

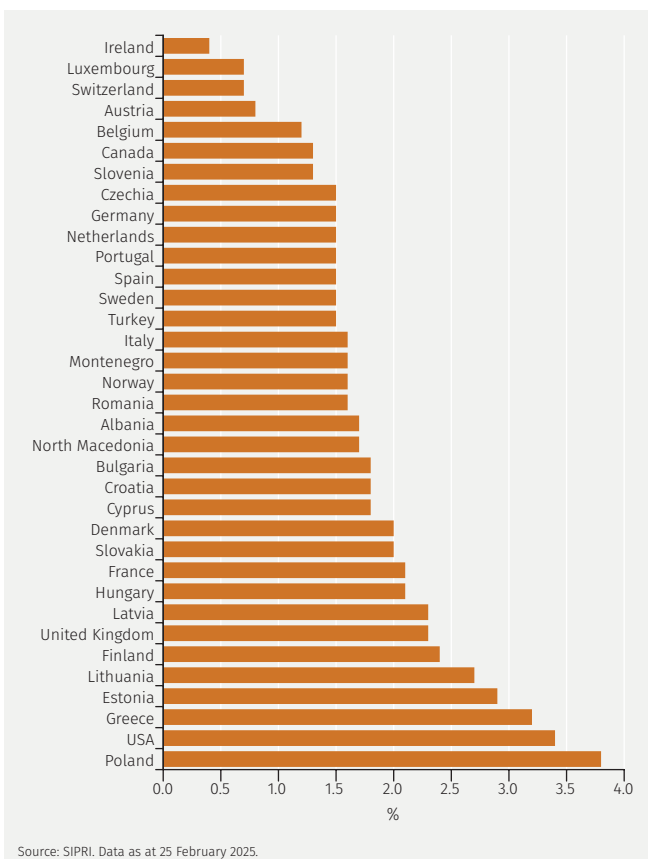


## DEFENCE SPENDING IN EUROPE

Following what appear to be dramatic shifts in US defence policy, in particular with regard to the North Atlantic Treaty Organisation (NATO), there is a great need to increase defence spending in Europe. But how much do European nations spend on defence? And how does that vary with geographic location, income levels and other factors? In this issue of *InFocus*, EFG chief economist Stefan Gerlach looks at the data.

Defence spending as a fraction of GDP varies sharply between countries. While the United States has consistently maintained a high level of military expenditure relative to its GDP, defence budgets in Europe have varied significantly. Figure 1 shows the fraction of GDP that was spent on defence in 2023 in 33 European countries, the US and Canada. Strikingly, it varies by a factor of 10 from 0.4% of GDP in Ireland to 3.8% in Poland.<sup>1</sup>

1. Defence spending as a share of GDP in 2023



The US has historically spent more on defence than the democracies in western Europe and Canada, averaging 3.8% of GDP in the 2000-23 period. This high level of spending reflects its global military commitments and strategic priorities. The

US maintains military bases and conducts military operations worldwide. In doing so, it incurs large costs for personnel, equipment and logistics. The US is also a leader in defence technology, which requires large budgets for research and weapons development. Finally, the US defence sector is a major employer and source of tax revenues in many US states, with strong political support for maintaining high levels of military funding.

European defence spending has been shaped by a sense that the region is protected through NATO membership, a historical reluctance to militarisation following two devastating World Wars, and a perception that the security situation had improved massively following the collapse of the Union of Soviet Socialist Republics (USSR) and the Warsaw pact. While NATO had indicated that members should spend at least 2% of GDP on defence, most European nations have fallen well short of this target. However, the Russian invasion of Ukraine in 2022 led to a significant shift, prompting many European nations to boost their military budgets in 2023 and in future years.

The UK and France, as Europe's two nuclear armed states that sustain overseas military installations and on occasion deploy forces outside of Europe, have generally spent more than other European countries on defence. While UK defence spending averaged 2.3% of GDP between 2000-23 (second only to Greece which spent 2.9% of GDP), spending in France averaged 2.0%.

Germany, which for historical reasons has been reluctant to spend more on its military than necessary, has spent on average 1.3% during this period. Italy and Spain, the fourth and fifth largest European economies, have on average spent 1.5% and 1.4% of GDP.

Canada has historically spent less on defence than most of its European NATO allies, averaging about 1.2% of GDP between 2000-2023. No doubt this is due to the perception that Canada is unlikely to be engaged in a land war in Europe.

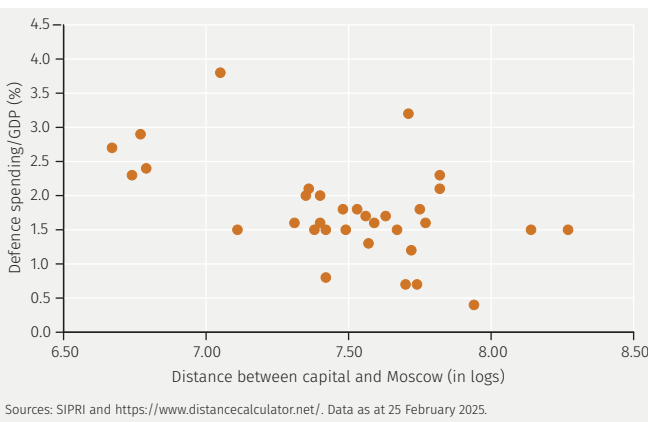
<sup>1</sup> For Ireland, GNI is used rather than GDP, since the latter is boosted by the presence of large international companies located there for tax purposes.

# DEFENCE SPENDING IN EUROPE

## Correlations

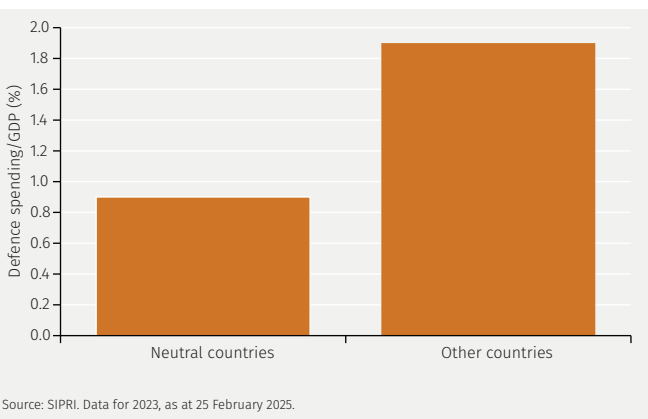
What factors might explain differences in defence spending as a fraction of GDP in 2023 among European countries? Given that one of the major concerns for many European nations is the risk of military conflict with Russia, geographic location is likely a significant factor. Indeed, the six countries sharing a border with Russia—Norway, Finland, Estonia, Latvia, Lithuania and Poland—devoted an average of 2.6% of their GDP to defence in 2023. In contrast, other European countries allocated only 1.6% of their GDP to defence.

### 2. Defence spending and distance



Another way to capture this geographic effect is by considering (the logarithm of) the distance between a country's capital and Moscow. The correlation between this distance and defence spending in 2023 is -0.5, suggesting that countries further from Russia tend to spend less on defence (see Figure 2). This variable may help explain why countries like Portugal, Ireland, Spain, and Italy allocate relatively little to defence.

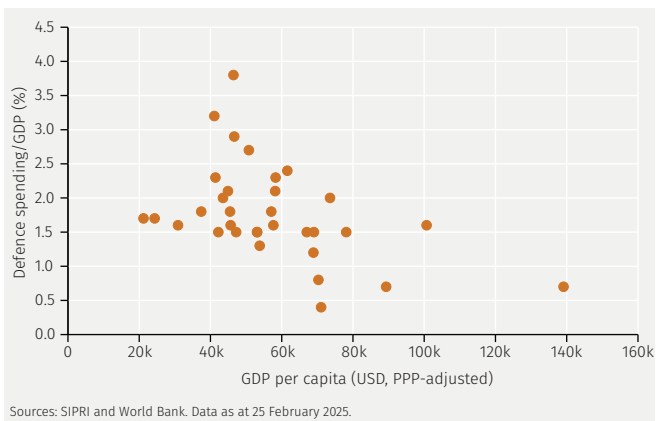
### 3. Defence spending and neutrality



Another factor is whether a country is neutral or a member of NATO. While the four European neutral countries (Austria, Cyprus, Ireland and Switzerland) spent on average 0.9% of GDP in 2023, European NATO members spent on average 1.9% of GDP (see Figure 3).

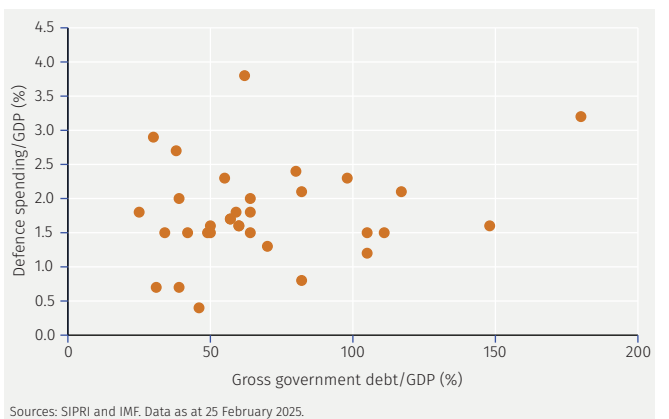
There is a strong negative correlation between Purchasing Power Parity (PPP)-adjusted GDP per capita and defence spending as a share of GDP (see Figure 4). Thus, higher income countries spend a smaller share of their income on defence. That finding does not depend on Luxembourg, which has very high real GDP per capita but which spends little on defence.

### 4. Defence spending and GDP per capita



Interestingly, the relationship between defence spending and gross government debt is positive (see Figure 5) but entirely dependent on Greece. It is arguably a special case in that its defence spending is high because of its long history of tensions with Turkey. Overall, there is neither a positive relationship that would suggest that large expenditures may

### 5. Defence spending and gross government debt



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## DEFENCE SPENDING IN EUROPE

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be at least partially covered by borrowing, nor a negative relationship that would suggest that countries with large debts attempt to save by lowering defence spending.

### **Conclusion**

Differences in defence spending across European countries in 2023 can be explained by a mix of geographical, political and economic factors. Countries closer to Russia tend to spend more on defence, reflecting their greater security concerns. NATO membership and a country's stance on neutrality also influences spending, with NATO members generally dedicating more resources to defence, while neutral countries tend to spend less.

Economic factors also play a role, with wealthier countries spending a smaller proportion of their GDP on defence. The level of government debt does not impact on defence spending.

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