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Fail to plan, plan to fail: European security and defence

by Ian Bond

If you are building a house, there is no point in collecting a pile of bricks, buying state-of-the-art household equipment and then waiting for a structure to emerge. First you plan, then you build. When the European Council discusses defence at its meeting in December, however, the focus will be on why Europe is not buying enough dishwashers. Designing the house will not be on the agenda. This is a mistake.

The closest thing the EU has to a blueprint for security and defence policy is the 'European Security Strategy' of 2003, lightly revised in 2008. Since then, the member-states have made limited progress towards their goal of being "able to act before countries around us deteriorate, when signs of proliferation are detected, and before humanitarian emergencies arise". They can point to some successes when reacting to acute problems – for example, the EU naval operation set up when piracy off Somalia became too serious to ignore. But taking into account all the resources the EU and its members have, they have done too little to shape their security environment in a time of change.

A number of European countries, including Italy, Poland, Spain and Sweden, want a new security strategy. With their encouragement, several European think-tanks jointly published a report in May 2013 entitled 'Towards a European Global Strategy', which contains many good ideas and has been the basis of a continuing programme of policy analysis and recommendations. But the official paper by the EU High Representative and the Head of the European Defence Agency, drafted in preparation for the December European Council, contains only a short section on "the strategic context". This section will not be discussed or endorsed at the meeting.

The UK, France and Germany have all been unenthusiastic about revising the 2003 strategy. France fears that a new strategy would no longer justify Europe's ambitious Headline Goals (targets for the military capabilities that are needed for EU missions) and Capability Development Plan (though in an age of austerity these seem out of reach anyway). Germany, after a period in the 1990s when it was willing to defend European values robustly, for example in Kosovo, seems at present to want to pretend that military force has almost no place in international relations.

The UK, on the other hand, wants the EU to concentrate on increasing military capability, not discussing strategy. But it will be hard for Britain to persuade its European partners to invest more in defence unless it can articulate what the purpose is. Without a strategy, defence procurement becomes little more than an expensive job-creation programme – easy for finance ministries to cut in favour of something more cost-effective.

The British government seems to have two fears about any attempt to agree a new European strategy. The first is that a lot of effort will result in a lowest common denominator strategy. There is a real risk of that – as with NATO's strategic concept. But even a minimalist agreed document would be better than nothing. Those who wanted to go further could, while those inclined to free-ride would face at least moral pressure to live up to the strategy.

The second is fear of 'competence creep', with the European Commission gaining influence in the defence field and undermining NATO and national decision-making. The British defence secretary, Philip Hammond, has already attacked the Commission for its directives on the defence trade – even though, as Clara Marina O'Donnell wrote in a recent CER policy brief, these common rules should help secure savings by removing inefficiencies in the European defence market.[1]

In current circumstances, however, this second fear looks misplaced. Leaving aside the (remote) possibility of Argentina attacking the Falkland Islands, very few threats to the UK would not affect the rest of Europe, or vice versa, so national freedom of action is anyway something of a mirage. And the UK would have plenty of support for keeping the Commission out of defence policy (as opposed to the defence market).

As to undermining NATO, Europeans can no longer assume that the US will always rescue Europe, if Europe does nothing to rescue itself. NATO's 'Steadfast Jazz' exercise, which took place in Poland and the Baltic region in November 2013, was the largest exercise conducted by NATO since 2006. Of its 6,000 participants, only 250 were Americans. If European nations were more capable of defending themselves, they would be both less dependent on the US, and less likely to provoke the US to give up on them in exasperation.

The fact that some EU member-states are not members of NATO is no longer as important as it was in the Cold War. Indeed, neutral Finland and Sweden took part in 'Steadfast Jazz'. NATO may remain the formal vehicle for territorial defence, but the withdrawal this year of the last US tank from Europe tells Europeans that, in whatever institutional framework, they need to be ready to look after themselves. The main difference between NATO's strategic concept and an EU strategy should be the latter's reliance on a 'comprehensive approach' to crises and conflicts, bringing together defence, diplomacy, development and other instruments.

"Without a strategy, defence procurement becomes little more than an expensive job-creation programme – easy for finance ministries to cut."

Though 28 countries with varying security concerns would undoubtedly find it difficult to forge a consensus, the European strategy should not be a compendium of national 'top priorities'. Instead it should identify those issues where a European contribution is most needed and most likely to be decisive. One obvious candidate is an end-to-end approach to conflict-driven illegal migration, for example from the Horn of Africa via unstable Libya to Europe.

A strategy without resource consequences would be useless. The decisions on spending priorities that flow from a European strategy need to reflect the comprehensive approach, so that every element is resourced by someone but not everyone tries to do everything. European countries remain wary of relying on each other to provide military capabilities when needed. But existing initiatives like the European Air Transport Command (a pool of almost 150 aircraft from Belgium, France, Germany, Luxembourg and the Netherlands) show that there are ways around the problem of trust. European nations should better co-ordinate their efforts in 'soft' security as well; development assistance can be just as important to Europe's security as the application of military force.

At present, not all member-states are pulling their weight, in hard or soft power terms. The UK spends close to 3 per cent of GDP on defence and development combined, France about 2.7 per cent and Sweden around 2.5 per cent. Germany spends little more than 1.5 per cent, Italy around 1.3 per cent and Spain no more than 0.8 per cent. The major contributors should press the back-markers to do more for European security, for example through well-targeted development assistance in fragile or conflict-affected countries in Europe's neighbourhood. A costed strategy that all 28 have agreed to may make it harder for the miserly to wriggle out of their responsibilities.

Ian Bond
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[1] Clara Marina O'Donnell 'The trials and tribulations of European defence co-operation', CER policy brief, July 2013.

CENTRE FOR EUROPEAN REFORM

Why Germany's trade surplus is bad for the eurozone

by John Springford and Simon Tilford

In late October, the US singled out Germany as a threat to the global economy. The Treasury issued a report saying that Germany's current account surplus – now around 7 per cent of GDP – imposes "a deflationary bias for the eurozone as well as for the world economy." Two weeks later, the European Commission promised to review Germany's surplus under its 'excessive imbalance procedure'. Many German politicians and business people quickly dismissed these interventions, claiming that the surplus is mostly with the rest of the world, not the eurozone, and so does not affect the periphery; that the surplus reflects the country's competitiveness; and that deflation in the eurozone periphery is positive as it indicates that these economies (and hence the currency union as a whole) are becoming more competitive. They are wrong on all three counts.

There is no doubting the competitiveness of Germany's manufacturing sector, but the main reason the country's external surplus has risen further (despite sluggish demand for German exports from a depressed Europe) is the weakness of domestic demand in Germany: this rose by just 0.8 per cent over the last year, despite very low unemployment. The result is that Germany is doing little to provide any offsetting stimulus to austerity and demand-depressing structural reforms in the eurozone periphery, making the south's adjustment all the more difficult to achieve.

Under a third of Germany's current account surplus was with the eurozone in the first half of 2013, compared with over three-fifths prior to the financial crisis. But this shift is largely due to falling German exports to the depressed periphery, rather than rising exports from the periphery to Germany. And even if the surplus with the rest of the currency union fell to zero this would be – according to the IMF – largely cyclical (reflecting the collapse in domestic demand in the periphery) rather than structural (reflecting a rebalanced eurozone economy); thus trade imbalances will re-emerge should demand recover across the eurozone.

German policy-makers argue that a rebalancing of the German economy would be of little benefit to the currency union's peripheral economies. After all, Spain's exports to Germany only constitute 4 per cent of its output. A programme to drive up German domestic demand would simply reduce

German competitiveness while doing little to stimulate the periphery's exports. This argument misunderstands how real currency appreciations work. After a decade of wage restraint, the German real exchange rate is strongly undervalued relative to the rest of the eurozone. This makes its goods artificially cheap, crowding out those of other eurozone countries from both eurozone and world markets. If Germany's real exchange rate rose by around 20 per cent (and so returned to its value when the euro was launched), Spanish, Italian and French manufacturers would be able to retake market share. Their exports to eurozone economies and to the rest of the world would rise more rapidly, and the risk of deflation would diminish. The adjustment process for the eurozone – and for that matter, the world – would be less painful.

There are two routes through which Germany's external surplus compounds deflationary pressures in the eurozone, making it harder for the periphery to recover. The first is by pushing up the value of the euro. Before the crisis, Germany's trade surplus was offset by the deficits of the other member-states. But as these deficits have narrowed the eurozone has moved into a large external surplus and the euro has appreciated. An economy with a big trade surplus tends to experience currency appreciation because demand for its currency outstrips the supply of it. A strong euro hits demand for eurozone exports, especially the more price sensitive ones of the southern European member-states, and lowers the prices of imported goods, reinforcing downward pressure on prices. Eurozone policy-makers bemoan the strength of the euro, but it is a product of asymmetric rebalancing within the currency union. The second channel through which Germany's surplus spreads deflationary pressure is through the weakness of German inflation: feeble domestic demand (the flipside of the surplus) means that annual consumer price inflation has fallen to little over 1 per cent.

To pull off what Germany did in the run-up to the financial crisis – cut costs relative to the rest of the currency union and rely on exports to offset the weakness of domestic demand, but without suffering deflation – the peripheral eurozone economies need higher inflation in Germany and much stronger German domestic demand. After all, that is how Germany was able to do it: demand was sturdy (and inflation robust) elsewhere in the eurozone. If Germany is to help stabilise the eurozone economy, demand must rise strongly relative to supply in the German economy (that is to say the external surplus must shrink). If it does not, the periphery will only be able to recoup competitiveness by experiencing deflation. Spain is now some way down this route, with serious implications for the sustainability of its debt stock.

Deflation in the eurozone periphery should not be welcomed as an adjustment in relative prices and hence in competitiveness; deflation risks leading to falling nominal GDP and worsening debt traps. Deflation pushes up real interest rates (further depressing economic activity), and can render monetary policy ineffective (the ECB cannot reduce nominal interest rates below zero). Moreover, the lower the rate of inflation, the bigger the primary budget surplus a government needs to run in order to prevent the stock of public debt to GDP rising, hastening the point at which debt becomes unsustainable.

> *"Deflation in the eurozone periphery should not be viewed as a welcome improvement in competitiveness; it risks worsening debt traps."*

The Germans are not powerless to address the imbalances in their economy. If the periphery can take steps to prevent excessively strong growth in domestic demand, then Germany can do the opposite. More expansionary fiscal policy would help, particularly if this took the form of cuts in value-added taxes and lower income taxes for people on low incomes. But fiscal policy alone cannot reflate the German economy, because the obstacles to stronger domestic demand (and inflation) are to an extent structural. One is the country's system of collective wage bargaining which delivers wage restraint even when the labour market is tight and corporate profits are at record levels. The bosses of Daimler-Benz, BMW and VW recently threatened to relocate production if the German government introduced a statutory minimum wage. But wage dumping is not the answer to Europe's economic woes. Another problem is poor productivity (and low wages) across much of Germany's services sector. Liberalisation here would boost investment, and hence productivity, in the longer term.

The US is right to single out Germany for criticism. And the European Commission needs to stick to its guns and demand that Germany address the structural problems behind the imbalances in its economy. These pose as big a threat to the future of the eurozone as those of Italy or France, and need to be approached with the same sense of urgency.

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and Simon Tilford
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On target, off track: Europe's failure to protect the climate

by Stephen Tindale

Europe likes to see itself as a leader in attempts to control climate change. But it is not. The EU's own greenhouse gas emissions are falling. However, that is due to de-industrialisation and the fact that so many of the goods Europeans consume are now manufactured in China or India. The amount of carbon emissions caused by Europe, taking account of the pollution attributable to such goods, is rising.

November's UN climate summit in Warsaw made no significant progress. The key point of disagreement was money. Developing countries, led by Brazil, China and India, argued that rich countries should help poorer countries to protect themselves against extreme weather – pointing out that rich countries became wealthy by burning fossil fuels and are responsible for most historic emissions. But developed countries, including EU states, refused to pay for past pollution. They argued that current emissions are more significant than past ones. This is unscientific – because carbon dioxide remains in the atmosphere for up to two centuries – and irresponsible.

The Warsaw summit agreed to introduce new targets by 2015, to come into force in 2020. The annual climate conferences now move to Peru and then France. In January the European Commission will propose an EU target for greenhouse gas reductions by 2030. Well-crafted targets can play a useful role in shaping policy discussions. But good policy can be adopted even without targets. Brussels's policy focus should be on reducing pollution while at the same time strengthening the economy. The top priority should be to minimise coal use.

EU regulations are forcing the closure of some old coal power plants, but there is no ban on building new ones. New coal stations are more efficient than old ones, and are required to have technology to cut emissions of gases that cause acid rain. But they do not have to include carbon capture and storage (CCS) facilities. Without CCS, coal produces about twice as much carbon dioxide per unit of electricity as gas does, and 50 times as much as nuclear or wind. Energy companies are proposing 42 new coal power stations in nine member-states. Thirteen are in Poland and ten in Germany. In other countries, including France, Spain and the UK, no new coal power plants are proposed, but the amount of coal burnt in existing plants is increasing.

Poland is widely blamed for blocking EU attempts to lower emissions of green house gases. The country generates almost 90 per cent of its electricity from coal. Yet Poland is still a relatively poor member-state, and hence relies on coal rather than on more expensive alternatives like renewables. Germany has no such excuse. It has a target that 80 per cent of electricity should be renewable by 2050, but no target for heating and transport, which account for a much higher proportion of overall emissions. And in the meantime emissions from electricity generation are actually rising.

Chancellor Angela Merkel used to say that low-carbon bridge technologies are necessary, to protect the climate while the move to renewables is achieved. That was before the Fukushima accident, which prompted her government to close down the country's nuclear power plants. Coal generation is at present cheaper than gas generation, partly because the carbon price in the EU's emissions trading system is too low to be relevant and partly because Germany is importing cheap coal from the US. So Berlin is allowing a major expansion of coal generation – ten large new coal-fired power stations will open in the next two years. None of these will use CCS, because that technology is costly and unpopular with the German public. Coal will generate over half of Germany's electricity this year – hence the rising emissions. The country may reach its 2050 renewables target but, if it sticks to its present course, will have damaged the climate enormously while getting there.

Under EU treaties, member-states are free to choose the fuels they use. But pollution is a matter for the EU, because it does not stop at national frontiers. To get climate policy on the right track, European institutions should make two major changes. First, CCS should be made mandatory on any new coal station, through an emissions performance standard. Second, the emissions trading system should be underpinned by a price floor so that it encourages energy efficiency and investment in low-carbon energy supply. But the current price of under €5 per tonne is far too low to do this; the EU should introduce a floor price of €30 per tonne. Energy-intensive sectors which produce traded goods should continue to be protected from the carbon price through the receipt of free emissions allowances.

> *"The EU is losing its claim to leadership on climate change. The country most responsible is Germany – the region's supposed environmental champion."*

The EU is losing any serious claim to leadership on climate change. This will have serious consequences, not only for the climate but also for the economy and for Europe's soft power. The country most responsible is Germany, the member-state which often likes to claim green leadership.

Stephen Tindale
Associate fellow, CER

CER in the press

The Times
14th November 2013
"When I began to question my opposition to nuclear, I knew it was time to leave Greenpeace because being anti-nuclear is central to its DNA. If I had questioned nuclear opposition I'd probably have been out of a job," said Stephen Tindale of the **CER**.

The Wall Street Journal
14th November 2013
Outside Germany, critics of the country's trade surplus were unmoved. "We're talking tiny margins here," economist Simon Tilford, deputy director of the **CER**, said of the data released Thursday.

The New York Times
1st November 2013
"The root of the problem is that Spain is attempting to do two contradictory things: pull off an internal devaluation within the eurozone to bolster trade competitiveness, while ensuring that its debt burden remains sustainable," said Simon Tilford of the **CER**.

The Economist
25th October 2013
In a new publication the **CER** argues that the Commission "needs to act as referee in the political game, not as captain of one of the teams". ...The **CER** proposes a "forum" of national parliamentarians to scrutinise EU actions where the EP has no say, for instance in devising bail-out packages.

Le Monde
17th October 2013
Charles Grant, **CER** director, says that, in contrast to Angela Merkel, David Cameron seems to have built a pragmatic relationship with the Russian leader. And the foreign ministers of the two countries, Hague and Lavrov, get on.

The Financial Times
14th October 2013
"Contrary to popular opinion, EU immigrants are far less likely to take up benefits than the British population ... the great majority of EU immigrants come to Britain to work," said John Springford of the **CER**.

The Financial Times
13th October 2013
"Berlin and Brussels desperately need to show that the tough economic medicine they have been prescribing during the eurozone sovereign debt crisis works and Ireland is their best chance of a success story," says Hugo Brady of the **CER**.

The New York Times
3rd October 2013
Sergey Lavrov had been seen in the West as "Mr Nyet," Ian Bond of the **CER** said, persistently standing in the way of Western efforts to pressure President al-Assad of Syria, Moscow's main regional ally.

Recent events


Susan Schwab

26 November
Allianz-CER European forum on 'The biggest prize? Prospects for a Transatlantic Trade and Investment Partnership', Brussels
Speakers included: Karel De Gucht, Pascal Lamy and Susan Schwab

25 November
Breakfast on 'Is the eurozone out of the woods?', Brussels
With Olli Rehn, vice president, European Commission


Olli Rehn


Jeroen Dijsselbloem

11 November
Roundtable on 'Banking union and the future of EMU', London
With Jeroen Dijsselbloem, president, Eurogroup

8-9 November
CER conference on 'Europe's growth strategy & the world economy', Ditchley
Speakers included:
Marco Buti, Charles Goodhart, Rachel Lomax, Reza Moghadam, Mario Monti and Thomas Philippon

(L to R) Lord Kerr and Mario Monti

Forthcoming publications

Running into the sand? Europe's faltering response to the Arab revolutions
Edward Burke

The consequences of leaving the EU for British trade and investment
John Springford and Simon Tilford

The EU and Russia
Ian Bond

The transatlantic relationship and the Asia pivot
Rem Korteweg

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