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MEDIA BACKGROUNDER
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MEDIA BACKGROUNDER

MILITARY SPENDING IN EUROPE IN THE WAKE OF THE UKRAINE CRISIS

The political and military crisis in Ukraine has led to a major reassessment of threat perceptions and military strategies in much of Europe. Increased threat perceptions have led to calls in Europe for higher military spending and, in particular, a renewed commitment by NATO members to spend at least 2 per cent of their gross domestic product (GDP) on the military. This media backgrounder discusses the impact of the Ukraine crisis on military expenditure in Europe. The key points are:

- In ***Ukraine,*** spending on the armed forces is expected to double in 2015, but almost half of it will go to pensions, and systemic corruption may prevent much of the rest from reaching front-line troops;
- In ***Russia***, arms procurement is set to increase by 60 per cent in 2015, but economic pressures may lead to reductions;
- In ***Poland***, a 10-year military modernization plan will result in the country exceeding NATO's 2 per cent target in 2015;
- In ***Sweden***, there has been a rethinking of defence policy and increasing cooperation with NATO and Nordic partners accompanied by large increases in spending recommended by the national Defence Commission;
- In the ***Baltic states***, there have been increases in military spending in the past 2–3 years, but only Estonia meets NATO's 2 per cent target. Estonia, Latvia and Lithuania all plan to increase spending again in 2015, Lithuania by 50 per cent;
- In ***other European countries***, there were increases in military spending in most central European and some Nordic countries, but otherwise there was falling or flat spending in Western Europe; and
- Within ***NATO***, very few member states are likely to meet the 2 per cent of GDP pledge any time soon, although pressure is growing for increased spending.

Ukraine

SIPRI's provisional estimate for Ukraine's military expenditure in 2014 is 36.9 billion Hryvnia ($4.0 billion), an increase in real terms of 23 per cent compared to 2013, and 65 per cent compared to 2005.[1] However, this estimate may not fully include war costs and the final figure is likely to be higher. Most of the increased spending has gone towards personnel costs rather than arms acquisitions.

SIPRI's figures for Ukrainian military spending are considerably higher than most other sources as they include spending on:

- the paramilitary border guard—which has been directly involved in the fighting in the east;

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- interior ministry troops; and
- military pensions—which account for almost half of the total SIPRI figure for Ukraine's military spending, a legacy of the Soviet era.
- For 2015 Ukraine has announced a massive increase in military spending with a total budget for 'defence and security' amounting to 86 billion hryvnia ($3.9 billion), of which:
  - 40 billion ($1.8 billion) will be for the regular armed forces, compared to 15 billion budgeted in 2014;
  - 7 billion ($318 million) for the newly created National Guard, compared to 1.5 billion in 2014; and
  - an additional 6 billion hryvnia ($273 million) in state guarantees for the Ukrainian arms industry.

Despite 14 per cent inflation, the budget for the regular armed forces will more than double in real terms. However, the effectiveness of Ukrainian military spending is severely compromised by:

- systemic corruption that includes the procurement of substandard equipment at inflated prices in return for kickbacks;
- the selling-off at reduced prices of equipment and land to benefit individual senior officers;
- the use of military assets and personnel by officers for their own benefit;
- the payment of bribes to pass military academies, obtain desirable assignments, or avoid conscription; and
- a lack of funding reaching front-line troops, such that conscripts are frequently forced to purchase their own equipment.[2]

Russia

Military spending in Russia increased by 8.1 per cent in real terms in 2014 to 3.2 trillion roubles ($84.5 billion). Modernization of the Russian armed forces has been a major priority since 2011, with the aim of rearming 70 per cent of the armed forces with new equipment by 2020 (see figure 1). This effort intensified in 2014 with increased deliveries of new equipment such as Su-34 long-range combat aircraft, and Verba and S-400 surface-to-air missile systems. A substantial increase in military spending—around 15 per cent in real terms—to 4.0 trillion roubles ($66 billion) is budgeted in 2015, then remaining roughly stable in nominal terms in 2016–17.[3] Almost all of the increase is earmarked for procurement, which is set to increase by over 60 per cent in 2015 and to remain at this higher level in 2016 and 2017.

Most or all of the increases were planned before the Ukrainian crisis and the 2014 economic crisis. Falling oil and gas prices and economic sanctions have reduced state income dramatically and led to a major devaluation of the rouble. As a result, the initial defence budget for 2015, which was 4.2 trillion roubles ($69 billion), was cut by around 5 per cent in the revised budget presented in March 2015, which made cuts to almost all budget lines.

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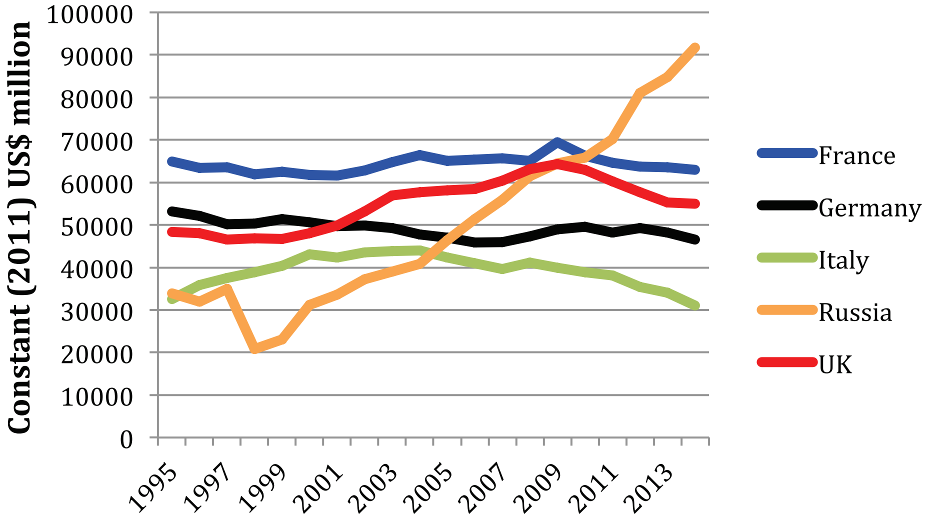
Figure 1. Military expenditure of Russia and major West European countries 1995–2014



In late 2014, Russia unveiled a new military doctrine, which emphasized the United States and NATO as the primary source of risks to Russia's security, while terrorism and proliferation of weapons of mass destruction were downgraded. The doctrine highlights:

- NATO's enlargement and enhanced capabilities;
- the increased presence of NATO troops near to Russia's borders; and
- improvements in US strategic capabilities.

Poland

In contrast to most of Western and Central Europe, Poland is likely to exceed the NATO 2 per cent target in 2015. Poland's military expenditure increased by 38 per cent in real terms between 2005 and 2014, including a 13 per cent increase in 2014. A further increase of 19 per cent in real terms is budgeted for 2015. The reasons for this are that Poland:

- largely avoided the economic fallout from the 2008 financial crisis; and
- has been willing to invest in its military, engage in NATO and US-led military operations and host the US ballistic missile defence programme (largely due to historical fears of Russia).

These latest increases are largely the result of a new 10-year military modernization plan from 2013–22, which aims to spend 130 billion zlotys ($35 billion) on new and upgraded military equipment. The programme covers the full range of land, sea and air

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systems, but some of the key purchases include:

- 32 combat and 70 transport helicopters;
- naval vessels and coastal defence systems for the Baltic Sea;
- 97 drones, and 20 air and missile defence systems;
- several hundred tanks and other armoured vehicles, and
- JASSM cruise missiles to arm Poland's new fleet of F-16 combat aircraft.

Polish industry is heavily involved in the programme, although the cruise missiles will be bought from the USA. Planned well before the start of the Ukraine crisis, events in Ukraine have prompted the Polish Government to seek to accelerate aspects of the programme. The Polish Ministry of Defence budget for 2015 amounts to 38 billion zloty ($9.9 billion), about 2.1 per cent of Poland's projected GDP in 2015. The defence budget is up from 31.8 billion zloty ($10.1 billion) in 2014.

Sweden

Sweden is a non-NATO member with increasingly close links to NATO, including participation in NATO-led military exercises and the NATO-led ISAF mission in Afghanistan. Sweden also plays an active role in the EU's Common Security and Defence Policy (CSDP) and has made a unilateral 'solidarity declaration' to provide active support to any EU member or Nordic country that comes under armed attack.

Sweden made significant post-cold war reductions in military spending and downsized its armed forces, which were re-oriented from territorial defence towards participation in overseas peacekeeping and other expeditionary operations. However, the Ukraine crisis has prompted a fundamental rethinking of Sweden's defence policy, with territorial defence once again on the agenda. Concerns over Russia's actions in Ukraine have been heightened by a number of confirmed and suspected incidents in the Baltic involving Russian military forces, which have prompted questions as to the adequacy of Sweden's military capabilities. These included incursions into Swedish airspace by Russian military planes and, most notably, the suspected incursion by a Russian mini-submarine into Swedish waters in the Stockholm archipelago.

A May 2014 report by the Swedish Parliament's Defence Commission received broad political support and described Russia's actions in the Ukraine as the greatest threat to European order since the cold war. While a direct attack by Russia on Swedish territory is considered unlikely, the Commission argued that a military conflict in the Baltic region would likely spill over to other countries. The Commission recommended an increase in the annual defence budget of SEK5.5 billion ($840 million), or about 12 per cent, by the end of the 5–7 years' Defence Planning Period (starting in 2015) to:

- increase the number of new Gripen-E combat aircraft from 60 to 70, equip them with cruise missiles and increase pilot training time;
- acquire 4 new transport aircraft;
- increase the number of submarines from 4 to 5, including 2 of a new class currently being developed;

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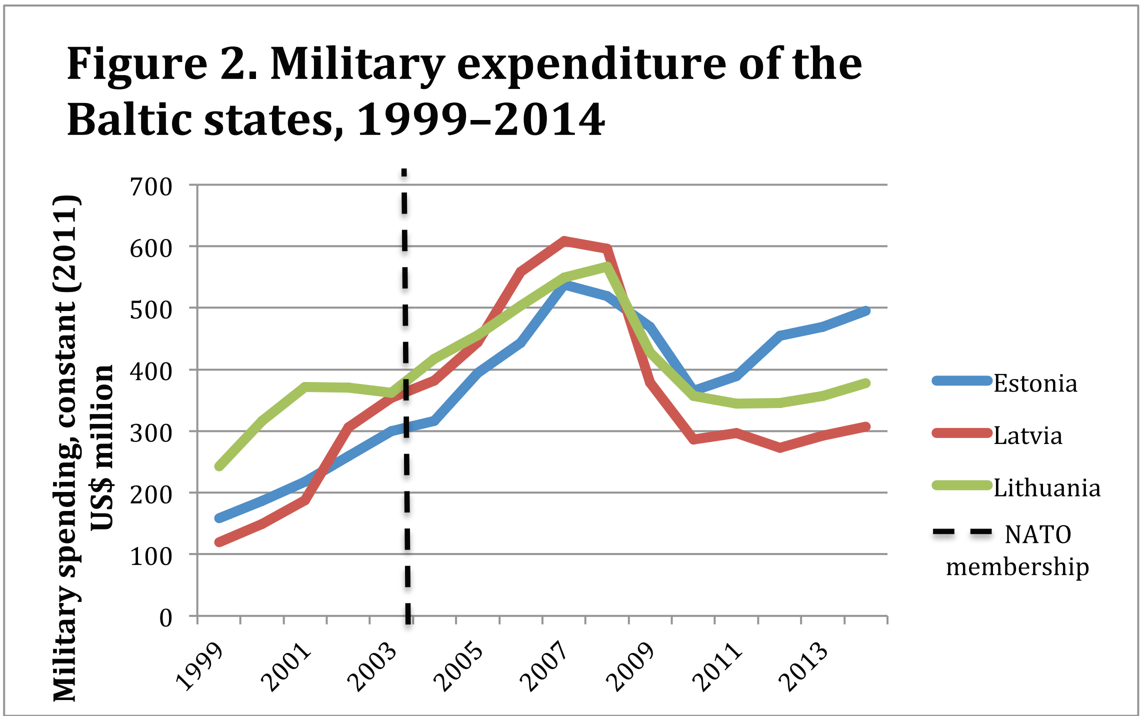

- upgrade Sweden's 7 surface combat ships;
- strengthen coastal defences, especially on the island of Gotland, through a new anti-ship missile system; and
- add a second battalion to the new medium-range air-defence system.

The 2015 Defence and Crisis Readiness budget passed by the Swedish Parliament in December 2014 amounted to SEK48.5 billion ($5.7), about 3 per cent higher than the initial budget for 2014, although only about 1 per cent higher than the provisional out-turn reported in January 2015, following mid-year budget increases.

The mid-year increases meant that Sweden's military expenditure increased by 5.9 per cent in real terms in 2014. However, the figure is still 2.5 per cent below the level in 2005 and 15 per cent below the level in 2000; thus, the increases proposed by the Defence Commission would still leave Sweden's military spending below the level in 2000.

The events in Ukraine have also prompted Sweden to seek increased military co-operation with NATO and its neighbours. In August 2014, Sweden signed a memorandum of understanding with NATO on 'host nation support' that would allow NATO troops to be deployed to Sweden under certain circumstances and to receive Swedish logistical support. (The current government has ruled out NATO membership.) Sweden has also proposed enhancing the Nordic Defence Cooperation (NORDEFCO) and extending it to Baltic states. In particular, Sweden and Finland have worked towards much closer military cooperation and agreed in January 2014 to

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pursue a 'special' partnership involving joint operations and equipment procurement. In February 2015, the Swedish and Finnish defence ministers announced a plan to enable the two countries' military forces to fight together in crisis or war situations.

The Baltic states

Estonia, Latvia and Lithuania are among the smallest members of NATO in terms of population, GDP and military spending, but—given their geographic location and history of Russian rule—have long sought to establish themselves as serious contributors to NATO. Events in Ukraine, as well as numerous incidents involving Russian forces (from airspace violations to the abduction of an Estonian intelligence officer by Russia in September 2014), have heightened their traditional fears.

All three countries increased military expenditure sharply in the years leading up to and following NATO membership in 2004, only to cut it sharply again during and following the global financial and economic crisis in 2008. In the last 2–3 years spending has been increasing once again, and the Ukraine crisis is further spurring this trend. Of the three, Estonia made the smallest cuts from its peak level of spending to the low point, by 32 per cent from 2007 to 2010, compared to 55 per cent for Latvia from 2007–12, and 39 per cent for Lithuania from 2008 to 2011 (see figure 2). Estonia was one of the few NATO members spending 2 per cent of GDP on the military in 2014, while the corresponding figures for Latvia and Lithuania were 0.9 per cent and 0.8 per cent, respectively.

Budgets for 2015 show a continued increase in military spending in all three countries and some degree of convergence:

- a 7.3 per cent increase in Estonia, to €412 million ($436 million);
- a 14.9 per cent increase in Latvia, to €254 million ($269 million); and
- most dramatically, a 50 per cent increase in Lithuania, to €425 million ($450 million).

Other European countries

Despite the strong condemnations of Russian actions in Ukraine and the defence policy responses taken by NATO, there has been little change in military spending budgets and plans in Western Europe, especially among the largest spenders.

France

France's core defence budget—excluding pensions and the gendarmerie—is constant in nominal terms in 2015 at €31.4 billion ($33.8 billion), in line with the 2013 'Loi de Programmation Militaire' (Military Planning Law), indicating a small real-terms fall.

Germany and Italy

Both the German and Italian defence budgets are marginally down, in line with previously announced plans as part of austerity measures. However, in February 2015 Germany announced plans to raise military spending in the medium term, although the

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Table 1. Defence budget plans for 2015 in selected EU and NATO states

Planning real increases	Planning real decreases	Small/no real-terms change
Belgium (+5.9%)	Bulgaria (-5.4%)	Netherlands (+1.4% nominal)
Czech Republic (+3.7%)	Denmark (-5.5%)	Spain (+0.5% nominal)
Estonia (+7.3%)	Finland (-2.3%)	Turkey (+7.8% nominal)
Greece (+2.7%)*	France (-3.4%)	
Latvia (+15%)	Germany (-0.5%)	
Lithuania (+50%)	Italy (-4.9%)	
Norway (+5.6%)	Portugal (-11%)	
Poland (+20%)	United Kindom (precise figure not available)	
Romania (+4.9%)		
Slovak Republic (+7%)		
Sweden (+5.3%)		

Notes: Figures for changes are in nominal terms and relate to available defence budget information, which does not always correspond to the SIPRI definition of military expenditure. Classification of countries as increasing/decreasing/small or no change in real spending is based on adjusting the nominal figures with inflation projections from the IMF *World Economic Outlook* database Oct. 2014. 'Small/no real-terms change' means a resulting real increase of decrease of less than 1%.
* In recent years, Greece's actual military expenditure has been consistently below budgeted expenditure, so projections of an increase in Greek spending in 2015 should be treated with caution.
Sources: Responses to SIPRI military expenditure questionnaires; official budget documents.

increases might not start until after 2016.

The United Kingdom

There have been no announced changes to the UK's existing plans (part of long-running austerity measures) for a modest cut in the 2015–16 defence budget. According to the Royal United Services Institute (RUSI), this will lead to British military spending falling below 2 per cent of GDP—for the first time since before World War II. Current British military spending plans beyond 2015–16 allow for a 1 per cent annual real increase in the equipment budget beyond 2015–16, while the rest of the defence budget remains constant in real terms. According to RUSI, this would see British military spending fall to around 1.5 per cent of GDP by 2020.[4]

In general, the pattern is of increases in military spending in most central European and some Nordic countries, but falling or flat spending in west European countries. (See table 1).

The NATO 2 per cent commitment

The September 2014 NATO summit in Wales was NATO's first major response to events in Ukraine. As well as producing a 'Readiness Action Plan' designed to improve NATO's ability to respond to the crisis and reassure eastern NATO members, the summit also addressed military spending (see figure 3). Member states 'pledged' to increase their military expenditure to NATO's long-standing target level of 2 per cent of

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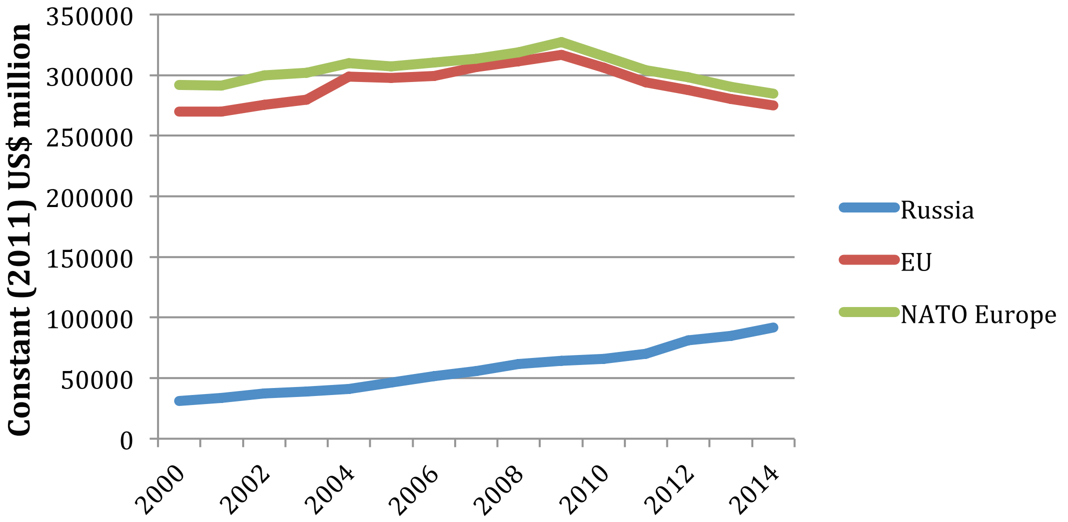
Figure 3. Military expenditure of Russia, EU and NATO Europe 2000–14



GDP over 10 years, or to maintain it at that level if they already meet it, and similarly to increase investment spending to, or maintain it at, at least 20 per cent of total military spending.

While only a political commitment, the pledge strengthens the status of the 2 per cent target, which was hitherto essentially no more than a guideline. The long-term, non-binding nature of the pledge represents a compromise between countries that were pushing hard for increases to military spending (mainly the USA) and others that were more reticent (especially Canada and Germany). Canada's military spending in 2013, for example, was just 1 per cent of GDP, and the Canadian Government argued that taxpayers would not agree to a doubling of military spending.

Unless tensions with Russia escalate significantly, it seems unlikely that many NATO members will meet this target. According to NATO figures:

- only Estonia, Greece, the UK and the USA met the 2 per cent target in 2014;
- only three other countries—France, Poland and Turkey—spent as much as 1.5 per cent; and
- some of the other major NATO countries, including Canada, Germany, Italy, the Netherlands and Spain, spent only 1.0, 1.2, 1.1, 1.2 and 0.9 per cent of GDP on the military, respectively.[5]

With the continuing focus on austerity and deficit reduction policies in most member states, there is little prospect for near-term increases in military spending. In the medium- to long-term, the increase of 80 per cent or more in military spending required by some member states to reach the 2 per cent target is unprecedented for

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NATO members in peacetime. Since the end of the 1950–53 Korean War, the trend in almost all NATO members' military budgets as a share of GDP has been downwards or flat, even during periods of increased tension with the Soviet Union.

The Ukraine crisis may well mark a break in the trend of falling military spending in Western and Central Europe. Even where countries are not immediately revising plans, there is growing pressure on NATO members to at least maintain, and if possible increase, their military spending in keeping with NATO commitments.

Endnotes:

[1] In this document, US dollar figures for countries' military expenditure in 2014 or previous years reflect the *average* exchange rate for the year in question. Figures for 2015 or later years reflect the *current* exchange rate at the time of writing, on 11 Mar. 2015.
[2] Chayes, S., 'How corruption guts militaries: the Ukraine case study', Defenseone.com, 16 May 2014, <http://www.defenseone.com/ideas/2014/05/how-corruption-guts-militaries-ukraine-case-study/84646/?oref=defenseone_today_nl>; and Lapko, A., 'Ukraine's own worst enemy', *New York Times*, 7 Oct. 2014, <http://www.nytimes.com/2014/10/08/opinion/in-war-time-corruption-in-ukraine-can-be-deadly.html?_r=0>.

[3] A *nominal value* is an economic value expressed in historical nominal monetary terms. By contrast, a *real value* is a value that has been adjusted from a nominal value to remove the effects of general price level changes over time and is thus measured in terms of the general price level in some reference year (the base year).
[4] Chalmers, M., 'The financial context for the 2015 SDSR: the end of UK exceptionalism?', RUSI Briefing Paper, Sep. 2014.

[5] NB: SIPRI data for certain NATO countries is higher than those provided by NATO, as SIPRI includes spending on paramilitary forces that are excluded from the NATO definition. These countries are Bulgaria, France, Greece, Italy, Poland and Turkey. However, as the NATO target of 2% relates to NATO's, not SIPRI's, definition, it is the NATO figures that are discussed here.