

DGAP POLICY BRIEF

Deterrence and Defense in Times of COVID-19

Europe's Political Choices



Sophia Becker
Research Fellow, Security
and Defense Program



Christian Mölling
Research Director



Torben Schütz
Research Fellow, Security
and Defense Program

Due to the COVID-19 pandemic, Europe is headed for a recession that will dwarf the economic downturn after the 2008 financial crisis. The impact on national defense sectors could be devastating. But as crisis and responses are still in the early stage, governments can still take measures to mitigate the effect on defense. To safeguard political and defense priorities, EU and NATO States need to act jointly and decisively.

- This crisis could deal the European defense sector its second major blow in ten years – and at a time when Europe's security is more acutely threatened than at any stage since the end of the Cold War.
- A range of different scenarios are plausible. In all of them, European cohesion is crucial to be able to mitigate the impact on the defense sector. Much will depend on US attitude toward NATO and Europe.
- The crisis also presents an opportunity to reassess the European defense strategy, refine priorities, and pursue arms control at a time when adversaries may become more open to such negotiations.
- Germany should use its upcoming EU Presidency to lead the effort to shield key European defense and industrial capabilities. It could propose a pragmatic redesign of instruments like the European Defense Fund and PESCO.

FROM CRISIS TO CRISIS: ANALOGIES AND ANOMALIES

The fight against COVID-19 is causing an unprecedented economic crisis. Given the enormous pressure currently building up on public budgets, this crisis could soon affect defense spending. When looking for guidance on what to expect and how to react, the 2008 financial crisis – which hit the defense sector severely – offers useful insights. Still, the current crisis will be different: First, the magnitude of its financial impact is expected to be much greater. Second, the European threat environment is far more challenging today, making the state's core task of effective deterrence and defense more urgent than at any time since the end of the Cold War.

The 2008 Financial Crisis

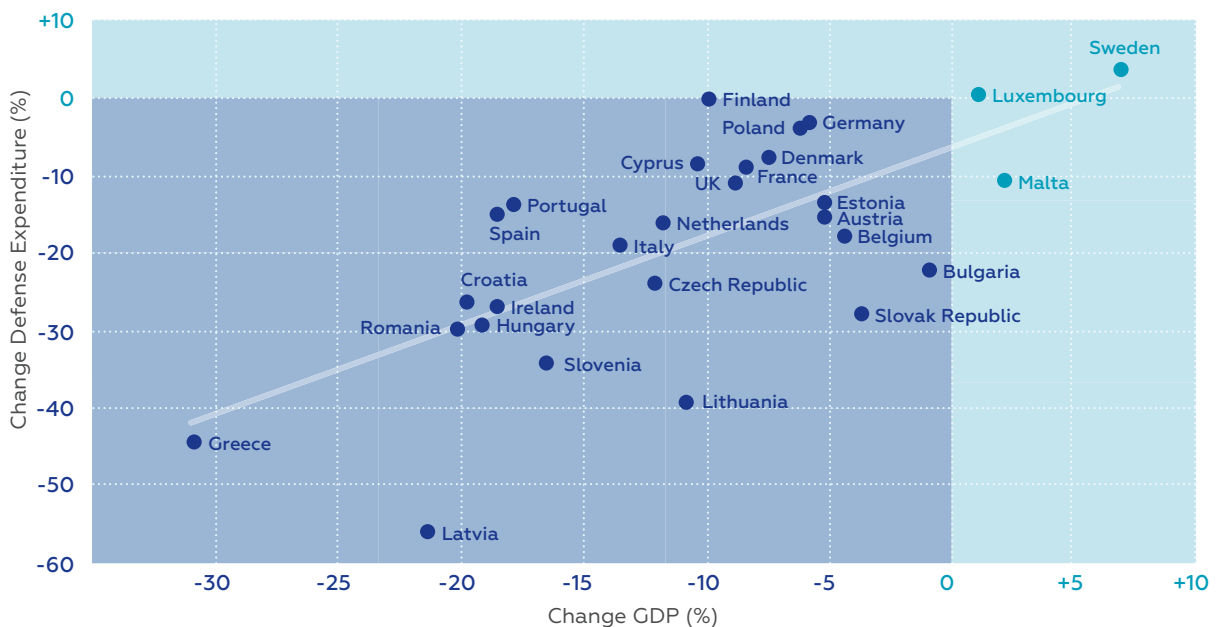
The impact of the 2008 financial crisis on public spending was immediate, massive, and long-lasting. As a consequence, the defense sector, i.e. armed forces structures, procurement, industries, and de-

fense innovation, were hit hard. European defense budgets saw cuts of around 30 percent in smaller states, 10 to 15 percent in medium, and around 8 percent in larger states.¹ Overall, about EUR 24 billion – or about 11 percent of total defense spending – were cut in the years following 2007/2008.²

However, the handling of the crisis and the impact on the defense sector in different countries depended not only on the magnitude of the economic blow but also on the political priorities and traditions of national governments. Finland lost 10 percent of its GDP but did not scale down its defense budget. Slovakia's economy shrunk by less than 5 percent of its GDP, but the government cut defense spending by almost 30 percent. Overall, about half of European governments made defense cuts roughly reciprocal to the decreases in GDP, as figure 1 shows.

Even though defense budgets slowly recovered toward pre-crisis levels after 2014, capabilities did not. Nationally as well as at EU and NATO level, sig-

FIGURE 1: EU28 GDP AND DEFENSE EXPENDITURE CHANGES 2008-2012



Source: For GDP Data - International Monetary Fund, World Economic Outlook Database³; For Defense Expenditure Data - Stockholm International Peace Research Institute Military Expenditure Database⁴

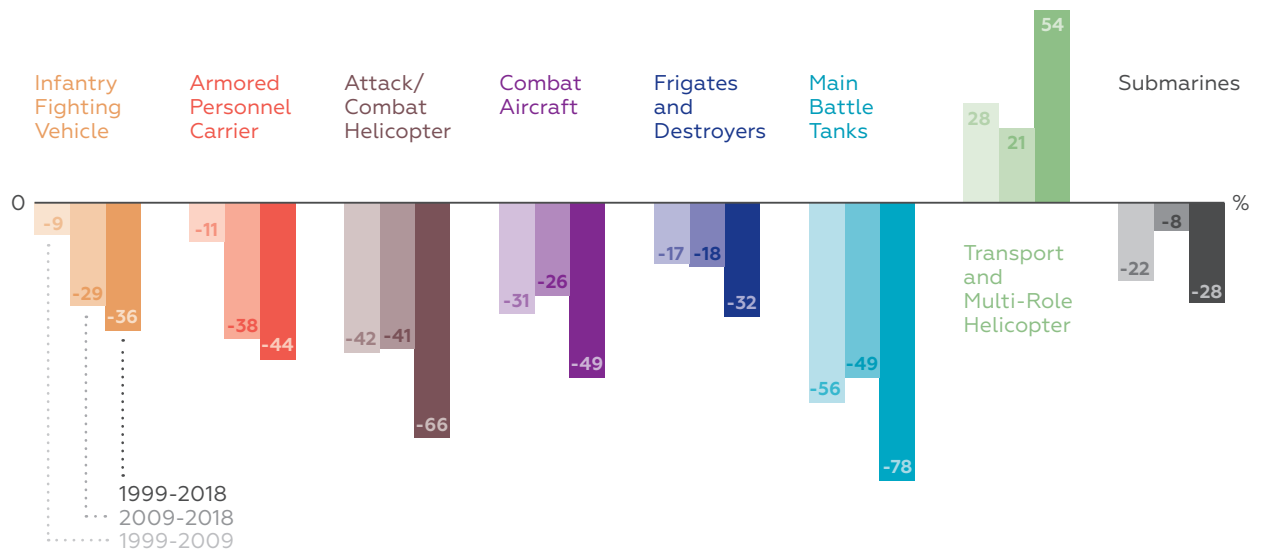
¹ Brune, Sophie-Charlotte and Mölling, Christian, The Impact of the Financial Crisis on European Defence, European Parliament, 2011, accessed April 3, 2020 under <https://www.europarl.europa.eu/document/activities/cont/201106/20110623ATT22404/20110623ATT22404EN.pdf>.

² Fiott, Daniel, Will European defence survive Coronavirus?, Elcano Royal Institute, March 27, 2020, accessed April 3, 2020 under http://www.realinstitutoelcano.org/wps/portal/rielcano_en/contenido?WCM_GLOBAL_CONTEXT=/elcano/elcano_in/zonas_in/commentary-fiott-will-european-defence-survive-coronavirus

³ International Monetary Fund, World Economic Outlook Database, accessed April 4, 2020 under <https://www.imf.org/external/pubs/ft/weo/2019/02/weodata/index.aspx>.

⁴ Stockholm International Peace Research Institute, Military Expenditure Database, accessed April 4, 2020 under <https://www.sipri.org/databases/milex>.

FIGURE 2: EU28 CHANGES IN MILITARY EQUIPMENT 1999-2018 (IN %)



Source: International Institute for Strategic Studies, The Military Balance, 2000, 2010 & 2019⁵

nificant gaps still exist. European armies have lost roughly 35 percent of their capabilities over the last two decades. Figure 2 shows that the ten years between 2009 and 2018 saw the most severe reductions, which in some cases even exceeded the equipment cuts of the previous decade.

Four Factors in the Current Defense Crisis

From 2020 onwards, European countries are likely going to find themselves under a double strain: While public finances will come under stress, the need for continued or even increased defense investment will remain as the security environment deteriorates. We currently see four factors framing our scenarios, which will determine when and to what extent European defense will be impacted by the unfolding crisis:

- Public finance
- The security environment
- The US contribution to transatlantic deterrence and defense
- Institutional coherence and coordination in European defense

Public Finance in European States

First estimates by the OECD and national institutions conclude that the initial economic impact of the measures to fight the COVID-19 virus will by far exceed that of the 2008 financial crisis.⁶ An OECD evaluation shows that the partial shutdowns in many countries could lead to an immediate 20 to 25 percent decrease in national GDP.⁷ For Germany, the Leibniz Institute for Economic Research (Ifo) estimates that the cost in terms of GDP loss could lie anywhere between EUR 255 and 729 billion depending on the duration of the economic shutdown.⁸

It is already clear that this crisis will put an unprecedented strain on public budgets as countries are struggling to reduce the economic blow. The severe socio-economic consequences of the crisis may force governments to prioritize immediate economic relief over long-term strategic defense considerations. As public debt rises, reducing defense spending may seem like an easy fix. This could develop into the second major hit to European defense budgets and the defense posture within a decade. Yet it is a

⁵ International Institute for Strategic Studies, The Military Balance, Volumes 100 (2000), 110 (2010), 119 (2019), London.

⁶ Dorn, Florian, Fuest, Clemens, Göttert, Marcell et al., Die volkswirtschaftlichen Kosten des Corona-Shutdown für Deutschland: Eine Szenarienrechnung, Leibniz-Institut für Wirtschaftsforschung an der Universität München e.V., March 2020, Munich, accessed April 6, 2020 under <https://www.ifo.de/DocDL/sd-2020-04-fuest-et-al-volkswirtschaftliche-kosten-corona-2020-04-15.pdf>, p.8.

⁷ OECD, Evaluating the initial impact of COVID-19 containment measures on economic activity, OECD, March 2020, accessed April 6, 2020 under https://read.oecd-ilibrary.org/view/?ref=126_126496-evgsi2gmqj&title=Evaluating_the_initial_impact_of_COVID-19_containment_measures_on_economic_activity, p.4.

⁸ Dorn/Fuest/Göttert 2020.

political decision to say if cuts in defense spending will be made and how substantial they should be.

A Changing Strategic Environment

Europe's strategic environment is different today from what it was in 2008. In the 2000s, the major military engagements by Europeans were expeditionary operations – and thus to some extent wars of choice. Today, Russia has re-emerged, threatening its neighbors more or less openly, and China is increasingly posing a military challenge to Europe and the United States. Deterrence and defense have once again become core missions of NATO.

However, this does not make crisis management in other parts of the world obsolete or less important: Europe cannot take a tough stance on Russia in the east and neglect the south. It is not possible for Europe to focus on just one pillar. It must address deterrence, defense, and crisis management simultaneously.

Even beyond the military domain, Europe's weakness can easily be exploited by competitors such as Russia and China. These powers are far from immune to the virus themselves, of course, and are already suffering from economic consequences such as declining oil prices in the case of Russia. But they won't lose time to step into the vacuum left by European and American retrenchment – including in Europe itself. Given the lack of US leadership in the global response to COVID-19, Beijing is currently positioning itself as the alternative provider of soft power. Beijing is presenting an image of control and benevolence, delivering medical equipment and test kits to Europe and elsewhere, while the United States is barely able to handle the crisis at home.⁹

The US as a Wildcard

The United States remains a source of uncertainty. Ever since Donald Trump took office, Europeans have doubted America's commitment to the transatlantic alliance and have started to strive for more autonomy. Even though the current administration has so far kept the US military posture in Europe intact, a major economic recession in the United States could make Washington reconsider. The US defense budget will not be immune to economic pressure. In the 2010s, even the USA – which had retained high levels of military spending in the immediate aftermath of the crisis because of ongoing military en-

gagements – had to recognize the need to balance military spending with increasing national debt.

Like in other countries, the consequences for the US defense budget will depend on the duration and the severity of the economic recession caused by the pandemic. A severe economic crisis during the presidential race could cause significant electoral pressure to reduce the defense budget and relieve ailing public finances. The current crisis could thus lead the US to speed up the retrenchment of its global posture. Facing hard economic choices, the US is likely to focus on China as the single biggest threat and retreat from Europe. This would leave Europeans with even more capability holes to patch. US commitment to maintaining its nuclear umbrella may strongly depend on Europeans increasing their efforts to ramp up their own capabilities. Political decisions about European defense spending will need to take this into account.

Russia and China won't lose time to step into the vacuum

Institutional Coherence and Coordination in European Defense

While defense remains a national prerogative, no European state has the size and resources to be effective on its own. Military power in Europe depends on multinational formations and coordination. Even when individual governments do operate nationally, they can only do so because they have allies at their back. Yet the 2008 financial crisis showed up severe shortcomings in institutional coherence. It was not just the euro which nearly fell victim to isolated national policies. Governments also decided to cut defense spending nationally, putting what they thought of as "sovereignty" before military effectiveness.

In the current crisis, the institutional challenge will be even greater as Britain, a major military power,

⁹ Campell, Kurt M and Doshi, Rush, The Coronavirus Could Reshape Global Order, Foreign Affairs, March 18, 2020, accessed April 6, 2020 under <https://www.foreignaffairs.com/articles/china/2020-03-18/coronavirus-could-reshape-global-order>

has left the EU. Britain's membership in NATO continues but cannot fully make up for the many close links between EU member states. Both the British government and EU countries have expressed the will to continue and possibly even intensify their cooperation in defense matters, but this may prove very difficult at a time of exploding debt and rising nationalism.

For the purpose of this paper, we assume that Britain will continue to be part of European defense, both as a member of the European caucus of NATO and as a close associate of EU programs like PESCO. This is why the authors speak of Europe rather than the European Union.

"MOVING TARGETS" – POSSIBLE SCENARIOS FOR CHANGE

At this stage, it is hard to predict specific outcomes. Any scenario outcome will be shaped by the four stressors described above: dwindling resources, a changing security environment, potential US retrenchment, and the issue of EU cohesion. The following four exploratory scenarios¹⁰ highlight these four stressors and their consequences for European defense, meaning its armed forces, defense industry, and military modernization. All four scenarios are built on the expectation that the economic situation will get worse.

Defense Sector Breakdown

In this scenario, the financial burden of the crisis quickly becomes so devastating that virtually all European governments prioritize short-term socio-economic spending over the medium/longer term responsibilities of the state, including security considerations. Smaller countries' forces will become almost completely inoperable, with air forces collapsing first due to their high maintenance and operational costs – leaving allied air space unguarded at times. Country after country pulls its contingents out of exercise and training rosters. While governments try to coordinate through EU and NATO, there is not much left to coordinate. As some governments are forced to declare bankruptcy, the remaining forces are needed for internal security tasks. The medium-term result is not a scale-down but a

FIGURE 3: FOUR SCENARIOS FOR CHANGE

DEFENSE SECTOR BREAKDOWN

- Devastating economic impact across Europe
- Military forces collapse, leaving Europe vulnerable to worsening threats

AMI GOES HOME

- Economic crisis forces USA to withdraw from Europe and concentrate forces in Pacific
- Europe must do more for its own defense with fewer resources

INEFFICIENT POOLING AND SHARING, AGAIN

- Europeans damage capabilities through uncoordinated cuts
- Remaining forces are barely sufficient to maintain defense and deterrence

SOLIDARITY FIRST – ESTABLISH LEAD NATIONS

- Larger countries take on more of the burden and maintain military capabilities
- "Framework Nation Concept Plus"

Source: Author's own compilation

¹⁰ Given the early stage of this crisis and the larger number of unknowns, these scenarios are to be understood as exploratory in nature. They do not feature a clear distinction between independent and dependent variables.

breakdown of the European deterrence and defense posture, leaving Europe vulnerable. The security situation is tense as Russian analysts assume that the nuclear threshold has been lowered due to the loss of conventional capabilities. The challenge for burden sharing and solidarity in the EU and in NATO will be to pick up the remaining pieces and rebuild a minimum credible posture. Some allies will not be able to contribute for a long time.

Industries will not only suffer from the immediate cuts but also from uncertainty over whether and when defense activities will resume. After the first shock, globally active European defense companies will start to leave Europe for places that offer more stability. European governments may be willing to let them go – allowing them to export defense industrial know-how and production facilities – if they promise to supply goods and services for the next two decades at reduced prices. Uncompetitive companies will become national branches of non-European holders and produce in license. Another consequence of the economic vulnerability will be that foreign investors, especially from Asia, buy into critical parts of the European supply chain.

Ami Goes Home

US withdrawal from Europe would be the most devastating outcome in both economic and security terms. In this scenario, the enormous strain that the fight against the pandemic puts on the US economy and the deep rift in US society result in strong political pressure to bring the troops home and to stop paying for European security. Those views were present among the American electorate prior to the pandemic¹¹ but are widely held now as the United States is consumed by the fallout of the crisis. As a result, the United States is pulling out of NATO, leaving Europeans to their own devices.

Regardless of the development of European defense budgets, this scenario places an extreme burden on European governments. The security environment becomes more perilous as the US ends its commitment to European defense. The loss of the US nuclear umbrella ignites an intra-European debate about nuclear deterrence. Given that Europe includes nuclear powers as well as countries that have signed and ratified the Treaty on the Prohibition of Nuclear Weapons, internal cohesion is strained. Both budget and nuclear debates meet with political resistance in individual states.

This paradoxical situation of having to spend more while budgets are becoming tighter exacerbates political rifts between Europeans. Just as during the last crisis, Europeans have different spending priorities. Diverging spending patterns impact defense industries differently across Europe. Procurement and modernization efforts become more and more asynchronous in the mid-term. Those Europeans who spend consistently retain both forces and industry, while others cut back. Uncoordinated capability retention wastes resources and weakens Europe's capacity to act even further.

Inefficient Pooling and Sharing, Again

This scenario is built on Europe's cardinal mistake during the last crisis: national instead of European decisions. European governments react to the financial challenge just as they did before – with uncoordinated changes to their armed forces. Domestic considerations take priority over the maintenance and generation of military capabilities and the respective equipment procurement. Instruments like PESCO and EDF are only paid lip service to.

*The challenge will be
to rebuild a minimum
credible posture*

As seen over the last decade, coordination and solidarity are crucial to prevent the loss of critical niche capabilities. National cuts have system-wide consequences, causing inefficiencies and damaging Europe's military capacity to act.

Only after a first wave of cuts will Europeans return to attempting some coordination within in EU and NATO. But as they lack a clear picture of who retains which capabilities, coordination becomes cumbersome. Moreover, as this is the second round of cuts within a decade, there is not much left to pool. Force modernization increasingly turns into copying US efforts with significantly smaller forces which will be

¹¹ Hannah, Mark, It's Not Just Trump. The American People Are Skeptical of NATO, Too, Politico, December 03, 2019, accessed April 6, 2020 under <https://www.politico.com/news/magazine/2019/12/03/not-just-trump-american-people-skeptical-nato-074813>.

equipped with imported material. Consequently, Europe's strategic autonomy decreases while its dependency on the US increases.

In this scenario, the United States continues to be committed to European security and NATO. The presence of US forces on the European continent remains a strategic priority. However, NATO will not be able to function across the same wide spectrum as before. This could trigger another burden- and risk-sharing debate on the value of deterrence versus expeditionary operations and put a strain on internal cohesion.

European defense industrial capabilities suffer as domestic demand and investment into research and development (R&D) plummet. Moreover, the industry's ability to increase efficiency through transnational M&A and economies of scale is constrained by heightened national sentiments. Companies decide to either aggressively internationalize, which means massively increasing defense exports, or to abandon production as the armed forces as an otherwise reliable client drop out.

Solidarity First – Establish Lead Nations

In our best-case scenario, we assume that the overall financial impact on defense budgets is mild and only a few countries will be hit more severely. Here, early political commitments by larger European countries soften the impact of the financial crisis on defense spending. The economic fallout of the pandemic has less severe effects on larger economies, enabling them to act early by taking on more national debt in order to retain their forces. Those forces constitute the anchor to which smaller armed forces, that are driven into more specialization by the crisis, can attach their capabilities. Available flexibility in the capability development plans is used to integrate countries that fall temporarily behind. Such an arrangement, similar to NATO's Framework Nation Concept, allows for a comparatively good balance of financial strain and retention of military capabilities. In a laudable display of leadership, commitment, and coordination Germany, France, and the UK make this approach work.

In order to protect the heart of European defense and deterrence, larger countries erect firewalls around critical military capabilities such as air-to-air refueling, electronic warfare, air defense, etc. Smaller militaries are reassured that allies will retain capabilities which they themselves can no longer afford. Europeans take stock and will identify and re-

tire unnecessary capabilities and outdated equipment. In order to provide modern equipment to armies that suffer disproportionately, European states introduce new contractual concepts. Larger countries can lease out equipment they have procured to support their industry. In turn, leading defense industrial companies include local suppliers in smaller states in their supply chains to make such deals more appealing.

As a result, Europe does not increase its dependency on the US. Instead, it incentivizes a European consolidation of industrial capabilities, supply chains, and procurement programs with larger states as lead nations. Moreover, the retention of a large part of the initial military capabilities allows Europeans more flexibility in addressing new and existing threats.

TAKING THE RIGHT MEASURES EARLY ON

As the unprecedented economic fall-out of this crisis is starting to become apparent, it may seem tempting to curtail defense spending. But given the current volatility in the world, it would be irresponsible to slash investment in risk prevention.

There is no automatism that sends European governments down the same path they took a decade ago. The world is just at the beginning of this crisis, and there is still time to shape the outcome of the current development. Germany and Europe should embrace six recommendations:

Don't Recycle the 2008 Playbook

EU and NATO should prevent unilateral action. Uncoordinated defense cuts would not only damage the alliance as a whole but also spread the narrative about countries free-riding on the back of other nations' efforts. Without proactive coordination or at least information-sharing, the capability landscape will get rougher, and misperception and distrust will grow. Given the size of European nations, there can be no such thing as a national defense anymore. Moreover, rebuilding capabilities is more costly than retaining them – another painful lesson from 2008.

EU and NATO should immediately convene for emergency meetings. They should try to preempt developments and present several alternative scenarios and possible joint reactions. They should also show where national reactions can be useful and where they do

harm. The objective at this early stage is to enable allies to understand their roles and responsibilities and to allow for a collective search for solutions.

EU and NATO need to reactivate their cooperation. To enable EU instruments to be used effectively, EU and NATO states have to be fully aware of what is discussed and designed in response to the unfolding crisis on the other side of Brussels.

Envisage the Next Generation of Defense Industrial Cooperation and Consolidation

Defense industries and technological innovation are also at risk due to the upcoming crisis. Similarly to the measures described above, a landscape of critical industries and technologies needs to be designed now. This will be difficult as there is no single authority with the comprehensive authority and capability to deliver such an overview. Instead, national interests will bias the assessment. Still, depending on the magnitude of impact, the crisis will offer an opportunity for restructuring and strengthening Europe's defense technological and industrial base. A new design, however, cannot be based on cuts alone. Therefore European procurement projects of a sufficient size to have a structural impact on the defense industrial sector should be envisaged early on.

This crisis offers a chance to overcome national sentiment

It is an old idea: increase the efficiency of invested resources through centralization and the economies of scale and learning. Even though NATO and Europe have a long track record of successful cooperation projects, political inertia has so far impeded further progress. However, this crisis offers a chance to overcome national sentiment in organizational and defense industrial cooperation. It should be seized, even though political resistance is to be expected – in this economic crisis, domestic jobs tied to defense production will be considered all the more valuable. Another obstacle is the firewall that traditionally separates civilian and military R&D in Europe. It

took the triple crisis of Ukraine, Brexit, and President Donald Trump's doubts about NATO to even partially overcome this blockade and to channel EU funds toward military R&D. So while cutting investment in R&D may seem like an easy fix, decision makers should be aware of the dire consequences for the next generation of defense solutions.

Rethink Strategy: Adapt the Level of Ambition

Strategy implies a constant adjustment between objectives and means. With fewer means available, objectives need to be downsized, or means have to be used more creatively. Hence, EU and NATO should consider lowering their level of ambition. An alternative would be to employ other means to achieve objectives: Conflict has already spilled out of the conventional military domain. If military means prove more expensive or less effective than alternative ones, it is prudent to consider a more comprehensive way to engage in conflicts and deter adversaries. Such a comprehensive conflict strategy could build on the lessons learned from hybrid warfare and foreign influence operations against Europe.

Embrace the Opportunity for Arms Control

A crisis in military spending provides an opportunity to develop and implement innovative methods and ideas for arms control. As COVID-19 will negatively impact the economic situation of many countries, including that of adversaries, arms control measures may gain appeal as a means to reduce defense spending. In combination with very low oil prices, Russia may not be able to continue with its current modernization plans. This goes for both conventional and nuclear armament. Moreover, the US is only now beginning its nuclear modernization which certainly has the potential to give Russia pause. Depending on the US financial outlook, negotiations among Moscow and Washington may become more likely.

Capitalize on Germany's EU Presidency to Shape the EU Response

Germany takes over the EU presidency in July. This may have looked like a routine job – until now. The fact that the largest EU economy, the largest defense spender, and the second largest military force in the EU takes over in midst of the crisis gives Berlin leverage to shape outcomes in the defense realm.

Germany could propose adapting the European Defense Industrial Development Program and the European Defense Fund to enable countries to safeguard critical capabilities. Both instruments should also be considered for developing and deploying innovative

means of conflict on the basis of the comprehensive conflict strategy outlined above. As Germany has led the work on PESCO, it should also come up with ideas for adapting PESCO to the new realities of the post-COVID-19 world. Moreover, innovative financing models could be developed with the EU covering the cost for maintenance or lease of systems. The EU could even become the operator, e.g. for routine transport planes and some infrastructure. All measures should be open to non-EU Europeans.

Safeguard the Transatlantic Partnership

The US remains the biggest single provider of European defense. Given NATO's integrated approach to transatlantic security, the European should make a particular effort to help US citizens as their cities are becoming hotspots of COVID-19. It would be a strong sign of transatlantic solidarity if European countries that have been less touched by the virus could quickly send medical personnel to the US. Helping the United States get through this health crisis now may prevent a defense crisis in Europe later.

Moreover, as transatlantic procurement contracts come under pressure, Europeans should try switching to leasing models instead of canceling. This would allow them to avoid damage to their own capability development and to US suppliers as well as to the political relationship.

CONCLUSION

Europe can still shape its own destiny: As crisis and response are still at an early stage, heads of governments and defense ministers can mitigate the effect on defense, if they put the right strategies in place now. Germany's upcoming EU presidency – if properly prepared for now – offers a genuine opportunity to avoid the mistakes made after the financial crisis of 2008. Europe would then have a chance to come out of the COVID-19 crisis with its security intact and possibly even strengthened.

DGAP

Advancing foreign policy. Since 1955.

Rauchstraße 17/18
10787 Berlin

Tel. +49 30 254231-0

info@dgap.org

www.dgap.org

[@dgapev](#)

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