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# Order: the Financing of Alliances and Western Power

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## Key Issues

- Gearing up for an era of great power competition means that NATO and EU members not only need to increase defence spending, but they need more transparent data metrics to ascertain their real commitment to defence.
- The 2023 Vilnius Summit may result in 2% becoming the baseline rather than ceiling for allied defence spending, but this misses the point about the quality of defence spending.
- EU states and European NATO allies will come under increasing pressure to boost defence spending, and increased spending will be at the heart of transatlantic unity. Questions remain about Europe's ability to take on more of the defence burden.

Russia's war on Ukraine and the rise of China are raising serious questions about order in international politics: the collapse of arms control treaties, the weaponisation of raw materials and technologies and the use of unconventional tactics to subvert international law and prey on vulnerable countries are the hallmarks of the emerging order. For most of the West, there is a need to re-learn the fundamentals of power. The risks posed by nuclear-armed adversaries and their greater reliance on war and aggression means that there can be no substitute for sustained investments in Western militaries: defence and deterrence are again the order of the day. However, if the West is to have a fighting chance at maintaining its military supremacy and upholding global order, it needs to answer some fundamental questions about its alliance system and what is expected of allies.

This Policy Brief looks at the nature of the West's military alliances, and, in particular, it focuses on burden-sharing in the North Atlantic Treaty Organisation (NATO). At a time when the United States (US) is focusing its attention on China and the Indo-Pacific, greater responsibility for the security of Europe *should* fall on European shoulders. In a context where the US has underwritten European security for close to 80 years, and where American lives and money have been put on the line, it is long overdue that Europe do more for its own defence. While any systemic decoupling of the transatlantic alliance should be avoided, Europeans cannot continue to free-ride on American power indefinitely.

Our arguments in this Policy Brief are based on observations made at an international security seminar held at the US Military

Academy, West Point, on 9-10 February 2023. During this seminar, the authors were part of panel discussions as moderators, speakers, discussants and rapporteurs and they exchanged views on the evolution of geo-economics and global strategic competition. In this regard, this first piece in a series of three Policy Briefs from the international seminar provides a window into the growing importance of burden-sharing and the economic fundamentals of defence. Needless to say, we write here in our personal capacities and none of the content herein can be attributed to our respective employers.

### The first line of defence

The first line of defence of the West is NATO, which is underwritten by American power. The alliance is a public good that is beneficial for all members and ensures that all allies feel secure. However, we also know that the military and financial contribution to collective defence in the alliance is disjointed – the US makes an outsized contribution to collective defence. As we saw with the previous US administration, the question of burden-sharing is a deeply political issue that underlies the healthy management of NATO. Europe, being a wealthy continent, has consistently under-performed in relation to defence spending. Europeans have historically failed to meet the "2% of GDP" pledge at the heart of NATO's defence investment plans, and many still do despite Russia's 2022 invasion of Ukraine - only 7 allies met the target in 2022. However, with the US increasingly focusing on the Indo-Pacific, calls for Europe to do more for its own defence will only become louder – regardless of who sits in the White House.

We have already seen how questions of burden-sharing in NATO are intensely political, and NATO as an organisation has had to adapt to pressure from Washington in this regard. To this end, in 2017 NATO Secretary General Jens Stoltenberg underlined the importance of "cash, capabilities and contributions" as a way of capturing what individual NATO allies bring to the alliance. At a time when former President Trump was calling for more investment in defence, NATO headquarters was at pains to show that commitment to the alliance could be measured in more than just defence spending. The reality, however, is that arguments for greater spending rang more loudly than any appreciation for commitments to military operations or what capabilities NATO allies were purchasing – even when acquired from the US.

There are, of course, numerous academic studies that have probed the realities of burden-sharing in NATO. Some scholars have argued that free-riding in NATO is an overblown argument, not least because there are questions about the causal link between increased defence spending and influence in Washington – top European defence spenders do not necessarily enjoy a closer relationship to the US. This same school argues that burden-sharing and free-riding should be understood in a geographical and temporal context – free-riding may fluctuate over time and depend on geopolitical circumstances. Another school of thought argues that many European NATO allies are not really driven by geopolitical or strategic considerations when planning their defence expenditure. Instead, so the analysis and data show, burden-sharing choices are driven by regional political economies.

### "Spending more, spending better"

The idea that NATO countries have to 'spend more and spend better' is not new, but so often the specific dynamics of spending better are overlooked. Whenever political leaders speak about the need to increase defence budgets, analysts immediately think of a country's overall defence expenditure, expressed in real terms or as a percentage of GDP. It is such a metric that forms the basis for NATO's "2% of GDP" target. Of course, many analysts have already questioned the value of such meta-metrics, not least because in some cases they may actually be artificially reached by allies due to inflation or budget cuts – it historically takes defence longer to feel budgetary cuts, and this raises defence spending artificially against other areas of government spending. For example, during the Covid-19 crisis there was a risk – that did not eventually materialise – that as the GDP rates of European countries decreased, the share of defence spending as a percentage of overall GDP would artificially increase, all while not doing anything to raise real rates of defence spending.

Therefore, when any discussion of top-line defence spending figures occurs we should immediately focus on the quality of the spend overall. In other words, there is a need to focus on exactly what alliance defence spending is geared toward. Fortunately, scholars have already attempted to disaggregate military expenditure in NATO and this has led to at least four main baskets of spending: 1) equipment costs (e.g. weapons systems); 2) personnel costs (e.g. payroll and social costs for civilian and military employees); 3) operations and management costs (e.g. spare parts, supplies and utilities); and 4) infrastructure costs (e.g. fixed military installations). Overall, the data shows us that only approximately 15% has been invested in equipment even though NATO and the EU have both established a "20% target" for equipment and research and development (R&D) as part of their overall investment in defence. Instead, the data shows that over 56% was spent on personnel, 24% on operations and maintenance and just under 3% on infrastructure.

Disaggregating defence spending in this way is important, especially in an alliance setting, so that we can enhance transparency and get a better handle on the state of burden-sharing. In this sense, if collective defence is to have any real meaning then allies have a vested interest in knowing where each dollar or euro is being spent. The lack of transparency certainly does not help overcome feelings of suspicion and accusations of free-riding among allies – mutual trust is at the heart of any alliance, yet without transparency on spending and commitments trust can be eroded. The reality today is that the data and accounting methods of defence spending in NATO are not conducive to producing a realistic and clear-eyed picture of allied commitments, and this lack of accuracy may even damage NATO's ability to identify vulnerabilities or gaps in its defence innovation and capability suite.

**Europe's burden?**

Ever since Russia's invasion of Ukraine in early 2022, Europeans have been called upon to support Kyiv with financial assistance, military advisory capacities and military equipment. As part of this effort, vulnerabilities in Europe's defence manufacturing capacities have been exposed with challenges associated with production times and scale for basic supplies such as ammunition. Still, even though the EU has developed new ways of delivering and reimbursing the military equipment being sent to Ukraine, Europe still falls short of American levels of military support. For example, whereas the US is estimated to have delivered €44.3 billion in military equipment to Ukraine since January 2022, the EU27 have delivered approximately €10.7 billion over the same period. In this respect, the EU has delivered the bulk of non-military financial assistance to Ukraine since January 2022 rather than military equipment – by January 2023, the EU Institutions had provided €30.3 billion to Ukraine compared to €25.1 billion by the US.

Despite Europe's support for Ukraine, however, the continent's commitment to defence cannot simply be measured in terms of the legacy equipment and ammunition it hands to the Ukrainian armed forces. Indeed, European investments in defence are required to ensure collective defence and deterrence – not simply to deter current and future Russian aggression, but also to be able to help manage future military friction with rising powers such as China. In this respect, several European countries have invested in a relatively rapid fashion in new equipment. Countries such as Croatia, Estonia, Latvia and Lithuania have moved quickly to buy air defence systems; others such as Finland, Germany, Norway and the Netherlands have procured next-generation fighter aircraft such as the F35; Poland has procured battle tanks and howitzers and the Netherlands have agreed to acquire howitzers too; and others, like France, have prioritised seabed warfare and nuclear modernisation. This is a very material contribution to NATO and EU defence.

**"The continent's commitment to defence cannot simply be measured in terms of the legacy equipment and ammunition."**

Looking to the future, however, Europe has to contend with the issue of sustained investment in defence. The level of ambition shown so far is quite underwhelming: only €8 billion over 7 years under the European Defence Fund, €7 billion over 7 years for military assistance and a proposed €500 million for a short-term, two-year, financial vehicle to support the production of ammunition. While all of these figures represent a real break-through in the way the EU approaches defence spending – for years the question of using EU funds for defence was taboo –, these amounts are too timid for the strategic reality facing Europe today. This is why some have called for a massive and sustained increase in defence investment. Looking at EU action in the Covid-19 recovery period, the European Commission initially borrowed up to €100 billion for economic support. Why not something similar for defence?

Such a financial level of ambition would be more than welcome for Europe's contribution to transatlantic burden-sharing, but the EU is still hamstrung by a number of structural factors that impede bolder action on defence. For one thing, Europe does not represent an integrated banking and financial system and it certainly cannot be likened to the US federal system. Borrowing for EU strategic projects cannot yet rely on mutualised debt and European states still protect and promote national banking champions for their own benefit rather than EU-level or NATO efforts. The truth is that, despite the crisis management steps taken in the wake of the 2008 financial crisis, the European banking system is still too fragmented and governments are not prepared to leverage existing financial sources found under the European Investment Bank. One wonders if European nations can seriously leverage the finances for collective defence without a proper banking union that integrates capital markets and allows for more fluid cross-border transactions.

### Toward and beyond Vilnius

In this first Policy Brief of a three-part series, we have addressed the issue of transatlantic burden-sharing and we underlined how important it is for Europe to be far more ambitious on defence spending. In the two Policy Briefs that follow, we argue that international politics is undergoing profound change marked by counter-order and disorder. In this piece, we have focused on "order" – or rather the steps the West needs to take to maintain the order it has enjoyed for several decades. Russia's war on Ukraine clearly undermines international order and the principle of territorial sovereignty. Europe has stepped-up its game and realised that the geographical proximity of the war means it needs to invest in military equipment and overcome political taboos in defence. Yet, without US support Europe's effort would have been largely futile and clearly America continues to undergird the NATO alliance in critical ways.

However, Europeans need to read the runes. The major issue today in international politics is China. The US has underlined its resolve to respond to this rise and its destabilising effects, and it has focused in on the Indo-Pacific theatre. Europe may not see China through a military lens, but the coming era of great power competition is a major test. The NATO alliance and the EU both need to come to terms with the challenge posed by China. While there is growing attention to securing supply chains and re-shoring or near-shoring manufacturing capacity, there can be no substitute for military power. When leaders sit down at Vilnius in the summer of 2023, they need a new vision for collective defence not only pegged to top-line defence spending: we need to see a real commitment to the quality of this spend through equipment acquisition and modernisation and defence innovation, in addition to personnel.

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