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**TRENDS IN DEFENCE RESOURCE MANAGEMENT  
IN EUROPE AND NORTH AMERICA AND  
THE NEW BURDEN SHARING DEBATE: A SURVEY**

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**GENERAL REPORT**

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## ***I. INTRODUCTION***

1. Military spending and burden sharing have been perennial and interrelated sources of tension within the Atlantic Alliance and within the political systems of its members. That should hardly be surprising in democratic political systems that routinely and transparently weigh the trade-offs between guns and butter. Obviously, no government ministry ever manages to acquire the resources it strives to obtain in order to achieve its goals. Thus, defence ministers oftentimes at least quietly agree with the critical voices of their allies that their governments are not spending sufficiently on national and allied defence, but they enjoy only limited leverage to wring out more resources from their government's national budgets.

2. Of course, national well-being is not only measured in security terms, security itself is not simply a military notion and burden sharing is not measured simply in terms of defence outlays. Resources available for national military establishments become even scarcer as political leaders settle competing demands for homeland defence, foreign aid, diplomacy, and intelligence, not to mention pensions, health, education, environmental protection, tax reductions and all the other claims on state finances that democratically governed societies demand. Since scarcity is the operative condition under which defence planners work, properly run military establishments must count on working with the resources that their political masters are likely to accord them, rather than the resources that they would ideally like to have in hand. Defence planning and budgeting is consequently a highly complex and challenging exercise in matching the size and the capabilities of national militaries to the resources that are, or realistically will be, made available to purchase these capabilities and to the missions that military leaders will be asked to undertake.

3. This exercise is, by its very nature, complex and politically sensitive. Not only must national security challenges be recognised and prioritised, but resources also must be allocated in such a way as to minimise security risks to the degree that this is fiscally feasible. If one wants to understand why NATO has not responded in a more robust fashion to the situation in Darfur, given the moral and strategic merits of the case, one would need, amongst other things, to consider the resource constraints confronted by allied militaries already deployed in a range of conflict-ridden areas, as well as the diplomatic problems involved with setting the terms for such an engagement.

4. A number of NATO countries are confronting major political difficulties in establishing defence priorities today that will shape the strategic landscape over the next thirty years. The United Kingdom, for example, is committed to retaining a nuclear deterrent after the current Trident system grows obsolete. The initial costs of doing so are estimated to be £20 billion, but those costs could well double over the lifetime of the system (Ian Sample). Moreover, rising equipment and personnel costs in the UK, as elsewhere, have to be funded from very tight defence budgets that are unlikely to rise substantially and could eventually begin to fall, given new demands on public resources that demographic trends will only intensify (Hartley). The British are also looking to purchase a range of other expensive systems including the Typhoon, the Joint Strike Fighter, two new aircraft carriers, etc. For its part, the French Defence Ministry is pushing for the construction of a second new aircraft carrier, although some political analysts suggest that there is not sufficient political will to sustain such a costly project (Tran). In the United States, a number of huge American defence systems currently on the drawing board are now considered vulnerable because of inexorably mounting fiscal pressures, sharply rising costs and the prodigious outlays linked to American deployments in Iraq and Afghanistan.

5. Indeed, what makes the current budget environment so daunting is the rapidly evolving strategic environment and the attendant uncertainties that this has injected into the military resource management and planning processes. Although the Cold War saw all manner of tensions arising out of defence spending and burden sharing matters, the relative stasis of the strategic environment during those years infused the planning process with a certain degree of predictability. Not surprisingly, some of the greatest budgetary tensions historically arose in the

wake of major doctrinal shifts, as occurred when the Alliance moved from a strategy premised on mutually assured destruction (MAD) to one based on flexible response in the 1960s. In that particular case, NATO's new posture resulted in a new emphasis on expensive conventional forces needed to diminish reliance on a nuclear tripwire that no longer seemed fully credible. That new posture, however, unleashed fresh burden sharing tensions within the Alliance as some member countries struggled to match their heretofore neglected conventional force structures to the new doctrine – an expensive proposition that even then many politicians and their constituents were reluctant to underwrite.

6. By comparison, the strategic environment today is changing at a far quicker pace. The end of the Cold War on the European continent, violent conflict in South-eastern Europe, the September 11 attacks and the rise of domestic as well as international terrorist threats, and the wars in the Middle East and Afghanistan have each contributed to a rethinking, not only of national defence requirements, but of allied requirements as a whole. A new NATO Strategic Concept was adopted in 1999, and many analysts already feel that the strategic environment has so substantially evolved that a new one is needed (Parliamentary Transatlantic Forum). Change in the strategic environment is indeed accelerating, and national and NATO planners are extraordinarily hard pressed to keep pace, particularly because defence budgets are so stretched for so many reasons. These budgetary pressures are going to place an ever-growing premium on laying out priorities and developing allocative efficiencies in the defence sector so that acceptable levels of security can be achieved in the face of potentially declining, or at least static, resources (Sandler and Hartley). It is worth pointing out here that military alliances can dramatically bolster cost-effectiveness simply by spreading the security burden. The cost-reducing potential of Alliance membership, for example, is increasingly discussed among traditionally neutral countries that are finding it difficult to muster resources for their own national defence (O'Dwyer). The irony is that NATO members themselves are still not fully exploiting their Alliance's potential to foster multinational resource efficiencies. NATO, for example, has never managed to standardize equipment in ways that would yield far greater procurement savings as well as improved military effectiveness (Sandler and Hartley, *The Political Economy of NATO*).

7. NATO and its member states are now deployed in regions characterised by instability and intermittent violence (Kosovo), and in other cases by wartime conditions (Southern and Eastern Afghanistan). These deployments have become catalysts for change and the source of enormous budgetary pressures that ironically render essential long-term military transformation all the more financially daunting. Active deployments are eating up resources that otherwise might have been spent on transformation; yet they are also demonstrating how essential transformation is. This is a genuine *Catch 22*, and the stakes are extraordinarily high.

8. Active force deployments have also revived old burden sharing debates. In his classic public goods studies of the 1960s, Mancur Olson argued that certain public goods like security within an alliance are "non-excludable" and "non-rival". In other words, under certain conditions, it is not possible to withhold a security benefit from a non-contributing ally, and the consumption of security by a particular ally does not necessarily detract from the consumption opportunities of others. If one characterises security in such public good terms, one begins to understand why there might be a temptation to "free ride" within an alliance, at least at the margins. Certain countries, for example, might find it difficult to make a noticeable difference in the general security environment, no matter what they were to spend on defence. This condition becomes an almost structural disincentive to spend on defence. Yet, many small countries during the Cold War felt that some respectable level of defence outlays were nonetheless an essential part of the Atlantic bargain, and possibly even a kind of insurance policy against being denied the benefits of the Alliance in the event that security were somehow to prove "excludable".

9. In some respects, this rationale slipped away in the early nineties with the dissolution of the Soviet threat. Almost every country within the Alliance took advantage of the altered environment

to cash in their peace dividend. Yet, the rise of compelling new threats and decisions to take on new missions to deal with them have subsequently revived old burden sharing questions. The uneven contributions Allies are making to the common effort in Afghanistan, for example, lie at the centre of this debate today (Ringsmose). The problem is not only financial; it also involves the willingness of some allied countries to put “boots on the ground”.

10. Indeed, looking along the spectrum from crisis prevention to military intervention to peacekeeping and post-conflict reconstruction, there is an array of means by which allied countries can contribute to security, writ large. Some might be tempted to argue that developing the capacity and indeed the willingness to project military power is only one aspect of burden sharing in the new strategic environment. Reducing threat, so the argument goes, also involves a high degree of civil engagement in crisis regions, an area where Europe might have a comparative advantage (Lindstrom). Reducing the burden sharing question to defence spending levels alone is, from this perspective, anachronistic.

11. Many security analysts, however, would suggest that the capacity to contribute to the hard security points along this spectrum should remain the ultimate measure of allied solidarity (Lis and Selden). Robert Kagan, among others, has argued that a division of labour, conferring upon the United States war fighting military responsibilities for Western defence and conferring upon Europe the civil dimension of crisis and post-crisis management, is a formula for transatlantic fragmentation and ultimate disunity (Kagan). The United States clearly needs to develop its peacekeeping capacities and Europe its war fighting capabilities.

12. NATO member and partner military establishments are in the midst of abandoning obsolete force structures that were originally arrayed to deter a land-based incursion from Eastern Europe (or from Western Europe in the case of the former members of the Warsaw Pact) to structures that emphasise light, rapidly deployable, mobile and sustainable expeditionary forces with a reach that goes well beyond Europe. NATO has created a new command, Allied Command Transformation, to encourage military innovation among NATO members and partners that might facilitate this broad reconfiguration of forces.

13. This transformation would be financially daunting enough were forces not on active deployment in conflict-ridden regions. But NATO member forces today are deployed on an array of missions under national, NATO, EU and UN flags. These missions are consuming resources, some of which might otherwise be used to underwrite transformation. In some cases, like Afghanistan or Iraq, those forces are deployed on highly costly military operations that are piling on enormous budgetary burdens, although, in most cases, countries have appropriated extra funds specifically to cover these mission costs. Repairing or replacing damaged equipment, responding to unanticipated equipment requirements, and higher than anticipated fuel and payroll bills are nonetheless stretching already tight defence budgets. NATO Secretary General Jaap de Hoop Scheffer recently noted that active military deployments in conflict situations are revealing a real gap between the aspirations for military transformation and the current state of allied forces. It is a gap that the soaring cost of new military hardware is only exacerbating (de Hoop Scheffer).

14. For newer members of NATO, these deployments have been particularly trying. They have exposed capabilities shortcomings while seriously straining already taut national defence budgets. The SFOR, KFOR and ISAF missions, however, have effectively served as a training laboratory for new members on resource management in deployment conditions. The lessons have been hard earned but extraordinarily valuable (Simon).

15. None of this is unfolding in a political vacuum. While the American defence budget has risen substantially, most European NATO members have kept their defence spending steady. European societies, with a few notable exceptions, have been reluctant to forego the so-called

peace dividend that allowed governments to slash defence spending after the collapse of the Soviet empire. These divergent spending trends have widened the capabilities gap between the United States and its European allies and created serious political tensions as well.

16. Paradoxically, European societies are increasingly being asked by their leaders to sanction military deployments deemed essential to national, European, transatlantic and indeed global security interests. Moreover, the EU itself is in the midst of developing its own military dimension. There has long been a hope that the development of an EU military dimension might help galvanise European leaders and their publics both to sanction increased defence outlays and to embrace the kind of multinational co-operation that would render European defence spending more efficient – something that NATO has never really managed to pull off. Yet, this has not happened, at least, not to the point where most European governments would willingly sanction greater defence outlays. Moreover, the insufficient level of co-operation between NATO and the European Union is leading to costly duplications that could exacerbate the enduring problem of allocative inefficiency in Europe.

## **II. THE NATO BUDGET AND THE BURDEN OF TRANSFORMATION**

17. Members of the Alliance contribute in different ways to the three NATO run budgets: the civil budget, the military budget and the Security Investment Programme. Each of these is underwritten by individual contributions from member states based on previously agreed ratios related to per capita GDP, the size of the national economy and several other factors. The military budget is NATO's largest. It covers the operational costs of the international military staff in Mons, Belgium, and the various NATO commands in Europe and North America. It also underwrites the costs of maintaining and deploying the NATO AWACs fleet, the NATO pipeline system and the Maintenance and Supply Agency.

18. The NATO civil budget covers the costs of running the NATO Secretariat in Brussels, including staff and administrative costs. It also underwrites the Partnership for Peace, the Euro-Atlantic Partnership Council, the Mediterranean Dialogue and a range of other programmes.

19. The budget for the NATO Security Investment Programme helps support selected allied military installations and construction projects. In recent years, this fund has underwritten projects that encourage transformation away from the old static defence postures toward crisis control, anti-terrorism and more mobile military structures. In practical terms, the fund finances various NATO functions including command, control and communications initiatives, software packages, logistics, training installations and transportation. Specific projects are funded through open bidding procedures and are NATO controlled and audited (Ek).

20. Mission funding has been a growing source of tensions within NATO in recent years. In 2005 NATO revised its approach to funding non-article 5 NATO led operations. It provided a set of principles that would inform funding for any given mission, although the primary mechanism remains the "costs lie where costs fall" rule. This also applies to partner countries participating in these missions, although it does not rule out the possibility of bilateral or multilateral aid for these countries. Costs not attributed to specific national militaries can be funded out of the NATO budget. The new concept also covers theatre level enabling capabilities that were once funded nationally. These costs are borne by the military budget and the Security Investment Programme, cover all manner of engineering support, fuel storage and other infrastructure costs, and are shared by all member states under standard cost sharing formula (Homan).

21. Needless to say, NATO budgets themselves are not typically the most salient source of allied financial burden sharing tensions, simply because these do not involve great sums of money. Indeed, NATO's budget is dwarfed by member nations' national defence budgets. National

defence spending priorities, capabilities issues and the willingness to deploy and sustain forces in the field are the real source of tension among allied countries. Indeed, the latter may be the most important of these, as a degree of asymmetry has emerged in force deployments, with certain allied countries taking on the riskiest missions and others generally abstaining from doing so – a course that is politically unsustainable and one that seriously jeopardises Alliance cohesion and solidarity.

22. While US defence spending has increased massively over the last five years, European defence budgets remain low in historic terms. European defence spending currently stands on average at roughly 1.9% of GNP (NATO Defence Economics Forum, 18-21 September 2006) as compared to US spending of roughly 3.8% of GDP in 2006. Turkey (3%) and Greece (3%) are the only two other NATO countries at the 3% level, while France at 2.4% and the United Kingdom at 2.3% are the leading defence spenders of NATO's European members in absolute terms (see Annex). Many NATO militaries have thus not been accorded the resources to underwrite military transformation, even though the deployments they have undertaken are demonstrating how important it will be to configure national military structures to new strategic realities. The perception of some is that while NATO forces are engaged in war-fighting situations, some Allies are simply unable or unwilling to contribute to the difficult missions, in part, perhaps, because their militaries are underfunded and not prepared for those missions.

23. In 2006 NATO ministers agreed that: "Allies who currently devote to defence a proportion of GDP which is at or above 2% should aim to maintain the current proportion. Nations whose current proportion of GDP devoted to defence is below this level should halt any decline in defence expenditures and aim to increase defence spending in real terms within the planning period. (DPC-D(2006)0004, 7 June 2006) The Heads of State and Government reiterated this position at the Riga summit in November 2006: "We are committed to continue to provide, individually and collectively, the resources that are necessary to allow our Alliance to perform the tasks that we demand from it. Therefore, we encourage nations whose defence spending is declining to halt that decline and to aim to increase defence spending in real terms."

24. NATO is also using the four-year-old military transformation agenda to advise member governments on future procurement strategies, although defence purchasing remains the sovereign prerogative of member states, both in NATO and in the EU. NATO's Prague Capabilities Initiative has called for improved chemical, biological and nuclear defence capabilities, intelligence, surveillance and target acquisition, theatre-to-ground surveillance, C3I (Command, Control, Communications and Intelligence), improved combat effectiveness including precision guided munitions, strategic air and sea lift, air to air refuelling, and deployable combat support. The mission in Afghanistan has only added to the list. Counter-IED (improvised explosive device) capabilities, for example, have recently become a key priority for obvious reasons. Many analysts suggest that one way of beginning to address some of these needs is to make more of these capabilities NATO, rather than nationally, administered. C3I as well as theatre missile defences are two broad areas that might increasingly be moved from national to NATO responsibilities.

25. NATO's capabilities shopping list is not easy to sell to voters in an era of tight budgets and slow economic growth. Not surprisingly, defence transformation budgets are fairly low and are far lower in Europe than in the United States (NATO Defence Economic Conference). The reasons for this transatlantic discrepancy are obviously related to different spending levels and Europe's structural lack of allocative efficiency, but they could also reflect divergent cultural outlooks on risk and return.

26. Alliance members will clearly have to generate new efficiencies to underwrite transformation costs. Common funding, shared purchasing, mission specialisation within Europe or within the Alliance as a whole, more open and transparent defence markets and planning procurement co-ordination are some of the vehicles through which NATO members might be able to take on these

costs without posing enormous burdens on national budgets. Common purchasing of equipment, for example, would allow member governments to enjoy scale economies that would help drive down costs. Mission specialization would mean that smaller countries, in particular, would not need to develop a broad range of capabilities which they can ill afford and which do not necessarily bolster their security or that of the Alliance. Multi-nationalizing certain NATO capabilities like transport or even medical care in the field would reinforce these efforts. This means, in effect, that systems would be jointly developed, procured, owned, maintained and operated under the aegis of the Alliance. The NATO AWACS system is the best example of this approach (Ellehuus). The barriers to multinationalization, however, are historic, formidable and persistent.

27. In what economists, at least, would describe as a “perfect world”, an Alliance such as NATO would have one central procurement agency drawing on a common budget to purchase equipment from defence industrial firms competing in a fully integrated pan-Alliance market. Costly research and manufacturing redundancies would thus be eliminated, costs would be reduced and interoperability improved. At the same time, allied countries would undertake a degree of specialisation as smaller countries, in particular, would feel sufficiently confident in their allies not to replicate the full range of capabilities of their far larger partners. In classical economic terms, countries would specialise in those military functions in which they might have a relative advantage and offer those military services in exchange for the specialised military services of its allies. Of course, this presumes that participating countries would have a perfectly shared strategic vision, great trust in their allies, and common threat perceptions. Given how difficult this has been to achieve, such a utopian “free trade security order” seems an impossible dream.

28. Some have taken this argument to an extreme view by suggesting that the United States should take on responsibility for war fighting and Europe oversee peacekeeping. Both Europe and the United States see this as a formula for Allied dissolution. One of the lessons of the Kosovo conflict was that all NATO countries should maintain capabilities for high and low intensity tasks and that European states should not simply rely on the United States to conduct all high intensity military operations. Of course, Europe needs these capabilities to exercise influence over operational and strategic decision-making. But within Europe itself there is clearly room for specialization. This might help Europe begin to overcome the real capabilities gap that currently exists (Abbasi).

29. Small countries, in particular, can ill afford to support a broad range of capabilities. For example, it would make no sense for a country like Denmark to develop a long-range transport aircraft. NATO’s Defense Planning Process (DPP) strives to encourage this kind of specialization, and it is increasingly encouraging multinational solutions to meet military requirements. Again the limits to the process of role specialization are naturally defined by the fact that national militaries are ultimately responsible for national as opposed to Allied defence, no matter how important the latter is to the former. Nevertheless with “out of area threats” now seen as posing the greatest threat to European security, there may be ever greater incentives to multilateralizing capabilities and this is one way that great scale economies can be achieved under the rubric of both the EU and NATO (Ellehuus).

30. The other extreme, however, is equally unrealistic. It would be characterised by a total lack of defence industrial co-operation, no national military specialisation, the imposition of all manner of national restrictions on forces in theatre (caveats), perfect redundancy of equipment and missions, full protection of national defence industries and consequently soaring equipment and force costs (NATO Defence Economic Conference). Naturally, though, allied countries are operating somewhere in between these two extremes, although many would like allied countries to move farther along the axis toward the perfect world paradigm. In other words, greater efforts are needed on several fronts to unify research, development and procurement efforts, while also achieving a higher degree of role specialisation within the Alliance and greater levels of common



funding for multilateral projects. Again, in economic terms, scale economies are needed to drive unit costs down, thereby making it possible to purchase more military “bang for the buck” (or the euro). National leaders may find that fiscal pressures are becoming so intense that they have little alternative to seeking savings through deeper operational and procurement co-operation.

31. Unfortunately, defence markets in Europe remain woefully disaggregated compared to the US market. There is no market depth, and massive duplication is evident. The countries insist on their own training and support facilities covering a broad range of needs and, as a result, there are few scale economies to drive down costs. Europe’s defence industrial sector is equally characterised by too many firms developing too many similar armament systems that will be manufactured in relatively small production runs. There is enormous duplication of research and development for aircraft, tanks, ships and missiles. Europe is currently developing three combat aircraft, where economic logic would suggest it should only develop one. The unit cost of this equipment is very high because of the lack of scale production. Unit production costs, it should be noted, generally fall by 10% for each doubling in cumulative output (Hartley).

32. NATO itself is seeking to address elements of this problem. Thirteen allied countries, for example, recently agreed to purchase jointly 17 Globemaster III long-range cargo jets as a response to NATO’s chronic airlift shortages. Under the plan, each participating country will pay for a portion of an aircraft, and thus the planes as well as their costs will be shared (Crowley). This is precisely the kind of project that the Alliance may need to deepen solidarity, reduce costs, boost interoperability and build real capability.

33. There is ample room to engage in more similarly structured projects, but member nations will ultimately need to eliminate many of the national barriers to open defence markets that make it so difficult to manage the exploding costs of military systems. Article 296 of the Treaty of Rome (previously numbered article 223), for example, exempts military equipment from the strictures of the Common Market, while the US Buy American Act lays out a range of structural barriers to a more integrated transatlantic defence market. Although American leaders sometimes complain that the problems lie in Europe’s lack of market openness and low level of defence spending, it is important to recognise that a mere 2% of US procurement is spent on foreign contracts. The problem clearly cuts both ways.

34. Certain common endeavours can serve as laboratories through which deeper collaboration might be attempted. A recent milestone in NATO transformation was the announcement in Riga that the new NATO Response Force (NRF) had become operational. But how it will be funded poses a set of problems which illustrate dilemmas that both Europe and North America confront. Currently if a country’s forces are serving a rotation on the NRF when it is called upon for deployment, the costs will fall only on those countries that are on rotation. Countries that deploy troops on dangerous missions will thus not only bear the real risks to those soldiers, they will also shoulder the costs of deployment, sustaining those soldiers in the field, and the costs of replacing worn and destroyed equipment. This state of affairs could put allied solidarity at risk. The Secretary General of NATO has lamented that, “If the NRF is deployed, only those nations who are in the force at the time of its deployment have to pay. [...] If you are not in the NRF at that time, you don’t pay. You’re lucky. To me, this is almost a lottery, not a funding arrangement for an Alliance built on solidarity” (de Hoop Scheffer).

35. The Secretary General has proposed developing a common funding mechanism for a trial period for short-term NRF deployments in order to assess the potential positive effects on the force generation process. This NRF test has been approved by the NAC, and the details for implementation are currently under review. But it is crucial to recognize that burden sharing is not simply an accounting exercise and efforts are needed to ensure that member nations also accept the burden of effective forces to NATO missions.

### **III. FUNDING MILITARY DEPLOYMENT AND PEACEKEEPING**

36. It is worth noting here that UN, EU and NATO peacekeeping operations are financed in very different ways. Because peacekeeping can be considered a legitimate public good that benefits the entire international community, the potential for free riding is ever present within all three organisations. In other words, states that do not contribute to peacekeeping can benefit from these operations as much as those that do. Dealing with this fundamental asymmetry is a challenge common to all three organisations. Each lacks permanent capabilities of its own and thus relies on member countries to conduct operations. While the UN invites member states to contribute forces to operations, NATO and EU have gone further both by agreeing capability targets for their members and by developing common training, procedures and standards (Homan). The UN, however, has been in the peacekeeping business longer than either NATO or the EU. NATO only formally embraced peacekeeping with the 1999 Strategic Concept, and the EU took on that role after adopting the Petersberg tasks in 1997 (Skons).

#### **A. THE UNITED NATIONS**

37. From 1988 to the mid 1990s, UN peacekeeping expenditures went from under US\$300 million annually to US\$3 billion (Sandler and Hartley). UN member state support for peacekeeping operations has been at least partly predicated on member governments' capacity to pay. Peacekeeping operations are financed outside of the regular UN budget through assessment accounts paid as a fixed share of UN member annual contributions. This is designed to provide a separate and permanent source of funding for these operations and to help overcome the free riding phenomenon. Contributions begin once the mandate for an operation has been adopted. But this can cause problems given national budget cycles (Homon).

38. The five permanent members of the Security Council and the 23 major industrial countries account for 98% of the total funding for these operations. Yet European and the US governments provide only a very small share of UN peacekeeping personnel. Of the 60,000 UN peacekeepers deployed in 2005, only 4,000 were from EU countries and only 100 were American. (This figure does not include UN approved missions to Bosnia and Herzegovina and Kosovo.) In broad terms, developed countries are paying developing country forces to carry out UN peacekeeping operations (Skons). Countries that deploy troops are reimbursed for soldiers and civilian specialists at very favourable rates.

#### **B. THE EUROPEAN UNION**

39. EU military operations, including peacekeeping and peace enforcement operations, are funded by member states outside of the Community budget. Expenditures arising from military operations are charged to members in accordance with a GNP scale. But those countries that opt out of missions have no obligation to provide financial support. In September 2003 the Council established the so-called ATHENA mechanism to cover the common costs of EU missions and to streamline the budget process. This can cover costs for establishing headquarters, expenditure linked to transporting forces to the theatre of operations, administrative costs, locally hired personnel, public information and accommodation expenses, the costs of using NATO assets and certain outlays accrued during the preparatory phase of an operation (Homan). The ATHENA mechanism calls for a special committee with representatives from each participating member state to approve budgets for the common costs of the operation. These decisions must be unanimously agreed and are binding. EU civilian tasks associated with these operations, however, are funded in various ways within the EU budget due to the different responsibilities of the Commission and the Council.

40. In Helsinki in 1999, the European Council identified a set of specific military capability goals that member governments should strive to reach. These are not funded by any EU budget but by the voluntary engagement of the member states. The initial goal was to develop by 2003 a force of 60,000 rapidly deployable troops that could carry out a range of the so-called Petersberg tasks and be sustained in the field for a year. When it was clear that this target was not going to be reached, the Council developed the voluntary European Capability Action Plan (ECAP). It also incorporated a so-called bottom up approach by encouraging greater synergies in national defence planning while advancing multinational solutions in the production, financing and acquisition of these capabilities, as well as a degree of role specialisation. These shared efforts, it was felt, would help generate the kinds of savings that might facilitate funding new defence capabilities.

41. Since the incorporation of the Petersberg tasks into the Common Foreign and Security Policy (CFSP) in 1997, the Union has been able to engage in humanitarian and rescue missions, peacekeeping operations and combat operations in certain crisis situations. The list was further broadened in 1999 to include a range of military and civilian crisis management operations, and the Council then decided to create a European Rapid Reaction Force to bolster the Union's capacity to achieve these tasks. Subsequent EU missions in Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia\*, and the Democratic Republic of Congo illustrated how different these missions can be, both in terms of operational conditions and in the kinds of forces required.

42. The range of civilian to military responses to crisis situations cuts across the three pillars of the Union. While the supranational Commission has full responsibility in traditional European Community functions, including foreign aid and other support systems that might be introduced as part of a conflict or post-conflict prevention package, the intergovernmental European Council is the lead institution in the case of military deployments that fall under the second pillar, while justice and police competencies can also be invoked under the third pillar (Bendiek). According to the Amsterdam Treaty, the financing of military operations is charged to member states proportionate to their GNP. To deal with some of the inherent tensions within this financing mechanism, the European Council in 2002 made a distinction between common and national costs for military operations where the former were to be funded through GNP based scales, while the latter were to be funded by the member states according to the "costs lie where costs fall" principle. This is very similar to the mission financing arrangement within NATO itself. Common costs include support for EU headquarters, infrastructures and additional equipment and other means of support for the forces (Skons).

43. Invariably financing EU operations can become somewhat complex. It raises questions about the distinction between administrative and operational costs, and it leaves a great deal of room for interpretation. Operational financing matters have also generated tension between the European Parliament and the Council. Consequently the Council adopted further reforms in February 2004 to speed up financial decision making related to decisions made to deploy forces. This led to the creation of an automatic mechanism for assessing common operational costs including the costs of using NATO equipment and infrastructures. Personnel and equipment used for EU peace support operations, however, will continue to be drawn from national resources, which partly overlap with NATO's own pool of resources and forces. In itself, this points to a growing need for close co-operation and co-ordination between the two organisations, particularly during the run-up to any potential force deployment.

### **C. NATO**

44. NATO peacekeeping operations, like all of its missions, are funded through the "costs lie where costs fall" principle. Accordingly, member government defence budgets are the primary

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\* Turkey recognises the Republic of Macedonia with its constitutional name.

source of financing NATO forces in the field, both for peacekeeping and higher intensity operations. The burden falls primarily on those countries that have agreed to deploy or that have forces that are on rotation to do so. NATO does not pick up the costs for operating the command structure, but that, in any case, would typically constitute a very small share of the total cost of any given operation. Needless to say, there is a growing sense within the Alliance that more common funded programmes are needed, both for the sake of economic efficiency and operational effectiveness and to bolster allied solidarity.

#### **IV. THE PROBLEM OF EU-NATO RIVALRY: RESOURCE IMPLICATIONS**

45. There are numerous reasons why NATO and the European Union need to deepen their collaboration and efficiency; financial considerations are not the least of these. Almost anywhere that NATO might deploy forces, the EU will likely be present in some guise because of its civil, political, diplomatic and developmental capabilities, as well as its emerging military ones. Working out operational co-operation between the two, however, has proven difficult. While the record of NATO-EU collaboration in Bosnia and Herzegovina was largely positive, with the EU assuming peace operations from NATO in Operation Althea launched in 2004, the two organisations acted almost as rivals during the run-up to the limited Darfur operations ("NATO and the European Union", 20-21 March 2006).

46. The European Security Strategy (ESS) agreed in 2003 outlined five key threats to the Union and its members: terrorism, the proliferation of WMD, regional conflict, state failure and organised crime. Countering these threats does not always demand military responses, and the Union has its two other pillars to call upon to help manage the threat environment – a resource, of course, that NATO lacks, and one that it cannot easily work with because of the lack of institutional linkages between NATO and the Commission. While the European Commission is structured to oversee the civilian elements of pre-crisis and crisis management, the Council oversees the military dimension. NATO's dialogue with the Union is largely carried out with the Council, and it has limited opportunities to work in a structured fashion with the Commission (Keohane).

47. The recently created European Defence Agency (EDA) is assuming defence planning and military research functions that were long the preserve of national governments and, to a lesser degree, NATO itself. The EDA is seeking to foster greater transparency among member state defence planners as a way to encourage joint development and joint procurement within Europe. Doing so at a transatlantic level has been a long-term NATO goal, but progress has only been partial. The Joint Strike Fighter and the NATO Alliance Ground Surveillance system are the latest examples. The concern is that now that the EU is in the same game, potential transatlantic collaboration could be neglected. So far there has been virtually no co-ordination in this vital area between the two organisations (Brooks Tigner, 11 December 2006).

48. Clearly, the resource justifications for deeper EU-NATO co-operation are compelling. Although there are perfectly justifiable reasons why Europe needs to develop a military capacity independent of NATO, there is no reason why this should not unfold in close co-ordination with NATO simply because of the finite nature of defence resources, the fact that so many NATO members are also EU members and because NATO members and EU members share the core values informing their respective defence postures. Indeed, the two institutions have a range of very similar military and political goals. Both the EU and NATO are seeking to improve their expeditionary capacity, in part, by developing multinational expeditionary battle groups – the 25,000-troop NATO Response Force and the two European Battalions of 1,500 soldiers each that, as of 1 January 2007, were to be available for rapid deployment (Beatty). Each organisation wants to encourage its members to manage costs more effectively by fostering multinational defence co-operation; each is intent on defending against the threat of terrorism, and both are looking to develop technological solutions to a range of these strategic challenges. In a perfect world, the two

organisations could provide an integrated spectrum of crisis responses to intervene at various points from conflict prevention before a crisis is manifest, to full combat intervention, to providing a post-conflict peace-keeping presence. In any case, the lack of co-ordination between the organisations means that there has been no effort to structure such a seamless spectrum, and there is a risk that scarce resources shared by national governments between NATO and the EU could be squandered as a result.

49. The EU does not have a defence budget of its own, but it does have funding to develop both dual use technologies and to conduct homeland security research. The EU will spend some €1.4 billion on homeland security and space research from 2007 to 2013 and expects industry to spend as much in partnership with it. This will generate important military spin-offs. The EDA has promoted the notion of a single EU market for defence equipment. As suggested above, the EDA has resuscitated the European Capabilities Action Plan (ECAP) and is encouraging members to share long range planning data. In 2007 the goal is to encourage the 27 countries to share out certain capabilities that they will collectively need for out-of-area missions and then to update ECAP with these objectives in mind.

50. One of the problems is that current planning cycles within Europe vary considerably, and this has implications for NATO and the EU. France, for example, plans as much as 30 years out while some countries operate within far shorter planning horizons (Brooks Tigner, 4 December 2006). The EDA is working with national officials, the EU military committee, the EU Military Staff (EUMS) and the EU Council of Ministers to encourage voluntary harmonisation of effort where this is possible ("EU/Capabilities: EDA to Prepare Capability Development Plan, Atlantic News No 3834," 19 December 2006). There are no reports, however, of any attempt to engage NATO in this important effort.

## ***V. DEFENCE BUDGETARY TENSIONS IN THE UNITED STATES: IMPLICATIONS OF THE IRAQ WAR AND THE GLOBAL WAR ON TERROR***

51. The US Defense Budget has been subject to unique pressures because of its massive deployment in Iraq. That budget has risen by roughly 60% since the 9/11 attacks, and the latest Administration request for the Department of Defense (DoD) budget has come in at \$481.4 billion, an 11% increase over 2007. That does not include two major additional DoD requests for funding the wars in Iraq and Afghanistan. Nor does it include \$22.5 billion for nuclear weapons programmes and other defence programmes managed by non-defence agencies (Matthews, 12 February 2007). Although this is the largest inflation adjusted defence budget in US history and would put US defence spending at 4% of GDP, it is considerably less, in relative terms, than the 6.3% of GDP which the United States was spending on defence in the 1980s (Hoffman).

52. The proposed budget includes the costs of expanding the Army and Marine Corps by 92,000 soldiers over the next eight years and the expenses tied to waging campaigns in Iraq and Afghanistan. Supplemental and bridge financing appropriations to underwrite the costs of these wars have also risen substantially in recent years. Through Fiscal Year 2006, the US Congress had appropriated \$437 billion for military operations, base security reconstruction, foreign aid and veterans health care related to three operations: Operation Iraqi Freedom (OIF), Operation Enduring Freedom (OEF) and Operation Noble Eagle (ONE) for enhanced security at military bases.

53. The longer-term problem for the United States arises out of the fiscal pressures that will invariably be felt once the post-war baby boom generation begins to retire. At that point, national defence budgets, including huge acquisition ambitions, are going to be in far sharper political competition with demands for Social Security, Medicare and other government services for the aging (Matthews, 11 September 2006). At the same time, soaring war related costs are already

exacerbating tensions between those who want to prepare for today's counter-insurgency campaigns and those who foresee very different kinds of future battlefields and want to prepare accordingly.

54. War costs have been driven up by a number of factors including the total number of troops deployed, the pace and type of operations in which they are engaged, the amount and type of equipment required for the mission, the number of personnel transported to theatres of operations, fuel costs (which rose significantly between 2001 and 2006), the kinds of support systems in place, and the rate at which equipment has been worn out or destroyed and then replaced. The Administration's latest budget includes \$37 billion simply for repairing or replacing damaged equipment, which is far higher than the \$23 billion the DoD had predicted last autumn (Matthews, 12 February 2007).

55. The Department of Defense describes the monthly cost of carrying out operations, excluding funds for new military equipment, research and development and test and evaluation, and the upgrading of military facilities needed for military operations as the "burn rate". By mid 2005, the monthly burn rate for operations in Afghanistan, Iraq and other dimensions of the Global War on Terror stood at \$6.8 billion, while total average monthly obligations in 2006 totalled \$9.7 billion for Iraq, Afghanistan and the effort to enhance US base security globally. War-related procurement costs and the need to provide greater force protection, such as night vision goggles, wheeled and armoured vehicles, body armour, etc; against unanticipated threats are also very significant. Between 11 September 2001 and the end of 2006, the DoD had received roughly \$60 billion in war-related procurement funds (Belasco). Rough figures on the average annual cost of supporting each soldier in the field rose in Iraq from \$284,000 in 2003 to \$361,000 in 2005, while for Operation Enduring Freedom in Afghanistan the costs fell from \$478,000 in 2003 to \$275,000 in 2005.

56. US defence spending rises are not only being driven by direct war costs. The costs of planned weapons systems have also been soaring, leading some to suggest that several systems on the drawing board may need to be shelved (Cavas). So far few big-ticket weapons programmes have been cancelled, even though the 26 largest acquisition programmes are now 40% over the planned cost and 80% behind schedule according to Lawrence Korb and Peter Ogden (Korb and Ogden). Some major defence programmes, however, could be in trouble on Capitol Hill, but derailing these systems is often politically difficult. The House Appropriations Committee's 2008 Defense Budget kills the armed reconnaissance helicopter programme, imposes significant cuts in missile defense spending (about 10% less than last year) and calls for a 13% cut in the R&D budget for the "Future Combat System" of the Army.

## **VI. CONCLUSION AND TENTATIVE RECOMMENDATIONS**

57. For nearly 50 years, the Alliance never deployed forces on active combat or peacekeeping/enforcement missions. The past decade, however, has represented a sea change. With NATO forces actively deployed in several regions and with NATO members engaged in other military operations including those in Iraq, budgetary stresses have increased significantly. The American budgetary dilemmas, as a result of the Iraq conflict described above, reveal the financial difficulties these stresses can potentially inflict on long-term military investment. But all NATO governments are confronting very serious budgetary tensions today (Darling). We are not living in an epoch of peace and global harmony, although the promises of such a world seemed very real a decade ago. Our militaries should be prepared to take on the real threats to our national and collective security.

58. Alliance parliamentarians should raise questions about the lack of multinational co-operation in a range of defence procurement and operational matters because purely national approaches

are generally far more expensive. Along these lines, NATO authorities and governments should be willing to expose these shortcomings in the peer review process and point to specific areas where certain allies are not meeting collective obligations. A similar kind of exercise is conducted with the OECD's Development Assistance Committee (DAC) so that there can be a transparent conversation about relative contributions to Development Assistance. This might be a model for similar conversations about contributions to collective defence.

59. One important element of the growing gap in defence spending and the related burden sharing lies in outstanding transatlantic differences about how to manage threat and even the very nature of threat. This is a more intractable problem best managed by constant dialogue, intelligence sharing, and careful collaboration. There will never be a perfect harmony of perspective, nor of interest, but the Alliance has long succeeded in discerning the points of agreement and managing disagreements in such a manner that the strategic relationship is not damaged.

60. NATO needs to identify practical and reasonable proposals to increase nations' willingness to provide the required assets and capabilities for the Alliance's operations and missions. Cost sharing might be one way to do so. However, some NATO members doubt whether extending common funding programmes would necessarily encourage member governments to assume a greater share of the burden. With strong support from the German government, NATO members have agreed to run a two-year test that will focus on strategic deployments for NRF operations. This test case is reversible; should it fail to re-energize the NRF force generation process, the funding arrangements will be put back to the principle of "costs lie where they fall". There are some Alliance countries that believe that common funding efforts should be put off until the results of this test case have been evaluated. Their principal concern is that a permanent reimbursement mechanism for capabilities provided by nations could actually undermine fair burden sharing more broadly defined.

61. That said, some analysts and NATO's Secretary General believe that the Alliance should identify more ways in which mission costs can be shared. They suggest that one of the strongest disincentives to participating in NATO missions today is the fact that costs now fall on those countries willing to participate in missions and not on the Alliance as a whole. The argument here is that some countries on active rotation are made to feel as if they have "lost a lottery". The "costs lie where they fall" system is thus seen by some as unfair, inefficient and a practice that undermines solidarity. Failure to correct this will ultimately weaken the strategic purpose of the Alliance itself. There are, for example, certain equipment purchases and operating expenses that might constitute public goods. Thus space-based communications systems and early warning and surveillance systems might be best purchased and managed as NATO rather than national assets. Most importantly, it is important to share in mission participation as well as mission costs if this proves feasible. The Alliance would not be viable in the long run if some members believed they could play their part by contributing money rather than troops to dangerous but necessary operations.

62. The perennial problem of inadequate defence industrial and procurement collaboration poses another set of problems. Common funded projects can enhance financial predictability, increase efficiencies and help free up some resources needed for longer-term transformation. In this regard, the recent decision to purchase jointly strategic airlift assets is a step in the right direction.

63. Now that the EU Battle Groups and the NATO Response Force are officially deployable, a dialogue is needed to ensure that these assets are complementary rather than rival. Joint training might unearth opportunities to improve interoperability. Common standards and transparent planning procedures would also create resource savings while triggering the kind of strategic synergies that would help these new forces become agents of genuine transformation.

Transparency in the political decision making overseeing their administration would make it easier to work out a division of labour, particularly in those cases when NATO and EU forces are to be deployed to the same region as they were in Darfur.

64. Indeed, NATO needs to deepen its dialogue with the EU on a range of strategic and military matters, as well as in civil relief policy, aid and reconstruction, police and judicial support in crisis regions. Those who argue that what is really needed is a deeper EU-US dialogue are disingenuously mixing apples and oranges (Lindstrom). A deeper US-EU dialogue is indeed very welcome for a broad array of reasons, many of which have little to do with hard or even soft security matters, but it cannot replace focused EU-NATO collaboration. The common NATO-EU agenda today remains far too restricted, particularly given the shared values of the two institutions, the fact that 21 NATO members are also EU members, that both institutions draw from many of the same resources, that they share an interest in encouraging scale economies and efficiencies in the defence industrial sector, that both are directly engaged in the development and introduction of transformative military technologies, hardware, and doctrine, and the ever present potential that they will be operating in the same crisis-torn regions. There are signs of improvement, and the EU, for example, is now playing a vital role in supporting the work of NATO Provincial Reconstruction Teams operating in Afghanistan. Still, more can be done.

65. The NATO-EU relationship should also frankly acknowledge that while NATO has a comparative advantage in high intensity conflict, the EU has a broader range of policy tools at its disposal. Acknowledging this reality and its implications could provide a foundation for deeper co-operation and less rivalry. Scenario and contingency planning, training and equipment co-operation could help make the NATO Response Force and the European Battle Group more complementary than rival. NATO and the EU should work to share resource and capability plans and both organizations should foster an environment that makes capabilities improvement possible without overlap and duplication (Cornish).

66. There is also very little margin for divergent doctrines, competing standards and profligate duplication. Efforts are needed to coordinate long-term planning and procurement collaboration so that both NATO and the EU understand what the other is trying to achieve in terms of military transformation, so that synergies can be exploited and inefficient overlaps can be avoided. The rather narrow and formal North Atlantic Council and NATO Military Committee dialogues with the EU Political and Security Committees should be substantially broadened. Europe and North America need to move beyond the Berlin Plus formula as this involves a NATO dialogue with the second pillar of the EU, the CFSP, while pillars one and three are also playing a crucial role in conflict situations. While the EU may still want to call on NATO assets for certain operations, NATO itself may need a system to call on EU assets, particularly in those areas like police, foreign aid and justice where it has no capabilities. This kind of resource sharing would lead to resource saving.

67. Yet, hard security burdens can never be shared equally across the Atlantic if Europe does not do more to integrate its own efforts in the defence sector. If any degree of specialisation is to unfold within Europe, NATO should be a welcome part of the process. Both NATO and the EU can reinforce European efforts to pool resources, share plans, and encourage transparency in defence budgeting, planning and procurement. The two institutions should reinforce these ends rather than act as rivals. Europe is not on the verge of creating a single military structure endowed with perfectly specialised national forces and a sole procurement agency overseeing a single defence market. But measures are needed to ensure far deeper collaboration within Europe than currently exists in everything from research and development, force specialisation, and common funding of capabilities and operations.

68. There may be even more scope within the EU than within NATO for the construction of a common defence market, but that does not mean that the transatlantic market should be closed.



On the contrary, insofar as a unified European defence market is built, it should remain open to its North American partners to the greatest degree possible. The reverse should hold true as well, and American leaders should understand that a more unified European market will prove a better partner for American business while providing cost slashing competition to American firms – something that will ultimately benefit the militaries and the tax payers on both sides of the Atlantic. Nationalistic defence purchasing is actually weakening collective security interests.

69. Far more concerted efforts are needed to counter demands for *juste retour* and offsets when international defence contracts are awarded. Both are costly practices that distort national economies and add significantly to defence budgets. While some workers and industries look like winners in these games, the broader economy and national militaries lose.

70. Parliamentarians need to encourage their governments to increase spending on research and development in transformational military technologies. Even if budgets are tight, there are ways to generate resources to bolster this investment, some of which have been adumbrated above. Military transformation is not cheap, and funding it will require allies to eliminate systemic redundancies including non-integrated defence markets and overlapping and redundant capabilities. Ultimately niche capabilities specialisation within the Alliance and within Europe requires confidence in one's allies.

71. Peacekeeping will remain a vital function for Western and NATO forces. It is increasingly apparent that wars can be won and lost after the territorial battle seems to be over. Winning the peace demands specialised training and equipment and sometimes as much political will as war fighting. To neglect this role is to risk military defeat – a hard lesson that the United States appears to have learned in Iraq. The assumption of peacekeeping duties should accordingly be recognized as a key element of any kind of burden sharing equation.

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