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# Europe's Strategic Future:
## Implications of the Eurozone Crisis

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1101 15th Street NW, 11th Floor
Washington, DC 20005

ISBN: 978-1-61977-033-1

**May 2013**

# Foreword

The analysis of the eurozone crisis is often limited to an assessment of its impact on the political and economic future of the European Union. Far less attention is given to how the crisis will shape Europe's role in the world and how other corners of the globe perceive Europe as a strategic actor. The economic crisis that began in 2008 has now become a multidimensional political crisis for both the northern and southern countries of Europe, and the trends do not all go in the same direction.

The Atlantic Council and the Royal United Services Institute (RUSI) have produced this joint publication to begin a more expansive conversation on the eurozone crisis by assessing its geopolitical and strategic impact. These papers bring a unique set of perspectives to the debate on Europe's future, offering analysis from India, the United States, and the United Kingdom. While each brief covers its own ground, some common themes emerge. First, Europe will be transformed by the crisis, but exactly what Europe emerges in the future remains unclear. Second, Europe is likely to remain inwardly focused in the coming decades, which will reduce its influence and weight on the world stage. Third, the crisis is weakening the perception of Europe among outside powers, including in the United States. This cannot help but have an impact on the transatlantic relationship, including the health and vitality of NATO.

We are pleased that this publication marks the beginning of a partnership between the Atlantic Council and RUSI, which will extend beyond work on the Eurocrisis. We are particularly grateful to RUSI Vice President and International Executive Chairman, and Atlantic Council board director, Alexander Mirtchev, who was a critical force in forging the transatlantic partnership between these two institutions. We are appreciative of the efforts of Barry Pavel, director of the Atlantic Council's Brent Scowcroft Center on International Security, and Jonathan Eyal, Senior Research Fellow and Director of International Security Studies at RUSI, for their work in producing this effort. We are grateful also to president of Center for Policy Research Delhi, Pratap Bhanu Mehta and Scowcroft Center deputy director Jeff Lightfoot for their contributions to these papers as well.

We hope you will agree that this transatlantic effort breaks new ground and introduces new voices and ideas into the conversation on the future of Europe.

Fred Kempe
President and CEO
Atlantic Council

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Director General
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# Europe's Euro Crisis: The Moment of Truth

Jonathan Eyal

## Summary:

*While there is evidence to support both positive and negative forecasts, it is clear that 2013 will be a pivotal year for the future of the eurozone. There is reason to be optimistic, as Germany appears willing to continue to shoulder the burden of responsibility, and the European Central Bank has formally accepted its role as a lender of last resort. On the other hand, the major systemic problems that precipitated the current crisis have yet to be resolved. Even if debt problems disappeared, high unemployment and a marked decline in global competiveness threaten continued stagnation in European economies. Whatever the outcome, it is clear that Europe will remain inwardly focused in the coming years, inevitably resulting in a declining role in global governance.*

## Introduction

An air of optimism dominates the counsels of European governments. While the severity and significance of the euro crisis cannot be underestimated, there is a feeling that the worst is behind Europe, that at long last, an answer to what looked utterly insolvable has finally found a solution. Only time will tell: since the euro crisis involves so many moving parts—governments and their ability to bring expenditure under control, banks whose audit books never seem to be either accurate or complete, international investors who may or may not lend, and the actions of important trading partners who may or may not help their economies to grow and thereby lift European economies out of their current stagnation—no prediction, however erudite, carries much conviction.

Still, certain predictions can be made with a high degree of certainty. Until now, the euro crisis has been about the peripheries, the relatively smaller countries on the edges of Europe: Greece, Portugal, Spain, and Ireland. In the coming year, however, the crisis will begin to affect Europe's biggest and key states: Italy, France, and, of course, Germany. This does not mean that the euro will collapse, nor does it necessarily mean that the crisis will continue: in fact, there are plenty of reasons for believing that 2013 will be the deciding year when the euro crisis will conclude, one way or another. But it is clear that the positive and negative scenarios remain evenly poised with a fifty-fifty chance, and that Europe's destiny will be written by the bigger states, rather than the smaller ones, as has been the case until now. Furthermore, it is clear that the Europe that will emerge from this crisis will be a very different one, regardless of whether the euro survives or not.

## Surprise: The Positive Ledger

It is easy to remain gloomy about today's Europe; that, in many respects, is the default position of most analysts and academics. But, even for the sake of just being original, it is worth considering the more positive outlook to this otherwise depressing situation:

- When the crisis erupted, people predicted that the eurozone would crack up. To date, it has not.
- There was also a widespread prediction that Germany would refuse to bail the others out. Germany remains a very reluctant payer, but it ultimately paid every single time when the chips were down, when Berlin was faced with a straight choice between a euro collapse or a fresh bailout. Indeed, if all the current bailout plans end badly and fail to prevent the bankruptcy of European nations, the German taxpayer may have to shell out a cool half a trillion euros, hardly an inconsiderable amount. Europe now has a permanent bailout facility fund, administered by a special bureaucracy which is destined to operate for years to come. Nobody thought this feasible in 2010, when Greece's financial situation began to raise alarm bells.
- Expectations of the violent breakdown of law and order in countries stricken by the economic crisis have not came to pass. There were plenty of demonstrations, and more can be expected in countries such as Greece or Spain. But extremist fringe political parties have remained on the fringes, and are likely to stay there. Indeed, if the recent elections in the Netherlands and Finland and projections for the German elections are any indication, voters are returning to the traditional political parties that alternated in power in Europe since the end of World War II.

And, as one looks into the future, there are also grounds for some additional optimistic scenarios. At long last, the European Central Bank (ECB) has accepted—at least in principle—that it should buy the debt of some individual crisis-stricken countries. That has had two important effects. First, it has—theoretically—raised the possibility of unlimited funding for government borrowing outside the normal operations of the market: the ECB has the ability to print as much money as it wishes and, at least in the short term, extricate Europe out of its immediate difficulty. Second, the ECB's intervention has had the necessary psychological impact: it has reassured investors and governments that there is a circuit breaker, a last-minute panic button that can be pressed should all other measures fail.

More important, it is worth remembering that the euro project was never about economics: it was part of a deal designed to disguise Germany's strength and France's weakness, hatched immediately after the end of the Cold War and German unification. As such, it remains just as important today as it was in 1992, when the Treaty of Maastricht was signed, and there are no indications that the Germans are tiring of sustaining it. The statements made by German Chancellor Angela Merkel, suggesting that the choice facing Europe is between the maintenance of the euro and "war" may be dismissed as infantile rhetoric. But the reality remains that a large part of the German governing elite genuinely has this black-and-white vision whereby the only alternative to their European project is violence, and a majority of the German electorate seems to share this opinion. However, few outside Germany are persuaded by this belief. But, for very obvious reasons, even fewer Europeans are prepared to disabuse Germany of this vision: allowing the Germans to pay to expiate their historic guilty conscience is one of fundamental tenets of the European Union, and the real glue that will hold the eurozone together.

Besides, the eurozone cannot break up if Greece or, for the sake of argument, Portugal, decides to leave the common currency; it can only do so when Germany decides it wants to leave, and there is no indication of this happening. So, while some countries may—*in extremis*—be ejected from the currency zone or choose to leave of their own accord, the currency arrangement as such is likely to endure as long as Merkel or her successors want it to. And—to continue our look into the abyss—even if the Germans do decide that the currency union no longer works for them, it is highly unlikely that they will encourage a return to the old national currency units; a new currency union will be formed with a smaller number of countries but with the same practical impact on the rest of the world.

It is also important to remember that mass sovereign defaults do not happen simply because governments cannot pay their debts; throughout history, governments were very rarely able to do so. Psychology plays an important part in the way such crises develop, and it is quite possible that the same international investors who lent money for years to governments without bothering to analyze their true financial situation, and who were subsequently spooked by Europe's debts, will simply tire of the current panic. Historically, as credit crises enter successive stages, their marginal impact on economies and markets lessens, if only because people get used to a new reality and begin to consider it as the starting point of their assumptions. International investors have very few currencies in which they can safely park their wealth, so the appeal of euro-denominated bonds will always be there, even if some of these bonds will be decidedly not for the fainthearted.

Finally, there may be a more technical reason for the crisis to calm down: the first, even if very tentative, indications that Europe may be returning to some economic growth. To be sure, this will remain anemic. Still, it is enough for some economic growth to return to persuade investors that Europe's future is not as bad as assumed: the debts of European governments will remain huge, but they will also become more serviceable, on the anticipation of greater tax revenues.

## The Known Unknowns

So, given these considerations, why should one still have grave reservations about Europe's future? The answer is simple: the biggest challenges that flow from the crisis are still to be tackled, and the effort required is Herculean.

First among them is the fact that if Europe is to avoid a permanent problem with the operation of its single currency, it will have to accept that the current expenditure cuts will become permanent. Or, to put it differently, what Europe is facing is not a one-off belt-tightening exercise, but a persistent squeeze on government expenditure for decades to come. It is worth recalling that the last time the French government balanced its books—that is, the last time it spent as much as it raised in revenues—was in the early 1970s in order to understand the magnitude of the task that lies ahead for European governments if they are serious about preventing the euro crisis from recurring. Of course, a mere diminution in deficit-spending could, over time, reduce overall debt levels. Still, it is highly unlikely that governments will ever have the resources to spend their way out of future recessions; indeed, the treaties now being implemented in Europe will prevent them from doing so.

But Europe's problems go deeper than just the euro, as the dual crises of unemployment and Europe's decline in global competitiveness indicate. About one in four Spaniards or Greeks are jobless; overall, 10.4 percent of the European Union's labor force—a total of 23.8 million men and women—had no work at the end of 2012. But the truly shocking figures are those for youth unemployment: half of Spain's graduates, for instance, have no chance of securing a gainful position. Undoubtedly, the debt crisis made matters worse, as governments slashed spending and banks stopped lending, pushing small businesses into bankruptcy. However, Europe's unemployment figures have been stubbornly high for decades; back in 2005, at a time when the world economy was booming, the European Union's jobless rate was only 1 percent lower than it is today. Debt, therefore, is only a marginal factor in Europe's economic malaise.

Competition from emerging economies and the migration of manufacturing jobs to low-cost countries in Asia is usually put forward as another explanation for Europe's predicament. But that, too, is only a partial explanation. Under normal market conditions, trade competition should encourage nations to diversify their economies to sectors in which they have a comparative advantage: that is what Germany did. So, it is not globalization as such but Europe's failure to adapt to it that lies at the root of the problem. The failure begins with an education system that is both poorly funded and tends to undervalue manufacturing skills. Italy still leads in fashion and industrial design, France dominates the luxury goods industry, and Britain is a global player in financial services, yet none of these advantages are sufficient to satisfy all the demand for work.

But the biggest problem is Europe's social welfare system, which, perversely, makes it both difficult to hire workers and virtually impossible to fire them; in some countries it is simpler to obtain a divorce than to dismiss a worker. It is this welfare system that will have to be reformed, and even dismantled in such cases. But this is a huge undertaking: Europe will be expected to give up its most prized asset, the one feature that differentiated the so-called old continent from the supposedly cut-throat market economies of North America or Asia. And, more significantly, all these changes will have to take place without popular support or consultation: all the measures are imposed from above, by Europe-wide unelected bureaucrats or by treaties concluded behind closed doors. Just about the only thing on which all European governments agree is that they must do everything possible to prevent their electorates from having a say on such matters, despite the fact that the choices European rulers currently make over expenditure and economic priorities are the bedrocks of democratic government. The gap between people and rulers has seldom been bigger in Europe's modern history, and is only likely to grow bigger.

Again, none of this means that Europe faces inevitable economic or social meltdown. But a lot of things will have to go well in 2013, and this time in the key European states, for the overall outcome to be positive and, at least for the moment, they do not appear to be going well. To start with, the elections in Italy ended in disaster. Unelected technocratic Prime Minister Mario Monti had never held any elected office or belonged to any party. He failed to win a sufficient amount of support from the people to remain in power. Instead, almost a third of the votes went to Silvio Berlusconi, a seasoned politician who is nevertheless dismissed by the rest of Europe as little short of a clown, and another quarter of the votes went to "Beppe" Grillo, an actual clown. The fear is that Italy's political instability—a specialty in the country since the nineteenth century—will bring about a return of the credit crisis, and this time involving a European state that is simply too big to fail but also too big to bail out. A crisis over Italy will force Germany to face the choices it always tried to avoid: that of accepting deep losses on the money lent to other European nations and that of accepting joint liability for the debts of others.

Furthermore, the crisis over Italy could be precipitated at precisely the moment when Germany itself is holding its general elections, now scheduled to take place in September. Germany's biggest political parties—Merkel's own center-right Christian Democratic Union and the center-left Social Democratic Party—both support additional bailouts to needy eurozone countries. But Merkel's Bavarian partner, the Christian Social Union and the centrist Liberals currently in the governing coalition are growing increasingly shrill in their opposition to any additional handouts of German cash. An electoral campaign dominated by the euro crisis will be a disaster for Europe, for it will paralyze German decision-making and also force Germany into imposing demands on other European countries, demands that will be difficult to meet but which will be considered essential by German politicians in order to appease their own constituencies. And, as if this was not enough, France will also have to show during 2013 that it is capable of reigning in its budget deficits, as it has promised to do; if it fails in this task, the eurozone crisis will return with a vengeance, mainly because investors will worry whether Germany can pay for both the bailout of France and Italy (it can, but only at the risk of unleashing huge inflationary pressures in Europe).

## And the Unknown Unknowns

Beyond that, there are ticking time bombs whose severity is simply impossible to predict. The first is Spain, where government expenditure was the glue that kept the country together, and where economic troubles now raise questions about the very survival of the state. A Spanish disintegration is not likely, but it is not a danger that can be discounted either, and it will have profound effects on other European states such as the United Kingdom, Belgium, Italy, and many of the eastern European states facing similar separatist movements. Big question marks also hang over the future of Greece, a dysfunctional country that simply has no ability to honor its existing debts, regardless of all the bailouts currently in place and regardless of how sincere its present government is.

Another Greek general election will be a disaster, since it is almost certain to herald the arrival in power of an unholy alliance between the extreme left and right of the political spectrum, just about the worst combination imaginable. There is also the danger of an economic collapse in Eastern Europe, in places such as Hungary, Romania, and Bulgaria, and the poorer eastern European nations. But the biggest "unknown unknown" is the question of how long and how much the people of Europe will tolerate politics that are only about austerity rather than economic growth, retrenchment rather than expansion, all administered by unrepresentative, self-appointed bureaucrats sitting in Brussels.

There is no need for fatalism: as suggested, Europe has avoided some of the worst pitfalls in the last two years, and may do so again. But there is no need for manufactured, synthetic optimism of the kind purveyed by the European Union in Brussels, either: the fact remains that, for years to come, the Europeans will remain obsessed by their own existential crisis, unable and unwilling to play their part in global governance. Europe's relative decline looks irreversible, even if its currency survives.

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# The Indian Perspective—Europe: A Continent without a Strategy

**Pratap Bhanu Mehta**


## Summary:

*India's perception of Europe is increasingly that of an incoherent actor unable to articulate its international interests. While EU-India trade flows remain considerable, a lack of military, diplomatic, and ideological clout renders it a marginal player in South Asia. If Europe can successfully navigate the current crisis and affirm its model of political and economic integration, it will be able to re-establish its influence in the region. However, as things stand it is difficult to see how India will include Europe as part of its strategic calculus in any serious way.*


## Europe through an Indian Lens

There has long been a duality to India's attitude toward Europe. Europe was admired as a possible economic model, and yet was considered largely irrelevant as a strategic actor. This duality has not significantly changed since the 2008 financial crisis. If anything, the crisis has diminished the attractiveness of the European model, as well as Europe's ability to act on the world stage. India views the region in much the same way that it views Japan: a significant economic actor, but not an especially important strategic actor.

Europe is important in many respects. It is the world's largest economy and matters a great deal to countries like India. In 2009–2010, Europe accounted for roughly 20 percent of India's exports, and about 13 percent of India's imports. A slowdown in the eurozone is expected to have an adverse effect on India's exports. Paradoxically, this slowdown represents an opportunity: In order to keep the trade momentum going in the face of a slowdown, India is assiduously pursuing a free trade agreement with Europe.

European foreign direct investment in India is relatively modest, amounting to about 3 billion euros in 2010. Compared to Japan or even South Korea, Europe is not an especially big player in the development of India's infrastructure. Despite the fact that Europe is a single market, European companies, unlike their Asian counterparts, find it difficult to form a consortium and bid for infrastructure projects. Participation in big infrastructure development is likely to be a source of great strategic leverage in the future. But the mounting financial costs of the crisis make it unlikely that Europe will be able to play a significant role in this area.

A few years ago, many observers in Europe and around the globe had hoped that the euro would emerge as a possible supplemental reserve currency to the dollar; currency is an important element in any country's strategic armory. Europe could then enjoy the "exorbitant" privilege of attracting capital by virtue of its currency. However, the European financial crisis has stunted the growth of this development. If anything, it has accelerated the rise of the renminbi as a possible rival to the dollar.

This is the broad economic backdrop against which India's perceptions of Europe's strategic importance needs to be assessed. The India–EU summit has acquired an independent political identity but it is hard to argue that, in terms of policy or public consciousness, the summit is more important than India's bilateral relationships with France or Germany. There is a deep-seated skepticism about Europe's ability to play an important role in global politics, and the role that it does play is regarded as largely derivative of the United States. It is very difficult for India to put Europe in any kind of strategic frame.

## Europe's Diminishing Role in Asia

Skepticism about Europe's global role stems from the fact that it is not a significant player in the most important theater involving the balance of power, Asia. As such, it is not much of a strategic, military, or political player in this continent. Europe's role in Afghanistan, for example, is considered largely marginal, and the aftermath of the financial crisis has diminished whatever strategic authority Europe might have had in Asia. Currently, most countries in Asia are subtly banking on the rise of China and are at the same time on the lookout for powers that could act as potential balancers. Europe has almost no part to play in this story.

In the aftermath of the financial crisis, Europe's prestige in Asia diminished further. In many ways the European project is a deeply impressive achievement. It has achieved the elimination of the violence that was once commonplace on the continent and its integration of former Soviet-bloc states was a great democratizing force. It is an extraordinary experiment in managing diversity through constitutional means.

But recent events have underscored the degree to which the disjunction between economic and political integration can be a source of crisis. This lesson has not been lost on the Asian powers. Despite making impressive moves toward creating regional trade structures, they are not quite ready to follow Europe in declaring the irrelevance of the nation-state paradigm. There is also a growing sense that the crisis has diminished Europe's ability to speak with an independent voice in Asia. Although the Chinese have been reluctant to bail out the European economies, the crisis has potentially left Europe more dependent on China, and at the very least this has diminished Europe's ability to take a strong stand on issues like human rights. In short, there is a perception that Europe will become more subservient to China, India's main strategic competitor.

There are other structural reasons why India considers Europe a political and strategic laggard. This has to do with three sources of power that are important in the modern world. The first is immigration. The simple truth is that diasporas impart considerable economic, political, and strategic momentum to existing relationships. Europe became multicultural as a result of immigration from former colonies during the twentieth century but, in contrast to the United States, it is not widely regarded as an area of potential immigration. With India for instance, Europe will always be at a disadvantage compared to countries like the United States or Australia, where ties of immigration are cementing more enduring political relationships. There was a hope that Europe's aging population might require it to be more open to immigrants, but the prospects of large-scale structural unemployment in the near- to medium-term make it unlikely that Europe will become more amenable to immigration, in political terms. Much will depend on the evolution of domestic politics in Europe. Should right-wing political forces gain traction within the continent on the back of the financial crisis, its reputation for insularity will be reinforced. If Europe no longer finds itself able to attract talented labor, there will undoubtedly be significant strategic consequences.

The second source of power is the ability to remain ahead of the curve in imagining a new world order. It has been very clear for some time that the post-World War II institutions of global governance, from the United Nations to the International Monetary Fund, do not reflect the realities of global power. There has always been a perception that Europe has been slow to acknowledge these changed realities, and this is seen to be one of the key obstacles to the reform of these institutions. Part of the problem is, of course, structural: formerly major powers like France and Britain are unwilling to forgo certain structural privileges to make way for Europe. This has, in some ways, made the reform of the UN more complicated. Such a posture underscores the point that there is no unified European political voice. There is still, at the end of the day, France and Britain, obdurately clinging to privileges that have outlasted their utility. It is difficult to see Europe gaining political influence if it does not take the lead on global governance reform.

Third, there is the interesting question of what Europe stands for ideologically. There is a mismatch between Europe's self-perception—and perhaps even American perceptions of Europe—and the rest of the world's perception of Europe. Prior to the crisis, Europe had tried to project itself as the "not-the-United States," to use a somewhat pointed phrase. In this respect, Europe employed a less reckless and perhaps more egalitarian model of capitalism than the United States. It also lacked hegemonic aspirations and thus did not have to bear the burdens that the United States has been saddled with in the Middle East and southwest Asia. Furthermore, Europe enjoyed a more progressive political climate that could potentially allow it to provide greater stewardship for the planet on issues like climate change than the United States.

## A European Foreign Policy?

There was always a great deal of exaggeration in this contrast between the United States and Europe. But the European crisis has dealt a blow to the idea of Europe as a "not-the-United States." It is true that the structure of welfare states in Europe remains different from the United States and, on the surface at least, European banks had different internal incentives than US banks. But Europe suffered a severe banking crisis, and in southern Europe a sovereign debt crisis, and its regulatory systems failed to act in time to prevent the crisis. One consequence of this is that Europe has probably lost even more intellectual credibility than the United States. Without the ability to project military force overseas, the only powers a union has are the power of its example and the persuasiveness of its ideas. It would seem that Europe is lacking on both of those points, and furthermore it does not carry any special authority in global debates on regulation and rule setting.

A European foreign policy remains an enigma to most outsiders. In short, Europe would only enjoy independent standing when it is seen as having positions that are entirely distinct from those of the United States. On Russia, these differences have been most palpable. But despite their respective presentations, the rest of the world does not view European foreign policy as independent. Europe's ability to shape outcomes in any region of the world—particularly conflict zones like west Asia and Afghanistan/Pakistan—is limited.

The US security umbrella has served Europe well, but there is also little evidence that Europe has the ability to adopt political stances that are distinct from the United States. On issues like Iran and the applicability of a "responsibility to protect" in different areas of the world, India has a position that is quite distinct from that of the United States. India, however, does not see Europe as offering any alternative to the United States.

There is considerable security cooperation between India and various European states, particularly on counterterrorism. India also has modest military-to-military engagements, particularly with France, but Delhi's preference is clearly for bilateral arrangements. The only area of hard power where Europe is of considerable importance to India is the defense industry. India has, traditionally, sought to maintain a diversified sourcing strategy for its armaments. European defense industries play a critical role in this diversification. Traditionally, European defense industrial firms, and particularly French contractors, have been considered reliable partners, and as an indication of this India recently chose the French fighter Rafale to be the central element in its air power strategy over the next two decades. Not only is the European defense industry competitive, it usually imposes fewer restrictions on India than comparable US firms in areas such as technology transfer. A deepening of this kind of defense cooperation is likely to remain of considerable importance to India in the foreseeable future.

Europe is, by virtue of its own being, important. If it remains a successful model of economic and political integration, capable of articulating a new vision of global governance, it will exercise considerable influence. At the moment, it is difficult for India to factor Europe into any serious strategic calculus. While trade remains important, the other drivers of a closer strategic engagement—flows of people and ideas as well as reputational effects—are largely absent in Europe. Europe's most powerful asset was the power of its example; and that example has lost much of if its luster.

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# Strategic Implications of the Eurozone Crisis: a View from Washington

**Jeff Lightfoot and Barry Pavel**

## Summary:

*While many Americans focus on the economic and financial impacts of the current eurozone crisis, it is clear that Europe's present problems may compromise core strategic aspects of the transatlantic relationship. The first strategic impact is likely to be a less ambitious Europe, with a reduced will and capability to act alongside the United States in global military contingencies. The second impact will be a shift in European geopolitics, with a stronger Germany affecting how Europe's powers relate to one another and to outside powers.*

## Introduction

The eurozone crisis is changing how the United States perceives Europe as a partner and an ally. US officials know that the crisis marks the beginning of something different, but do not know what will come out on the other end. What is evident, however, is that this crisis will reshape the balance of power in Europe and affect the role Europe plays in the world. More than just an economic matter, the eurozone crisis will have important strategic implications, which are not yet fully known. Once these implications are manifested, they are likely to result in changes in how the United States engages its European allies.

For most Americans, the eurozone crisis is seen first and foremost as an economic issue. Wall Street has come to view the eurozone crisis as one of the greatest risks to economic growth in the world, along with a Chinese slowdown and American political gridlock. Europe, which just several years ago was seen as a continent of modest economic growth and stability, is today viewed as a possible threat to the global economy and a major source of uncertainty. Moreover, Europe's inability to address its fiscal challenges prior to the onset of the crisis is seen as an example of what not to do as the United States grapples with its own daunting task of reducing its public debt.

Europe's economic instability has reinforced the longstanding American perception that Europe cannot get its act together to make important decisions 'as Europe.' The Obama administration has been particularly frustrated over the last year and a half at the inability of European leaders to get ahead of the unfolding crisis, which they feared could put the United States back into a recession, threatening President Obama's chances of re-election. Consequently, on occasion US policymakers have expressed their (unwelcome) opinion about what European governments need to do to resolve its crisis.

One lesson the US administration has learned from these developments is that when it wants to see action and leadership in resolving the crisis, it is most likely to get results from Berlin, not Brussels. Indeed, perhaps the greatest political implication of the eurozone crisis has been that it has finally provided American diplomats an answer to Henry Kissinger's Cold War era question about whom to call to speak to 'Europe': Germany.

The strategic impact of the eurozone crisis is far less clear than its political and economic implications. What seems likely is that the crisis will affect both how Europe engages in the world and how European countries and citizens relate to each other.

## A Reduced Europe on the Global Stage

The chief concern among Washington foreign policy experts is that the eurozone crisis will result in a weaker, distracted, and more inward-focused Europe. The crisis is consuming a great deal of the political capital of top European leaders. The populations that voted these politicians into office can vote them out of office—and indeed have done so all around the continent—and are weary from costly economic reforms. Many European citizens have less appetite for an expansive role for Europe on the world stage, which is manifested by a lowered ambition for Europe as a whole in global affairs.

A mere decade ago, several European countries, led by France, sought to make Europe into a pole of power to balance out a hegemonic United States. What a difference a decade makes. Today, one of Europe's primary occupations is to remain sufficiently relevant to Washington to maintain its diplomatic attention as the United States pivots to Asia and focuses on a crisis-stricken Middle East.

Of more pressing relevance to Washington are ongoing major cuts to European defense budgets that threaten to erode core allied military capabilities. Washington's concern was expressed most strikingly by former US Defense Secretary Robert Gates in his June 2011 farewell speech in Brussels, in which he warned that austerity would lead to a two-tiered alliance and might cause the United States to lose interest in the transatlantic security relationship. The cuts to European defense spending are significant not only in size but also because they affect both the United States' most capable and willful allies as well as its less enthusiastic partners. The United Kingdom is cutting its defense budget 8 percent over the period of 2015; the Netherlands is cutting 13 percent between now and 2015 and is scrapping the armored units from its military. Italy is cutting its defense budget 10 percent, while feisty Denmark is cutting submarines and armor from its military. Until now, cuts have largely spared France, which alongside the United Kingdom is the major strategic military power in Europe. But France faces its own bout of austerity, which likely will result in at least some defense cuts after President Francois Hollande's new defense white book is published in 2013.

In total, these defense cuts put the transatlantic defense relationship at risk. They will result in European militaries with less sheer firepower, a more constrained ability to deploy forces to distant contingencies, and limited ability to operate alongside US forces in high-intensity operations. The Pentagon viewed European military power with some skepticism prior to these austerity measures. These new reductions, and the perception of European strategic apathy, threaten to worsen already-skeptical attitudes in the US defense and national security community about Europe just as Asia is becoming the strategic topic of the moment in Washington. The cuts are also being watched closely on Capitol Hill, where a new generation of lawmakers lacking Atlanticist instincts is likely to ask tougher questions about the merits and value of sustained US security guarantees to a wealthy continent unwilling to finance its own defense.

## Changing Security Dynamics in Europe

Just as Europe's external relations may change as a result of the economic downturn, the crisis is likely to shape both the geopolitics of Europe and also produce new internal security concerns in Europe. This too may have significant strategic implications for the United States.

The most obvious geopolitical impact of the eurozone crisis is the emergence of Germany as the dominant political force on the continent. Twenty years after reunification, Germany undoubtedly calls the shots in Europe today, and acts more assertively than it has in the postwar era. Berlin's willingness to guarantee the survival of the common currency is the best example of its centrality to European affairs today. Unfortunately, Berlin's veto of the proposed BAE-EADS defense industry merger and Germany's abstention at the UN during the Libyan crisis demonstrate that Germany's newfound diplomatic confidence has downsides as well. Indeed, Washington has viewed Germany as too indecisive in its leadership of the euro crisis and too decisive in its refusal to take on a more assertive role in acting as a strategic partner of the United States. From a US perspective, Germany is a strategic donut hole in the heart of Europe, powerful enough to determine Europe's destiny, but too ambivalent over its newfound clout to lead Europe to greater strategic ambitions. If Europe as a whole adopts German strategic culture, the transatlantic partnership will find itself in dire straits.

Germany's success has come largely at the expense of France. For decades, Germany paid the bills while Paris called the shots on Europe's most important questions. Today, France is the junior partner in the Franco-German relationship. Germany's rising clout undermines France's traditional strategy of exerting French grandeur through the European Union. France's subordinate relationship to Germany may lead Paris to seek stronger partnerships with noncontinental powers. Under President Sarkozy, France forged a new relationship with the United States and NATO. Hollande, while more ambivalent about the transatlantic relationship, has not reversed any of Sarkozy's overtures, including France's historic 2010 bilateral defense arrangement with the United Kingdom. And France's early 2013 intervention in Mali demonstrated forcefully to the Hollande administration that it needs US support to achieve its security objectives through military force.

France is in the midst of drafting a new defense strategy, to be published in 2013. It remains unclear whether it, coupled with nearly inevitable defense cuts, will demonstrate an enduring French ambition to maintain a global role. Will France react to Germany's newfound clout by deepening ties with the United States or the United Kingdom? Or will France seek to play an even more assertive role in attempting to lead Europe into ambitious external operations, knowing that Germany's reluctance to engage militarily affords France this diplomatic opportunity? Further, how Germany seeks to leverage its relatively close relationship with Russia amidst these changing dynamics is another important factor in the equation.

Other valued US allies are feeling their own impacts from the crisis. Southern European countries, such as Spain and Italy, are likely to continue severe defense cuts in the coming years as they grapple with huge fiscal challenges. While these countries do not punch at the same weight as the United Kingdom and France, they provide NATO with core capabilities that would be missed if these countries were forced into even larger defense cuts. On the other hand, the Nordic countries have come through the crisis relatively well, with Norway and Sweden taking on more ambitious roles in the transatlantic alliance (to speak outside of just the NATO context in the case of Sweden), and northern Europe showing greater instincts for multilateral cooperation within the region. Meanwhile, Turkey sees the Arab awakening and the weakening of the European Union as another reason to turn away from a Europe that has rejected its advances and toward a leading role in a volatile Middle East. Considering the range of contingencies likely to emerge in the Middle East in the coming decade, this will offer Turkey a privileged position within the transatlantic alliance.

The crisis has had profound implications for the United Kingdom. The United Kingdom's defense cuts risk undermining the 'special relationship' with the United States and London's ability to serve as the prized full-spectrum ally the United States has counted on to be at its side in so many military engagements. Just as important, the crisis also has strengthened the traditional euro-skepticism of the Tories. The United Kingdom looks increasingly likely to opt out of any move toward greater European integration, making the departure of the United Kingdom from the Union a real possibility in the future. Would a less-European United Kingdom look more toward the bilateral relationship with the United States and other Anglo-Saxon countries? And would the United States be interested in investing diplomatic energy in a much-weakened ally?

The crisis could potentially offer opportunities for outside powers, particularly cash-rich Russia and China, to influence European affairs. Russia already has emerged as an important player in Cyprus' fiscal crisis, providing a $3.2 billion loan to the government in early 2012 absent the stringent conditions offered by the European Union, European Central Bank, and the International Monetary Fund. But Russia ultimately failed to come to the rescue of Cyprus in a second bailout, leaving it no choice but to negotiate a bailout with the European Union. For its part, China has been viewed on occasion as a potential savior for Europe's debt woes with its more than $3 trillion in foreign currency reserves. Beijing has offered verbal support for Europe, but until now has prudently avoided a major bailout that could put public money at risk. The bottom line is that non-European governments have an opportunity to secure major influence in Europe by offering rescue assistance, but so far seem reluctant to assume the risk in doing so. Nevertheless, the fire sale of public assets in southern Europe could offer the opportunity for unscrupulous Russian oligarchs to gain a greater investment profile, and resulting influence, in Europe.

Finally, the economic impact of the crisis may produce internal challenges to Europe's security. High youth unemployment is one of the most worrisome aspects of the eurozone crisis. A major outbreak of youth violence or hooliganism in a European country remains an outlier scenario, but it cannot be discounted as Europe's economic slump persists, particularly in southern Europe. Sustained high unemployment also risks worsening Europe's disconnect between its majority populations and its significant and growing Muslim minority.

A related cause for concern seen from a US perspective is the rise of nationalism on the continent, including the increase in influence of far right parties in some European countries. A cautionary perspective is worth keeping in mind, however, as European countries with vigorous far right parties have opted instead for more moderate forces in recent elections in the Netherlands, Greece, and France. Finally, related to rising nationalism is the growing movement toward secession seen in Belgium, Spain, and the United Kingdom. An independent—and anti-nuclear—Scotland could have major implications for the United Kingdom's nuclear submarine fleet, which is currently based in Scotland. And would an independent Catalonia or Flanders join NATO as sovereign states? What would happen to the already weakened defense budgets of the United Kingdom or Spain if they were to see important parts of their territory secede?

## European Futures and the US Response

What does all this portend for the medium- to longer-term future of Europe? There is a strong sense that Europe will never be the same. The eurozone crisis will not be a hurricane, momentarily causing destruction and chaos but with everything returning to normal once the mess has been cleaned up. Rather, it is a structural crisis, which will have permanent impacts on Europe's internal and external dynamics.

Europe likely faces a binary future; the status quo is no longer sustainable. The markets have lost confidence in Europe's former economic and political structure. Further European integration is needed to give the European Union a greater degree of coherence on fiscal policy and banking regulation in order to put an end to the crisis. This will require difficult choices that politicians will struggle to sell to their populations, but which must command popular support if they are to avoid a worsening of Europe's democratic deficit. This progress is unlikely to happen in one 'big bang' summit, but is more likely to take place incrementally at a pace dictated by market forces. Further European integration at the economic level could set the stage for continued integration at the foreign and defense policy levels, which could have a major strategic impact on Europe's role in the word.

The other possible future is that Europe fails to integrate further, setting off a gradual unraveling of the European project with an uncertain end. This could be as limited as a Greek exit from the eurozone, or a much larger and more sustained reversal of the European Union. A catastrophic outcome remains unlikely, but even a small initial event—such as a Greek exit from the Euro—could spark a major loss of confidence in the euro and the European project more broadly.

Regardless of the outcome, US officials should keep several likely developments in mind, which will affect how Washington engages Europe and how Europe engages the world in the future. One likely result of the crisis is a reduced NATO. With free-falling European defense budgets, NATO may come to function less as a pure military alliance with robust, extant military capabilities and more as a core command-and-control structure capable of integrating the contributions of allies and valued partner countries. (Regardless of budgets and capabilities, NATO still will retain the invaluable political consultation mechanism that lies at its heart.) Second, European summit meetings may appear tedious and boring to US policymakers occupied with a volatile Middle East and focused strategically on Asia. However, while no one summit may solve all of Europe's problems, these meetings have in the past produced steady and incremental progress in shaping a new European Union, and could do so again in the future. If such an outcome repeats itself, it could have an impact on how the United States engages its European partners. US policymakers should take care to follow the developments of the Eurozone crisis with a focus not just on its economic implications, but also how the summits will affect Europe's strategic engagement with the United States. After all, regardless of the crisis and its effects, Europe is nearly certain to remain Washington's preferred partner for global affairs in the decades to come.

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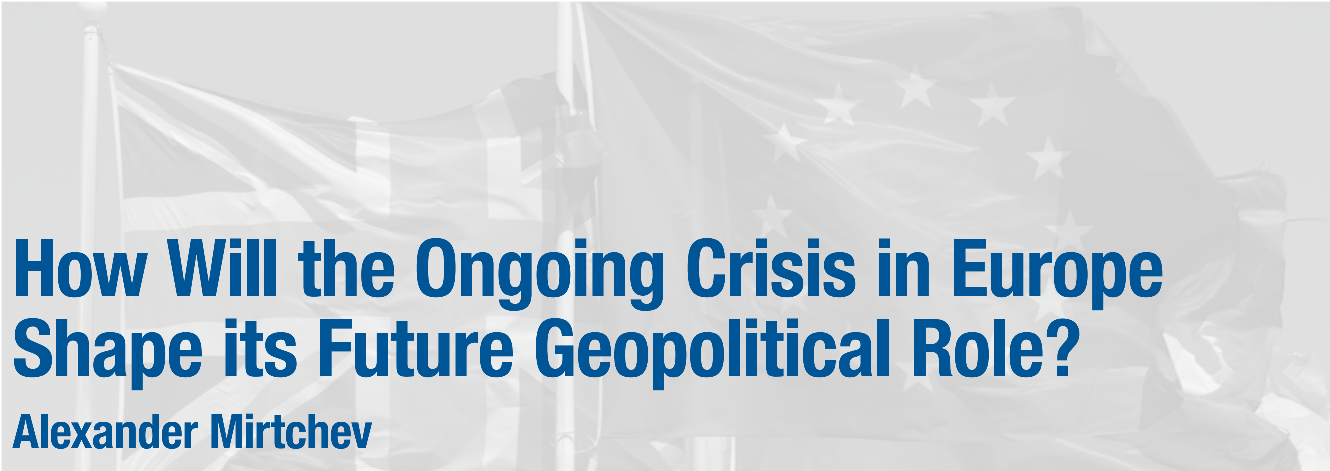

# How Will the Ongoing Crisis in Europe Shape its Future Geopolitical Role?


## Alexander Mirtchev



## Summary:

*Europe's future geopolitical role will be shaped by the ways in which the European Union reconciles its deep-seated structural problems. The progression or digression of military, economic, and political union will decide Europe's engagement in the world, and whether it can project influence independently or will continue to rely on soft power and multilateral approaches. Ultimately, Europe's international standing rests on the ability of the European Union to sustain itself, which in turn is dependent on the political will of the Europeans themselves.*


Europe's future geopolitical role is contingent on the fate of the European Union, in particular the ongoing existence of the eurozone and impact of its crisis. The main questions that need to be answered in assessing the European Union's future are: what are the *likely directions of future strategic engagement* by the European Union; *what power would the European Union be able to bring to bear* in such engagement; and, ultimately, *is the European Union likely to exist as a geopolitical entity in the future*?

The answers to those questions lie both in the current economic and political conditions that influence the actions and strategies of the European Union and in the foundations of the grand bargain that led to its creation.

First, the European Union *will continue to strategically engage with the rest of the world* and will endeavor to impose its own agenda on a number of global processes. However, its ability to achieve targeted outcomes faces a number of hurdles. It will be constrained in the breadth of its geopolitical engagement, concentrating its efforts and abilities on issues of major significance, such as energy and finance. The European Union will also continue its endeavors to act as a monitor and judge of good conduct by countries in Eurasia, Africa, and Latin America. It will still be lecturing others on human rights and democratic development, irrespective of the situation within the Union itself, but it is likely to have less impact on the decision-making of countries that may emerge as new power centers for these respective regions.

In the area of global political issues, the European Union is likely to be a secondary force to the United States, China, possibly India, and regional unions around powers such as Brazil or Russia. What the European Union can and is likely to focus on is the role of a trusted "broker" and a factor of balance in future geopolitical tensions and confrontations between major powers. This could entail a greater focus by the European Union on the strictures and enforceability of international law, and a greater focus on diplomatic processes that do not rely on internal EU resources.

To maintain its geopolitical positioning, the European Union would be increasingly reliant on multilateral approaches and mechanisms—through existing institutional channels, and potentially new roles for frameworks such as the Group of 20. For example, in order to carry sufficient geopolitical weight, the European Union would do well to maintain the interest of players like Turkey in ongoing engagement and closer ties with the Union. Turkey has already established its intent to conduct itself as a regional power center in the Middle East, and is assuming leadership in a much more efficient and effective manner than the European Union on a number of issues of global significance. Losing the interest of Turkey to be a part of the European Union would reduce the sway that the European Union currently has and may potentially wield in the future.

Second, the European Union will *continue to endeavor to develop its hard power capacities*. The EU Defense Partnership is still on the agenda, despite a number of hurdles of practical and political nature. However, at present the European Union as an entity is unable to project a viable foreign policy stance and to mobilize a military presence that can project hard power. This weakness has been highlighted by a number of international conflicts, where European Union member states have either been late to engage, or were unable to do so without the support of others, in particular the United States. One of the latest examples was the action in Libya where, despite the reluctance of Washington, the forces and air power of certain European NATO members were only committed when the United States had assured the allies of its involvement.

The development of hard and concomitant soft power capabilities by the European Union is impeded by structural issues, reduced economic resources, and clashing political agendas. Conflict-related diplomacy and the participation in conflict itself do not easily fit with the more established EU processes of integration, convincing, and influencing inter-state processes. In practice, an EU defense force would need to be a combination of the major military powers of the Union, such as the United Kingdom and France, with a sprinkling of other countries' military contingents that would have a relatively limited role and presence. This immediately raises the contradiction of one member-state facing a proportionately larger cost than others for the projection of hard and soft power by the whole Union. It would be inevitable that domestic political pressure would challenge the commitment of a country's forces, in particular if loss of life becomes a factor.

In order for such hard power to materialize, the process of its development would have to be an outgrowth of other integration processes within the European Union. In all likelihood, EU hard power capacity would be directly proportional to the level of fiscal and political union achieved within Europe. The more clarity there is in how the member-states share the economic and financial costs of other integration activities, the easier it would be to formulate the appropriate methods of sharing the burden of creating and projecting a unified military and foreign policy stance.

The emergence of EU hard and soft power is probably going to be the result of dealing with specific crises faced by the Union as a whole than of a process of majority voting and referendums within the various member-states. It is possible that future geopolitical engagements could create a forcing action for internal EU processes to be modified to facilitate the emergency creation of hard and soft power, sometimes outside the scope of the accepted practices of legal, economic, and constitutional changes in the Union.

Third, *as a political project, the European Union's future would be assured if the political will behind its continuous existence remains in place*. This will has been challenged by increasingly nation-centric views by different members, the anti-European sentiments in certain European constituencies, and the perceived weight of problems associated with membership in the eurozone and the European Union, respectively.

A key factor that would determine the continued political support for the European Union would be the state of the Union's economy. The economic problems facing today's Europe are unlikely to disappear over the short- to medium-term. In effect, the same political will that sustains the Union is also behind the preservation of the single European currency. In that light, although the political commitments behind the eurozone are being subjected to increasing internal political pressure within the major EU economies, in particular Germany, the interests vested in maintaining the euro remain strong. There are no indications that the political will behind these commitments has waned, and it may not dissipate as long as the eurozone and the European Union serve the political purpose of maintaining a politically stable Europe.

The question is whether the European Union can bear the economic cost of such political stability. This cost is directly linked to the social practices and approaches that are actually maintaining the political stability of Europe, ranging from the extensive social safety nets that are ultimately maintained through Union membership, to the manner by which the imperative of economic productivity is subjected to social concerns.

These principles are both laudable and well-meaning, but when looked at from the cold-hearted perspective of economic growth, they generate problems. As demonstrated by the travails of the eurozone economies since 2008, the efforts to maintain the socio-economic arrangements prevalent in European economies have led to sluggish growth, unemployment, and even measures that run counter to the implicit and explicit guarantees that states have made to their populations, as was the case in Cyprus in 2013, for example.

Of particular significance for European and, ultimately, global economic security, is the fact that the political nature of the European project often does not favor straightforward economic solutions or unified policy decisions. Indeed, the political aspects appear to have increasingly trumped the economic ones. The measures proposed to date and likely to be put forward in the future persist in addressing the liquidity of member-states, while the actual underlying problem, exposed initially during the global financial crisis was, and remains, solvency.

In addition, the proposed approaches of "more Europe"—tighter European integration—are clashing with the visions of the populations of a number of member-states that seek to have their own economic—and even foreign—policy, independent of Brussels, Berlin, or Paris. Instead, there is a need to address the fundamentals and rediscover the wellspring of economic growth, even in stronger economies, as well as of seeking new forms of leverage that would make Union-wide policies acceptable for all member-states. It is imperative to resolve from where growth will come, and how the economies within the Union are to achieve a level of competitiveness and improve productivity.

In essence, the future power of Europe and the future of the European project itself may be considered to be down to the future of Germany. Today, Berlin bemoans the lack of fiscal discipline of southern Europe, knowing full well that Germany itself was a major source of financing the perceived excesses of those same economies. The government and the business elites recognize the need for continued financing of what are ultimately customers for German goods. On the other hand, the increasing unhappiness of the German population about bailing out the rest of Europe is imposing restrictions on how much the German government can be seen to help others. In addressing the problems of Europe, the government of Angela Merkel is challenged by the convergence of contradictory political considerations that curtail its ability to react to the crisis. This is unlikely to change for any future German government elected after this September's general elections.

In the future, Europe would be even less capable of applying economic resources to maintain the political framework of the Union. To begin with, the ability of governments to spend their way out of future recessions is almost negligible, and that is unlikely to change, barring drastic technological advances in globally significant fields such as energy, computing, or biotechnology. In addition, the ability of the European Union to address crises is hampered by its cumbersome decision-making mechanisms and undermined by the ability and need of the governments of individual member-states to be seen to act independently. That means that the future economic outlook for Europe is far from optimistic, which in turn implies greater pressure on the political undertakings that support the European edifice.

The upcoming challenges faced by the European Union and the strategies adopted to address them will also be shaped by the extent to which the European Union sticks to its intended goal as a political project. It can be said to have been established as a mechanism after World War II for harnessing German ambitions and intentions toward economic dominance of their chosen sphere of influence. Although today's political goal of the EU project may not appear the same on the surface, it remains closely related to providing an economic outlet for any possible endeavors by individual countries within the European Union to achieve political expansion. In a sense, the European Union is a balancing mechanism—fire that needs continuous stoking and the output it produces does not always exceed the resources that are put in.

Although there are a number of vested interests in maintaining the European Union and the eurozone in their current form, there are also rising pressures that open the door to new conflict flashpoints. The first such point has already been reached, and there is a rising level of dissatisfaction with the benefits that national populations accrue from EU membership, as well as resentment between different member-states' inhabitants. For example, anti-German sentiments abound in the populace of most southern European countries, while at the same time Germany and other northern European countries like Holland see themselves forced to pay for the increasing "ingratitude" of southern member-states. Other areas of friction include the British and the Eurozone members, the "new" entrants to the European Union and the established powers, and other divisions and subdivisions within the European Union. These tensions are continuously fluctuating, and interpolate various subsets, where opponents on a specific issue band together against former allies on other issues.

Ultimately, the future role of Europe will be determined by the manner in which it is able to generate vested interests by other actors in the continued well being and strength of the European Union. As an existing ally of the United States, the European Union is likely to maintain its position in global negotiations, relying as much as possible on the geopolitical clout it can extract from being seen by many as the "more reasonable" part of the Western alliance. On the other hand, it will inevitably try to establish specific bilateral arrangements with others, such as China, Russia, India, Brazil, the Middle East, Australia, Japan, and South Africa. The likely risk such a two-pronged strategy faces is becoming isolated and not trusted by either the United States or the new actors it is trying to woo.

The other factor that would determine the existence and role of the European Union will be how it integrates into upcoming geopolitical reshuffles of power. Before the end of the Cold War, Europe was a buffer between the United States and the Soviet Union, which entailed Washington's continued and sustained support. The intrinsic need for such a role for Europe, however, gradually died down after the end of the Cold War, with America's interests shifting toward the Asia Pacific and the Middle East. The various elements of the political will supporting the European project may be reinforced down the road, but such support is just as likely to evaporate under the spotlight of social upheavals and discontent resulting from economic turmoil. The erosion of this political will would be exacerbated by the continued inability of the European Union to operate as a unified geopolitical entity.

The very survival of the EU as we know it has been questioned increasingly since the eurozone crisis began. The doubts have been reinforced by the lack of viable strategy put forward for consideration, and by the plethora of nation-centric approaches put forward instead of long-term compromises. If the present is any guide, the most probable conclusion is that there is a loss of political consensus, and each new strategy comprises already undetermined and often nebulous goals.

Unless there is a revamping of membership structure, rights and responsibilities within the European Union, and a clear enforcement mechanism for implementing those changes, the European Union may gradually dissipate as a geopolitical force. It is also necessary to admit that the very implementation of such drastic measures may push certain governments to the brink of leaving the European Union altogether. This less optimistic scenario is likely to go through a number of iterations, but will finally result in several tiers of "integration," with a core of European countries with close bilateral ties, similar economies and matching political visions, and one or more peripheral groups of European countries tied together according to economic strength, culture, or traditional relations.

There is also the option of the complete revamping of the European Union, with the terms of the Maastricht Treaty renegotiated to reflect the new terms of monetary union, probably of certain "core" economies, coupled with more stringent fiscal and political union, with member-states giving up sovereign powers to a new European central body. Such a scenario would create the framework of a new economic and customs union in Europe, within which the different members would pursue different lines of economic and foreign policy development. The new European Union could have a major power focus, with a number of countries grouped within the orbit of Germany, with several other "groups"—the United Kingdom, Ireland, and the Netherlands on one side, the eastern European members on the other, and the southern European economies constituting a third "satellite group." This scenario would ultimately open the door for a new redistribution of geopolitical power across the continent, allowing countries to seek new partnerships and new arrangements without being constrained by their membership in the new version of the European Union.

All of the above scenarios and iterations do not actually represent different future paths. Rather, they are a representation of the potential ranges of the fluctuating future and capacity of Europe to contribute to and influence global geopolitical processes. It is likely that Europe will go through different aspects of all of these iterations, and they would leave an undeniable mark on its ability to alter global agendas. However, the fundamental factors of European geopolitical weight are unlikely to evolve beyond recognition, and will still rest on the economic, cultural, socio-political, and military wherewithal that specific member countries would possess and be willing to exert on behalf of the respective guise that the European Union will don in the future.

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