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Bastian Giegerich
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Budget Crunch: Implications for European Defence

Bastian Giegerich

The global financial crisis of 2007–08 and the subsequent recession in most European economies has created a new dynamic for defence spending. Even before the crisis, the punishing demands of operations on armed forces revealed shortfalls in capabilities and the cost of new equipment was rising at a rate of 5–10% per year. As both trends continue, European governments now struggling to control public deficits have launched a series of austerity measures across the board. In the overall scheme of government priorities, defence spending has become discretionary and many defence ministers have already been asked to make do with less money.¹

There are two basic options in light of these developments: either lower ambitions and accept that reduced financial resources will lead to reduced capabilities, or use the budget crunch as an opportunity to do things differently, to protect capability and perhaps even improve it. Lowering ambitions would need to go hand in hand with an honest assessment of the additional risk such a course would create for the security of European nations. Neither security challenges nor demand for international crisis-management operations will disappear. Europe would simply be less able to address the former or contribute to the latter. Such an approach would see funding for defence investment (equipment procurement plus research and development) and international operations hit hardest, because those budget items are easier to cut than personnel or fixed military infrastructure at home. In short, defence capability would be driven by the budget,

Bastian Giegerich is Research Fellow for European Security at the IISS.

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not by policy. But with less money for defence, the way that money is spent becomes of paramount importance. If budgetary pressure leads to structural reforms that eliminate unnecessary legacy capabilities and focus on capabilities relevant to present operations and future contingencies, this crisis will be a blessing in disguise.

In recent months, senior policymakers have embraced multinational collaboration in Europe to help manage defence in an age of austerity. NATO Secretary-General Anders Fogh Rasmussen recently called on governments to explore role specialisation to enable Allies to focus on particular sets of capabilities rather than to try individually to maintain as full a spectrum as possible. German Defence Minister Karl-Theodor zu Guttenberg, in an address to the IISS in June 2010, similarly advanced the idea of a better division of labour among European allies as a way to reduce budget pressures. The European Defence Agency argued in April that ‘pooling and sharing can provide solutions for more efficiently meeting European capability requirements in a constrained budget environment’. The idea of multinational initiatives is not necessarily new, but shrinking defence purses across Europe are a forcing event and a possible catalyst for change. Multinational collaboration is intended to create more bang for the euro through greater efficiency in the use of resources; it is supposed to help countries spend their pared-down defence budgets better. Whether it will or not depends, as always, on how it is done. There are different methods carrying different costs and benefits and there is a history of multinational collaboration on capabilities in Europe that provides insights into what to avoid and what to encourage. Understanding the methods available and identifying lessons from recent experience will be key to exploiting potential benefits.

Costs and benefits of collaboration
Multinational cooperation can be applied to both the equipping and use of armed forces. In an economic sense, collaboration is assumed to lead to a more efficient use of scarce resources through economies of scale (for example bigger order books which reduce unit costs) and other efficiency savings, such as reduced support and administrative efforts. By collaborating and spending money together, moreover, countries should be able
to develop capabilities that might be too expensive to acquire in a purely national framework. In military terms, cooperation is expected to lead to increased harmonisation of requirements and standardisation, which would translate into greater inter-operability of deployed forces. At a time most operations are multinational, this is an important factor. In the political sphere, cooperation might foster greater cohesion and a common outlook on security policy and on how to respond to challenges and risks. Finally, in the defence-industrial realm, it might reduce duplication and lead to further consolidation and, in some cases, technology transfer.

On the other hand, all these potential benefits have their mirror images in the form of potential costs. In economic terms, collaboration is often expected to generate disproportional demand for coordination, which might cause delays and introduce risks that could outweigh the expected savings. In military terms, cooperation could reduce operational effectiveness, for example through caveats imposed by different partners on deployed personnel and equipment. Depending on partners for capabilities, moreover, might create problems for security of supply. This is closely linked to the political dimension, as multinational collaboration will need to be driven by compromise and will invariably lead to reduced national autonomy. Governments would be right to fear possible entrapment: close cooperation might make it difficult to extract themselves from what they perceive as undesirable operations if their partners are keen on them. Governments might likewise fear abandonment in the opposite case: they might find that an operation they want to conduct depends on access to a partner’s assets. Finally, in industrial terms collaboration might entail a loss of skills and jobs for some participating countries.

There is thus a complicated relationship between the costs and benefits of collaboration. Clarity is crucial about what costs are acceptable in exchange for what kind of benefits. Only then can informed decisions about whether and how to engage in new multinational initiatives be made. There is a further complication: a closer look at different methods of collaboration reveals a tricky relationship. The more likely a certain method is to create
significant benefits, the more likely it is to create significant costs. There is no silver bullet. What form of collaboration to engage in will, therefore, depend on the specific parameters of the problem at hand.

**Using capabilities: pooling and sharing**

One common form of collaboration is the so-called sharing of capabilities. National capabilities would temporarily be made available in a multinational context but without a multinational mechanism for their use. For example, Belgium, France, Germany, Greece, Italy, the Netherlands, Portugal, Spain and the UK signed a Declaration of Intent in November 2008 to enable the generation of a combined European maritime-strike capability. This European Carrier Group Interoperability Initiative aimed to increase inter-operability among European navies and associated air groups, so that participating countries would find it easier to contribute assets to a composite carrier strike group on a temporary basis in support of EU and NATO commitments. This inter-operability would be achieved as a result of common concepts and information exchange. The coordination of training and maintenance is also a possibility to be further developed. All participating units, however, would remain under national command authority and costs would be met on a national basis. National governments would thus retain their decision-making autonomy and define the conditions for use of the shared capabilities. On the other hand, the benefits that might be expected from this form of cooperation are somewhat low, in particular with regard to efficiency savings.

A second form of collaboration is the pooling of capabilities. This would entail the delegation of nationally owned resources to a multinational structure. A good example is the Movement Coordination Centre Europe (MCCE), created in 2007. Its mission is to coordinate transport (air and sea) and air-to-air refuelling capabilities of participating countries so that they can be used more efficiently. Countries provide data to the MCCE regarding available capacity on a voluntary basis. The centre relates these to requests for these capabilities and suggests a match. Capabilities used and provided by participating countries are calculated according to a specific formula. This planning and coordination leads to higher use of existing
capabilities while lowering personnel and logistics costs. Even taking the costs of running the centre into account, the efficiency savings are notable. Some 22 countries, including Canada, Turkey and the United States, participate in the MCCE. While this method is relatively non-intrusive in terms of national autonomy, because assets remain under national control, it does create greater potential for efficiency savings through the multinational structure.

A third way of going about collaboration is role and task sharing. Countries would rely for some capabilities on partners or a multinational structure, while providing another part of the capability spectrum themselves. This could be organised in a complementary fashion, requiring countries to give up some capabilities provided by others. A less demanding form would be for countries to build up existing areas of excellence without giving up other capabilities. Smaller countries, in particular, could be encouraged to specialise in a particular niche, a capability rarely found among partners but of significant importance for operations. A group of countries might likewise decide to invest together in a very costly capability and provide it on behalf of a broader coalition.

Examples for each of these incarnations exist. The Netherlands decided to make a financial contribution to Germany’s procurement costs for the A400M transport aircraft in exchange for access to the capability. The Czech Republic chose to specialise in nuclear, biological and chemical (NBC) defence and serves as lead nation for an NBC defence battalion. Satellite-based reconnaissance capability at the EU satellite centre in Spain, aside from commercial imagery, is provided by a small number of EU member states because they are the only ones who have such a capability. All forms of role and task sharing would reduce duplication and redundancy, in particular if a coordinated and complementary approach were followed. Countries might also gain access to capabilities they could not afford on their own. On the other hand, mutual dependency would significantly increase, making this a high risk–high reward approach. In practice, then, although pooling and sharing is already under way, European governments seem to have a clear preference for methods that have low political costs, even if its means forgoing financial savings.
Procurement: joint acquisition and co-development

Collaboration in equipment procurement presents a slightly different picture. It is astonishing to see how little money European governments invest together. A quick glance at basic spending data across Europe demonstrates the potential for doing much more: according to the European Defence Agency, some 76% of all defence investment by EU member states in 2008 was spent on national programmes that do not involve international collaboration. For research and technology, an area that will help determine future capabilities, this figure rises to 82%. There is thus clear evidence that governments in Europe continue to spend money on their national supplier bases, generating duplications and inefficiencies. The result is too many programmes for too little money.

One method that has been used successfully in the past is the pooling of acquisitions. This would entail procuring and operating capabilities jointly, so that no purely national capabilities existed. This is costly in terms of political autonomy, so its application is usually limited to very expensive or enabling capabilities. NATO’s fleet of AWACS aircraft is the most widely known example. The same principle has more recently been applied to strategic airlift. Ten NATO members plus Finland and Sweden jointly acquired three C-17 transport planes, procured through the NATO Airlift Management Organisation. These planes, based in Hungary, are (like AWACS) flown and serviced by multinational crews. Operations are conducted on the basis of national requests by participating countries and can be in support of NATO, EU or UN operations. Participants in effect buy a tranche of flight hours to regulate access. This method, given its high political, military and possible industrial costs, is for the most part appropriate only for capabilities that countries cannot afford on their own.

A more traditional form of collaboration in the area of equipment procurement is co-development, in which a set of defence contractors develops and (usually) produces equipment for several customer nations. But it has been, in fact, such large co-development projects that have cast a shadow over the promise of cooperation. A perception has taken hold that collaboration will result in projects that are late and over budget. A quick look at major single-nation programmes, however, reveals that they
do not fare much better. Research has shown that, in particular, schedule slippage is related to the technical complexity of the programme, not the level of collaboration. Nonetheless, the travails of the A400M transport aircraft that played out in late 2009 and early 2010 warrant a closer look, in order to assess the perils and merits of multinational procurement cooperation.

The A400M is currently expected to be about four years late, with delivery not to begin before 2013. It might not, at least initially, fulfil the capability requirements defined by the customer nations. As revealed over the past 12 months, the project was wildly over budget. Instead of the agreed price of around €20 billion for 180 planes, estimates in 2009 ran to a total of just over €31bn. After tense negotiations the customers agreed to a price increase to €22bn plus €1.5bn in export finance for EADS, the contractor. Potential damage claims, contractually foreseen, were waived by the customer governments. EADS took losses amounting to approximately €4.2bn and introduced cost-cutting measures estimated to be worth another €3.6bn. While the economic and military promise of creating a highly capable plane at a competitive price is now much less convincing, the political logic behind the A400M made it too big to fail. The project generates jobs and technological know-how and prevents European countries from being completely dependent on the United States for future airlift capability.

Both customers and suppliers share the blame for the A400M’s problems. On the one hand, management mistakes were made at Airbus Military and its parent EADS, including an underestimate of technological risk and a failure to respond vigorously to early indications that the project was in trouble. On the other hand, the customers were guilty of introducing risk into the project by insisting on developing a European solution for the plane’s power plant when a competitive North American option was available. They insisted, moreover, on different national variations of the plane, such as terrain-masking software to enable low-level flight for Germany and strengthened floors and cargo ramps for the UK. This is a clear sign that requirements were not truly harmonised.
The A400M project was, initially, much lauded as bringing a commercial approach to multinational procurement. The contract foresaw a fixed price for a certain number of aircraft, with damages for delays or if a customer withdrew. Importantly, the contract was designed as a ‘single-phase’ arrangement that did not distinguish between development and procurement phases. In the past, transitions between phases would trigger a new round of multinational negotiations, which was almost guaranteed to add to delays and costs. The A400M shows that neither flexible contracts with different phases nor a single-phase commercial approach offer guaranteed success.

The transport plane is far from the only collaborative project that has run into trouble or failed to provide the expected benefits. As of early 2010, for example, some 14 customer nations had ordered a total of 529 NH90 multi-role helicopters. Once in service throughout those countries, the NH90 is set to replace no fewer than 12 different weapons systems. Rather than taking a single centralised approach, however, customer nations insisted on going through their own certification of airworthiness processes, driven to a great degree by requirements that are not harmonised. The winch that (among other things) enables soldiers to rope down from the helicopter, for example, is certified for loads of up to 270kg, as contractually specified. Germany, however, chose to limit the maximum weight to 237kg in its certification. The European Defence Agency estimated that introducing a single certification process would have saved up to €4bn between the customer nations.

Many other projects have turned out disappointing in one way or another. Final assembly for the Eurofighter Typhoon takes place in four different factories located in the main customer countries. The UK chose to withdraw from the multinational Horizon frigate programme and to instead build its own. Both France and the UK pulled out of the Boxer armoured vehicle programme. NATO invested enormous time and effort in the Allied Ground Surveillance project, only to kill it after years of investment and start over.

**Identifying lessons**

Another lesson from past projects is that governments tend to be willing to carry extra costs in order to protect national industries, mostly by insist-
ing on specific shares of the work to be carried out. The principle of *juste retour*, allocating work share to national industries according to the take-up of production by those nations, is bound to create extra costs, although there are industrial benefits. In the current budgetary environment it might well prove impossible to get rid of *juste retour*, given the high industrial stakes. But even limiting the use of work-share arrangements would generate significant future savings.

Collaborative programmes, too, move at the speed of the slowest participant. The multinational A400M programme, for example, was unable to proceed before May 2003 because it took the German government longer than expected to secure parliamentary approval to allocate funds to the project. Germany’s partners could not do much other than wait.\(^{11}\)

The most disruptive issue, however, seems to be the inability to harmonise requirements and timescales. If customer nations are unwilling to compromise on the precise specifications of a new piece of equipment and the date they would like to have it in service, suppliers are forced into an overly complex process, likely to result in a more expensive product. Customers who insist on procuring wildly different and incompatible national versions thus pay a high price for their ‘gold-plating’ strategy. Not only will unit costs rise, it will also be virtually impossible to generate efficiency savings later on, because varying national versions are likely to require separate training and servicing processes. They will also reduce inter-operability when assets are deployed.

Extrapolating from these observations, it becomes obvious that the expectations of participating nations need to be aligned for collaboration to work. This will become more difficult as the number of participating countries rises. Anchoring major equipment programmes on the NATO or the EU level will thus only make sense for some areas. Using these frameworks is likely to create a political obligation to allow all countries to participate that so wish. Such inclusiveness might reduce the effectiveness of the collaboration. A more appropriate role for NATO and the EU (or rather the European
Defence Agency) would be to make sure the different multinational constellations that arise are broadly working in the same direction and in support of strategic priorities defined by these organisations. Coordination and information exchange facilitated through these institutions would avoid duplication and fragmentation.

To make co-development more productive, several issues will need to be tackled. Firstly, greater transparency about project risks should be established. This would, on the one hand, involve the coherent use of milestones throughout a project and functioning project control. It is surprising, for example, that annual payments by customers to fund development of the A400M were not linked to the achievement of contractually defined goals. On the other hand, greater transparency also requires a certain flexibility. If service requirements were to change over the course of a project, for example, the effect would need to be properly evaluated and priced in.

Secondly, adopting a strategic approach over the lifetime of a capability, making provision for both development and operations together, would be desirable. If collaboration is not to stop with procurement, it is paramount that customers do not demand incompatible national versions. If collaboration on equipment is firmly anchored on the assumption that, in more cases than not, the armed forces of the partner nations will be deployed together, benefits will be enhanced.

Thirdly, greater harmonisation of requirements is essential, despite the difficulties that it would involve. Expending considerable energy on this harmonisation early in a project, to determine how much common ground really exists, would be worthwhile. This would be easier if requirements were to be defined in functional terms – if customers define a task they want their equipment to achieve rather than define the way that task is to be achieved. Industry could then take the lead role early in a project by coming up with a unified technical specification for the stated tasks. For the longer term, procurement cycles could be better aligned among governments so that the common ground also extends to the timescales for major projects.

Fourthly, collaboration has a better chance of yielding results if the decision-making process during a project is not unnecessarily politicised.
If ministries were willing to empower integrated multinational project teams, or in some cases international procurement agencies, they would gain quicker decision-making and lower administrative burdens, albeit at the cost of some direct control.

Finally, governments should encourage supplier consortia made up of complementary industrial partners, rather than forcing direct competitors to work together, as the latter actually entrenches industrial duplication and inefficiency. This, in turn, would depend on an alignment of defence industrial policies. If governments continue to favour national industries rather than support specialisation between countries, this is unlikely to work.

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Budget pressures are forcing governments to re-think approaches to pooling and sharing resources and collaboration on defence procurement. There seems to be a paradigm shift in the making, where economic and military logic calls for more collaboration, driven further by the multinational nature of deployments. Concern about the loss of national autonomy and industrial capacity, however, stands in the way. It is therefore possible that short- and medium-term financial pressure can generate short-term collaboration without changing the underlying assumptions. Leaders could chose to muddle through rather than take the crisis as an opportunity for change.

Collaboration in equipping and using military forces is not automatically the right thing to do; not every defence euro spent together is spent well. But at a time when spending more is out of the question, cooperation at least provides an opportunity to spend better by spending together, as long as the different avenues to cooperation are understood and past lessons heeded.

Greater collaboration among European governments is not about creating a European army. The motivation should not be ideological, but hard-nosed pragmatism: cooperation is about delivering usable capabilities at better value for money to ensure that the inevitable period of constrained resources does not lead to the downgrading of European defence capabilities.
Notes


5 Some actually fear a ‘renationalisation’ of defence in Europe. Under such a scenario multinational collaboration would go down as governments use the budget crisis as an incentive to play up protectionist tendencies and, for example, buy exclusively from national suppliers to protect jobs. Some of the 2009 stimulus packages included allocations for extra defence expenditure which was, by and large, spent at home. Ramping up protectionist logic and retrenching even further to the national level would be short-sighted, as it would leave a country’s armed forces less well equipped, less inter-operable even with its closest partners, and with higher costs for the taxpayer.


9 Ibid.


12 Marcel Dickow, ‘Rüstungskooperation 2.0: Notwendige Lehren aus dem A400M-Projekt’, SWP-Aktuell, no. 36, April 2010, p. 3.


14 This point was raised by industry representatives at a roundtable organised by the Centre d’Étude et de Prospective Stratégique in London in February 2010.