NATO in the aftermath of the financial crisis

SUMMARY *Since the onset of the financial crisis, in 2008, members of the North Atlantic Treaty Organisation (NATO) have reduced their defence budgets by billions of euros. Moreover, reduced investment on specific critical capabilities is affecting the ability of NATO to act.*

Investment in equipment, and research and development has also been reduced. Whilst saving money immediately, this also potentially endangers international security. This trend is particularly visible in western and central Europe, but the US has also recently adopted measures to reduce its budget deficit.

The international context remains unstable and NATO is still confronted with a broad range of security threats. Allies have therefore been challenged to find the necessary resources both to maintain assets and to overcome disparities in capabilities.

In response to such funding difficulties, the European Union has implemented the Pooling and Sharing Initiative, while NATO has embraced the parallel concept of Smart Defence. Both envisage multinational cooperation and coordination, in order to secure critical capabilities for the future and spend money more efficiently, while improving interoperability amongst partner countries.

NATO allies face the choice of pooling and sharing certain capabilities at an international level or losing the capacity to act globally.

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In this briefing:

Issue definition

The world's economic problems are indirectly affecting NATO's budget, as national governments are implementing cuts to defence programmes and assets.

Combined, the NATO allies[1] account for 60% of worldwide defence spending[2].

However, differences in defence budgets are becoming increasingly wide, both between EU Member States (MS) and between the EU and US. The role of EU Member States on the international stage is at stake, especially considering that spending in emerging countries continues to increase.

The Libyan campaign (2011) has shown that the **EU** cannot conduct operations alone. EU allies needed US help and, in certain cases, ran out of planes, smart munitions or weapons. Evident deficiencies persist in the field of air-to-air refuelling, surveillance, intelligence and reconnaissance.

According to (some) experts, EU Member States are spending on outdated weapons and equipment, and are not capable of rapidly deploying troops, even in the EU's neighbourhood and sphere of interest.

European allies total 2.3 million military personnel, but only a small proportion of them are available for rapid deployment, or even suited for expeditionary missions outside Europe.

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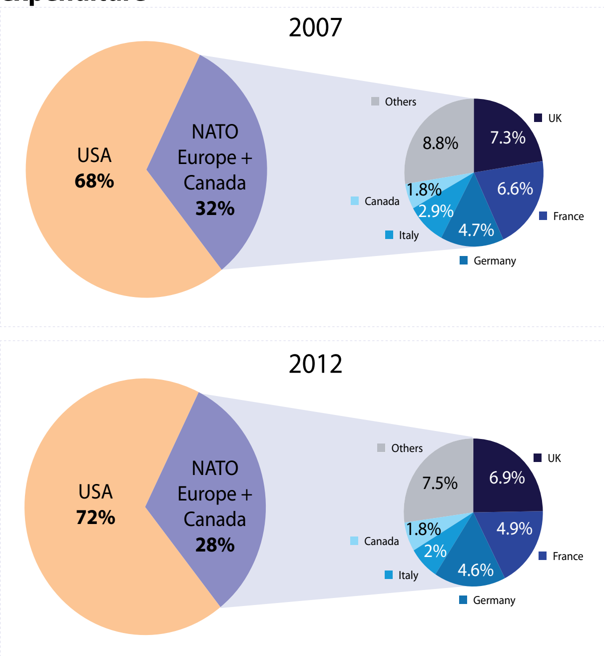
Impact of budget cuts on NATO

World military expenditure[3] did not increase in 2011, the first such year since 1998. It amounted to **US$1 738 billion** worldwide, with Europe accounting for US$407 billion.

The United States now accounts for 72% of combined NATO defence **budgets**, and almost all European allies fail to reach the 2% of gross domestic product threshold devoted to defence, agreed[4] by all NATO members.

The US's share of NATO defence expenditure has grown over recent years while the EU's has declined.

Figure 1 - Proportions of NATO defence expenditure



Data source: Adapted from NATO Secretary General's Annual Report 2012.

Concerning modernisation of capabilities[5], only five allies in 2012 spent more than 20% on major equipment, and only nine spent more than 10% on future capabilities. As a result, reliance on the US is increasing, and the possibility of conducting a major operation without its help less and less likely.

NATO European allies' spending has declined to 1.6% of GDP, way below the US's 4% level. With current austerity measures, the situation is deteriorating further.

Cuts in defence spending are expected to continue over the next decade, putting NATO's military credibility at stake. Moreover, little information about defence expenditure has been shared among EU Member States, and there is no coordination of budgetary decisions in defence.

Within the EU, the largest cuts were made by smaller countries, with rates above 20% (**Latvia** cut by 21%, **Lithuania** by 36%). On average, other countries made reductions of around 10-15%.

The three major EU spenders have also made, since 2008, reductions in military spending. The **United Kingdom** announced cuts of 7.5%, but the estimated reduction could total 20%-25% by 2014-15. **Germany** is planning widespread cuts, including selling undelivered transport aircraft. **France** has not reduced spending, but the budget allocated for 2013 and 2014 is lower than that planned in its previous multiannual military budget law.

Greece implemented a 16% cut, with further reductions planned as well as restructuring of its troops envisaged in the future. A similar reduction is estimated for **Italy**, with major cuts on operations and maintenance expenditure. **Spain** has reversed recent increases in military expenditure with an 18% cut, dropping to 1% of GDP – third lowest in NATO, after **Luxembourg** and **Hungary**.

Poland is the only EU member State which has maintained its levels of economic growth throughout the economic crisis. Its defence expenditure grew by 29%.

A positive trend can be seen among non-EU allies. **Norway** followed the same path as its neighbour, **Sweden**. Oslo devoted 20% more funding to the military, while Stockholm increased its commitments by 11%. **Canada's** defence expenditure grew by 16%[6], while **Turkey** increased its military budget by 37%[7]. Ankara is currently reforming its military despite the financial crisis. Internal and external security threats –

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disputes over maritime borders, and trouble in Syria, Iraq and Iran – have pushed Ankara to pursue a deterrence policy, to be achieved through a modern, specialised and robust military.

The **United States** has already made clear that it expects more from its European allies, especially within their own neighbourhood. Currently 31% of its defence budget goes on investment, compared to the EU's 22%.

After the recent fiscal cliff agreement, however, the Pentagon is expected to face heavy cuts, estimated at around US$45 billion – or a reduction of about 9% of the 2013 budget – in particular in the fields of operations, maintenance costs and weapons programmes. Cuts of US$487 billion are expected over the next decade.

NATO's response and the Smart Defence Initiative

NATO Secretary-General Anders Fogh Rasmussen suggests keeping the current defence instruments and working closely to develop new capabilities in order to bridge the current gap, especially within the European Union. He has stated that current commitments are essential for the security of the next generation.

After 2014, NATO will terminate its mission in Afghanistan, and will have no major operation to run. NATO allies will have to resist the temptation to reduce investment on capabilities, with the Alliance likely to have to focus on different defence threats (e.g. cyber threats) and therefore adapt its resources to the new scenario.

The **NATO Parliamentary Assembly**, in its Resolution 397 on the defence and security implications of the euro crisis, of November 2012, urged EU Member States to refrain from making further defence cuts. It suggested rebalancing the current spending situation, to redouble efforts to pool military resources and to find new channels of NATO-EU cooperation.

Smart Defence Initiative

The Smart Defence Initiative (SDI) was launched at NATO's 2012 Chicago Summit and encompasses a set of 22 cost-efficient and long-term projects. One of its main objectives is interoperability, in order to connect capabilities under the same command chain and control arrangements.

The SDI aims at more efficient use of resources, together with enhanced multinational cooperation, in order to align collective requirements and national priorities. The whole concept is built around the way NATO allies spend money, focused on improving operational effectiveness and delivering economies of scale without questioning directly their level of defence expenditures.

Allies are therefore encouraged to drop unnecessary equipment while merging their efforts on training and investments.

Special Representatives were also designated in order to achieve national support and promote the SDI.

The idea is not new, since many efforts have been made by NATO since the 1990s to foster the idea of pooling and sharing. This latest initiative stems primarily from the financial crisis, the lack of interoperability as demonstrated in the Libyan operation and from the evident need to rebalance the transatlantic relationship.

Examples of Smart Defence projects include the NATO Universal Armaments Interface, the multinational aviation training centre, pooling of maritime patrol aircraft, multilateral cooperation on munitions, and other specific programmes. Some already existed and have been reinforced (e.g. NATO's missile defence capability). Previous examples of multinational cooperation include the airborne warning and control system (AWACS) project, air policing in the Baltic, strategic airlift capabilities and the strategic airlift interim solution (SALIS) project.

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Few major projects have been identified for the short term, but the SDI will also promote strategic measures in the mid-term, to address critical shortfalls in capabilities and develop an ambitious agenda.

EU reaction

Despite the efforts made by the European Defence Agency, the European Commission (EC), under the Seventh Research Framework Programme, and the European Space Agency, the situation within the EU shows that national governments have continued to manage the defence sector on national lines, with consequent inefficiencies and a low degree of interoperability.

Most EU Member States have cut defence expenditure, cancelled or delayed plans for equipment acquisition, scaled down orders, retired platforms and/or sold key assets.

The EU reacted to this decline by agreeing on the "Pooling and Sharing" (P&S) Initiative, at the September 2010 meeting of European Defence Ministers. This initiative seeks more coordination and efficiency while avoiding isolated production which can lead to duplication and poor interoperability.

The concept of "Pooling and Sharing" has brought several Member States together in defence initiatives. The Benelux countries have pooled training and maintenance, and the Baltic countries have built a joint defence college. In addition, the Weimar Triangle (France, Germany and Poland) and the Visegrad Four (Czech Republic, Hungary, Poland and Slovakia) have also created local frameworks for logistic and training. Currently, there are around 100 bilateral or multilateral P&S projects.

Similar initiatives - for instance on air-to-air refuelling- can be found in both the EU's P&S Initiative and NATO's SDI, posing the question of consistency.

Future scenarios

According to commentators, NATO allies need to combine their efforts in order to minimise the effects of the crisis on defence spending. However, only a few allies may be able to acquire certain capabilities, while others may be in a position to focus their limited resources on "niche" assets (in the field of strategic lift, logistical support, power projection and missile defence). As most allies are no longer capable of acquiring certain military capabilities and closer cooperation is necessary anyway, multinational coordination is seen as the only way to share procurement programmes and stay relevant on the international stage. The alternative for the EU and its Member States is not being able to conduct major operations in the future.

According to NATO's Jamie Shea, the EU should push its Member States to comply with the capabilities threshold currently in place. The United States is now turning to Asia, with Europe no longer seen as the continent on which to focus troops and money. EU-US components should be combined under the NATO umbrella, and interoperability should be set as one of the main criteria to be taken into consideration when spending on research and development.

As the modernisation gap between the US and EU was already widening before the financial crisis, the slower pace of the EU allies is putting more pressure on larger EU Member States to compensate for this trend. Keeping their influence in the NATO decision-making process implies using their resources more efficiently, and increasing levels of cooperation. NATO's ambitions are therefore dependent on the strategic decisions and defence expenditure of the three major EU spenders: France, Germany and the United Kingdom.

Nevertheless, the situation depends not only on defence budgets. Another important criterion to be taken into account

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is coordination between EU Member States. In this respect, there is a huge room for improvement as national governments are reluctant to give up sovereignty in the field of armed forces. Pooling and sharing requires high initial investments which only pay off at a later stage. This is not compatible with the urgent need to reduce spending immediately in the aftermath of the financial crisis. Keeping NATO relevant will therefore require concessions and strategic decisions.

European governments should also commit themselves to stable defence budgets, less devoted to unnecessary manpower or outdated weapons, while investing in technological innovation. Common procurement, pooling arrangements and specialisation would be the key initiatives for reforming NATO's set of capabilities. Investment priorities should be streamlined and a higher threshold of deployable forces should be agreed upon.

Main references

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Endnotes

[1] NATO members are: *EU Member States,* Belgium, Bulgaria, Czech Republic, Denmark, Estonia, France, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, United Kingdom; *plus non-EU members*, Albania, Canada, Croatia, Iceland, Norway, Turkey, and the United States.

2 Data source: NATO Secretary-General's Annual Report 2012, 31 January 2013.

3 According to SIPRI, "military expenditure" refers to all government spending on current military forces and activities, including salaries and benefits, operational expenses, arms and equipment purchases, military construction, research and development, and central administration, command and support.

[4] According to the NATO Parliamentary Assembly, "many analysts and NATO officials cite 2% of gross domestic product (GDP) as the target level of spending in the Alliance".

5 Data source: NATO Secretary-General's Annual Report 2012.

6 From 21 100 to 24 495 million Canadian dollars, according to SIPRI.

7 From 21 847 to 29 934 million Turkish Lira, according to SIPRI.

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