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# DEFENCE AND INDUSTRIAL POLICY IN POLAND:

## Drivers and Influence


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## ABSTRACT

Defence and industrial policy in Poland has undergone a dynamic evolution in the last three years. This process has been driven by a rise in military threats to the East of Polish borders, but rests also on traditional concepts in Poland's strategic thinking, predominately as regards the special role of the DTIB in state defence policy. Poland has formulated a new, relatively ambitious defence and industrial policy as a result. Following over two decades of deterioration of its DTIB, Poland is now aiming to establish its national defence and conventional deterrence potential, and restore industrial capabilities in some key technological areas. It looks to do so chiefly through transfer of technology from global prime contractors, consolidation of its DTIB under a single holding (PGZ), and national R&T/R&D projects.

## DEFENCE AND INDUSTRIAL POLICY IN STRATEGIC DOCUMENTS

A unifying document, which would present leading assumptions, goals, tools and methods of implementing the next Polish defence and industrial policy – National Armaments Policy – is expected by the end of 2017. Yet, its baseline elements can be derived from two documents, which have already been adopted: Strategy for Responsible Development (February 2017) and the Concept of Defence of the Republic of Poland (May 2017). The National Security Strategy (2014) and the White Book on National Security (2013) are formally valid – at least until replaced by updated documents – but widely considered outdated, due to dynamic developments in European security environment, that have taken place since their presentation.

The Strategy for Responsible Development sets forth principles and objectives of a new Polish economic policy, focused on reindustrialisation and developing new tools to support the development of the general industrial base in Poland. Industry is seen in the Strategy as a harbinger of new technologies, which – in turn – are key to sustaining economic growth in the long run. In this context, defence industry in indicated as one of the most important elements of Poland's economy. The document recognizes, that Polish defence companies can generate "technological impulses" and establish a solid foundation for developing dual-use technologies, while also having the biggest potential for innovations. Further, Polish DTIB – consolidated under the PGZ and supported by a number of smaller private companies – is assessed as capable of becoming a regional defence industrial leader.

An underlying philosophy, which will be guiding the road towards achieving this goal is the increase of Polish defence budget to 2,2% of GDP in 2020 and 2,5% GDP in 2030. – The Strategy is the very first document, which formally introduces this goal. Assuming a stable economic growth in Poland, the planned increase of this indicator would mean, that Polish defence budget could grow almost twice from EUR 8,8 bln in 2016 to more than EUR 15 bln in the year 2030[1]. What is stressed in the Strategy is that the extra money for defence is meant not only to provide Polish armed forces with new capabilities, but also allow a technological breakthrough in the Polish DTIB. Top armament programs – like air and missile defence, submarines or attack helicopters – shall be run in cooperation with global prime contractors and involve technology transfers to Polish defence companies. The latter should be enabled by offset agreements, considered instrumental in assuring that Polish DTIB will benefit from the technical modernization of the armed forces.

The Concept of Defence of the Republic of Poland is an outline of conclusions from a Strategic Defence Review, a cyclical process with the latest reiteration (third after the end of the Cold War) completed in early 2017. It's main purpose it to set out a vision of tasks, capabilities and organisation of the Polish armed forces in the perspective of the year 2032. The Concept puts the military threat, posed by Russian aggressive policy and force posture, atop the list of security challenges for Poland[2]. This is the first time ever in Polish post-cold war history that a strategic document directly indicates Russia as a source of military threat to the state. Consequently, the Concept makes an argument,

[1] Author's own calculations.

[2] The remaining threats are: structural instability to the East and South of Europe, terrorism, weakening of political cohesion in NATO and the EU, economic and demographic changes, new technologies in the battlefield.

that the core tasks of Polish military should be territorial defence and – as an overarching goal – developing a national defence and deterrence potential to deny Russia an ability of scoring a quick win in Central and Eastern Europe through a hybrid warfare/limited war scenario. It is stressed in the Concept, that Poland needs to be able to effectively defend itself, so that a coalition scenario can be enabled. Further, Poland needs to be ready to engage in collective defence of NATO allies on the Eastern Flank. The document confirms also Poland's readiness to contribute forces to peace and stabilisation operations as well, but makes it clear that it will be a secondary task to territorial defence.

The Concept signals the intention to increase the number of military personnel to 200,000 from 130,000 in 2015. This includes forming a fourth division of operational forces. Further, it announces a new command structure of the armed forces and highlights some key investment programs, which will be priorities in the technical modernization of the military – air and missile defence, fifth generation multi-role fighters, submarines, attack helicopter, rocket artillery, or new generation main battle tank.

However, as regards the defence and industrial policy, the Concept follows the Strategy for Responsible development and points out to the upcoming National Armaments Policy for details about the new Polish policy towards the DTIB. Nevertheless, the Concept confirms the goal of spending 2,5% GDP on defence by 2030 and, more importantly, announces a deep reform of the defence material acquisition system. It stresses, that a new legal, administrative and organisation solutions will allow to streamline the process, in which investment programs are managed throughout the entire life-cycle, starting from formulating technical and tactical requirements, through development to upgrades and disposal.

## THE STRUCTURE OF THE DTIB IN POLAND

Unlike the majority of EU Member States, the vast part of Polish DTIB remains directly owned by the state. For more than 20 years it has remained, however, heavily fragmented. Initial consolidation did not bring much value added, since some significant companies stayed for long outside them. Namely, the "Bumar Group", established in 2002 and rebranded as Polish Defence Holding in 2013, did not include neither WZM Siemianowice (producer of KTO "Rosomak", the basic armoured wheeled platform used by Polish Army), nor 11 military-run agencies focused on providing servicing, maintenance and upgrades (so-called WPRPs), nor two shipyards in Szczecin and Gdynia. As a result, there was an internal competition, particularly with regards to the future armoured platforms.

The consolidation went on a fast track only in 2014, when the Polish Armaments Group (PGZ) was established to become the Polish defence industrial champion and took under its umbrella (through capital restructuring) all state-owned defence enterprises. These included WZM (renamed "Rosomak" after its top product), WPRPs and shipyards (the latter joined PGZ only in 2017). This allowed the PGZ to formally took over a huge chunk of Polish DTIB and – for the first time ever – ranked 60th in the 2015 edition of the SIPRI top 100 list, with an estimated arms sales at the level of USD 1,2 bn. Nevertheless, the PGZ represents mostly land systems, military electronics and naval branches, although it comprises more than 60 individual companies and employs directly 17,500 people.

The aeronautics branch has been finally privatized between 2007 and 2010, when the last relatively large helicopter companies controlled by the state – in cities of Świdnik and Mielec – were acquired by respectively Finmeccanica and Sikorsky. These two firms, together with Airbus Group's EADS-PZL Warszawa-Okęcie (privatized in 2001) are operating mostly within global supply chains of their parent companies. They are also responsible for the bulk of Polish armaments exports, at least value-wise, due to exporting platforms to end users (W-3A Sokół, a Polish-developed mid-size helicopter) and components for final assembly in various locations across the world (cabins and other structures of S-70 family or AW169). Nevertheless, the entire export value of Polish defence companies stood at approximately EUR 420 mn in 2015 and EUR 395 mn in 2014.

The military electronics branch is shared between the PGZ and a few small and medium private companies, which tend to focus on software and high-tech electronic components. Some of them are very successful in cutting-edge electronic technologies and occupy a significant share of niche markets. The biggest of them is WB Group, which focuses on C4ISR/battlefield awareness systems, and on unmanned platforms for reconnaissance/surveillance. The group of private defence companies in Poland comprises of 13 bigger enterprises and around 50 smaller firms, which mostly work on software and tine components. They employ in total less than 2,000 people and approximately EUR 200 mn yearly turnover.

The domination of state-owned defence industry in Poland is reflected in its governance system. Different supervisory roles towards the PGZ are played by four ministries: Ministry of National Defence, Ministry of Development, Ministry of Treasury and the Ministry of Foreign Affairs. This proved to hamper coordination of defence and industrial policy. Yet, the MOD should be considered the primary supervisory entity for the Polish DTIB, following transfer of tasks regarding negotiation of future offset agreements from Ministry of Economy (now: Development) and the supervision rights towards the PGZ from Ministry of Treasury.

Industry associations: Polish Chamber of National Defence Manufactures, established in 1995, and the newly-formed Union of Defence Industry Employers and Producers, which is a vehicle of SMEs, play only advisory roles towards the MOD. However, the Chamber proved to help promote Polish defence companies abroad.

## WHAT DEFENCE AND INDUSTRIAL POLICY?

Following assumptions presented in the Concept of the Defence of the Republic of Poland, it is arguable that the next Polish defence and industrial policy is likely to be informed by two overarching goals: the drive to improve national defence and deterrence potential by deploying state-of-the-art capabilities, and the willingness to rebuild the DTIB through transfer of technology from global prime contractors. Both will have deep implications for some key elements of the policy: Poland's approach to security of supply, openness for cooperative programs, stance towards European defence industrial policy or the choice of economic policy tools, deployed in support of defence companies.

But it is the changed threat perception what should be considered the foundation of the next Polish defence and industrial policy. Following a peaceful withdrawal of Soviet forces from Poland, over the 1990s and early 2000s the popular perception of Russia in Poland was focused on a hope for a success of democratic reforms and liberalization of Russian foreign policy. The use of force by Russia against Ukraine and increasingly provocative Russian military activity towards NATO (large scale, snap military drills, violations of airspace over the Baltic, etc.) made Polish political elites consider Russia again a long term challenge for security of the state. While extreme scenarios of all-out war between NATO and Russia are largely dismissed in the Polish strategic debate, there is however an agreement – across the entire political spectrum – that a limited/hybrid warfare scenario involving Baltic states and Poland should guide the national defence planning. On top of that, there is also an understanding among Polish strategic community that current Russian policy towards Central and Eastern Europe is a continuation of a long-term strategic thinking of this country's elites. These have been looking at CEE as a sphere of privileged political and economic interests; a sphere in which Western presence – military in particular – is a threat to Russia. Consequently, Russian policy is widely seen in Poland as unlikely to drop its provocative stances, even in effect of a potential regime change.

A straight consequence of the above is a very traditional approach to the role and function of the DTIB in a situation, when a large-scale military conflict cannot be excluded. In the case of a new Polish defence and industrial policy, this translates into an approach in which DTIB is seen a cornerstone of security of state, not just a regular part of the economy or a yet another branch of industry. As such, the DTIB cannot be approached with a market logic, but rather a strategic approach. This is likely to be the way in which goals of building national defence and deterrence potential and reinforcing DTIB are implemented in Poland.

Within this framework, security of supply comes to the fore as a primary issue of concern for Polish civilian and military authorities. Further, security of supply is understood broadly: the guiding assumption for all key investment programs is to assure a maximal level of state control over the entire weapon and weapon system's life cycle – particularly in servicing, maintenance and upgrades. This is to be achieved through transfer of technology to PGZ, which is meant to assure on-time access for Polish military to the servicing/maintenance base. Further, this assumption implies also freedom to upgrade systems, had the evolution of doctrines or battlefield technology required it. The latter issue covers the sensitive problem of source codes – in Polish debate about technical modernization of the armed forces it is often stressed that any serious programme needs to cover transfer of source codes, so that future upgrades of a procured system are possible without negotiations with foreign entities, or subject to consent of their respective governments.

This approach is likely also to affect Poland's willingness to join cooperative R&T/R&D programs. So far, Polish record in such endeavours has remained modest. Poland never participated in any of the big European programs; attempts to launch regional projects (mostly within the Visegrad Group) failed too. If the priority is now put on assuring a maximal level of the security of supply through mastering technology by Polish companies (mostly PGZ), then common programs do not necessarily come in first place, as issues like labour share and intellectual property rights come into play. Yet, it is now often repeated by Polish political leaders (and the Concept confirms it), that a future generation of the main battle tank is seen as a potential for an international project. This should be considered as a signal of a general willingness of Poland to run at least some programs in a cooperative mode.

A technical tool to assure transfer of technology will be, then, offsets rather than cooperative programs. Polish approach to offsets has evolved over the recent years – new legislation on offsets entered in force in 2014. In case of the F-16 contract (2003) the vast chunk of the offset considered non-defence businesses (like investments in automotive industry). Following a public criticism of that deal – however, strictly as regards its economic, not military, effect – changes were made in Polish law regarding offsets. The aim of the above-mentioned bill from 2014 is to make sure, that offset commitments of the winning contractor involve mostly defence companies, and are designed in line with the underlying principle of reinforcing security of supply.

If offsets are considered the main way of meeting basic goals of the next Polish defence and industrial policy, then the tension with the currently developed EU approach to EDTIB becomes evident. The European Commission has sustained its negative assessment of offsets as a tool, which "distorts" the defence equipment market in the EU. The EC's pursuit for the universal application of principles set forth in the directive 2009/81/EC and transposed to national legal order cannot be easily reconciled with Polish approach to defence and industrial policy. Polish officials often underline, that art. 346 of the Treaty on the Functioning of the EU remains in force, what allows the derogation of EU law in relation to programs, which have crucial importance to Polish security and defence. As a NATO flank state, widely assessed to be a direct target for Russian military actions had a conflict sparked in the region, Poland may easily prove – if a case against is at some point brought to ECJ – that a majority of its investment programs are de facto fulfilling the understanding of "essential interests" of its security from the art 346. Further, there are cases of using the principles of the directive – like the purchase of lead-in jet trainer for Polish pilots from Leonardo (M-346 Master platform). Polish official position towards the recently unveiled European Defence Fund is also positive, signalling willingness to test ability of Polish defence companies to successfully bid for grans in international consortia.

## CONCLUSIONS

Poland is the only EU Member State which has to include in its defence planning a threat of the use of military force against itself, and at the same time has a significant DTIB, which can still offer some competitive products, even if its overall capability had deteriorated following years of underinvestment. These two facts establish a paradigm, which will guide the likely development of Polish defence and industrial policy in the future. It's vital to understand its implications. The defence effort of the state has to naturally involve the DTIB and simultaneously follow a strategic approach, rather than a pure market logic. Other Central and Eastern European EU Member States cannot really be compared to Poland precisely for the lack of a developed DTIB – neither the Baltic States, nor Visegrad partners of Poland, nor even Romania (the strongest EU militarily south of Poland) could rely on national defence companies in providing capabilities for their armed forces. Poland, however, aims to turn its DTIB – long criticised for lack of competitive edge and said to be doomed to fail – into an asset, augmenting its national defences.

Consequently, Poland is not likely to change its defence and industrial policy, at least unless European security environment significantly improves. The stakes will remain to improve defence and conventional deterrence potential of Poland, and only in the second place to generate innovation impulses for the economy as a whole. Hence, a strategic approach to investment programs will prevail over the market logic – offsets are likely to remain an instrument of choice as regards key acquisitions; international cooperation in projects will be tailored to the strategic interests of Poland. In this context, it is worth also noting that the new defence and industrial policy of Poland may be seen as a phase of developing its DTIB, analogical to what the top EU defence producers were doing over the 1990s, when consolidation and intergovernmental projects were applied selectively with an overarching goal to reinforce DTIB, so that it could become ready for the next phase – cross border cooperation and integration at the European level.

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*The Armament Industry European Research Group (Ares Group) was created in 2016 by The French Institute for International and Strategic Affairs (Iris), who coordinates the Group. The aim of the Ares Group, a high-level network of security and defence specialists across Europe, is to provide a forum to the European armament community, bringing together top defence industrial policy specialists, to encourage fresh strategic thinking in the field, develop innovative policy proposals and conduct studies for public and private actors.*

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