

# Navigating Financial Turmoil: Strategies for Defense Spending by NATO Alliance States in the 21<sup>st</sup> Century

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## Abstract

*In the 21st century, defense financing is a significant challenge in the context of evolving security threats and budgetary constraints. In the context of modern warfare, nations have certain commitments to allocate as much financial and substantial resources as possible to maintain robust defense capabilities.*

*In the first part, I will highlight the conflicts that have succeeded in convincing individual states, both the NATO alliance and globally, to invest some of their financial resources in defense.*

*In the second part, I will briefly outline the ways in which a state can fund its defense budget even though there are economic constraints, technology tends to evolve, but also the geopolitical sphere is constantly changing.*

*In the third part, I will highlight the principle on which the Euro-Atlantic alliance should be based, the principle of the "3E", and I will represent the spending that has taken place within the NATO alliance.*

**Key words:** financing, Euro-Atlantic alliance, economy, fiscal effort, political commitments

**J.E.L. classification:** G20, J38, O20

## 1. Introduction

In the context of the current geopolitical landscape, the financing of defense initiatives is a cornerstone that is essential in the sphere of global national security strategies. In the 21st century, nations face a multitude of complex threats from military aggression. Allocating financial resources for defense, therefore, has become an increasingly challenging and nuanced endeavor.

At the heart of this defense funding challenge is the imperative to adapt to an evolving security environment. Traditional notions of warfare have been upended by technological advances and asymmetric threats, requiring agile and forward-looking defense strategies. Funding for defense initiatives must therefore not only consider conventional military capabilities, but also address emerging threats in the areas of cyber security, space and information warfare.

The challenge of financing defense extends beyond mere budgetary allocations and includes a comprehensive reassessment of national security priorities. In addition, an ideology is forming around the defense funding sphere that highlights a nation's fiscal constraints and domestic priorities. At a time of economic uncertainty and austerity measures, governments are often forced to make difficult decisions in which resource allocation is considered to plug 'holes' that are identified in certain areas of a state.

A balance needs to be struck between the need to invest in a nation's defense and the demands of social welfare, infrastructure development and the ability to raise economic strength year on year, thus presenting policy makers with a delicate balancing act.

The globalization of security threats has made defense financing a matter of international interest and cooperation.

Initiatives such as defense cooperation agreements, arms control treaties and multilateral security alliances play an increasingly important role in shaping defense financing strategies.

Thus, the challenges posed by defense financing in the current context transcend simple budgetary considerations to encompass a complex interplay of strategic, fiscal and international dynamics. Given the evolution of conflicts and the need for heightened security, there is a need for the wisest allocation of resources which should be guided by the following: foresight, pragmatism and the ability to understand in depth the interconnected nature of contemporary threats that have been brought to the security level, bringing into clearer light the nuances and complexity of financing defense initiatives in the modern world.

## **2. Theoretical and empirical foundations of defense spending amid financial turmoil**

The literature reviewed for the study on "Navigating Financial Turmoil: Strategies For Defense Spending by NATO Alliance States in the 21<sup>st</sup> Century" will delve into several core of themes in cause to provide a comprehensive understanding of how economic crises impact defense spending and strategic will response among NATO countries.

Firstly, it will examine existing research on the economic theories that will explain the relationship between financial stability and military expenditures. Classical economic theories, such as those posited by Keynesian and neoclassical economics, will offer different perspectives on government spending during economic downturns. Keynesian argues for increased public spendings for stimulating economic growth meanwhile neoclassicals advocate for fiscal austerity (Wolf, 2012). Understanding these theories is crucial for analyzing NATO countries defense spending strategies during actual financial turmoil.

Secondly, the literature review will explore empirical studies that document historical trends and patterns in defense spending among NATO member states, in particularly during periods of economical crises. Research in this area often highlights the trade-offs that governments face between maintaining military readiness and addressing pressing economic challenges. For example, studies show that in the time of 2008 global financial crisis, many NATO countries were forced to make cuts to their budgets as part of broader austerity measures. For instance, some of the studies suggested that while countries were cutting defense spendings could provided immediate fiscal relief, it could also lead to reduced military readiness and capability gaps in the long run.

In the end, by reviewing these cases, the study aims to identify common factors that influence defense spending decisions, such as the severity of the economic downturn, political pressures and security threats.

By synthesizing these findings, the literature review will help to formulate a better approach to defense spending that NATO countries can adopt to navigate future financial turmoil effectively.

## **3. Research methodology**

In this article it is essential to adopt a comprehensive and systematic methodology. The methodology employed in this context relies on a multifaced approach that encompasses proactive risk assessment, strategic planning, effective communication and continual monitoring and adaptation.

This kind of comprehensive methodology will enable a through investigation into the strategies employed by NATO alliance states to manage defense spending during periods of financial turmoil.

In the end, continual monitoring and adaptation are integral components of the methodology for addressing financial crises. By regularly assessing the effectiveness of strategies, monitoring key performance metrics, and staying abreast of changing market conditions, organizations can make necessary adjustments and fine-tune their approaches. Flexibility and agility are key in adapting to evolving circumstances and ensuring long-term stability.

## **4. Findings**

### **4.1. Crises in the context of the 21st century**

The current geopolitical landscape of the 21st century is one of tensions and conflicts that continue to escalate and shape current international relations. Today, one of the key areas of concern is the

ever-deepening rivalry and tensions between the three world powers: the United States, China and Russia (Volkov, 2013). This rivalry is since the three countries are trying to assert themselves and dominate from three points of view: economic dominance, military supremacy, global influence in a business context. Thus, developing a complex web of alliances and conflicts that impact on countries around the world.

In the context of regional conflict, the civil wars in the Middle East serve to maintain tensions while aggravating the geopolitical situation.

Within the Middle East, long-standing conflicts stemming from history between Iran, Saudi Arabia and Israel have continued to keep the region unstable and at the same time, these conflicts have managed to influence other actions such as Syria, Yemen and Libya have begun to accede to this type of conflict, eventually leading to the destabilization of peace and the formation of a major humanitarian crisis.

At the same time, these conflicts have mainly served as proxy battlegrounds for external powers, increasingly complicating organization's efforts to keep the peace.

Long-standing tensions in both the Middle East and Eastern Europe have led to the escalation of a civil war in Israel and the Russian-Ukrainian war in the current context.

Despite differences in context and scale, wars and conflicts in the 21st century have several elements in common, conflicts that come from the past (historical conflicts), religious conflicts and not least territorial claims.

An analysis has shown that in the case of the current wars, the Russian-Ukrainian war and the war between the state of Israel and the Hamas group, an asymmetrical power dynamic can be observed, as Russia is for Ukraine, so Israel is for the Hamas group, each of these nations possessing much greater capabilities, military and financial resources than their opponents.

SIPRI's annual report on the growth of defense spending and arms purchases showed a record annual increase of 3.7% year-on-year. According to one of the authors of this report it is exposed that "*Whether the economic situation of countries has been satisfactory or not, the military is benefiting from more financial resources than in previous years*" (Glucroft, 2023).

Reflecting the recent structural deterioration in the global security sphere, more countries are increasing their spending to upgrade and modify their military capabilities.

At the European level, amid growing tensions in the European area over Russia, spending in the security and defense sphere has increased or will increase in the coming years, and one example could be the initiative to increase Sweden's defense budget, which officials say will increase by 45% between 2020 and 2025, while in the Pacific area, in response to threats from China's growing military might, Japan has begun the necessary steps to double its military force by the end of 2027 (Gheorghe, 2019).

#### **4.2. Financing of armaments expenditure at NATO alliance level and at global level**

In the context of escalating tensions in the 21st century and emerging security threats, the financing of defense budgets is of particular importance because it is only through a developed budget that both military systems and military technology can be modernized. Adequate funding and management of defense investment can enable the modernization and advancement of military technology, thus ensuring that armed forces remain agile, adaptable to whatever the situation demands and capable of dealing with evolving threats.

According to a study by the Stockholm International Peace Research Institute (SIPRI), NATO member countries have started to increase their funding for defense equipment since Russia illegally annexed the Ukrainian peninsula of Crimea and supported separatists in eastern Ukraine.

Starting from the intention to arm a nation, military spending is clear, and the mechanism and method of funding, remain challenges for governments of nations. The monetary resources required to be able to arm a state vary, but could be as follows: government borrowing, revenues from the sale of natural resources, increased tax rates.

Each of these possibilities for procuring financial resources comes with several consequences that can ruin a state.

Research on how military spending is financed is scarce and concentrated in debt as one of the main sources of revenue. This may therefore suggest that debt is not always used to finance the defense budget, as its use depends on national or regional characteristics and changing political conditions.

Based on the ideology of policy makers, the use of debt could finance the defense budget, because the need to repay this debt will occur in the future, and government borrowing will become beneficial, from a government policy point of view, because the repayment debt could fall on the future administration.

At the same time, there are several scenarios in which public debt could have consequences or benefits for the country that will request the funds, and these are the following:

- If a country has a sufficiently developed rating, public debt could be an affordable way to finance military spending and could exclude unpopular methods:

- Tax increases.
- Reducing certain expenditures in different sectors.
- Inflationary effects.
- Raising public debt are irrelevant, as the need will be self-imposed at some point. It is found in countries that do not have sufficient tax revenues, and this debt could become an additional method of financing.

- In the case of countries that prefer indebtedness, excessive debt could lead to the destruction, excessive slowdown of the economy and fictitious enrichment of a nation.

According to estimates by the World Bank, the global average of taxation as a percentage of gross domestic product (GDP), known as the tax effort, was 14% in 2020. For countries that are economically developed and are members of the OECD (Organization for Economic Co-operation and Development), the tax effort averaged 34% (Tian, 2023).

### **4.3. Results of defense financing expenditure at NATO alliance level**

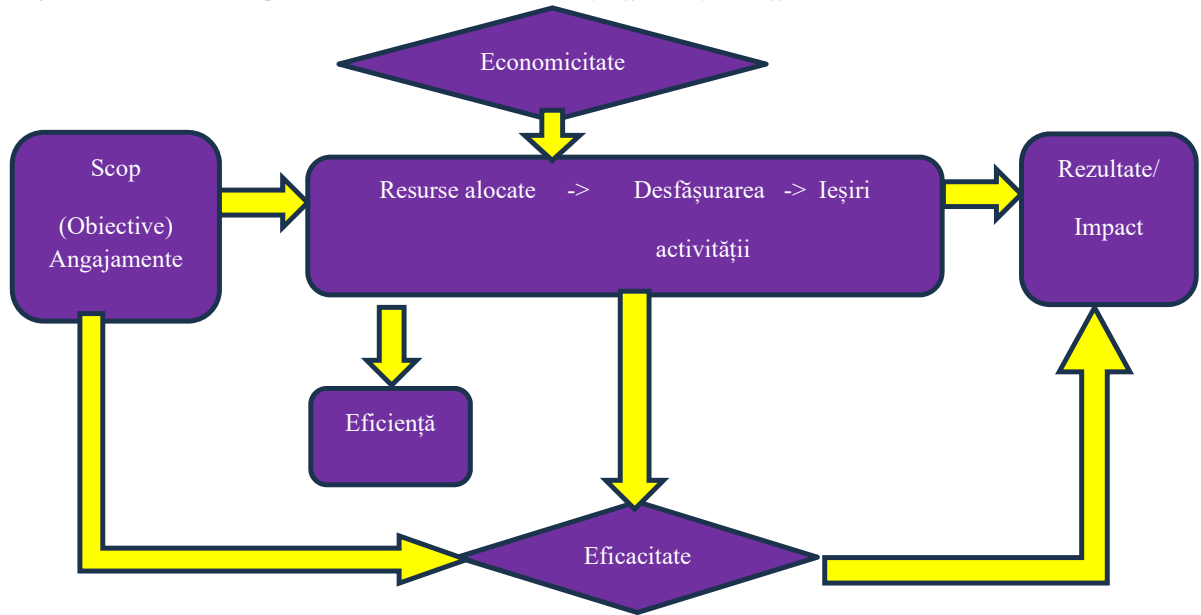
The North Atlantic Treaty Organization (NATO) has been, and still is, a cornerstone of international security since its inception. One of the most essential components of all Alliance operations is the provision of defense funding, which ensures that member countries can collectively address security challenges and maintain deterrence against potential threats.

Starting from the decision-making processes resulting from the specific decisions on the allocation of human resources, both material and financial, public organizations consider the rational selection of optimal options, and through a S.W.O.T. analysis, both the strengths and weaknesses of the decision on the resources to be allocated, the time required and the risks that may occur in the implementation process will emerge.

In situations that are under the managerial aspect, public institutions, even those that are of the logistical support type, have considered both the restrictive resources and those that are aimed at the realization or implementation of the variants at the level of decision-making and work processes. It is therefore appreciated that in public organizations it is mandatory that "in specific management processes, to adopt in performance the obvious elements" that refer to the following decisions:

- Well-founded decisions that refer to work processes, resources such as human, material and financial resources, which are necessary to achieve the objective.
- Well-founded and correlated decisions that involve planning as the main process.
- Decisions that do not include the additional financial efforts of resources that are represented in the budget.

Figure no. 1. Relationship between the three E's (economy, efficiency and effectiveness)



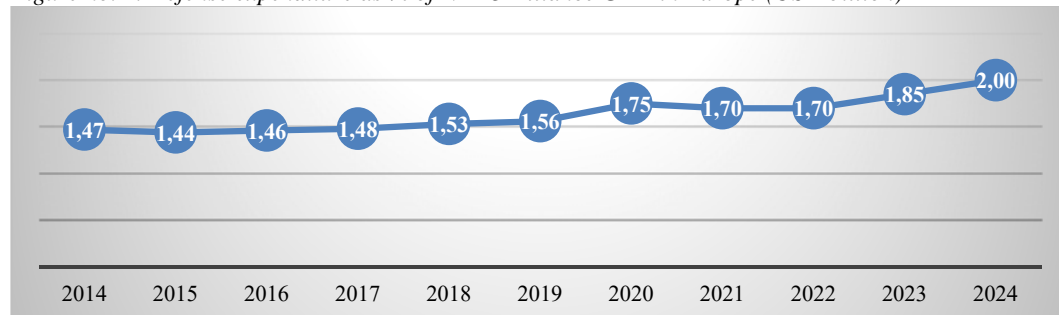
Source: Author's own contribution

Within NATO, defense spending is intended to reflect the Euro-Atlantic organization's commitment to collective defense and to share the burden between member states. In accordance with Article 5 of the North Atlantic Treaty Organization Treaty, the solidarity and mutual support of this alliance is emphasized.

Defense spending is intended to serve as a key indicator for assessing NATO members' commitments to meet defense investment objectives. Following the Wales Summit and Russia's illegal invasion of Crimea in 2014, it was agreed that at least 2% of Gross Domestic Product (GDP), i.e. at least 20% of defense budgets, should be allocated to the procurement of modern military and research equipment.

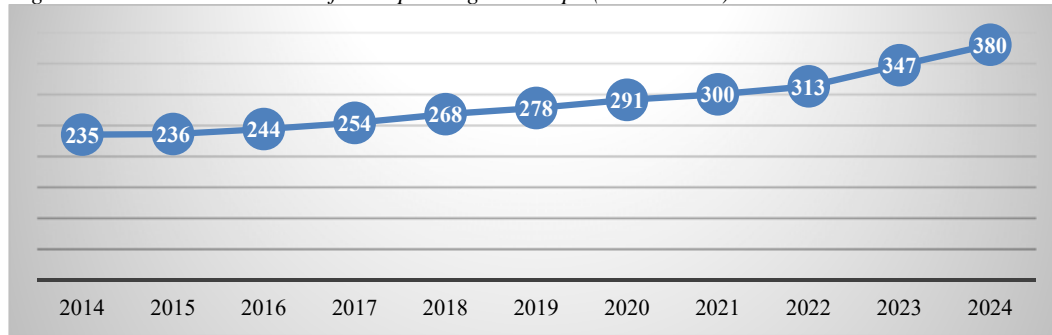
The forecast for the year 2024 is that the 32 countries that are part of the NATO alliance will be able to use 2% of GDP for defense, which for some countries represents a six-fold increase compared to 2014, when only some allies met this standard, and in line with the decisions taken at the Vilnius Summit in Finland, a decision was taken that the new defense investment commitment will be as follows: 20% of defense budgets will be allocated for augmentation, equipment and research programmed. At the same time, over the past decade, "NATO Allies in Europe have steadily increased their collective defense investment - from 1.47% of their combined GDP in 2014 to 2% in 2024, investing a total of \$380 billion in defense" (NATO, 2024).

Figure no. 2. Defense expenditure as % of NATO Alliance GDP in Europe (USD billion)



Source: Author's own contribution

Figure no. 3. NATO Alliance defense spending in Europe (USD billion)



Source: Author's own contribution

The above graphs show the increases in expenditure under commitments that NATO member states have made over the last decade since the start of the conflicts in Eastern Europe and Israel and the escalating tensions in the Pacific Ocean.

It is very clear that economic growth over the last decade has been driven by public spending and accompanied by declines in consumption and investment in security and defense compared to pre-war trends.

Given these concerns about armament and the mobilization of financial resources and their redirection towards defense budgets, a downward trend in economic growth has been observed globally.

A study of six major US wars: World War II, the Korean War, the Vietnam War, the Cold War, and the wars in Afghanistan and Iraq, led to the conclusion that war and its costs negatively affect the national economy, taxes, public debt, inflation, and tax rates end up rising substantially (IEP, 2023).

## 5. Conclusions

Starting from the myth "War is good for the economy", we can conclude that government investment in modern technological industries, education or infrastructure, which could bring financial resources and lead to the development of a state, is replaced by spending on security and defense.

Balancing budgets and peace are therefore a challenge for policy makers, because in most cases the costs of conflict tend to far outweigh the costs of prevention and resolution. Despite this, allocating resources to conflict resolution efforts often enters a competition of urgent priorities such as education, healthcare and infrastructure development.

At the NATO Alliance and global level, international aid and donations end up outstripping the costs of a war, as reconstruction and peacebuilding could play a crucial role and represent a negative impact in terms of finances.

Despite post-conflict efforts, sustainable peacebuilding would remain elusive in many parts of the globe, the long-term economic impact could be felt for generations, hindering development and perpetuating cycles of violence.

So, funding models adopted in the 21st century should not only be adopted for immediate needs, but also for the underlying structural causes of conflict.

The methodology for navigating financial turmoil and implementing crisis management strategies in the XXI century requires a systematic and dynamic approach. By integrating risk assessment, strategic planning, effective communication and ongoing monitoring, organizations can effectively manage crises, safeguard their financial health and thrive in an ever-changing economic landscape.

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