders, transparency in choosing the winning bid, effective review mechanisms and clear rules for subcontracting. Out of the five types of contract award procedures, only two allow for negotiations with selected company(ies) without prior publication of a contract notice, and only, if specific conditions are met (such as a crisis requiring immediate procurement). The remaining three kinds of procedures bind procurement agencies to publishing a contract notice in advance. Further, they prevent the exclusion of bidders from placing a tender for contract for reasons, except in such cases as when a would-be bidder has a proven criminal or negligence record. As a result, the Polish defence equipment market has become—for the first time ever—open to defence companies from across the whole EU.

Liberalising the European Defence Equipment Market. The new law was needed to align the Polish procurement system for defence equipment with the principles set forth in Directive 2009/81/EC, which aims to apply the basic rules of the EU's common market—principally, free competition—to public contracts for defence equipment. As a general rule, EU regulations have never applied to defence and security even when there was a clear economic dimension, such as the production, procurement or trading of weapons. A special clause (Art. 346) of the Treaty on the Functioning of the EU provides an exception allowing any Member State to take “such measures as it considers necessary for the protection of the essential interests of its security” without regard to other provisions of the treaty though they “shall not adversely affect the conditions of competition in the internal market regarding products which are not intended for specifically military purposes”. Adopted in the 1957 EEC Treaty of Rome, this clause persisted in subsequent EU treaties and established a basis for states to protect their national defence industries from external competition and to look to domestic security, economic and social interests rather than cost-efficiency, competitiveness and transparency across the EU. The result was overcapacity in the EU defence sector and fragmentation along national borders.

With the rapid advance of the EU common market and post-Cold War shift from large-scale armies for territorial defence to smaller, rapidly deployable forces, this economic situation in the European defence equipment market became unsustainable. Adjustment policies restructured the sector halfway-through: the aerospace industry consolidated around four prime contractors (the British BaE Systems, Franco-German-Spanish EADS, Italian Finmeccanica and French Thales), while maritime and land sectors remained largely isolated in national markets.

The idea behind liberalisation—of any sector or market—is to allow free competition and to let free market forces ultimately decide the optimal allocation of assets. Free competition helps companies that have comparative advantages (technological, organisational, etc.) and can lead to better equipment at a lower price. Consequently, it eliminates businesses that generate losses or which cannot find niches in the market. This is, however, not what the EU Member States are exactly willing to achieve with regards to the defence equipment market. They fear uncontrolled liberalisation could jeopardise their security and economic interests to a high degree, leading to a sustained fragmented and economically ineffective defence sector. The main danger is seen as overdependence on American technologies, offered by more competitive U.S. defence industry giants.

For these reasons, Art. 346 TFEU remains in force. In line with the European Commission's communication from 2006—which preceded the adoption of the directive and was a first step towards liberalising the market—EU members should consider the derogation clause an exception rather than a general rule. However, the rule is not breached as long as a state can effectively argue before the Commission or the European Court of Justice (if a case were brought by the Commission) that applying the exception was crucial to its security interests. Further, the directive itself also contains exclusions. It does not apply to such things as contracts awarded for intergovernmental armaments research and development investment programs. By using those exemptions actively, EU members may be able to keep the economic policy option with regards to their defence sector and shape its developments according to national priorities. A mix of selective liberalisation and active promotion of the most competitive industries, offering benefits for the whole economy on the macro scale, is likely to mark the top European weapons producers' economic policy.

Polish Defence Sector. Over the last decade, Poland has consolidated its defence sector, copying the restructuring strategies adopted by other European states. As a result, a “national champion” was established: the state-owned Bumar Group, comprising 25 individual companies from the land and electronic/sensor branches. Some public companies remain, however, outside of the group, including two prime contractors of armoured vehicles (HSW and WZM Siemanowice), a dozen military repair and production centres, and military shipbuilding industries. As well, the aerospace branch is largely private companies.

The sector is diversified as to market position and business perspectives. Profitable companies developing cutting-edge technologies operate alongside declining businesses striving to find a market for their products. The aerospace branch seems to be the most competitive, with business opportunities not contingent on Polish orders, as most firms function within international supply chains, providing components, spare parts and aero structures for their parent companies (Europe's EADS, America's Sikorsky or Italy's AgustaWestland). The sensors/electronics industries note a relatively good outlook as well, thanks to less resource-consuming R&T, allowing them to develop systems that are competitive on both the domestic and global markets.

The business condition of the land-based systems sector is complex, however. Reliant on heavily modernised Soviet technologies, orders from the Polish armed forces, and highly volatile export markets, it struggles to find financing for developing new products. It either aligns with international champions or integrates off-the-shelf components into its indigenous platforms.

The military shipbuilding industry is in a relatively worse condition, still seeking market opportunities.

Perspectives for the Defence Industry in Poland. The new law on defence equipment procurement will seriously limit flexibility to use protectionist tools, widely applied by Poland to sustain its technological and industrial defence base and assure security of supply for its armed forces. Preferring indigenous weapons systems to products offered on the global market and offset agreements (providing for the transfer of technologies and investments from the winner of a tender to the customer's defence sector) have been the chief elements of the Polish approach towards its defence sector. Today, both have become irrelevant, and as a result there is growing fear that free competition will wipe out the majority of the defence industries in Poland.

Nonetheless, there is still a viable economic policy option for the industry provided that Poland develops and pursues the right defence industry strategy. The strategy should promote multinational investment programs and R&T projects in armaments as a means of developing and acquiring weapons. As these programs and projects are excluded from the new procurement regime, they could help promote existing centres of excellence—often too weak to enter the global market—and let them mature under the umbrella of the state. These projects can also contribute to a further restructuring of the sector, however, the consolidation should be driven by economic factors and group only those companies that can benefit from each other while operating within the same consortium or holding. Finally, by using Art 346 TFEU occasionally for key tenders, Poland could also help sustain and develop industries it considers vital to security of supply.