

Reducing Defence Expenditure in Greece: A Recipe in View of the Turkish Rivalry

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Abstract. The persistent Troika (IMF, ECB, EC) guidelines require defence expenditure cuts together with terminating the operation of most of the Greek defence industries thus looking forward to collecting some form of a peace dividend. This paper proposes a compromising solution aiming at restricting defence spending without adverse repercussions on national security issues. It proposes, more specifically, an import-substitution policy concerning the procurement of defence equipment, placing emphasis on domestic production to the best possible extent. Needless to point out that the impact of such a policy on production, employment and growth is positive beyond any doubt, especially as it concerns the revival on ENAE.

Keywords: Defence expenditure, peace dividend.

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I. INTRODUCTION

In the middle of a six-year economic crisis turmoil the Greek authorities had to decide on the extent to which defence expenditure cuts were necessary and to what extent such cuts were feasible without endangering the country's national security interests. Taking such a decision, however, presupposes that one takes into consideration that National Security and Defence is classified as a public good in which case its consumers enjoy the following benefits:

- a. Non-rivalry, meaning that several consumers can consume the same good without diminishing its value.
- b. Non-excludability, ensuring that no consumer can be prevented from consuming the specific good.
- c. The indivisible benefit accrued following the simultaneous consumption of any public good guarantees that the satisfaction enjoyed by an individual consumer does not entail a corresponding benefit reduction for the rest of the society members.

It follows, therefore, that National Defence, in its capacity of a public good, can not be considered as subject to the laws of supply and demand in a manner followed by a producer addressing any private good market under the profit-maximisation guidelines. It has been

considered necessary, therefore, to focus on the issue of National Defence by means of a specific scientific area, that of Defence Economics.

The rising costs of defence systems imposing a binding constraint on national budgets thus leading to their dramatic reduction has come to be one of the most challenging Defence Economics issues of our days. In view of such an environment one needs to embark on a constrained-optimisation procedure bearing in mind the effectiveness of the country's defence systems on one hand and the various non-defence alternative needs in the "peace dividend" sense, on another.

Such an assessment exercise, however, presupposes distinguishing between defence spending and security the latter being the ultimate requirement. Given, however, that assessing security is practically impossible its value is approximated assuming that it stands as a monotonic function of the country's defence expenditure. This assumption in its turn presupposes that defence spending is channeled to the purchase of those items that can lead to security maximization, something which is not always realistic bearing in mind that security depends on a wide variety of additional variables such as the domestic defence industrial base.

It is evident, therefore, that deciding on the extent to which defence spending is indeed a top priority presupposes thorough and deep understanding of both the "peace dividend" concept, as well as the existence of a sound defence industrial base.

II. THEORETICAL BACKGROUND

The concept of the "peace dividend" is used to describe the benefits derived following the reduction of defence spending and the channeling of expenditure away from defence to non-defence activities. From the point of view of Economics, reducing defence spending is interpreted as an investment procedure entailing adverse direct consequences like unemployment or underemployment at its initial steps while bringing about long – term benefits following the re-employment of the resources previously engaged in defence activities, to the production of non-defence items.

The realization of such a procedure, however, depends on the extent to which factors of production may be able to shift away from the defence and towards the non-defence production mechanism, a very important, but also time-consuming procedure. It is necessary to remember that this shift refers to much more than just money transfer from one category of expenditure to another. What it involves, instead, is the redistribution of resources in the country's industrial complex including training of military and civilian personnel, as well as adoption of the capital equipment previously employed in the defence line of production to be used for non - defence purposes. Thus, scientists and engineers shall be trained to contribute to the development of alternative lines of production while land and capital equipment like military bases and defence installations shall be converted to adapt to the non – defence production specifications.

It is important to remember that such a process does not result to a direct and immediate peace dividend ready to be channeled to alternative activities. In fact ignoring the short – run adjustment cost of such a radical transformation procedure would lead to disregarding the resource unemployment or underemployment suffered following the defence spending restrictions. Such restrictions would bring about a considerable social and economic impact translated in terms of unemployment of the military and civilian personnel previously employed in the defence lines of production especially in areas in which such an activity represents the main source of income and employment.

Consequently, defence - spending reduction must be regarded as an investment activity entailing short – run adjustment costs mainly in terms of unemployment, followed by a series of medium and long – run benefits as transformed resources become engaged in the production of

non – defence items. This means that the cost – benefit analysis of such a venture demands the calculation of the present value of a time series of returns (either positive or negative) on the basis of a commonly accepted interest rate. Once this has been carried out, the policy maker will be in a position to question the validity of two myths: The first claims that there is always a direct and tangible peace dividend collected by the economy of a country that embarks in such a resource shift. The second myth argues that reducing defence expenditure shall lead to a non – reversible economic crisis. Such a possibility, however, seems rather remote as it presupposes, implicitly at least, that such an economy relies exclusively on its defence industrial base for its existence. But even in cases of large, industrial economies relying heavily on defence equipment production, exporting such items instead of cutting down their production tends to be a rather popular practice. Such practices, however, while supporting production and the balance of payments of the producing country, encourage local and small – scale warfare via the promotion of arms trade worldwide.

Last but not least a final point must be taken into serious consideration: Once the focus shifts to defence spending it is important to determine its nature. In fact there is a vast difference between importing defence equipment, even if such a move includes military offsets, and manufacturing the equipment at home using the domestic defence industrial base. It is obvious that the latter case is by far preferable since it contributes to the local GDP by mobilising the domestic production mechanism via the use of the national human and property resources. The successful implementation of this option, however, presupposes the existence of a reasonably well - developed domestic “defence industrial base”. This term is employed to describe the national defence industry which has come to represent more than just a means to support the national defence and security policy. In fact, by means of taking advantage of international trade and R and D agreements several countries use their national defence industrial base to promote their foreign and economic policy interests. Thus the benefits accrued by means of developing and supporting a sound defence industrial base stem from its potential to safeguard the availability and immediate access to the defence equipment items required during crises periods, relieved from the pressure exercised by international oligopolies mainly concerning price issues. But as earlier stated, the most important benefits of developing a sound domestic defence industry relate to its contribution to the national growth and employment, the export promotion and the support of technology transfer.

III. THE GREEK CASE

The background of the Hellenic industrial defence infrastructure reveals the absence of elementary long – term planning, given that the various production units composing this defence industrial base have been built following the 1974 Greek – Turkish crisis which revealed a number of serious weaknesses regarding equipment procurement of the Hellenic Armed Forces. In fact, the main weakness being the dependence on foreign producers has caused serious delays in delivering the equipment or its spare parts in time neutralising, as a result, a considerable number of units during crises periods while depriving the economy of substantial foreign exchange reserves.

Once such weaknesses pointed the need to a national defence structure the National Defence Industrial Service (“ΥΠΟΒΙ”) undertook the task of setting the foundations of such an industrial complex in 1977. These led to establishing “EAB” (Hellenic Aerospace Industry), “EBO” (the so-called Hellenic Arms Industry which later merged with “PYRKAL” to form the Hellenic Defence Systems – “ΕΑΣ”), the buying – up of “Steyer” which changed to “ΕΛΒΟ” (Hellenic Vehicle Industry), the promotion of the two major shipyards building activities and the encouragement of the private sector to contribute to the local defence industry.

The progress attained on the basis of this infrastructure regarding the support of the Hellenic Armed Forces equipment needs leaves a lot to be desired, given that it has been able to support only a small percentage of the national defence requirements, as these are described by means of the Medium – Term Development and Modernisation Programmes (EMΠΑΕ). The main reason of this failure is the inefficiency caused by the deep involvement of the political influence through the public sector. Such forms of political interference promote extensive corruption which, in its turn, leads to waisting public resources and delaying equipment deliveries. This, in its turn, promotes imports of equipment at the expense of domestic production in order to guarantee the readiness of the Hellenic Armed Forces. The involvement of a corrupt and inefficient public sector is distructive to such an extent that it makes other relevant problems like the one caused by the absence of coordination with the Defence Ministry or with academic and research institutes appear rather minor.

One can hardly wonder, therefore, why the Hellenic Defence Industry suffers heavy losses. In fact, by the end of 2013, the debt of ΕΑΣ to the government amounted to more than €1 bill. while the losses of ΕΛΒΟ have been far from negligible.

Given the above disappointing background it has already been pointed out that the domestic industry can support just a small fraction, maybe a one-digit percentage figure, of the Hellenic Armed Forces equipment requirements, thus failing to contribute to the country's economic growth (Zombanakis 2009). Resolving the problem of this negligible contribution to the national GDP (which explains why all calculations of any possible peace dividend are meaningless) calls for the following recipe:

1. The political involvement in the implementation of the Medium – Term Development and Modernisation Programmes (EMΠΑΕ) must be strictly prohibited unless foreign policy issues arise.
2. The implementation of the Medium – Term Development and Modernisation Programmes (EMΠΑΕ) and, consequently, the equipment choice must follow the so called PPBS (Planning Programming Budgeting System) based on a cost – benefit analysis reasoning. This logic, in its turn, relies on a constrained-maximisation technique which aims either at a benefit maximization given the financial constraints or at a cost minimization when focusing on a specific target.

There is, in addition, a second reason why research on the Greek case points to reaping just a negligibe peace dividend when moving resources from defence to non-defence lines of production (Brauer 2003). This reason relates to questioning the choices made at a political level, choices which led to transnfering resources to non-defence activities which, however, have been proven inefficient and, as a result, non-productive in terms of a peace dividend contribution. A typical example of such a case is the persistence of the authorities to curtail defence expenditure as this has been scheduled in the EMΠΑΕ, despite parliamentary approval, arguing that the funds curtailed were to be channeled to financing the 1996 Olympic Games in Athens. The failure to host the 1996 Olympic Games in Greece hardly contributed to using these funds for productive purposes. The 200 billion drachmas debt of the notorious “agricultural cooperatives”, by contrast, has been “favourably arranged” in 1997 while during the same year the public sector enterprises after suffering losses of the order of 586 billion drachmas have been encouraged to continue doing so by receiving subsidies amounting to 1,35 trillion from the state budget. Assessing the reasoning and validity of such decisions which certainly fail to produce any form of peace dividend requires the following information: The subsidies of the public sector enterprises for the specific year have been about 70% higher than the annual defence expenditure of the country which amounted to 800 billion drachmas. Given that due to severe defence budget cuts the government opted for purchasing F-16 fighters (7.0 billion drachmas each) instead of F-15 (14 billion drachmas each) one can safely argue that the

“favourable arrangement” of the agricultural cooperatives has deprived the Hellenic Air Force from acquiring 15 F-15, a certainly much more useful fighter for the geopolitical and strategic targets of Greece compared to the F-16¹. Likewise, the annual public enterprises subsidies could be able to finance the purchase of 193 F-16 (more than three times the number required) or 96 F-15 (i. e. about 2.5 times more than the Hellenic Air Force requirements) (Kyriazis and Somakos 1999).

It is rather straightforward to conclude on the basis of the above, that assessing any form of peace dividend is rather impossible in the case of the Greek economy, given both the negligible contribution of the defence - industry resources to the country's GDP and the fact that once these resources are eventually diverted, they are channeled to activities in which they are wasted rather than being productive. It is also easy to see that the responsibility for the mismanagement of the state-owned defence industrial base as well as the selection of the economic activity to which funds earlier designed for defence spending may be diverted is clearly a government burden. An evaluation of the final choices in all such cases demonstrates the extent to which the political authorities have simply mismanaged and eventually wasted the resources involved.

IV. THE TURKISH CASE

The Defence Industrial Base Secretariat (SSM) is responsible for the development and technological update of the Turkish defence industry which is financed by the Defence Industries Support Fund (DISF) using tax revenues on income, petrol, beverages and tobacco, legal gambling and betting, interest-rate revenues and military service exemption fees. These revenues supplemented by the annual state budget provision for the armed forces lead to building up a sizable economic magnitude and lead to the conclusion that the Turkish defence expenditure as this is reported in the state budget is rather underestimated.

A second major fund that finances the defence spending of the country is “OYAK” (Armed Forces Trust and Pension Fund) which, however, is included in the defence budget. Founded back in 1961 it concerns local investment activity in real estate, banking, automobile and oil industries etc. It is also the recipient of a considerable number of state subsidies thus being one of the top five cooperatives in Turkey.

The so-called TSKGV is a similar fund established in 1987. This fund has similar benefits and finances major defence production programmes, thanks to its connections with the country's political and economic network.

Last, but not least, the Turkish Armed Forces Fund (TAFF) contributes to the development of the country's defence industry by encouraging and supporting investment activity in its fields of interest. Its annual revenue exceeds \$1.0 billion and relies heavily on taxes collected from beverages and tobacco, gambling and lottery. It is also a major partner of a number of defence industries like Aselsan (electronics), Aspilsan (batteries) and Havelsan (airspace industry) and non-defence firms like Ditas (oil transportation), Netas (telecommunications), Koytas (machinery) and Otomarsan (transport equipment).

It is only straightforward to see that the distortions introduced by the functions of these funds to the structure of the local economy are far from being negligible, especially as it regards

¹ The F-15 is a twin-engine fighter jet capable of extremely high speeds and altitudes. It can operate in all weather conditions and carry a variety of air-to-air and air-to-surface weapons. The F-16 is a less powerful but more maneuverable single-engine fighter aircraft, cheaper, and lighter designed with an emphasis on ease of maintenance and maneuverability.

competitiveness, income distribution and social welfare and account for the reasons why the Turkish armed forces do not welcome the prospect of the country's full EU membership.

Concluding this brief overview of the Turkish defence industry one must point out the contribution of major firms like "FNSS" (army vehicles co-production with US firms), "MIKES" and "TAI". (participation in the F-16 production programme together with Lockheed Martin) and "TEI". (joint production programme of F110/GE100 engines for F-16, together with General Electric Company).

The outlook for the next 25 to 30 years is that this industrial complex shall contribute to the replacement or modernization of a large number of defence equipment items, a contribution that is expected to cost about \$150 billion including operation and maintenance (Pavlopoulos 2000)². This investment programme aims at producing high technology equipment that will cover about 50% of the Turkish armed forces requirements.

As it concerns import substitution using domestic production Turkey usually favours joint ventures for co-production, an option to which foreign partners usually impose constraints regarding high technology transfer.

On the basis of the above it becomes obvious that Turkey has got a clear upper hand compared to Greece regarding the extent to which the domestic defence industrial base contributes to the armed forces equipment requirements. It is, therefore, ironic to listen to the Turkish Prime Minister concluding during his October 2010 visit to Athens that "behind the [Greek economic] crisis one can see defence spending". It appears, however, that Mr. Erdogan failed to recall that contrary to the Greek case the flourishing Turkish defence industry supplies the country's armed forces with a considerable percentage of their procurement requirements thus contributing to enhancing the economy's rate of growth and employment rate, while contributing to technology transfer. By contrast, the contribution of the Greek defence industry to the country's ΕΜΠΑΕ requirements is minimal thus encouraging imports of equipment by local agents against the interests of the Greek economy.

V. PROPOSING A SOLUTION

The Troika demands that the majority of the Greek defence industries must close down on the grounds of their long term history of losses. The Greek side, by contrast, insists on the argument that these firms are operational in view of the political cost suffered following their closing down and the impact on unemployment that such a possibility entails.

Looking for a compromising solution between these two extreme positions one may recall that recent literature sources argue in favour of the benefits accrued when promoting the local defence industrial base in the logic of an import – substitution strategy aiming at supporting the procurement requirements of the armed forces to the best possible extent (Andreou et al. 2013). The economic dimension of such benefits (GDP rise, unemployment reduction, technology transfer), is accompanied by operational ones (immediate availability of equipment and support during crisis periods together with independence from foreign procurement agents, suppliers and firms). It is only reasonable to argue, therefore, that to the extent that the increase of defence spending on equipment is considered necessary, it may regard to a considerable extent procurement requirements satisfied by the domestic defence industrial base. This, in its turn, presupposes that this domestic defence industrial base has gone through an upgrading procedure to relieve itself from the state interference, mismanagement and corruption. Such a procedure may also aim at a close cooperation of the defence equipment producers with the

² Out of a sum of \$150 billion, the Turkish Navy is allocated \$25 billion including \$2 billion aiming at building a helicopter carrier.

Defence Ministry and the ΕΜΠΑΕ, as well as the various academic institutions that can support research and development programmes for the armed forces.

The colossal damage incurred upon the security and defence structure, as well as the economy of Greece as a result of the fatal managerial blunders committed in the past has revealed its painful consequences in the case of the ENAE shipyards. The fact remains, however, that the attainment of the strategic, political and economic targets of the Greek policy making have always presupposed and still do, to a very large extent, naval dominance. One may therefore argue in favour of the following proposition when facing the pressure exercise by the Troika to close down the various defence industries:

Terminate the operation of all production units comprising the Hellenic defence industrial base (possibly excluding EAB) in return for re-operating the ENAE (Scaramangas Shipyards), following the return of the firm under state control. This proposition may contradict the reasoning analysed so far relying on favouring the privatization of the defence firms, it will, however, enable the payment of all fees and fines imposed by the European Commission so far imposed for extensive state subsidization of the ENAE during the past. This in its turn will lift all prohibitions concerning possible defence and non-defence equipment production and export by the company, bearing in mind that producing exclusively to satisfy the Hellenic Navy needs is clearly only a short-term option during a period in which export orientation can guarantee the long-term prospects of the largest shipyards in the area. A solution along these lines will allow, to a large extent, the re-employment of those that have been previously employed in the firms comprising the Hellenic defence industrial base; it will contribute to the country's growth rate through its own production as well as its support to a cluster of complementary shipbuilding firms. Once thus established in the international competitive environment then the firm may be privatized for a much higher price compared to what its present value can allow while a merger with the Eleusis Shipyards may be a promising option in view of the tough competition in the area of defence firms worldwide.

The ENAE - case stagnation has been translated to a heavy toll for the Greek national security, defence and economy, given that the country has been deprived of the enormous benefits and advantages which the commission and use of the four 214 -Type submarines would entail in return for at least €2.5 billion payments already realized. During a considerable time period the reliability, effectiveness and operational potential of one of the best conventional submarines ever built have been questioned by the press on account of a series of financial manipulations and scandals related to its procurement procedures. In such cases, however, in which a selection of a vital weapon system is involved, one must be able to distinguish between the financial dimension of the procurement process which admittedly leaves a lot to be desired in the specific case, and others like the geopolitical and operational value of the system acquired. It goes without saying that the consideration of all these aspects is a necessity before an objective evaluation of any defence system provision may be seriously considered.

Given the analysis thus far, the fact remains that during crises periods suggesting a defence procurement reduction recipe is more than attractive for the average tax payer, especially in cases in which such recipes bear a substantial weight given that they are suggested by the IMF and the ECB. It is the duty of the policy maker, however, to underline the pressures, demands and threats coming from the part of Turkey regarding a variety of issues the latest being the possibilities of Cyprus exploiting its hydrocarbon resources jointly with Greece and Israel. Such an environment may lead to a considerable extent of instability thus allowing practically negligible margins to defence spending reduction policies.

Focusing on the 214 - Type submarines case and in view of the priorities assigned by the Turkish government for the acquisition of a number of brand new ones, their purchase and recent arrangement for their delivery to the Hellenic Navy seems to be a rather successful move to support the bargaining power of the Greek side in the case of a joint venture together with Cyprus and Israel to exploit the hydrocarbon resources in the area.

One can only wish that the acquisition and commissioning of the four 214 – Type submarines may be the first step to the direction of resolving the ENAE issue which is admittedly rather complicated. But it is far more than certain, that no cost can be considered high enough to counterbalance the benefits following the revival of the ENAE and their contribution to the production and export activity of the country.

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