DefenseNews

French Debt Rating Downgrade Poses Little Threat to Defense, Officials Say

By PIERRE TRAN

PARIS — A recent downgrade of France's cherished AAA sovereign debt rating was unlikely to spur additional defense spending cuts beyond the reductions industry and the services already expect, analysts and executives said.

Successive French administrations have effectively safeguarded the defense budget from cuts, maintaining annual spending at about 30 billion euros ($39 billion), around 2 percent of gross domestic product.

That made France, along with Britain, one of the rare NATO members that sought to stick to a spending guideline of 2 percent of GDP on defense.

Although there is broad popular support for defense in France, what is even more treasured is its status as an AAA-rated sovereign debt nation, a defense official said when reports emerged of a possible downgrade.

French President Nicolas Sarkozy had for weeks talked up the importance of holding onto that top rating, so when rating agency Standard & Poor's on Jan. 13 cut France to AA+, the airwaves were full of talk of political and financial repercussions.

But the downgrade was not seen as a signal to cut military expenditure, as expectations had been rising that defense was in line for a reduction.

"It seemed inevitable to me," said Jean-Pierre Maulny, deputy director at think tank Institut de Relations Internationales Stratégiques.

France was about the only European country not to have cut defense spending since 2008, the previous financial crisis, he said. Nothing would be done before the April presidential elections, but afterward, whoever gets in, there would be a "resetting," he said.

"After the elections, they will have to move," he said.

Generally, however, defense is not treated as a "variable budgetary factor," he said. The government would not "be heavy-handed" on cuts, as the sector employs 160,000 people and a halt to activities would destroy jobs.

Britain, for example, had planned to cut defense around 20 percent but reined that back when planners realized the effect such a deep reduction would have, Maulny said.

The British government has adopted a 7.5 percent cut in defense spending.

Apart from cuts, there could also be action to boost revenues, Maulny said.

In response to the 2008 crisis, France drew up a 2 billion euro defense recovery plan, bringing forward orders to keep factory lines busy and the supply chain in business.

Defense Minister Gérard Longuet went to the Toulon naval base Jan. 14, and visited the Dixmunde, a third Mistral-class command and projection ship ordered from naval company DCNS under that recovery plan.

Russia has ordered four Mistral-class ships, so that pump-priming order may have helped bring in a foreign sale.

On the overall defense budget, some of the expected cuts would come from fewer overseas deployments, including a withdrawal from Afghanistan, Maulny said. Some 600 million euros is budgeted annually in expeditionary and overseas operations, and that shot up to around 1 billion euros with the Libya campaign, he said.

Until the elections, nothing will happen, Maulny said. "After, they will have to act," he said.

A defense executive said the government's commitment to reduce the public deficit and achieve a balanced budget by 2016, rather than the ratings downgrade, had sparked concerns.

That pledge to reduce to zero the ratio of public debt to GDP is what has convinced industry and defense officials the military faces a hard time in the coming years.

"There are fears in the Ministry of Defense it will be difficult to avoid a rethink of the budget law," the executive said.

"They have to find billions of euros in four years," the executive said, referring to money needed to reach a balanced budget.

There is also the awareness in industry and the armed forces that they have benefited from a 10-year drive to renew the equipment stock and that the time of such sustained defense spending is over.

"There has been a big effort over 10 years," the executive said. "The forces are much better equipped than they were 10 years ago."

Among the modern gear, the Army is getting the Véhicule Blindé Combat d'Infanterie (VBCI) fighting vehicle, Felin infantry kit, NH90 and Tiger helicopters; the Navy, FREMM frigates; and the Air Force, Rafale fighters.

A second defense executive said it was too early to tell, but defense cuts risk pushing industry into recession.

It is clear the defense budget will be reduced, but that was not due to the downgrade, said Loic Tribot La Spiere, chief executive of think tank Centre d'Etude et Prospective Stratégique.

The certainty comes from defense's ranking as the state's third-largest expenditure, after education — which cannot be touched — and debt repayment, Tribot La Spiere said.

"The crisis is here," he said. "Budgets will be tighter, there will be greater vigilance, a closer management."

That financial management discipline was not directly related to the downgrade, he said. France had managed to raise funds in the money markets on good terms since the lower rating, he said.

The challenge was how to reduce defense without destroying the coherence and capabilities of the forces.

There will be industrial consolidation, such as the steps taken by Safran and Thales in optronics, but thought needs to be given on raising revenues, Tribot la Spiere said.

For instance, one idea was to get companies that benefited from the armed forces' protection of their sites, internally or externally, to pay for that security, as a sort of "tarification of protection," he said.

That would be similar to the practice where mountain climbers who are rescued by the gendarmes or civil security forces are billed for the expense, he said.

The loss of the AAA credit rating would not direct any immediate consequences on the defense budget, said Hélène Masson, research fellow at think-tank Fondation pour le Récherche Stratégique.

"The reduction of deficits will impose measures, this 'sanctuarization' of defense investments is no longer sustainable," she said. "We will have to wait until the second half of 2012 for the next budget for revisions and reset of programs."

One of Standard & Poor's criticisms in its downgrade decision was that a policy of cuts alone would worsen the situation.

"We believe that a reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumers' rising concerns about job security and disposable incomes, eroding national tax revenues."

Sarkozy has recently raised the prospect of an increase in value-added tax (VAT) to help pay for social and welfare benefits, dubbed a "social VAT." The employers' federation favors the measure, which would raise revenue but would not be linked to employees' pay, which the federation says increases French labor costs. ☐

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