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# The European Debt Crisis and American Security Policy

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The European Union (EU) is building the institutional capability to play a larger role in global security affairs and there is an acknowledged need for it to develop improved power projection capabilities if it is going to engage in the full range of crisis management tasks. European militaries, however, are for the most part still in the process of transforming themselves from static defense forces into deployable units that are useful for the sort of crisis management missions in which the EU envisages itself playing a larger (and more independent) role in the future. In doing so, Europeans will encounter distinct costs that have only been partially dealt with to date.

We should not discount the progress that has been made in pooling assets as a way to manage the costs of European ambitions, but there are near-term and long-term trends that will significantly impact European spending on defense and foreign affairs. In the near term, there is the on-going sovereign debt crisis in the Eurozone that has obvious implications for spending across the board. Yet, even if this is solved in a relatively painless manner, there is a more consequential long-term demographic trend in Europe that will impact spending for security and defense for many years to come.

The consequences of Europe's fiscal difficulties for the United States' economy are self-evident, but there are security consequences to consider as well. Although it is easy to dismiss European militaries for their relatively small contributions to North Atlantic Treaty Organization (NATO) and US-led military operations, those militaries compose the vast majority of the assistance the United States has received in global military operations since the end of the Cold War. A rapid decline in the ability of European states to fund their militaries would mean that the United States would be faced with conducting future operations without significant contributions from the militaries with which it has developed 60 years of standardization and coordination through the NATO alliance. Even more of the burden of global security operations

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would be shifted onto the United States while it is attempting to cut defense spending and modernize aging weapons systems and platforms.

European military contributions to NATO and US-led operations are modest, but they do add up. In Afghanistan, for example, the member states of the European Union contribute approximately 35,000 of the 130,000 forces in the country.<sup>1</sup> European partners supply close to 90 percent of all non-US forces in the country with most of the remainder supplied by Australia and non-EU allies such as Turkey. In other words, European militaries supply a number of boots on the ground roughly equal to forces in the surge implemented by the United States in 2010. If European defense budgets continue to collapse and those states are no longer capable of their current level of contributions to ongoing operations, the United States armed forces will be stretched further than they currently are and lose a degree of strategic flexibility in terms of a surge capacity that has been employed with limited success in both Iraq and Afghanistan.

The ability of European states to manage the effects of the dual storm of the financial crisis and the long-term demographic shift on their military capabilities will be determined by two factors. First, their ability to shift funds within existing defense budgets away from personnel and toward operations and procurement. Second, their ability to manage the process of base closures across Europe as a whole and rationalize their defense infrastructure on a European rather than a purely national basis. This is a process that is far more likely to occur within the context of the European Union and the Common Foreign and Security Policy (CFSP) rather than in a NATO context because of the higher public popularity of the CFSP in Europe compared to public enthusiasm for the transatlantic alliance.<sup>2</sup> If the CFSP is successful, the United States will likely have European partners capable of participating in future operations at levels similar to current levels. If it is not, European militaries are likely to be so underfunded in the coming decades that they will not be able to maintain a sustained presence outside of Europe. This would mean that the ability of the EU to function as a security provider in a global context (the goal of the CFSP) would be severely compromised and that the current level of EU action outside Europe would represent its high-water mark. Although this may not appear highly relevant in a purely American context, this turn of events would increase the burden on the US military at a time when many in Washington are looking to the defense budget as a source of long-term savings. Simply put, the United States would no longer be able to count on the current level of participation of European militaries in its international coalitions and would have to make up the difference through an increased commitment of American personnel and resources.

The United States has a considerable amount at stake in the successful development of CFSP even though it is designed to give the EU an ability to play a more independent role in global affairs. It can be argued that a failed CFSP would be a net gain for the United States because it would eliminate a potential competitor for influence in the international environment, but this misses the fact that European and American security interests coincide on many basic issues. States on both sides of the Atlantic are vulnerable to the

fallout of failed and failing states and most of their current military operations, be it the counterpiracy mission off the coast of Somalia or the NATO mission in Afghanistan, revolve around this issue. It is likely that a transatlantic alliance will endure based on mutual security interests. Yet, given the short- and long-term financial constraints on European defense spending, significant changes will need to occur that rationalize European defense spending in a European-wide program rather than in independent national efforts. Such a program can only be implemented by the European Union through the Common Foreign and Security Policy.

This article first examines the consequences of the sovereign debt crisis in Europe. It then considers the longer-term effects of the demographic shift in Europe and the consequences of a rapidly aging population on defense spending. Finally, it offers some potential steps forward including introducing a defense infrastructure rationalization process in Europe similar to the Base Realignment and Closure (BRAC) process implemented in the United States starting in the 1990s.

### ***The Debt Crisis and Its Effects on Spending***

The global economic downturn and the sovereign debt crisis have distinct implications for defense spending across Europe. Although there are variations across the member states, the aggregate figures for 2008 and 2009 are telling. In that period Europe-wide Gross Domestic Product (GDP) shrank by 5.6 percent. Overall government expenditure rose by 2.4 percent between 2008 and 2009 while defense expenditures fell by 3.5 percent.<sup>3</sup> In other words, while European governments on average attempted to alleviate the effects of the global economic downturn through increased spending, they also shifted resources away from defense budgets to partially defray those expenditures. It is, of course, impossible to balance the national budgets of the members of the EU through cuts in defense expenditures that only in a few countries amount to more than 2 percent of GDP, but in times of fiscal constraint, European defense budgets are a relatively easy target for reductions.

The member states of Central and Eastern Europe are enacting severe cuts in defense expenditures over the next few years. Bulgaria enacted a 40 percent cut in its budget for 2010. The Czech Republic reduced its defense budget by 20 percent between 2008 and 2011, and Latvia cut its defense budget by nearly 50 percent between 2008 and 2010. The more established and wealthier members of the EU are also making significant cuts. Austria is seeking to trim its budget by 20 percent by 2015 and Germany is attempting to implement a 25 percent reduction in the same time frame. The two members comprising the bulk of the EU's deployable capability, France and the United Kingdom, plan less dramatic cuts. Both expect to cut their defense budgets by approximately 7 percent by 2015.<sup>4</sup>

It is overly optimistic to assume that those reductions represent the bottoming out of defense budgets because the sovereign debt crisis affecting Ireland, Greece, Portugal and other states in the EU will be a burden on the

rest of Europe for some time. Even if the sovereign debt crisis does not spread beyond the states currently affected, the banking system in Europe is heavily exposed to what were supposedly safe sovereign debt investments. Significant government bailouts of French, German, and Italian banks may become necessary to ensure the stability of the financial system. As political leaders look to find areas of savings in strapped financial times, they are likely to continue to cut into defense and foreign affairs budgets to make funds available for the more critical functions of preventing bank failures and a liquidity crisis in Europe.

Greece, Portugal, and Ireland are minor players in international security affairs, but much of the rest of Europe will also be fiscally constrained for some time as a result of their banks' accumulation of sovereign debt. German and French banks, for example, hold approximately 900 billion Euros in Greek, Portuguese, and Irish debt that may become worth far less in the near future if a restructuring of that debt becomes necessary.<sup>5</sup> Investors in Greek sovereign debt lost 50 percent of their investment and there is no guarantee that further reductions will not be forthcoming.<sup>6</sup>

If Italy and Spain are added to this list of states that may be in need of debt restructuring or bailouts, the consequences of the sovereign debt crisis could dramatically expand. In order to prevent defaults that would have disastrous consequences for the viability of the common currency, holders of that debt may be forced to accept large write-downs on their investments.<sup>7</sup> Large-scale public funding would then be required to ensure the viability of exposed banks in Germany and France, and to some extent, this is already occurring: The European Central Bank (ECB) announced in December 2011 that it would loan nearly 500 billion Euros to more than 200 troubled banks across Europe.<sup>8</sup>

Given the large exposure of French, Italian, and German banks to questionable sovereign debt, it is highly unlikely that this will be the full extent of either ECB or national involvement in bank bailouts. The risk that the common currency will collapse is relatively low given the political capital invested. Yet, the leveraged nature of the financial system in Europe means that it may be very difficult to prevent the crisis affecting the peripheral countries of Europe from having significant effects on the more economically robust members of the currency union. As Peter Boone and Simon Johnson at the Peterson Institute for International Economics ask, "If Italy has a disorderly crisis, how safe are French banks? And if those banks aren't safe, how safe is France's sovereign debt?"<sup>9</sup> The lack of a satisfying response to this basic question is at the heart of the matter and shows no sign of being resolved in the near term.

It does not take extreme scenarios such as the collapse of the Euro or the exit of Greece from the common currency to project an extended fiscal crunch across Europe that will force governments to channel funds to maintain the stability of the banking system. Although the Greek crisis has already been factored into the equation and likely can be managed without additional intervention to support the banking sector, the equation changes significantly if Italy and Spain are added as variables.<sup>10</sup> As two of Europe's larger economies,

the contagion of the sovereign debt crisis to Italy and Spain could force large interventions to prevent panic.

Although defense spending is a small percentage of total government spending, it represents a target of opportunity for national leaders seeking additional budgetary savings and ways to channel existing resources toward the critical function of stabilizing the banking sector. Compared to other budget items that the public is deeply concerned about such as health, pensions, and other direct benefits, defense is not a core concern of most Europeans and there are few domestic political ramifications to cutting the defense budget.

### ***The Effects of an Aging Europe***

The debt crisis and its impact on European budgets is a relatively short-term problem; the longer-term issue for European defense budgets is a demographic shift with profound consequences. As a number of studies conclude with some detail, the population of most European countries is aging rapidly, meaning that growing expenditures for retirement benefits and health care for the aged will be paid from a constantly shrinking tax base.<sup>11</sup> At the same time that the European Union is attempting to build a Common Foreign and Security Policy that will permit it to play a larger role on the global stage as a security actor, the member states of the EU will be set upon by a host of difficult choices. Choices whose likely resolutions will deprive the EU of the financial resources required if it is to play a role in military operations outside of Europe.

The average age of the population of Europe will increase dramatically in the next twenty years. The median age in Germany and Italy, two of Europe's most populous states, will be 50 in 2030; by comparison the current median age in Florida, the "grayest" state in the United States, is 42.<sup>12</sup> According to estimates by the Center for Strategic and International Studies, given current benefits, each retiree in Germany will have to be supported by 1.6 workers, while each Italian and Spanish working-age person will have to support one retiree.<sup>13</sup> Across Western Europe, the over-65 population will increase by 40 percent by 2030 while the working age population is expected to continue to shrink, even factoring in current levels of immigration.<sup>14</sup> The consequences of this situation are unavoidable and there are no solutions that do not involve distinct changes to the nature of the welfare state as it currently exists in most of Europe. Either benefits will have to be reduced, taxes will have to increase, governments will have to borrow more to sustain the aging population, or immigration will have to sharply increase to supply the workforce and rebalance the population.<sup>15</sup>

Some members of the EU are already engaging in reforms along these general lines, but none of those options are attractive. The political consequences of these reforms are readily apparent to those leaders who face protests over increases in retirement ages or university fees in France and the United Kingdom respectively. The negative political consequences of taking such actions to ensure the viability of the welfare state directly impacting citizens' current benefits or incomes makes another option more likely in the near future: shifting resources from other forms of government spending to maintain the

pension system. Among the likely candidates for cuts are defense and international affairs budgets which lack a strong constituency in the face of competing demands from European publics accustomed to generous social benefits and security guaranteed by the United States.<sup>16</sup>

Over the next several decades, Europe likely will have fewer resources to devote to international affairs. An aging population will require more and more resources and there will be fewer working-age individuals whose income can be taxed to pay for benefits. Some changes can and are being implemented, such as raising the retirement age and shifting health care toward private insurance-based programs, but in the near future governments will likely continue to trim spending on international affairs, the military, and foreign assistance programs. Simply put, a proposal to cut benefits to the fastest growing segment of the population has political consequences at the voting booth, but reducing spending on defense and international affairs has little domestic political cost among most European publics.

### ***National Defense Budget Trends***

The broad budgetary picture provides some indication of the overall trends across European defense budgets. From 2001 to 2009, total European defense spending declined from 251 billion to 218 billion in inflation-adjusted Euros.<sup>17</sup> At the same time, however, spending per soldier increased from 73,000 to 91,000 Euros. This is a reflection of the large-scale drawdown in the overall size of European militaries, many of which underwent a process of professionalization as conscription was phased out in France and other member nations of the EU.<sup>18</sup> On the one hand, this is an encouraging development in that more resources are being spent on each individual member of the force. On the other hand, the force structure in most European militaries remains relatively inflexible and incapable of sustained expeditionary operations.<sup>19</sup> The draining effect on France and the UK of operations over Libya is an indication of the current limits to Europe's deployable power, and those two countries represent the bulk of Europe's expeditionary capabilities.<sup>20</sup>

One way in which scarce resources can be used to greater benefit is by pooling and sharing. Across Europe, there is considerable duplication of effort in a range of areas that impact national defense budgets; pooling resources and asset sharing can wring greater effectiveness out of increasingly limited resources. For example, the European Air Transport Command at Eindhoven, the Netherlands, allows participating states to maximize the use of heavy-lift capabilities in the most efficient way possible. In May 2011, defense ministers from across the EU signed an agreement on the administrative arrangements for the European Air Transport Fleet, which aims to improve EU airlift capabilities.<sup>21</sup> Other efforts are underway to improve the coordination of maintenance facilities for aircraft across Europe.

But there are limitations to the gains that can be made from such pooling and sharing arrangements. Most significantly, there are political obstacles to pursuing these cost-saving measures. Pooling maintenance, for example,

requires that some maintenance facilities be closed to consolidate the work in fewer locations. Yet which facilities to close, and where to sacrifice the jobs of those who work at those facilities, is a difficult question at best that required complex negotiations in the United States to balance the facilities closures between the individual states.<sup>22</sup> It can only be an even more difficult process in Europe among sovereign states, particularly during an economic downturn.

At the same time, some members of the EU are finding that pooling and asset sharing have not produced the gains they expected. Germany, for example, is planning to engage in fewer such arrangements in the future because expected savings did not materialize.<sup>23</sup> This does not mean that pooling and asset sharing is a dead end in terms of bringing greater efficiency and cost savings to European militaries. Yet, it cannot be invoked as a mantra that will solve the large-scale mismatch between European ambitions and resources. Most decisions on pooling and asset sharing will have political and economic consequences as expected savings often come from closing facilities and cutting positions. As members of the EU seek to move beyond the low-hanging fruit of airlift coordination to the more potentially contentious issues of pooling national maintenance facilities (with the attendant employment consequences) or developing truly multinational units, progress on such cost saving measures will tend to compete against countervailing pressures to maintain the status quo. This is not to dismiss the real gains that can be achieved from pooling and sharing, but rather to underscore that those gains will not necessarily be easy to reap, nor will they serve as a complete solution to the underlying budgetary challenges.

European militaries will be increasingly expected to do more with existing or decreasing levels of funding; therefore, the challenge will be to shift resources within national defense budgets so that more of those limited amounts is spent on operations and procurement and less on personnel. Any national defense budget rests on a tripod of resource investment on operations, procurement, and personnel with smaller fractions being spent on infrastructure and research and development. Ideally, there should be a rough balance between the three legs of the tripod in any nation or military that engages in expeditionary operations. For the most part, European defense budgets are heavily weighted toward personnel. Most spend well above 30 percent of their national budgets on personnel and several, including Belgium and Portugal, spend more than 70 percent on personnel.<sup>24</sup>

The result is that only a small fraction of each Euro in the national defense budget is spent on operations or procurement. In other words, most of the defense budget is spent on maintaining militaries that cannot go where they are needed with the equipment necessary to perform the missions and tasks that the EU has designated. Serious reform needs to start with recalibrating the balance between personnel and other expenditures within the national defense budgets so that operations and procurement are favored in this era of fiscal restraint. Unfortunately, the trend appears to be somewhat in the opposite direction. In 2008, members of the EU spent an average of 54 percent of their defense budgets on personnel. That number increased to 56 percent in 2009.<sup>25</sup>



## Conclusion

The preceding analysis begs the question: what can the EU do to ensure that it can continue to play, and possibly expand, its role in the global security arena? The answer is twofold. First, the EU will need to move forward with internal reforms that permit the development of a truly European security policy. Second, the EU will need to build a renewed transatlantic partnership leveraging the respective strengths of the United States and the EU.

At the moment, most European militaries are downsizing, but doing so independently of one another. What is lacking is a truly European strategy for pooling and asset sharing that moves beyond satisfying national budgetary concerns. The EU should draw on the experience of the United States in the 1990s for lessons learned. The Base Realignment and Closure Commission (BRAC) essentially removed the base closure process from the political arena and allowed for a rational downsizing of the US military at the end of the Cold War. In Europe, however, this process needs to be predicated on the establishment of truly multinational organizations that are educated, trained, and based together. Although there are some multinational formations and military colleges, they are a relatively small part of the overall package.

The second part of the answer is establishing an improved transatlantic partnership. For a long time, the United States has complained regarding European allies' inability or unwillingness to fund defense. The former US Secretary of Defense Robert Gates's valedictory speech to his European counterparts was only the most recent example.<sup>26</sup> But the current security environment makes it clear that both Europe and North America will likely face threats and challenges arising from failed and failing states that require improved expeditionary capabilities. Both the European Security Strategy and the US National Security Strategy outline these common threats in detail to include: terrorism and proliferation, illegal immigration, organized crime, as well as the need to assist in preventing humanitarian crises resulting from state failure.

A renewed transatlantic partnership should acknowledge the relative strengths of both sides. While the United States has vast capabilities in strategic lift, logistics, surveillance, intelligence, and reconnaissance, Europe brings a variety of skill sets to the table as well. In addition to the European militaries compatibility with the US armed forces based on sixty years of close collaboration, many European states also have deployable paramilitary police forces that provide a critical asset in the gray area between operations requiring military forces and those categorized as civilian missions. Additionally, the EU's rule of law assistance missions could be further coordinated with US assistance missions. Although it can be argued that such actions remove some of the independence of CFSP and thus defeats its original purpose, that is not necessarily the case. In any renewed transatlantic partnership focused on preventing state failure and dealing with the consequences, the EU may be put in the position where it serves as the junior partner. Clearly, this would be the case in purely military operations, but the defining feature of the current security environment is that current operations

require a mix of military, civil, and paramilitary assets, and in a number of cases Europe possesses significantly more capability than the United States.

The EU can improve the match between its resources and its ambitions, but it requires a realistic appraisal of what is possible in an era of financial restraint. The still evolving sovereign debt crisis and the long-term demographic shift across Europe will only constrain resources further in the coming years. A failure to incorporate those factors into defense planning will set the EU on a path of declining relevance in international security affairs.

Incorporating these factors will require a concerted effort on the part of European political leaders to push for Europe-wide reforms. National defense budgets in a number of EU member states will need to shift from personnel expenditures to procurement and operations. Pooling and sharing of resources will need to move beyond the relatively easy fixes of airlift and sealift coordination to areas that would have employment consequences in member states. Finally, there is a need for a reassessment of the transatlantic relationship required to build a partnership leveraging existing strengths and resources.

The future of European defense capabilities is not a purely European affair. European militaries are a small, but significant, component of US-led multinational operations. If those contributions cease to exist as a consequence of the failure of the EU to cope with the dual pressures of the sovereign debt crisis and the demographic shift, the United States will lose the vast majority of the operational assistance it relies on in global security efforts. A failed CFSP would ultimately increase the strain on US armed forces.

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