



A PROJECT-DRIVEN COOPERATION FOR THE CENTRAL EUROPEAN DEFENCE SECTOR

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The defence sector in Central Europe faces a combined challenge of sinking national defence budgets and structural capability deficits. The countries need to spend less, more wisely and in a more transparent way, but they need to support their national industrial base at the same time. More common spending is required, preferably using the European Defence Agency as well as NATO. The selection of priorities should be determined by military and industrial needs and elaborated in national defence industrial strategies that will help identify overlaps and room for cooperation.

Multiple challenges for the defence sector

Since their accession to NATO and the European Union, the Visegrád Four have enjoyed a historically unprecedented high level of security. A military attack against any one of them is hardly imaginable; the internal security cooperation within and beyond Schengen provides for more effective ways of facing transborder crime. With the membership, however, they have also assumed part of the responsibility for the security of the whole. As a result, they have engaged far beyond their bor-

ders, in places such as Afghanistan, the Balkans, or Africa without much previous experience.

Central Europeans share the same structural challenges as their Western neighbours when participating in overseas operations that constitute a large part of EU and NATO operational activity. Firstly, the costs of military equipment have been rising continually. The asymmetric warfare requires emphasis on information gathering and evaluating as well as high precision weapons that minimise collateral damage. High costs of training in combination with domestic public opinion demand investments into force protection.

Secondly, most European militaries have huge structural deficits from the Cold War when they were not formed as intervention armies, but as armies of territorial defence. As a result, they lag behind their allies, most notably the US military, in deployability. The European militaries do not possess key strategic enablers, such as strategic airlift, air-to-air refuelling, C4ISTAR systems, or precision-guided ammunition.

At the same time, the European countries are not ready to invest into their military capabilities the



necessary resources. The “peace dividend” of the 1990s has been replaced by objective budgetary constraints of the economic downturn. Instead of rising, the defence budgets have become a handy source of money for other policies. Hardly any of the European Allies meets the level of expenditure agreed by all NATO countries – at least 2 per cent of GDP.

Lastly, the Central European states face a specific dilemma of how to approach their industrial and research base. Should the industry attempt to serve the needs of the national militaries and be confronted with rough competition from Western Europe and the US? Or should it produce for export to the East regardless of the domestic military needs? Or should the states leave the whole sector to market forces and risk its complete annihilation?

Two ways forward

All in all, the Central European countries do not have the required capabilities to participate in NATO and EU operations sufficiently, but they are not able to find a remedy by themselves, because they lack the necessary resources. International cooperation is needed, either through NATO or the EU (or both), which would allow for either pooling the countries’ sources or for decreasing the price per unit, or both at the same time. There are two ways forward – structure driven and project driven, which are not mutually exclusive and may even complement each other. At the EU level, the European Commission promotes the former whereas the European Defence Agency (EDA) is a vehicle for the latter.

The military procurement constitutes one of few remaining distortions of the EU internal market for the Commission. Based on the Article 346 of the Treaty on the Functioning of the European Union, the armaments and trade with military material is exempted from Treaty provisions, including the prohibition of discrimination based on nationality and the regulation of state aid and procurement methods. For many years, the Commission has been attempting to curb the very vague and broad

provision of the Article 346 and define more clearly what may and what may not be singled out from the Treaty scope. Most recently, two directives on defence procurement and transfers of defence materials respectively were adopted by the Parliament and the Council – the so called “defence package”. The aim of the new rules, at least from the Commission’s perspective, was to minimize the scope the Article 346 and to simplify and boost the intra-EU trade in defence material with the final objective to create the EDEM – European Defence Equipment Market. The EDEM would respect the specific nature of the defence sector, but would introduce as many market tools as possible. Using the same perspective, the Commission has understood offset agreements (i.e. contracts conditioned by investments in the given country) from the same perspective of market distortion and has struggled to limit their use.

From the perspective of the Member States, the creation of EDEM would help increasing the competitiveness of the European defence industry and may provide for savings in their expenses. At the same time, however, the collateral restructuring of the sector could have devastating effects on their respective companies, largely subsidised from national budgets through Article 346 and providing thousands of jobs. Therefore, the Member States often prefer a more controlled, top-down approach, which is less risky for jobs at the price of relieving the national budgets only partially. In 2004, they established the EDA to help them in this endeavour (and covered the real motivation with nice talk of converging defence needs and creation of common capabilities).

The EDA provides a platform for the Member States to invest jointly into defence research and procurement that falls under the Article 346. The cooperation enables the states to develop and acquire capabilities that are too expensive for a single national budget, but are badly needed in the current security environment. Examples of projects that have been concluded under the auspices of EDA are numerous, from developing new technology for military hospitals to rocket propulsion. The project-based approach permits sharing the



costs and building ties between defence companies across the EU without exposing the whole sector to standard market pressures.

Future developments

The Member States and their defence industry will be under great pressure in the following years. The economic upheavals have further curtailed the defence budgets, but the structural deficits of European militaries have remained and so has the political and security pressure to deploy them overseas. The states will be squaring the circle when trying to increase their capabilities, decrease the costs and sustain their industrial base. There is no easy way forward, but some paths are more acceptable than others.

The structure-driven path has hit the wall of state interests. The defence package has brought market as far as the Member States were ready to allow. The Commission will now concentrate on correct implementation and most probably will not attempt to draft new secondary legislation. Decoupling of the state from the industry champions would be necessary to move further, but that would require a revision of the Article 346. Treaty change is close to impossible in the current political and economic situation, especially if it meant job losses for some countries (which it surely would).

At the same time, national protectionism does not offer much comfort to the national defence bases either. The shrinking national defence budgets cease to guarantee survival of national defence companies. There is little hope for the rotten parts of the sector, but even the healthy companies are in danger. The competitive segment of the industry needs new contractors, which means other states' governments, and the same rules that have protected it in past now may cause great losses.

The project-driven approach remains as a viable path forward. The choice of projects, in which the Member States invests, is surely based on the structural needs of the national military, but business concerns may inform it too. By investing in a given project, the state offers its companies an op-

portunity to bid within the project's scope and to establish business ties with other companies across the European Union that may outlive the project's lifetime. At the same time, it does not preclude the state to use the Article 346 in other procurements.

The participation in such projects seems particularly advantageous for Central European countries. They have a very limited pool of major defence companies that would act as contractors for governments. Rather, their defence industry consists of smaller firms supplying bigger, foreign corporations. That is why the Central European states have made use of offsets very often in the past, because they helped connecting their companies to the final contractors. With the Commission actively struggling to limit the use of offsets, the project-based investment in defence research and procurement might be a substitute.

Recommendations for the Visegrád Group

There is little hope that the Visegrád countries raise their defence budgets significantly in the coming years. Even Poland, which came out of the crisis well, does not fulfil the NATO 2 per cent commitment. There are too many economic and political pressures on the governments to channel the sources elsewhere. Therefore, different ways must be used to improve the capabilities and boost their defence industry. Three, interconnected recommendations can be made for the Central European states:

- *Central European countries should set out on the project-driven cooperation.*

That is where they will gain most for every euro spent. The infrastructure is up and ready in the form of the European Defence Agency. The countries just need to use what is on offer and earmark finances for collaborative projects. Using the EDA would be more advantageous than ad hoc cooperation within Visegrád, because the Central European businesses need to get involved in supply chains of major Western European companies. In fact, regionalisation has been an important re-



cent trend in European defence as the examples of Franco-British or Weimar cooperation prove.

- *Both military needs and domestic industrial base considerations should define the spending priorities.*

Clearly military needs must determine the defence spending, but there are too many needs and too little budgets. The industrial base should set the priorities. The countries should invest in projects that not only help their militaries develop new capabilities, but also enable their companies to participate in the research and production and establish contacts with partners across the border.

- *A defence industrial strategy should set the national priorities.*

The Central European countries need to set priorities for the future development of national defence industry. A coherent strategy or a white paper will help to identify EDA projects suitable for the domestic industrial base. At the same time, a consistent effort to develop special segments of the industry supported by a strategy will also serve as a justification of offsets in case of off-the-shelf procurements.

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