

**GLOOMY EXPECTATIONS – ANALYSIS ON THE SHORT-TERM FUTURE OF EUROPEAN DEFENCE CAPABILITIES**

“Precaution is better than cure.”

Johann Wolfgang von Goethe

## FOREWORD

Defence establishments all across Europe have to face a strengthening pressure from the public for cutting their budgets. As the financial crisis drought the monetary ocean – however virtual it was – scarcely given and decreasing resources began to meet with increasing demand. Under the tense rivalry between the players of the public sectors for more money, defence sector seems to be losing.

This trend will cause serious problems and defects in establishing the future’s military capabilities while slightly affecting today’s armies as well. At the same time, it should only be considered as an effect, a natural result of the causality between the changing economic environment and the financing of defence sectors. The real cause lies almost certainly in structural problems. The aim of this article is to identify symptoms and components of the structures which show slight or severe malfunctions and to analyse their nature. One can hardly summarize the whole spectrum of problems, taking their given complexity, but revealing certain symptoms may offer some solutions and experience for inventing new innovative ways for solving the crisis of the European defence capabilities.

## FOUR REASONS FOR THE FURTHER DECLINE OF EUROPEAN DEFENCE CAPABILITIES

After the collapse of the bilateral world order, the defence sector had to redefine its role in Europe. With the most demanding threat gone, it found itself in an odd situation where the threat-based defence establishment has become unfounded. Numerous ways were tested before the capability-based planning emerged from the group of other solutions and later on proved to be at least as durable as its predecessor.

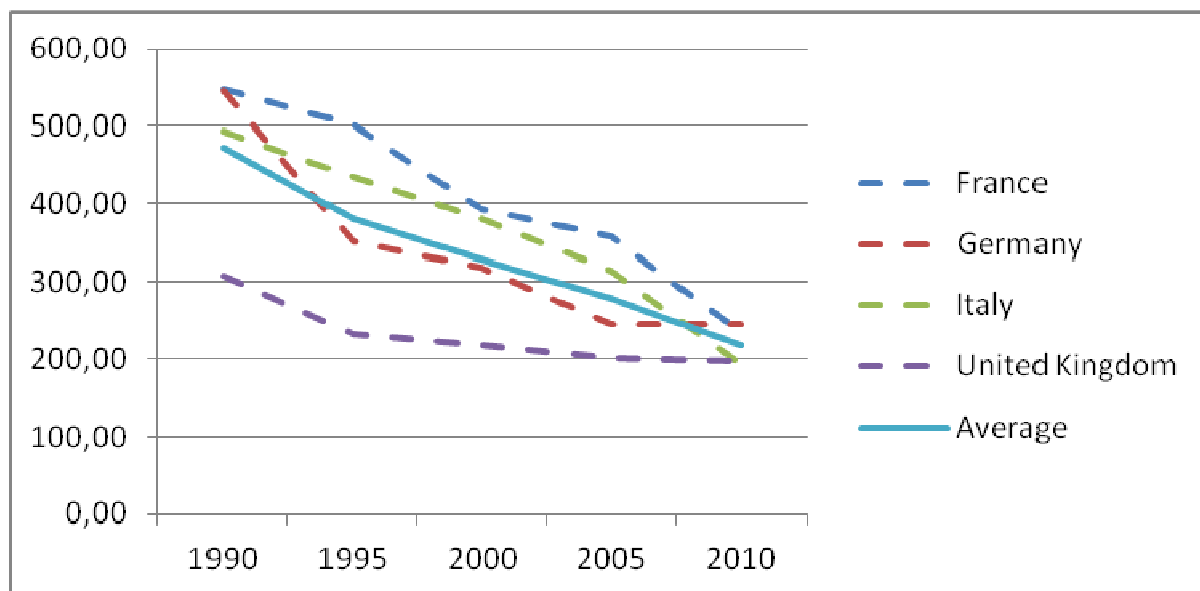
Two decades have passed since then and European armies have become smaller, lighter, more deployable, more interoperable and above all, cheaper. Capability-based concepts prevailed but simultaneously failed to reinvent genuine roles and functions for armies. With the absence of evident threats in the neighbourhood of Europe defence is still without a crystal-clear purpose and in my opinion it is one of the main reasons for the constantly decreasing defence expenditures in real terms. Also there are indications suggesting that European defence capabilities will further decline at the end of the long road.

Four separate patterns can be identified which help assess the current and future situation of the defence sectors in Europe.

First, the continuous transformation of the last 22 years have cut down ‘high-end’ capabilities almost entirely and left Europe dependent on US capabilities more than ever. European armies remain formidable and the best of them are still amongst the most capable ones in the world, but the ever-growing pressure to extract more money from the defence sector seems to cripple even the strongest of them on the long run.

## HADTUDOMÁNYI SZEMLE

Gergely NÉMETH

Budapest, 2012.  
5. évfolyam 3-4. számFigure 1: Change in personnel strength since 1990<sup>1</sup>

Second, the involvement in the Iraq and Afghanistan war cost a lot, consuming vital financial, human and material resources. These missions were principally financed from military budget, resulting in a new burden on the armies. As of June 2010, European NATO members contributed 41,000 troops in addition to the 96,000 US soldiers.<sup>2</sup> This is as high as 2%<sup>3</sup> of the total European NATO strength on every 6 month period.

Third, the inaccurate structure of armies and the 'long peace' damaged the healthy distribution of resources between personnel, maintenance and development costs. Currently, most of the developed armies have to spend more than 50% of their budget<sup>4</sup> merely on personnel costs, draining essential resources from other areas of defence.

<sup>1</sup>Estimations based on Financial and Economic Data relating to NATO Defence. Accessible at: [http://www.nato.int/nato\\_static/assets/pdf/pdf\\_2011\\_03/20110309\\_PR\\_CP\\_2011\\_027.pdf](http://www.nato.int/nato_static/assets/pdf/pdf_2011_03/20110309_PR_CP_2011_027.pdf). Retrieved 24th May 2012.

<sup>2</sup>Belasco, Amy: The cost of Iraq, Afghanistan and Other Global War on Terror Operations since 9/11, p. 13. Congressional Research Service Reports, in: <http://www.fas.org/sqp/crs/natsec/RL33110.pdf>. In: 24/05/2012.

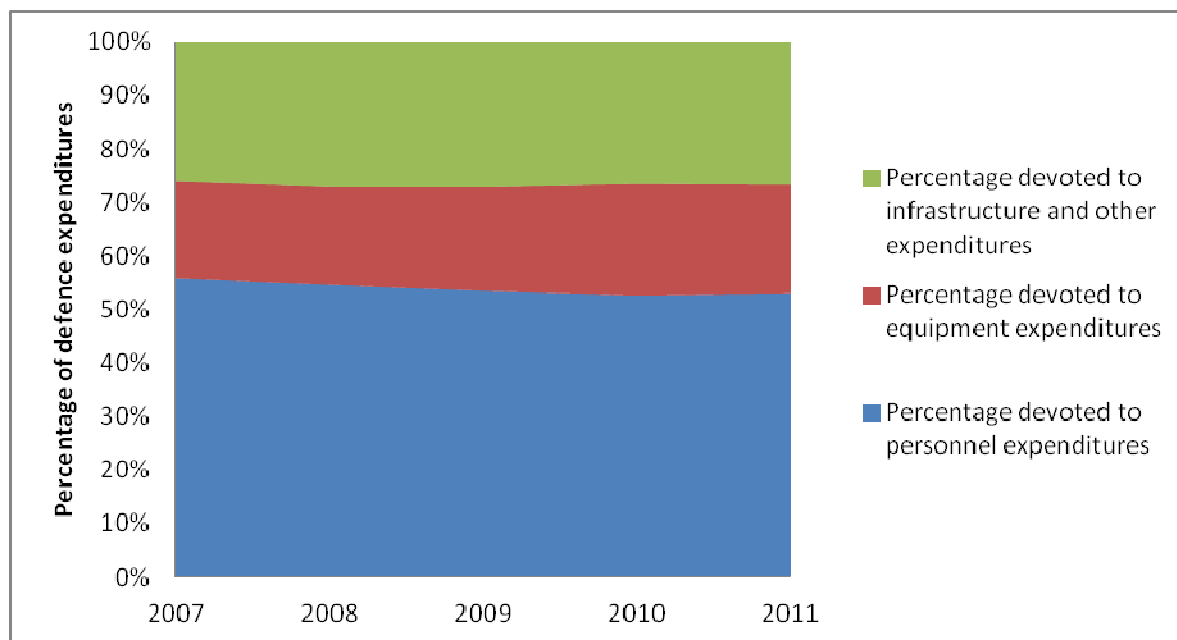
<sup>3</sup>The European NATO Allies cumulative Personnel Strength was 2,096 Million in 2010.

Source: Financial and Economic Data relating to NATO Defence. In: [http://www.nato.int/nato\\_static/assets/pdf/pdf\\_2011\\_03/20110309\\_PR\\_CP\\_2011\\_027.pdf](http://www.nato.int/nato_static/assets/pdf/pdf_2011_03/20110309_PR_CP_2011_027.pdf). In: 24/05/2012.

<sup>4</sup>Bassford, Matt et al: Strengths and Weaknesses of the Netherlands Armed Forces. A Strategic Survey, p. 31. In: [http://www.rand.org/pubs/technical\\_reports/2010/RAND\\_TR690.pdf](http://www.rand.org/pubs/technical_reports/2010/RAND_TR690.pdf)

## HADTUDOMÁNYI SZEMLE

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5. évfolyam 3-4. számFigure 2: The average structure of defence expenditures (European NATO Allies)<sup>5</sup>

Finally, the European sovereign debt crisis seems to be a historical blow for defence, as it is accelerating the aforementioned extraction of resources from this sector. Most of the defence budgets are to be suffering further cuts, while their commitments in Afghanistan, the need for reinforcing the lost material, the replacement of the obsolete weapon systems and the cost of future tasks related preparations would demand significantly more financial resources. Moreover, non-combatting elements of European armies are equipped with numerous weapon systems which are reaching or have already exceeded their useful and effective lifecycle but there are no financial funds for their replacement.

Currently Europe is facing several grave crises, grave crises amidst which the future of the defence sector has to be decided on. Recent trends show that given the current level of financial support European military capabilities would probably decline further which could revive a debate on the role and mission of the European armies resulting maybe even more serious questions in the near future. The aim of this study is to provide a broad picture on how the major security providers in Europe are conducting defence cuts and some hints on what losses it will result. .

## THE WAY WE ARE HEADING - DEFENCE CUTS AND THEIR CONSEQUENCES

According to the NATO database<sup>6</sup> the European NATO members spent roughly EUR 216 bn<sup>7</sup> in 2010 and EUR 211 bn in 2011. This is as much as 1.7% of the GDP in 2010 which dropped slightly in 2011.<sup>8</sup> Taking the ten years' trend into account, European NATO Allies' military expenditures declined from a 1.9% GDP share basis in 2000 to an estimated 1.7% by 2010.

<sup>5</sup>Estimations based on: Financial and Economic Data relating to NATO Defence.

<sup>6</sup>Financial and Economic Data relating to NATO Defence. In:

[http://www.nato.int/nato\\_static/assets/pdf/pdf\\_2011\\_03/20110309\\_PR\\_CP\\_2011\\_027.pdf](http://www.nato.int/nato_static/assets/pdf/pdf_2011_03/20110309_PR_CP_2011_027.pdf). Downloaded: 24/05/2012.

<sup>7</sup>Dollar-euro exchange rate in 2010 constant prices is 1,326. Based on: <http://www.neded.org/files/international/exchange.pdf>. Downloaded: 12/05/2012.

<sup>8</sup>Financial and Economic Data relating to NATO Defence.

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Although the volatile decline of the defence spending slowed down by the end of the period of 2007-2010, it seems that a revival of defence cuts is yet on the doorstep. As for the short-term future, according to Strategic Defence and Security Review, UK will have to spare EUR 5.1 bn until 2014,<sup>9</sup> but shadow defence secretary Jim Murphey states that cuts of more like 40 billion is necessary.<sup>10</sup> In the meanwhile Germany is acting the same way: defence spending is planned to be cut by EUR8.4 billion between 2010 and 2014.<sup>11</sup>, also should be mentioned that France is planning to save EUR 3.5 billion during the same period.<sup>12</sup> Taking into account the possible Italian measures the major security providers in Europe will cut an estimated EUR 18-20 billion until 2014, which is more than the annual defence budget of Turkey.

Reduced budgets will be possibly insufficient for maintaining existing capabilities on the present level. By the estimation of former US defence secretary Robert Gates, maintenance requires 2-3% annual increase of the defence budget<sup>13</sup> while Professor Kirkpatrick argues with a 10%<sup>14</sup> average increase in equipment procurement. These numbers suggest that reduced defence expenditures will certainly result in a further cut in the defence structure.

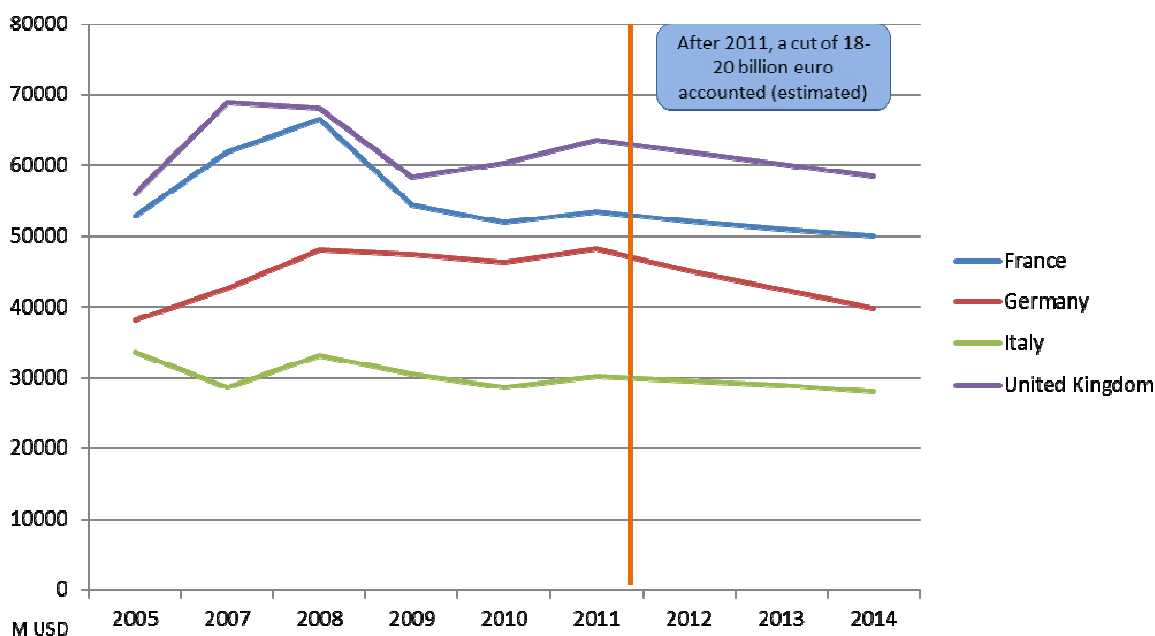


Figure 3: Actual and planned defence expenditure (prices in 2005 constantdollar)

Taken into account the high political ambition of using military forces for crisis response and peace support operations the decline of defence spending seems to raise serious risks in the near future.

Unfortunately, despite the emerging risks, defence cuts can be seen – from political point of view - as a reasonable solution for mitigating financial problems under the pressure of the European sovereign debt crisis. Amongst others

<sup>9</sup>Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review. In: [http://www.direct.gov.uk/prod\\_consum\\_dg/groups/dg\\_digitalassets/@dg/@en/documents/digitalasset/dg\\_191634.pdf?CID=PDF&PLA=furl&CRE=sdsr](http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/documents/digitalasset/dg_191634.pdf?CID=PDF&PLA=furl&CRE=sdsr). Downloaded: 12/05/2012.

<sup>10</sup>Norton-Taylor, Richard: Britainsignals more cuts. The Guardian. In: <http://www.guardian.co.uk/global/defence-and-security-blog/2012/jan/09/army-military-defence>. Downloaded: 12/05/2012.

<sup>11</sup>Benitez, Jorge: Impact of German Defence Cuts on Force Structure and Procurement Decisions. In: <http://www.acus.org/natosource/impact-german-defence-cuts-force-structure-and-procurement-decisions>. Downloaded: 12/05/2012.

<sup>12</sup>Mölling, Christian: The Impact of the Financial Crisis on European Defence, p. 12. EU Documents and Publications. In: <http://www.isn.ethz.ch/isn/Digital-Library/Publications/Detail/?id=131035>. Downloaded: 12/05/2012.

<sup>13</sup>Defence spending in times of austerities. In: <http://www.economist.com/node/16886851>. Downloaded: 12/05/2012.

<sup>14</sup>Kirkpatrick, David: Rising costs, falling budgets and their implications for defence policy. Economic Affairs, December 1997, p. 10-14

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Frank Barney argues that with a financial setback on the doorstep, defence savings would offer a considerable stimulus to the economy.<sup>15</sup> Barney's argument sounds rational considering the fact that present security environment suggests no major, conventional threat in short term. Albeit there are other military-related threats and challenges, like terrorism, migration and the problem of failed states, these tend to stay under a certain level of risk, and the present military capabilities should be sufficient for handling most of the perceived scenarios – even if some amendment from internal forces could be necessary.

Nevertheless the problem is not the current situation. As for the existing expeditionary capabilities, Europe is still only one step – although a great one - behind the US, and ahead of most of its potential rivals. Major European armies have the capabilities to plan, initiate, conduct and maintain expeditionary operations even in great distances which constitute the basis of an outstanding projective deterrence capability. This can be only matched by the USA and maybe Russia and China. The collective EU spendings was equivalent to the combined defence budgets of the eight next biggest spenders.<sup>16</sup>

The reduction in defence spending therefore does not seriously affect the current balance of capabilities but it does affect future capabilities. "Bonsai armies" will be formed with severely lacking organic capabilities.<sup>17</sup> Current and ongoing reductions in defence budgets are hindering the replacement of weapon systems lost or consumed in Afghanistan, and in addition, the upgrade of existing weapon systems and the acquisition of new ones. These should be all fundamental to prepare armies for the requirements of the 21st century battlefield and to enhance their availability, readiness and deployment.

Future capabilities are essentially planned for providing a useful toolbox in order to successfully handle every assumed or identified challenge in the distant future. And the distant future has an utmost attribute, namely: it is highly uncertain. As a matter of fact future assumptions have become increasingly questionable.<sup>18</sup>

As there is no "silver bullet" for planning, every scenario assessed is uncertain in its probability, scale and outcome. More like a guess-shot in the dark. For this reason military planners have to plan a complex toolbox, able to handle almost every presumptive scenario. And establishing these capabilities would cost a lot of money.

Every planning phase starts with the assessment of future challenges and with the identification of possible scenarios. At the end of this phase planners usually come up with something horribly expensive as they want to cover all of the identified threats and challenges with capabilities of which the majority have to be developed from a relatively low baseline. Therefore every capability development plan is getting more costly by the second, third and etc. year of the planning period.

Additionally, realized developments tend to stay under the required level which will cast surplus needs on the long term. This will result in an exponentially increasing budget request on the long term.

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<sup>15</sup>Barney, Frank: Howtosavetheglobeconomy: Cutspending. Foreign Policy, Feb 2012. In:

[http://www.foreignpolicy.com/articles/2012/01/03/4\\_cut\\_defense\\_spending](http://www.foreignpolicy.com/articles/2012/01/03/4_cut_defense_spending). Downloaded: 12/05/2012.

<sup>16</sup>Howorth, Jolyon: Strategy and theImportance of DefenceCooperationamong EU MemberStates, p. 3. Security Policy Brief. No. 12, September 2010. In: [http://www.egmontinstitute.be/papers/10/sec-gov/SPB-12\\_Howorth-defence-cooperation.pdf](http://www.egmontinstitute.be/papers/10/sec-gov/SPB-12_Howorth-defence-cooperation.pdf).Downloaded: 12/05/2012.

<sup>17</sup>Mölling, Christian: Europe withoutDefence, p. 3. SWP Comments 38. November 2011. In: [http://www.swp-berlin.org/fileadmin/contents/products/comments/2011C38\\_mlg\\_ks.pdf](http://www.swp-berlin.org/fileadmin/contents/products/comments/2011C38_mlg_ks.pdf). Downloaded: 12/05/2012.

<sup>18</sup>Spiegeleire, Stephan de: Strong int he 21st Century. The Hague Center forStrategicStudies. July 2010. No.4. p. 7. In: <http://www.hcss.nl/reports/strong-in-the-21st-century/11/>

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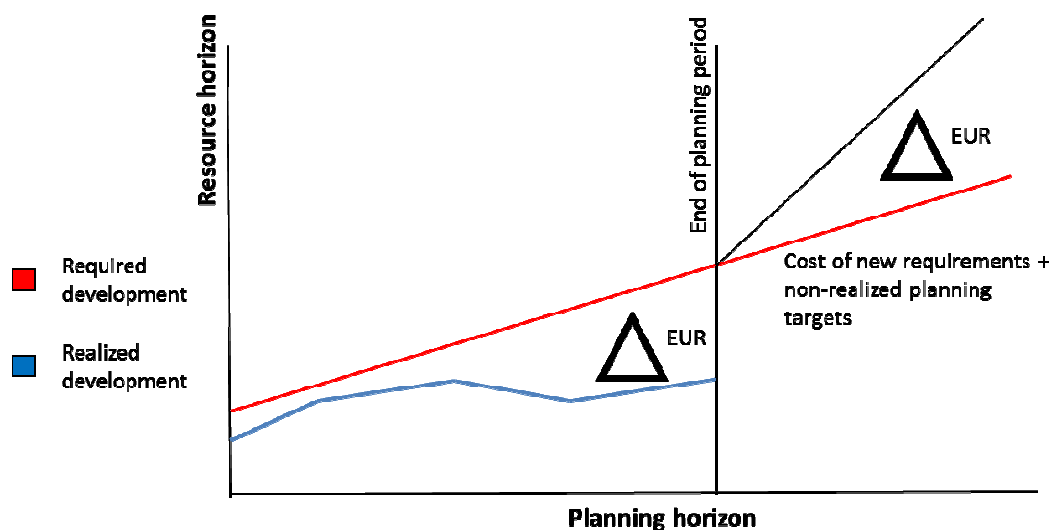
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Figure 4: The nature of future planning

The usual method for avoiding the increasing budget requests is the reassessment (and practically the cut) of the capability ambitions. Sometimes it is called transformation or defence review followed by monetary constraints.

Examplifying the above, assuming that projected defence budget are reduced, development plans should be revised and future objective would be cut first. If this occurred, the army would have to go with its existing capabilities while essential developments could be vanished due to the insufficient funds.

This process is leading toward an aging army structure, equipped with obsolete weapons, which is also pressing the budget from the maintenance side as the aging weapon systems will sooner or later reach their maintenance-peak. The extended reliance on aging weapon systems will affect training just as well as the morale of the personnel.

To sum up, on the one hand defence cuts can be regarded useful in the short-term and can channel money into the central budget without harming serious interests of the voters – acting as a “low-cost” fiscal stimulus. However, these are also very dangerous tools of saving money as they are hindering the preparation for future challenges and by the unfortunate attribute of the future challenges, (namely they are uncertain), the effects of defence cuts are hardly predictable. Presumably the way of defence cuts will be paved with hidden bombs and time will explode them.

## HOW IT SHOULD BE DONE - OPTIMAL LANE FOR DEFENCE SPENDING

Before analyzing the reductions in defence by major security providers, the assessment of an optimal budget spending volume is necessary. My estimation is based on NATO benchmarks.

According to the NATO benchmark, defence budget should represent a 2% share of the GDP, and 20% of the defence budget should be devoted to development<sup>19</sup> in order to maintain the existing and to develop the required capabilities.

<sup>19</sup>Strengths and Weaknesses of the Netherlands Armed Forces – A Strategic Survey, p. 29. RAND Publications.

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The 2/20 ratio can only be held on the long term if the defence budget is increasing nominally. There are several underlying reasons. Different factors like inflation, the rising costs in personnel spending (salaries, additional incentives, growth in personnel), the maintenance costs and the costs growth of weapon systems will “eat up” the budget without nominal increase. The rising demand (money needs to spent) against an unchanged supply (money granted) will result in a structure sufficiently transformed in order to survive with the scarcely given resources.

Therefore the 20% ambition can be only a goal for the first year of the development plan. Focusing only on acquisition programs, during the next year (base year+1), inflation would cause an additional 2.7%<sup>20</sup> cost growth, and a further 5% average annual increase<sup>2122</sup>would appear. Moreover, for the whole lifecycle, acquisition programs tend to cost 26% more than initially planned<sup>23</sup>but this fact will be excluded from the equity. To summarize, an average of 7.7% increase would occur in acquisition cost each year.

Let's take the example of an imaginary country planning to replace its AIFVs with a new system with a total acquisition cost of EUR 1 bn. In this case planners would have to incorporate the projected rise in prices, an expectable annual EUR 77 m increase resulting in a EUR 385 m additional cost projected to a five year period, which is roughly a 39% increment. And this is not even on the top of the list.

According to GAO<sup>24</sup>, total acquisition cost of the Apache BlockIIIA have increased by 48.3% since 2006.<sup>25</sup> C-130 Avionics Modernization Program increased by 50.1%,<sup>26</sup> CH-53K Heavy Lift Replacement Program by 35.5%,<sup>27</sup> while the acquisition of Stryker Family Vehicles reached a 47.4% growth of costs in five years – albeit the latter one with some increase in quantities.

Based on my rough estimations, an average 20% growth in acquisition costs included in a five year development plan would result in a gradual 2% projected increase in the defence budget for each year. And this is only development, not to mention the cost of infrastructural development, general R&D activities and rising personnel costs. As cited earlier, Robert Gates said, that maintaining existing capabilities costs 2% more annually, which gives us a requirement of an additional 4% annual increase above the optimal budget structure.

Instead of closing to the above presented ratio, European NATO countries spend only an average of 13.5% for equipment related expenditures (comprising the majority of the overall development expenditures, excluding only general R&D costs) in 2011.<sup>28</sup>Average personnel costs for European NATO Allies is as high as 61.8%.<sup>29</sup> The remaining 24.7% is spent for infrastructure, maintenance and other expenditures.

In: [http://www.rand.org/pubs/technical\\_reports/2010/RAND\\_TR690.pdf](http://www.rand.org/pubs/technical_reports/2010/RAND_TR690.pdf). Downloaded: 12/05/2012.

<sup>20</sup>Eurostat. HICP InflationRate.In:

<http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&language=en&pcode=tsieb060&tableSelection=1&footnotes=yes&labeling=labels&plugin=1>. Downloaded: 12/05/2012.

<sup>21</sup>United StatesGovernmentAccountability Office: DefenceAquisitions – Assesment of SelectedWeaponPrograms, p. 177. In: <http://www.gao.gov/assets/590/589695.pdf>. Downloaded: 12/05/2012.

<sup>22</sup>Accordingto GAO (United StatesGovernmentAccountability Office) totalacquisitioncosts of Major DefenceAcquisitionProgramsincreasedwith an average of 5% between 2010-2011 and showed an average of 17% increasebetween 2006-2011.

<sup>23</sup>Cancian, Mark F. (Col.): CostGrowth: Perception and Reality, p. 6.

In: [http://www.dau.mil/pubscats/PubsCats/AR%20Journal/arj55/Cancian\\_55.pdf](http://www.dau.mil/pubscats/PubsCats/AR%20Journal/arj55/Cancian_55.pdf). Downloaded: 12/05/2012.

<sup>24</sup>United StatesGovernmentAccountability Office.

<sup>25</sup>DefenceAquisitions – Assesment of SelectedWeaponPrograms, p. 51.

<sup>26</sup>DefenceAquisitions – Assesment of SelectedWeaponPrograms, p. 67.

<sup>27</sup>DefenceAquisitions – Assesment of SelectedWeaponPrograms, p. 69.

<sup>28</sup>Financial and Economic Data relatingto NATO Defence.

<sup>29</sup>Financial and Economic Data relatingto NATO Defence.

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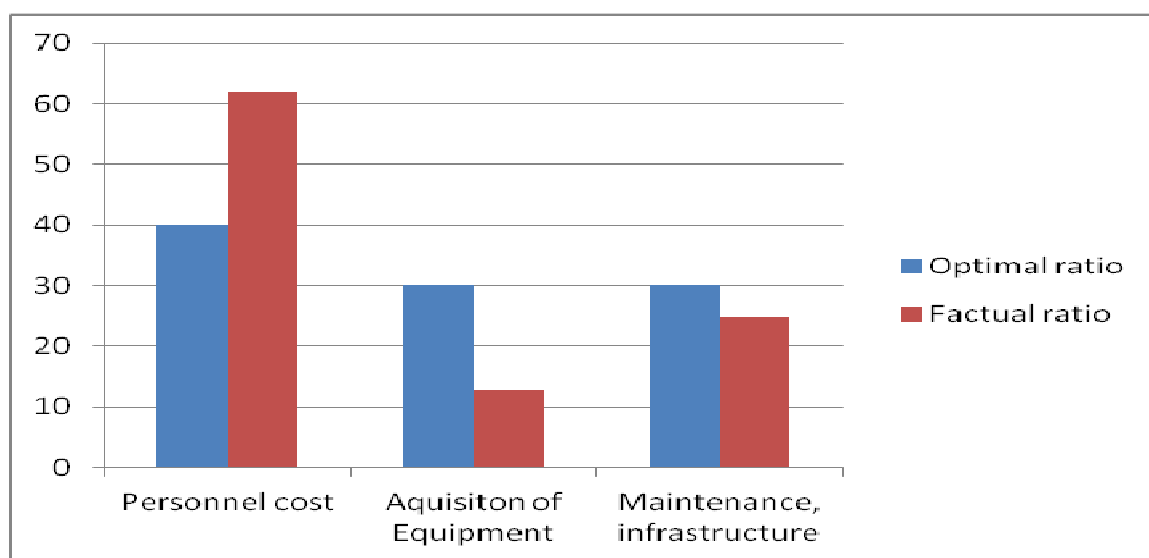
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Figure 5: Optimal and factual ratio for defence budget (European NATO Allies)

In order to re-establish the optimal balance in favour of the acquisition, an imaginary country with a EUR 10 bn defence budget should increase its budget with an initial EUR 0.75 bn (a 7.5% increase) or channel the same amount of money from other parts of the defence chapter. Following it should add an additional 7.7% increase to the budget every year only to cover increasing expenses assuming a continuous modernization.

For our 'imaginary' country this would result in a defence budget as high as EUR 14.46 bn by the fifth year, effecting a 45% increase in five years. This would suffice for a continuous replacement of aging weapon systems, equipping the army with state of art equipment and cover necessary training costs.

The probability of such increment in the near future is very low: As a consequence of the extended absence of any increment a gradually increasing gap will evolve between 'real-world' spending and optimal spending (see Figure 5). This rolling gap will finally result in periodical transformation processes when the force structure will be adapted to the realities.

## BAD BARGAINS - TRADING THE PRESENT FOR THE FUTURE

At the beginning of the new decade, signs of the global financial drought could be traced everywhere. The good utilization of the scarcely provided financial resources is more important than ever, therefore every area which is financed by the central budget has to prove its worthiness in order to take its share.

Under these circumstances, defence is obviously struggling to demonstrate its importance as at the moment no major threat can be detected on the horizon. The future is a very different story, though, which can easily cast threats and challenges bigger than what we are able to imagine and react to, nowadays. The future is a very different story though; it can easily cast threats and challenges bigger than what we could imagine and react to at present.



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Still, future remains uncertain, therefore hardly assessable and easy to debate with. It provides the false comfort for decision makers that they need only to deal with the issues of the present while future problems can be dealt with later on. Recent developments have shown that politicians are eager to extract resources from defence budget and are not really concerned about the later consequences.

Ironically for the defence sector, it is not able to defend its interest on the base of military reasons, since it cannot assess a 100% precise future, therefore its reasons remain soft.

In the meanwhile, force capabilities are not developing and the necessary resources are vanishing. Even on the short term, Europe will lose sufficient capabilities and with them, its ability to react and deter threats.

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