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European Defense Spending: Trade-Offs and Consequences of Non-Alignment

KEY MESSAGES

- **European states are not aligned in their military spending priorities, and for this reason, simply increasing national defense spending will not automatically translate into higher common EU industrial and operational capacity**
- **As long as EU and member state priorities remain unaligned, the risks of wasting growing military funds are considerable and should be more widely debated at the political level**
- **There are four main defense risks emerging from this context: worsened fragmentation of the European defense industrial base; competition between different European companies for components and raw materials; mismatch between operational needs and industrial supply; and challenges to the definition of a common strategic autonomy**
- **The economic impacts of an increasing militarization of commercial and civilian industry and increased challenges for green transition should also be considered**
- **Risk mitigation strategies should favor efforts promoting strategic alignment and political convergence rather than simply agreeing on higher national expenditure targets**

The February 2022 invasion of Ukraine by Russia led to a sea change in European countries' attitudes to arms production. Many European states and the EU sought to dramatically improve their own military readiness and capability and provide Ukraine with the arms and ammunition it needed to fight against Russia. National governments and the European Commission rapidly discovered that their defense industries lacked the capacity to produce arms in the quantities needed for the first high-intensity war in Europe for almost 80 years (Fiott 2023; Håkansson 2024).

This realization led to a series of national decisions to increase defense spending as well as EU initiatives spearheaded by the European Commission to incentivize and coordinate, culminating in the Spring 2024 European Defense Industrial Strategy (EDIS). More money to spend may generate the impression that Europe will increase its capacity and solve most of its strategic challenges. Yet, agreeing to spend more does not mean that member states and EU institutions are on the same page regarding what to do with it, and increased spending may be wasted and not lead to increases in defense production. As we will argue here, increasing defense expenditure in Europe does not automatically translate into increased common capacity.

UNEVEN SPENDING INCREASES

Data from the Stockholm International Peace Research Institute (SIPRI) on military expenditure suggests that EU member states have, overall, responded to the February 2022 Russian invasion of Ukraine with increased defense budgets. Collectively, military expenditure numbers in 2022 were 3.03 percent higher compared to 2021 (after adjusting for inflation) and rose again by 11.03 percent in 2023 (SIPRI 2024).[1] That increase followed year-on-year increases since the 2014 Russian seizure of Ukrainian territory; since then, EU NATO countries' military expenditure (that is, without Cyprus, Austria, Ireland and Malta, as well as Finland and Sweden as they only recently joined NATO) has increased by almost 50 percent, from EUR 145 billion in 2014 to a forecast EUR 215 billion in 2023 (measured in constant 2015 prices) (Stamegna et al. 2024).

However, increased defense spending was not a common, harmonized European response. Instead, a handful of countries appeared to have been galvanized into action, while a larger group lacked the same sense of urgency. The overall increase between 2021 and 2023, therefore, masks considerable differences among EU/European NATO members. While most of the 27 EU member states increased their defense expenditure, many did so only slightly. Just ten members of both the EU and NATO met NATO's target of spending 2 percent of GDP on defense in 2023, up from six in 2021. Exceptionally large increases were recorded in Poland (up 75 percent between 2022 and 2023) and Finland (up 54 percent between 2022 and 2023) (Tian et al. 2024). Conversely, defense expenditure in four EU member states (Italy, Greece, Cyprus, and Romania) decreased in 2023 compared to 2022 (SIPRI 2024).

Another important way to assess countries' defense expenditure commitment is the speed at which defense spending increases are planned. Some of those states that have announced large increases are unlikely to make fast progress. For example, in Janu-

[1] Authors' calculations based upon data downloaded from the SIPRI military expenditure database. Accessed from https://milex.sipri.org/sipri June 10, 2024.

ary 2023, President Macron announced a planned medium-term increase of about one-third in the French defense budget. While France is due to meet the target 2 percent of GDP spent on defense in 2025, which had been agreed to by NATO members in 2014, the full increase will not be complete until 2030 (Rose and Achi 2023). While the planned large-scale investments in capabilities like drones and military intelligence would clearly augment the French armed forces, the envisioned timescale means that they are a medium-term investment rather than a response to the current crisis. Italy is operating on an even longer timescale. Unlike France, Italy is a long way from the 2 percent goal as reported by its defense minister in November 2023, and no year was given as to when that might be achieved – Stamegna et al. (2024) point to Italy's ongoing public finance problems and the Eurozone's public debt criteria as causes. Poland, meanwhile, has already embarked upon a significant spending increase: in 2023, defense spending rose by 75 percent compared to the previous year, and will reach 3.9 percent of GDP in 2024, almost twice the 2 percent target (Strzelecki and Pawlak 2023). It remains to be seen whether this level of spending can be sustained, and whether Poland is able to use the extra money effectively, but it is clear that some states are moving toward a war economy, whereas others are not.

In other words, there does not seem to be a Europe-wide consensus on whether there needs to be substantial and sustained increases in defense expenditure or how quickly this needs to happen. This may undermine the ability of the European Commission to marshal significant long-term resources toward defense production, despite its ambition to do so. The EU's long list of programs and policies employed and/or introduced since the beginning of the war indicates that there is a growing willingness among EU institutions to step up their commitment to defense matters, both in terms of arming Ukraine and strengthening European military capabilities (Håkansson 2024). However, that has not translated into a common understanding of the scale of the military threat and how this should be addressed from an industrial perspective. For reasons such as different threat perceptions among national electorates, different international defense commitments, tensions between political and economic logics, and industry constraints, EU countries are not aligned in their rearmament priorities, and are largely following national imperatives (Fiott 2023). This is particularly noticeable in Central and Northern European states where threat perceptions of Russia are highest (Chovančík and Krpec 2023).

The EDIS proposals of March 2024 represent an attempt to plan what an EU-led transition to an economy preparing for war might look like (European Commission and High Representative 2024). However, it has long been observed that EU initiatives on defense industry and procurement favor the larger Western European arms-producing states and firms (Mawdsley 2008). Chovančík and Krpec (2023) argue that Western European firms are better integrated and thus better placed to benefit from EU initiatives like the European Defense Fund (EDF). EDIS also seems to echo the French vision of an autonomous Defense Technological and Industrial Base (DTIB), even though economists question whether highly internationalized supply chains make this impossible (Kleczka et al. 2024), as well as whether purely EU firms could fulfil demand rapidly enough (Wolff 2024). EDIS is likely to have three areas where member states disagree: (1) the Commission taking on war powers; (2) finance; and (3) whether it is more important to build up capacity at speed or autonomously. The latter two are areas where the lack of consensus on threats will cause conflict, as the 2024 Czech initiative to procure ammunition globally for Ukraine, when purely EU efforts failed, shows.

In theory, increased European military spending might be expected to lead to general industrial development, intra-EU or NATO cooperation enabling economies of scale, and an increase in EU or NATO political leverage over states' national defense policies and decisions. But so far this has not happened. In fact, there are several risks associated with an uncoordinated increase in military spending, and this has received far less attention than the issue deserves.

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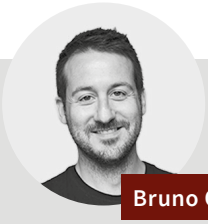

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POLICY CONCLUSIONS

The Consequences of European Defense Fragmentation

Worsened fragmentation of the European defense industrial base – An increase in available funds may lead to higher levels of fragmentation of the already fragmented European defense industrial base. It is likely that the uneven increases in defense spending, linked to differing threat perceptions, will be accompanied by traditional European government preferences to spend on national champion defense companies. This is logical – as DeVore (2017) argues, even small national defense industrial sectors can offer an important advantage in times of war, especially increased military adaptability (as we have seen in Ukraine). But as each country tries to maximize domestic economic benefit, they will collectively forfeit opportunities to build a more productive, autonomous, and efficient European defense industry.

Competition between different European companies – The fragmentation described above has other consequences. Poland's acquisitions from South Korea are a good example of a national growth strategy for DTIBs (Chovančík and Krpec 2023). However, while such purchases are rational responses to filling urgent military capability gaps, there are signs that competition and duplication among EU countries are driving prices up, rather than triggering economies of scale that a coordinated effort could allow. A scenario of competition between different EU countries would thus probably lead to an actual increase in prices of raw materials and components (Fiott 2022). Mader et al. (2024) show how public support for European security and defense spending is cost sensitive – a prolonged period of high military expenditure preparing for a potential conflict could reduce public support.

Mismatch between operational needs and industrial supply – Some of the recent pre-war EU initiatives, chiefly the European Defense Fund (EDF), have received criticism for prioritizing industrial objectives over operational ones. The EDF put the focus on innovation and industrial development, and its priorities appear to be based on industrial preferences, rather than the operational needs of European armed forces (Martins and Mawdsley 2021). The EDIS continues this pattern. One EDIS proposal, for example, focuses on enabling joint planning through a 'European Defense Industrial Readiness Board' with substantial industrial representation. If the new funding proposed in EDIS follows a similar logic, and with expected lack of coordination among EU countries, there could be a further mismatch between what is needed by Europe's militaries and what is produced by industry.

Challenges to the definition of a common strategic autonomy – A non-alignment in defense spending across Europe will further complicate the narratives around the EU's concept of strategic autonomy. If different spending priorities are a consequence of different threat perceptions and different visions about the future of EU defense, the idea of a single understanding of a European strategic autonomy is undermined even further. In other words, when we read "strategic autonomy," we need to ask, "for whom?"

Wider Economic Impacts

Excessive militarization – While attention has mainly been focused on low levels of European military spending, European leaders should also be wary of the risks of excessive militarization, or perceptions thereof. Defense spending represents a diversion of funds and resources from civilian production and welfare. While the defense economics literature has not reached a consensus on where the line can be drawn (see discussion in Dunne and Smith (2020)), spending more than is necessary could "crowd out" civilian industries upon which European prosperity and defense budgets ultimately depend, for example through shortages of specialized workers. Attempts to rapidly build up defense industry may also result in calls to provide governments with new powers to, say, suspend local democratic processes concerning planning and building construction. Moreover, military funding of dual-use technologies, as well as military funding of civilian research environments, have been seen as a threat to science and technology and problematic to the freedom and autonomy of scientific research, while military funding of civilian tech companies such as Google has triggered protests from tech workers (Sainato 2024). More directly, perceptions that Europe has excessive military spending would be likely to further undermine the ability of European leaders to reach a consensus or coordinate their efforts, given that political polarization is rising in many European states. It is therefore important that the EU and European governments are seen to deliver value for money and not to be wasting taxpayers' money on inefficient and ineffective spending.

Challenges for green transition – There is a particular risk that European attempts to meet the urgent challenge of improving defense production and military capability act against the equally important long-term goal of decarbonizing European industrial and energy sectors. If that were perceived to be happening, it may be even harder to achieve a European consensus on military expenditure. There is a risk that funding will be redirected away from developing and implementing green technology and toward defense and military sectors that have been criticized for being high carbon emitters (Egeland 2023). For example, President of the European Council Charles Michel has proposed cutting the EU renewables fund from EUR 10 billion to EUR 1.5 billion and diverting those funds into military investments (Gavin et al. 2023). It also remains to be seen whether the leadership of the EU and European states are up to the

task of undertaking two ambitious transformations of European industry simultaneously.

Increases in defense spending will not automatically translate into higher common EU industrial capacity. In fact, as long as priorities remain poorly aligned, the risks of wasting the growing availability of military funds are considerable and should be more widely discussed at the political level. Risk mitigation strategies should favor efforts promoting strategic alignment and political convergence rather than simply agreeing to make more funds available.

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