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IMPACT OF THE ECONOMIC CRISIS ON DEFENCE POLICIES: A COMPARATIVE STUDY

The international financial crisis has conditioned the amount of public budget assigned to national defence in the world's principal economic and military powers and this tendency may have a serious impact on the design of defence policies in the medium term. This article analyses in detail the evolution of defence expenditures in our geopolitical environment.

Defence policies, NATO, defence expenditure, financial crisis, European Union

1. THE INTERNACIONAL ECONOMIC CRISIS AND ITS IMPACT ON NATIONAL DEFENCE POLICIES

In the current global crisis, a comparative analysis of the defence policies of certain world powers must be conducted within the framework of the international crisis that was triggered in 2008. In terms of its specific origins and evolution, we must clearly identify the background, the trigger, the effects and the anti-crisis policies drawn up by the governments and international bodies.

In regard to its origins, there is an increasingly popular theory whereby, in the early years of the 20TH century, the major international investors operated within an environment of increasing uncertainty as to the future evolution of commodity markets such as oil and natural gas, raw materials and rare minerals.

Such uncertainty was partially induced by an increase in demand from emerging powers such as Brazil, India or China, but the key factor behind price rises was mainly the growing speculation in futures markets, since the production of most energy resources and raw materials had not seen such drastic reduction as to justify the spectacular price rises on the global markets.

As oil market data reveals, the demand for oil of the United States had risen from 16 million barrels a day in the early 1990s to around 21 million in 2005-2007, which is equivalent to a 30% rise in consumption prior to the downward trend caused by the economic crisis. As regards the production of the OPEP countries over the same period, this increased by 37%, while that of non-OPEP countries rose by 21%, giving a total global production of 73.5 million barrels a day. It seems obvious that the rise in oil prices from $45-47 to $110 over the same two decades did not correspond simply to supply and demand, even when taking into account the average global inflation figures for that period.[1]

Simultaneously, in countries such as the US, UK and Spain there was major speculation in the property market which had the direct effect of raising the cost of mortgages taken out by families along with an overvaluation of the assets held by the domestic banking sector.

Both trends demanded constant expansion of the national and international credit system, which could only be maintained by ignoring the minimum solvency and liquidity ratios of the financial entities, which was in turn encouraged by the self-serving reports issued by the rating agencies. A portion of this credit demand was caused by increasingly complex and volatile financial products that allowed the multinational banking sector to continue granting loans through indirect channels that could scarcely be monitored by domestic or international monetary authorities (the US Federal Reserve, central banks, the European Central Bank or the International Monetary Fund).[2]

Within this international context, the collapse of Lehman Brothers on 15 September 2008 triggered a financial crisis in the North American economy, which spread through the entire global financial system provoking, in the medium term, an economic recession and the surfacing of over-indebtedness, both public and private, which some of the major economic powers had incurred.

In 2008, the level of public debt among OECD countries varied considerably. Alongside heavily indebted countries such as Japan (180.7% GDP); Greece (110.6% GDP); Italy (98% GDP) or Belgium (90% GDP), others maintained a more moderate level of debt, such as Ireland (28% GDP); South Korea (29% GDP); Spain (33.7% GDP); Germany (39.5% GDP); the US (40.1% GDP) or France (53.4% GDP).[3] The impact of the financial crisis and the policies adopted by the governments clearly highlighted the differences in the short-term solvency and credibility of those countries' economies, generating fresh speculative movements on the international equity and debt markets. In just two short years, the public finances of many solvent countries would become seriously affected by spiralling public deficit.

1 WILLIAMS, J.R.- *Oil Price History and Analysis*. http://www.wtrg.com/prices.htm (consulted on 01/08/2011).

2 WHITE, L- H.- Housing Finance and the 2008 Financial Crisis.- CATO Institute. August, 2009. http://www.downsizinggovernment.org/hud/housing-finance-2008-financial-crisis (consulted on 01/08/2011).

3 Data obtained from the OECD. See: http://stats.oecd.org/Index.aspx?DataSetCode=GOV_DEBT (consulted on 01/08/2011).

One of the main effects of the economic crisis has been the rethinking of the economic policies, both tax and financial, which had been applied by the governments of these major international powerhouses. The financial endorsement which the governments afforded their banks in the first few months to avoid economic collapse, combined with the economic recession of 2009 and 2010, generated budget deficits that could barely be covered by the issuance of general government debt securities onto international markets overflowing with paperwork and suffering growing uncertainty as to the solvency of many economies that had been deemed solid and reliable just months earlier.

Indeed, over the course of a single year the public deficit of countries like Ireland (14.3% GDP); Greece (13.5% GDP); the UK (11.3% GDP); Spain (11.2% GDP) or the US (11% GDP), surpassed the 10% barrier, alerting the global markets over the complicated future of these economies as regards addressing the rising public debt being issued.

Such uncertain international forecasts were made worse by the impact of the recession on the private sector, with reduced production, rising unemployment and home mortgage delinquencies, a notable fall in public tax income and an insufficient amount of liquidity caused by cuts in bank lending.

Since 2010, in order to contain the rising public deficit and debt, governments have been applying various budgetary adjustment measures which are making short-term economic recovery all the more difficult.

When we look at the impact that the economic crisis has had on global defence spending, contrary to what we might expect, we find that the upward trend initiated before 2008 has in fact continued. According to statistics published by the Stockholm International Peace Research Institute (SIPRI), between 2005 and 2011 defence expenditure at constant 2010 prices increased globally with the exception of Europe, the cases of Saudi Arabia, China and the US being particularly noteworthy. (See tables 1 and 2).

Table 1 - Military spending by regions

(billions $US at constant 2010 prices)

2005	2006	2007	2008	2009	2010	2011	
1336	**1380**	**1431**	**1507**	**1607**	**1623**	**1625**	Worldwide Total
22,7	**23,6**	**24,6**	**27,8**	**28,6**	**29,6**	**32,2**	Africa
7,3	7,3	8,0	9,4	10	10,5	13,1	North Africa
15,3	16,3	16,6	18,4	18,6	19,1	19,1	Sub-Saharan Africa
631	**644**	**664**	**714**	**767**	**791**	**780**	Americas
579	588	605	650	701	721,4	712,7	North America
4,7	5,0	5,6	5,7	6,2	6,3	6,5	Central America and the Caribbean
47,2	51,0	53,5	58,6	60,3	63,6	61,1	South America
236	**249**	**267**	**283**	**317**	**322**	**330**	Asia and Oceania
1,2	1,4	1,9	1,9	1,8	2,0	2,2	Central Asia
173	185	201	212	236	240	250	East Asia
41,4	41,9	42,6	47,1	54,5	54,8	53,0	South Asia
19,8	20,9	22,2	22,9	24,6	24,9	24,6	Oceania
356	**365**	**373**	**384**	**392**	**375**	**376**	Europe
287	289	290	296	303	289	283	Western Europe
47,9	53,4	58,9	64,9	66,4	65,5	72,1	Eastern Europe
21,7	22,3	23,7	22,4	21,9	21,0	20,5	Central Europe
90,5	**97,7**	**103**	**99**	**103**	**105**	**106**	Middle East

Source: **SIPRI** http://www.sipri.org/research/armaments/milex/resultoutput/worldreg2011

Table 2 - 10 Countries with highest military spending in 2011

2011 Ranking (2010)	Country	Spending in Billions $US at market exchange rates	Percentage variation 2010-2011	Percentage variation 2002-2011	Percentage of GDP (estimated)
1 (1)	United States	711	-1,2	59	4,7
2 (2)	China	143 (estimated)	6,7	170	2.0 (estimated)
3 (5)	Russia	71.9 (estimated)	9,3	79	3.9 (estimated)
4 (3)	United Kingdom	62,7	-0,4	18	2,6
5 (4)	France	62,5	-1,4	-0,6	2,3
6 (6)	Japan	59,3	0	-2,5	1
7 (9)	India	48,9	-4,9	66	2,6
8 (7)	Saudi Arabia	48,5	2,2	90	8,7
9 (8)	Germany	46.7 (estimated)	-3,5	-3,7	1.3 (estimated)
10 (11)	Brazil	35,4	-8,3	19	1,5
	Worldwide	**1.738**	**0,3**	**42**	**2,5**

Source: **SIPRI** (11 October 2012) http://www.sipri.org/research/armaments/milex

Analysis of this data reveals three key facts:

1.- On a global scale, the impact of the economic crisis has not been borne by defence budgets, as many governments have believed that upholding national security should be given priority over other policies and have used defence spending as a tool for offsetting the economic crisis;

2.- Contrary to the rest of the world, in Europe part of the cost of the crisis has been borne by defence budgets in an attempt to reduce public deficit. France is the most notable exception to this trend;

3.- The uniqueness of the European case shows how the political and cultural foundations underlying the defence policies in Europe clearly differ from those prevailing in the US and the rest of the world.[4]

In light of these facts, it would be fair to ask ourselves whether the European defence policy model, which reveals a decisive influence of cooperative security generated by EU integration, responds to the future tendency which will prevail in the international political system or, as upheld by Robert Kagan, corresponds to an aftereffect of the Cold War in which a considerable part of the economic cost of European defence was borne by the two superpowers (the US and the USSR); a phenomenon which will not occur over the coming decade.

Whatever the answer to this question may be, the truth is that even those major powers that have continued to increase their military budgets have been forced to curb this rise and to review their strategic doctrines for the coming decade. Obviously, this is not only affecting military procurement programmes and the availability of personnel (military and civil) for the armed forces, but will also affect the operational capacity of units and commitment to future international peace-keeping missions.

2. THE UNITED STATES

To a large degree, the experience of the US once again reveals the foreseeable evolution in this sector's international trade. The budgetary debate between the Department of Defense (DoD) and Congress for the 2011 and 2012 fiscal years clearly established the need for acquisition affordability and a rebalancing of force by reforming the military procurement and maintenance procedures, including a review of ongoing R+D programmes, in order to optimise them in budgetary terms.

4 The German government intends to allocate €31.68 billion for its 2012 defence budget and reduce it to €30.43 billion in 2015.

http://www.bmvg.de/portal/a/bmvg/!ut/p/c4/NYvBCsIwEET_aDeBCqU3SoDoJL3YekvbEFaapKybevHjTQ7OwDvMY_CJpdEe5K1QinbDEaeFuvkDczg8vFLmskKgSG9xTDngo35WBouKTirFRaFCz1YSw55YtmoyczFAKo5Km15p9Y_-tre7aS6npjXXfsA9hPMPWnFFxQ!!/ (consultado el 01/08/2011).

The UK intends to reduce its defence budget between 2010 and 2015 by 8.5% in real terms.

http://www.mod.uk/DefenceInternet/AboutDefence/Organisation/KeyFactsAboutDefence/DefenceSpending.htm (consulted on 01/08/2011).

In March 2010, the Italian government approved a 10% reduction of its defence budget, which had initially been approved at €14.28 billion and already included a reduction of 0.4% over the 2009 budget. For 2011, it is considering a 20% reduction in operational and maintenance expenditure.

http://www.defensenews.com/story.php?i=4645413 (consulted on 01/08/2011).

France is the exception to this tendency towards defence cuts and is set to increase defence spending by €2.6 billion between 2010 and 2013.

http://ambafrance-us.org/spip.php?article1751&xtor=AL-13.

Both criteria have a direct impact on the defence industry, since a rebalancing of force implies distributing units differently, as well as the materials they use; i.e. giving priority to some weapons programmes and abandoning or replacing others. At the same time, the adoption of more efficient military procurement and maintenance procedures would mean greater competition among providers, tighter control over the productivity and profitability criteria of the approved programmes, including potential returns, and tougher penalties from the DoD for breaches of contract by companies providing material and services, including the permanent abandonment of procurement plans. (See table 3).

Table 3.– Status of the Weapons Programmes proposed by the DoD in the 2011 budgets

Weapons Programmes reduced or cancelled by the DoD	Status in 2011
F-35 Joint Strike Fighter (JSF) Extra Engine	On hold
C-17 Globemaster Strategic Airlift Aircraft	Cancelled
Next Generation (CG(X)) Cruiser	Cancelled
Third Generation Infrared Surveillance (3GIRS)	Cancelled
Net-Enabled Command Capability (NECC)	Cancelled
Command Ship Replacement (LCC---R)	Postponed till 2015
Expeditionary Fighting Vehicle (EFV)	Cancelled
F-35B Short Take-Off/Vertical Landing (STOVL) Joint Strike Fighter (JSF)	On hold
SLAMRAAM Surface-to-Air Missile	Reduced
Non-Line-of-Sight Launch System	Proposed cancellation
EP-X Manned Airborn Intelligence, Surveillance, and Reconnaissance Aircraft	Proposed cancellation
SM-2 Block IIIB Missile	Proposed cancellation

Source: **Olson, L.-** *Fiscal Year 2012. Defense Spending Request Briefing Boook.*
http://www.armscontrolcenter.org/policy/securityspending/Fiscal_Year_2012.pdf

In his *Directive dated 3 November 2010*,[5] the Under Secretary of Defense set out the measures for economic optimisation and cost control that are to be applied by the heads of all DoD departments and agencies. He established five specific categories of measures:

A.- Availability of affordable material and control of cost increases

B.- Productivity and industrial innovation incentives

5 Under Secretary of Defense.- *Implementation Directive for Better Buying Power – Obtaining Greater Efficiency and Productivity in Defense Spending* (3 November 2010).
http://www.ndia.org/Advocacy/Resources/Documents/LegislativeAlerts/Implementation_Directive_
6 Nov2010.pdf (Consulted 03/08/2011).

C.- Promote real competition among providers

D.- Improve the service procurement procedures

E.- Reduce non-productive processes and bureaucracy

Of special note are the measures aimed at encouraging productivity and innovation within the defence industry in order to achieve real competition among contractors:

1.- Rewards for contractors that have efficient supply chains and indirect systems of expense management;

2.- Increased use of Fixed-Price Incentive Firm Target (FPIFT) contracts as opposed to Firm-Fixed-Price contracts for programmes which are more than$100 million over the Acquisition Category ID (ACAT I) and a review of all contracts above that amount for the remaining ACAT levels, standardising contracts to give them a ceiling of 120% and a 50/50 share ratio;

3.- Adjustment of payment release as a performance incentive;

4.- Extension of the US Navy pilot programme to make it a Superior Supplier Incentive Program;

5.- Reinvigorate research by independent industry and the development and safeguarding of basic defence technology;

6.- Presentation of a competitive procurement strategy for each stage of the programme;

7.- Remove competitiveness barriers;

8.- Increase the dynamic role of small companies in competing for the defence market.

As we can see, the DoD has set in motion a sweeping reform of its defence promotion and procurement policy whose effects cannot yet be definitively assessed. However, taking into account the past record of such reforms, they will surely have a decisive impact on the reorganising of the US defence industry over the coming years.

3. THE LEADING EUROPEAN POWERS

The European option of reducing defence expenditure in order to reduce the excessive indebtedness of its economies has led the governments of the leading European powers to review the conditions for approved weapons programmes, put new programmes on hold for the next few years and even cancel some, and stimulate joint production with other countries.

Naturally, such defence cuts had to be compatible with the approved strategic priorities, though they forced the United Kingdom to publish a new National Security Strategy in 2010, replacing the one which had been approved just two years earlier.

3.1. United Kingdom

The Conservative government led by David Cameron decided to reduce the defence budget by 8% by way of substantial reductions in personnel and military procurement plans. Yet such cuts must also allow for the two strategic objectives deemed essential: maintaining the deployment of forces in Afghanistan and creating a balanced defence by 2020.

The contemplated cuts represent a saving of 20 billion pounds sterling. To that end, they plan to reduce troop numbers by 17,000 (7,000 in the Army, 5,000 in the Navy and 5,000 in the Air Force) by 2015 along with a further reduction of 25,000 civilian defence staff.

As regards the cuts in military procurement and maintenance programmes, it has been decided to:[6]

1.- Reduce the number of nuclear warheads, maintaining the current *Trident SLBM*;

2.- Withdraw troops from overseas bases, especially the 20,000 stationed in Germany, by 2020;

3.- Postpone the decommissioning of Vanguard class nuclear submarines

4.- A progressive withdrawal of the Nimrod MRA4 and Harrier aircraft together with a reduction in the fleet of Tornados, paving the way for the closure of three air bases;

5.- A reduction in the number of aircraft carriers and modernising of their structure to make them interoperable with Joint Strike Fighter aircraft;

6.- Replacement of 42-type destroyers by 45-type;

7.- The stationing of units in a greatly reduced number of bases allowing for the sale of closed bases;

8.- A reduction in the number of tanks and heavy artillery;

9.- Renegotiation of defence industry contracts.

3.2. France

As a result of the *Defence White Paper*, the *Loi n° 2009-928 du 29 juillet 2009 relative à la programmation militaire pour les années 2009 à 2014 et portant diverses dispositions concernant la défense* was passed in 2009.[7] This legal text provides for defence spending of €185 billion for the entire period (calculated at 2008 prices), of which €102 billion will be allocated to military procurement.[8]

6 HM Government.- *Securing Britain in an Age of Uncertainty: The Strategic Defence and Security Review* (2010); pages 21 to 27. http://www.analisisinternacional.eu/archivo/viejos/doc14.pdf

UK Ministry of Defence.- *Equipment, Support and Technology for UK Defence and Security: A Consultation Paper*.- http://www.mod.uk/NR/rdonlyres/F4ACE80C-BFD7-463D-99A6-2B46098BB0C4/0/cm7989_Eqpt_supp_tech_ukdef.pdf (Consulted 03/08/2011).

7 The legal text is available at http://mjp.univ-perp.fr/defense/lpm2009.htm (consulted on 04/08/2011).

8 *Annuaire Statistique de la Défense 2010-2012.*

Despite the budget cuts announced by the French government, the military procurement plans were upheld by Minister Hervé Morin thanks to an anticipated increase in revenues through to 2013 of €2.6 billion from the sale of property and unused defence telecommunications frequency bands.

Consequently, the initially envisaged impact of the cuts to the budget earmarked for equipment is not estimated to exceed €1.3 billion, thus allowing key programmes to continue, such as the *Rafale* (Dassault) fighter plane; participation in and acquisition of the A-400M; the *European Multirole Frigates* (FREMM); the *Suffren* class nuclear attack submarines; the advanced combat infantry system or the *Integrated Infantryman Equipment and Communications* (FELIN). On the other hand, they have considered postponing development of the *Mirage 2000D* and the acquisition of the *A-330 Multi Role Tanker Transport aircraft*. Overall, the impact of the French defence cuts will have less of an effect on its industry than in the case of the UK and Germany.

3.3. Germany

In the case of Germany, the budget cuts are not due to the economic crisis, which should place its budgetary deficit below 3% of its GDP in accordance with the convergence criteria, but rather the major reorganisation which the *Bundeswehr* is undergoing in order to become a professional army.[9]

The report produced by the Commission set up by Chancellor Angela Merkel recommended reducing the 2010 budget by €450 million, to €31 billion in total, of which €250 million correspond to cuts in military development or procurement programmes.

Its recommendations highlighted:

a).-An operational capacity for the Army of 6 Brigades, made up of 6 battalions, plus a Parachute Brigade for special operations, along with two General Staffs to manage and control the Brigades;

b).-A reduction of Armed Forces personnel from 252,000 to 165,000, of which 7,500 would be volunteers and 157,000 professionals. Voluntary service will last for 23 months, with a 6-month initial trial period. Finally, and following the changes made by Parliament, they are considering a 2013 target of 185,000 personnel comprised of 170,000 professionals and 15,000 volunteers.

c).- The material cuts include the *A-400M* programme and the NH-90 and *Tiger* helicopter programmes, along with the temporary suspension of its order for 37 *Eurofighters*, 25% of the 400 *Puma* armoured vehicles and the *MEADS* missile defence system.[10]

http://www.defense.gouv.fr/content/download/133340/1317464/file/ANNUAIRE%20Stat2010-2011.zip (consulted on 04/08/2011)

9 Given that federal legislation provides for compulsory recruitment as the formula for citizens' fulfilment of their duty to defend the country, whereby the introduction of the professional army model would require constitutional amendment, in order to avoid this legal pitfall the German government has put the application of this provision on hold as opposed to formally repealing it.

10 The Gobal Financial Crisis…".- *op. cit.* pp. 47-50.

4. CONCLUSIONS

1st - While the global economic crisis is financial in origin, it has ultimately affected the growth of Western economies and, in the medium term, has generated differing responses among countries and regions in terms of the response priorities for the necessary reduction of their budget deficits and public debt.

2nd - The leading European powers, in contrast to the global trend, have opted to make significant reductions in their defence spending by reducing civil and military personnel along with arms acquisition programmes. This will doubtless affect their operational capacity in the medium term. France is the exception to this.

3rd - The defence cuts introduced by European powers will force their defence industry to seek alternatives by following four basic lines of action: a) boost internationalisation, whether through joint production of advanced material and/or boosting exports to third party countries; b) bolster the standardisation and modularity of the material; c) increase the returns in material procurement and d) develop civil applications from research programmes or military production.

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