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Research Report

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NATO's Two Percent Illusion

Germany Needs to Encourage Greater Efficiency within the Alliance

Christian Mölling

In order to plug the gaps in NATO's defence capabilities, Europeans – and Germans especially – need to increase defence spending to 2% of gross domestic product (GDP). The United States especially has been insistent on compliance with this target, which was set in 2002. But this benchmark has long been known to be an illusion, one many European NATO member states are neither willing nor able to implement. In any case, the 2% benchmark focuses on expenditures rather than improved outcomes. The federal government should develop its own concept of how NATO can apply its financial resources more efficiently – and it could use output criteria and specific contributions to convey its concept.

The Ukraine crisis has fueled the discussion of how to fill the gaps in NATO's defence capabilities. The United States is focusing on Germany in particular, in the hope that other NATO member states will follow suit if even the reluctant Germany is seen spending more on defence. The goal of 2% of GDP was adopted by NATO's member states in 2002, but currently only four states fulfil the nonbinding requirement: the USA, Estonia, Greece, and Great Britain. Moreover, Germany's expenditures are distinctly lower than those of France and Great Britain, whom it considers as its peers in defence policy.

However, Germany refuses to increase its defence expenditures, contending that the 2% benchmark as such is not useful and emphasizing instead greater efficiency in the application of defence outlays. Yet it has not

offered any specific or constructive suggestions in response to Washington's demands.

But Berlin can neither escape American pressure, nor ignore the financial consequences of the new security situation for national defence budgets within the alliance. The federal government should therefore develop its own blueprint for how NATO can apply its resources more efficiently, the core of which could be a stronger focus on efficiency achieved by linking the 2% input criteria with output criteria and specific German capability contributions to alliance defence; and it should assertively present its ideas before and after the September 2014 NATO summit in Wales. In this context, Germany could notify NATO of additional defence expenditures which it can already foresee will become necessary.

Lack of focus on efficiency

Until now, efficiency – the question of the actual utility of defence expenditures – has not played a role in connection with the 2% target. But when it comes to appropriate defence capabilities for NATO, then it becomes essential to consider specific contributions, such as planes or tanks. Because some NATO states are better than others at managing their resources, levels of defence expenditures alone are not very meaningful. Moreover, in many European countries after the end of the Cold War, the defence budget has become more important for social policy than for defence because of the jobs it offers in the armed forces, defence administration and industry. This priority shift leads to inflated defence personnel budgets and an armaments policy that primarily serves to generate employment and protect industrial interests. As a result, defence establishments have lost military efficiency. Conversely, a large budget does not imply efficient capability generation. And when states undertake defence expenditures that strengthen NATO's defence only incidentally, that is not really solidarity.

Dwindling critical mass

The adoption of the 2% target was based on the historical observation that greater defence expenditures produce visible increases in output. However, this was particularly true for countries in which armies and armament industries comprised a significant portion of GDP – if that portion is large enough, greater investments combined with scaling effects result in improved military capability. This was true until the end of the Cold War e.g. in Germany, France or Britain. However, because the armed forces and defence industries of Europe have been shrinking since then, the scale effects have been replaced by tipping points: capabilities are increasingly approaching a bottom line beyond which they become ineffective. In some cases, these capabilities are only effective if they are used in an

alliance context; and even at this level, some capabilities (such as amphibious units) are dwindling, because fewer and fewer countries possess them in ever smaller quantities. Some capabilities (such as certain kinds of intelligence) have already disappeared from the alliance entirely.

Questionable signals

The arbitrary correlation between GDP and defence spending leads to politically questionable signals. Greece provides a useful example, as it adheres to the 2% guideline only by virtue of the fact that its GDP sank faster than defence expenditure in the context of an impending sovereign default – as is rarely acknowledged. Conversely, a country whose defence expenditures grow at a slower pace than its GDP remains at a disadvantage regardless of how much it spends.

If Germany were to meet the 2% demand, it would have to spend around 20 billion euros more per year. The defence budget would increase from its current amount of 32 billion euros to 52 billion euros. With such a gigantic armaments program, Germany would dominate yet another European policy arena in addition to fiscal policy. Its defence budget would be the largest in Europe, larger than those of France and Great Britain.

Belt tightening

The NATO defence planning process has disclosed deficits in the defence capabilities of the alliance. In order to minimize these, NATO has drawn up a list of priority deficit areas. In response to the problems that became apparent in the Ukraine crisis, NATO is currently developing the "Readiness Action Plan" (RAP). Further reductions in these capability gaps would require additional expenditures. Most European member states in NATO plan, however, to contribute less to NATO this year than that they have until now. For them, as Britain's

minister of defence put it, the financial crisis remains the greatest threat to the security of Europe. Even if the economic outlook improves, NATO's European member states are unlikely to burden their budgets with an additional €50 billion per year to attain the 2% goal.

That is why defence budgets will continue to develop unequally. Many states will contribute less to NATO's capabilities than before the financial crisis. Meanwhile, the costs of weapons systems rise inexorably by 5 to 10% per year.

How could Germany react?

Rather than clinging to the 2% illusion, the allies should face those realities and challenges which they could deal with through improved national contributions and practical cooperation. Specifically, it is foreseeable that Europe's limited resources will force member states to make their defences more efficient.

Germany can use the commitment to greater responsibility, made at the Munich Security Conference in 2014, as well as the mutual defence clause in NATO's Article 5, which the alliance is currently reinforcing with the RAP, to make the case that its contributions to these efforts are both legitimate and militarily required. It is already clear that the German armed forces will have to engage more in collective defence alongside crisis management. This could mean, among other things, that all elements of the armed services – rather than just two brigades – must be prepared to contribute to Article 5 commitments and crisis management at the same time.

There are tight fiscal limits for the foreseeable additional expenses. The debt ceiling, recently added to the German Basic Law, forbids that annual new debt exceeds .35% of GDP after 2016. Moreover, the governing coalition has set itself the goal of a "black zero": it wants to avoid any new debt.

The government and the federal legislature will have to seek a new compromise

between fiscal discipline and defence capability. Specific project proposals, which derive from NATO priorities and embody the German emphasis on efficiency, stand the greatest chance of success.

Output criteria

In the NATO context, Germany should suggest output criteria as an alternative or addition to the 2% goal, in order to better channel national efforts. These criteria are basically already available: the forthcoming RAP, and the list of the alliance's most serious deficits, adopted in June, articulate a catalogue of key missing capabilities.

Contributions which prevent deficiencies from reaching critical mass, should be given special priority: some allies have gaps and deficiencies in their capabilities, while others possess considerable surpluses. Both should be compiled in a *Criticality Ranking*. A point system could honor contributions to scarce capabilities in particular. High surpluses, which indirectly signal wasted resources, would earn minus points.

In order to take into consideration the varying resources of smaller and larger countries, contributions to capabilities should be related to the overall size of the armed forces. This would reward the specialisation of smaller armed forces in important specific capabilities. Conversely, this would make render it apparent that large armies do not necessarily make a special contribution to collective security.

Finally there could be a sustainability bonus for states which make an explicit commitment to designate 5–10% of their defence investment to offset inflation in this sector, thereby ensuring that their capabilities would still be available in ten years.

Possible German contributions: Enabler

Germany could specifically provide so-called "enablers" – systems which enable the deployment of armed forces (such as

intelligence) or significantly increase its effectiveness (such as air-to-air refueling). Firstly, this would be easier to explain to a German public still sceptical of combat operations than the procurement of major military systems. Secondly, this happens to be where the alliance has its greatest deficits. Thirdly, these “enablers” can be applied to both crisis management and alliance defence – rendering them an especially effective investment.

Specifically, Germany could make permanent and guaranteed contributions through the secondment of more specialized personnel in the NATO command structures, the provision of deployable field hospitals, and the procurement of reconnaissance systems. Germany could expand its command and control capabilities in the context of the framework nation concept (see below).

The Ukraine crisis has laid bare the alliance’s deficits in logistics and transportation. Here Germany has traditional strengths. One specific option might follow from the fact that the federal republic is currently renegotiating its orders of airborne transportation like the A400 M and the NH 90 helicopter. Suggestions for a multinational helicopter regiment have already been submitted by one of the government’s coalition partners. In this way, Germany could expand its role NATO for a logistical hub for the alliance.

Efficiency gains through the Framework Nation

With the Framework Nation Concept (FNC), Germany has contributed a concept for configuring armed forces that is based on considerations of efficiency, preservation of critical mass, and different abilities to contribute capabilities among alliance members. In this concept, the Europeans create groups of smaller and larger member states. These would agree in advance which nations would provide which kinds of troops and materiel. The framework nation, for example Great Britain or Germany, would

function as the military backbone of these cooperating groups. It would provide the necessary basic military infrastructure: logistics, command and control, etc. The smaller nations would concentrate on specialized contributions and thereby enable the group to sustain operations longer. Thus not all states would have to provide and pay for full spectrum capabilities. More resources would be available to procure what the group actually needs.

That said, Germany should significantly increase its contributions: the current cooperations, begun under the FNC, are more oriented towards political symbolism than military efficiency.

The federal republic should commit itself to lead four FNC brigades as a framework nation while only providing for a maximum of 60% of their capabilities. This would force it to aggressively seek cooperative solutions and greater efficiency. The more “military mass” the FNC generates the more it will be accepted.

Acting as framework nation, Germany could identify the strengths of smaller NATO states and serve as a focal point for their common capability contributions. Specific proposals could follow from the NATO planning process, as well as the output criteria suggested in this paper.

If a case for increased expenditures were made in this way, it would not only reinforce Germany’s goal of greater efficiency, but also improve its ability to act in the framework of the EU. If this led to the proportion of GDP devoted to defence increasing over time, the United States would be appreciative as well.

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