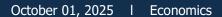
Defence Spending in a Debt-Laden World: Strategic Priorities vs Fiscal Realities





Global military expenditure surged to USD 2.7 trillion in 2024, in nominal terms, accounting for 2.5% of global GDP (Refer to Exhibit 1), marking the sharpest annual increase since the end of the Cold War, at 9.4%. This spike is largely driven by escalating geopolitical tensions and a growing perception of security threats.

NATO members have agreed to increase their defence spending to 3.5% of GDP by 2035. They also aim to allocate an additional 1.5% of GDP to security-related costs, supporting areas like cybersecurity, intelligence, and critical infrastructure. This is an increase from the current 2% target. If fully achieved, this could mean approximately USD 800 billion more spent annually on defence compared to pre-2022 levels, before the Russia-Ukraine conflict began. This rise in military expenditure isn't limited to NATO countries; nations like Japan, Australia, and Israel have also committed to boosting their defence budgets.

Global public debt reached approximately USD 100 trillion in 2024, equivalent to 92% of global GDP. According to the International Monetary Fund, this figure is projected to grow by 2.8% in 2025 and could surpass 100% of global GDP by the end of the decade. Against this backdrop, the surge in defence spending presents a fiscal dilemma—particularly for countries already burdened with high levels of debt. With aging populations and rising borrowing costs, fiscal policy faces a critical trade-off between meeting spending demands and pursuing debt reduction. As tax increases and spending cuts remain politically unpopular across much of the world, the rise in defence budgets is likely to be financed through additional borrowing.

The economic impact of increased military spending is mixed. For countries making substantial investments in domestic industrial capabilities, it could positively contribute to GDP growth. However, in others, the rise in government spending may have a minimal effect on overall economic performance.



Source: SIPRI, World Bank



Recent Trends in Military Spending

Rising geopolitical tensions, increasing security threats, de-globalization, and a stronger emphasis on defence self-reliance have collectively driven a surge in global defence spending. On an absolute basis, the United States, China, Russia, Germany, and India are the top five military spenders (Refer to Exhibit 2), collectively accounting for approximately 60% of global defence expenditure. The table below outlines the top military spenders across regions, along with the key drivers behind their defence expenditure.

Table 1: Region-Wise Top Defence Spenders

Region	Country	Defence Spending (%GDP)	Defence Spending (% General Government Spending)	Key Drivers /Notes
Americas	Colombia	3.4%	10.0%	Internal Conflicts, Narcotics Control, and Regional Stability
	Ecuador	2.2%	5.5%	Narcotics Control, Shared Borders
	USA	3.4%	9.1%	Global Security Commitments, Global Power Protection, Counter-terrorism
Asia & Oceania	China	1.7%	11.4%	Military Modernisation, Regional Tensions
	Japan	1.4%	2.7%	Regional Threats, Defence Policy Shifts
	India	2.3%	10.5%	Regional Threats, Military Modernisation
	South Korea	2.6%	13.5%	North Korea Threat, Strategic Autonomy
Africa	Algeria	8.0%	12.1%	Regional Security Risks, Tensions with Morocco
	Morocco	3.5%	10.7%	Regional Security Risks, Border Security, Strategic Partnership with the U.S. and the EU, Receiving Military Aid and Training
	Botswana	2.8%	8.0%	Internal Security, Focus on Peacekeeping Contributions
Europe	Germany	1.9%	3.9%	NATO commitments and European security, Military Modernisation
	Poland	4.2%	8.5%	High threat perception from Russia, Rapid modernisation, Frontline NATO member
	France	2.1%	3.6%	Geopolitical threats, Meeting NATO Requirements
	Greece	3.1%	6.6%	Tensions with Turkey and Cyprus, Proximity to Unstable Regions (Middle East)
Middle-East	Israel	8.8%	20.0%	Active Military Conflicts- Israel, Syria, Lebanon, etc., Geopolitical Instability
	Saudi Arabia	7.3%	22.3%	Regional Security Risks- Tensions with Iran and its proxies, Situation in Yemen

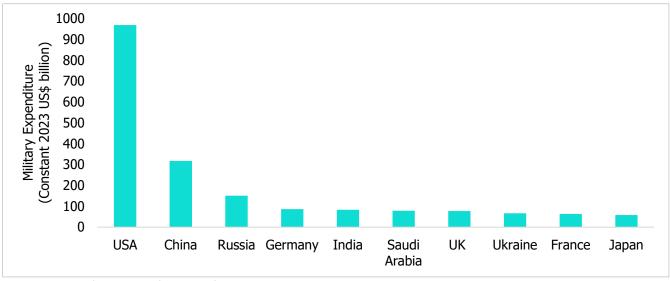


Key Highlights

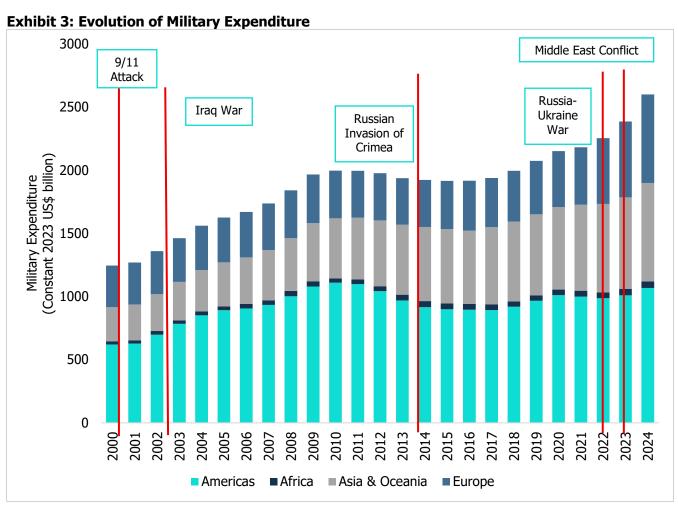
- Since 2001, the U.S. has remained the world's largest defence spender, with a 2024 budget of USD 947 billion. In Latin America, Colombia leads in relative terms. The Americas still hold the largest share of global spending at 39% in 2024, though down from 46% in 2020. (Refer to Exhibit 4).
- Driven by the Russia-Ukraine war, Europe's defence spending grew at a 10% CAGR between 2020 and 2024 (Refer to Exhibit 4), raising its global share from 19% to 25% (Refer to Exhibit 4). Poland (4.7% of GDP) and Greece (3.1% of GDP) lead in relative defence spending. Germany has seen the largest absolute increase, with a 7.9% CAGR in 2024, though its defence spending remains modest in relative terms to GDP (1.9%) and general government expenditure.
- In Asia and Oceania, defence spending has steadily risen since the early 2000s, driven by China's military modernisation, North Korea's nuclear threat, and territorial disputes. Despite a 3.3% CAGR, the region's global defence share declined from 25% (2020) to 23% (2024) (Refer to Exhibit 4)
- China's military spending grew 12% annually (2000–2009), now moderating to ~7% per year. Despite its scale, it remains modest in relation to GDP (1.7%) but high in terms of government spending (11.4%). India's (2.3% of GDP) and South Korea's (2.7% of GDP) high defence spending is mainly driven by regional threats and military modernisation.
- Japan saw a 21% jump in 2024—its largest increase since 1952—raising defence spending to 1.4% of GDP, a 66-year high.
- In Africa, while internal conflicts maintain elevated military outlays, regional trends have diverged. Northern African economies, such as Morocco, have seen a significant rise. In contrast, sub-Saharan Africa has seen a slight decrease in overall military spending, largely due to budget cuts in countries such as South Africa, Nigeria, and Ethiopia.
- Morocco and Botswana are Africa's key defence players with respect to GDP and government spending. The share of Africa in global military spending has remained unchanged at 1.9% between 2020 and 2024 (Refer to Exhibit 4).
- Persistent instability and the Israel-Hamas conflict have spurred further military spending in the Middle East. Israel and Saudi Arabia remain the region's top spenders. With respect to its share in global defence spending, the Middle East's share rose to 9.1% in 2024 from 8.3% in 2020 (Refer to Exhibit 4).
- In essence, a convergence in military expenditure trends has emerged across regions, particularly in the post-pandemic era (Refer to Exhibit 3). While Europe's share in global defence spending has surged, Asia and the Americas have seen relative declines (Refer to Exhibits 4 & 5).



Exhibit 2: Military Expenditure - Top 10 Countries



Source: SIPRI Military Expenditure Database, Apr. 2025



Source: SIPRI Military Expenditure Database, Apr. 2025



Exhibit 4: Share of Regions in Global Defence Spending

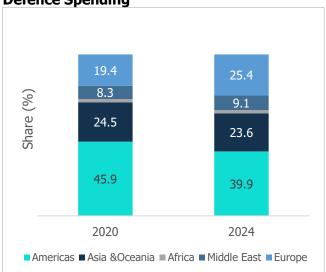
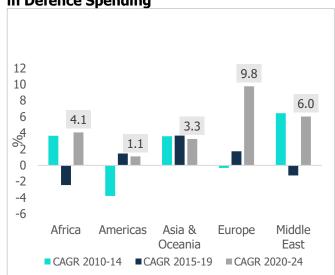


Exhibit 5: Europe Sees Highest Rise in Defence Spending



Source: SIPRI Military Expenditure Database, Apr. 2025

The Challenges and Opportunities with Europe Accelerating Defence

Escalating geopolitical tensions and diverging interests with the United States have prompted a notable rise in defence spending across Europe. In 2024, the region spent approximately USD 681 billion on military expenditures in real terms, representing an unprecedented 17% (YoY) increase. Both individual countries and the European Union have committed to raise defence budgets to meet the NATO target of 3.5% of GDP by 2035 from the current 2% target. However, the European defence sector faces deep-rooted structural challenges, including overregulation, chronic underinvestment driven by prioritization of social spending, and political fragmentation.

Years of insufficient public defence investment and heavy reliance on the U.S. security umbrella have created significant capability gaps (Refer to Exhibit 6). Moreover, Europe's defence spending in 2024 was primarily directed toward current expenditures, such as salaries and wages of military personnel, rather than capability enhancement. Spending on military equipment accounted for only 15% of total defence expenditures, falling short of NATO's 20% target. Between 2020 and 2024, approximately 64% of defence procurement by European NATO members originated from the United States. Europe's defence industry remains fragmented, dominated by small, nationally focused players, which limits the potential for large-scale production and innovation. In contrast, the U.S. and China have outpaced Europe in defence-related technological advancements (Refer to Exhibit 7).

A key challenge lies in diverging national approaches to defence spending. Germany, France, and Greece's military spending was close to NATO's target of 2% in 2024, while Italy, Portugal, and Spain remained below this target (Refer to Exhibit 8). Germany has eased borrowing constraints to meet rising defence needs by amending its debt brake law to exempt military expenditures above 1% of GDP from borrowing limits and creating a separate EUR 500 billion infrastructure fund. Spain, on the other hand, has taken a more cautious approach, citing economic and political concerns.

Access to private financing for EU defence firms also remains limited, hampered by a lack of depth and liquidity in capital markets vis-à-vis their US counterparts. Additionally, a complex regulatory environment also deters investment in defence-related activities.



Despite these headwinds, Europe has taken meaningful steps to strengthen its defence capabilities. Initiatives such as the European Readiness Plan 2030, the Security Action for Europe (SAFE) plan, the establishment of the European Defence Fund, and the Defence Omnibus Simplification policy signal a more strategic approach to bolstering collective defence. While the technological gap with global peers persists, strategic partnerships with countries like Ukraine—where AI-driven defence technologies have recently been adopted—alongside cooperation with Israel and Türkiye, are expected to accelerate modernisation efforts. Europe is also home to several world-class defence firms—five of the world's 20 largest defence companies are European, with the potential to scale up production.

Europe stands at a critical inflexion point. Its ability to ensure long-term security will depend on its capacity to balance multiple priorities: strengthening historic alliances, deepening defence integration, and embracing emerging technologies.

Exhibit 6: European Union Military Expenditure (SD Billions) in 2023



Exhibit 8: Defence Expenditure (%GDP) of Selected European Economies



Source: NATO

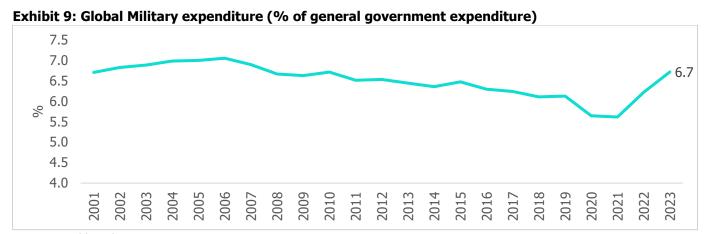


Rising Defence Budgets Reduce Fiscal Flexibility

The global public debt reached approximately USD 100 trillion (92% of global GDP) in 2024 and continues to rise rapidly due to a sluggish recovery in growth and the aftermath of pandemic-related fiscal support. Approximately two-thirds of the world's economies now have a higher public debt burden than they did before the pandemic. Notably, global public debt is expected to surpass its pandemic-peak by 2030, reaching 100% of global debt. Furthermore, rising borrowing costs and elevated social expenditures resulting from demographic pressures remain constraints. In this context, increasing military spending further complicates the fiscal landscape. Global military expenditures accounted for 6.7% of total general government spending in 2023, up from 6.2% the previous year (Refer to Exhibit 9). With current policy priorities increasingly oriented toward defence, this share is expected to rise further.

Among the countries in our coverage universe, nations such as Greece, the U.S., France, Portugal, Italy, Spain, the UK, Brazil and Canada face limited fiscal space for increased military spending due to already elevated debt levels. Their high tax-to-GDP ratios further constrain the scope for raising additional revenue through taxation. Notably, the United States, with its high military spending, faces conflicting objectives due to an elevated interest payment burden. The combination of increased defence expenditure and rising interest rates presents challenges in balancing fiscal priorities. While Singapore's gross government debt to GDP ratio is very high, the government is estimated to have limited or no net debt as a result of its large investments thus providing enough fiscal space for its high military expenditure. Overall, countries with lower debt levels have more room for fiscal manoeuvre. (Refer to Exhibit 10)

In China, official debt figures exclude augmented liabilities, potentially understating fiscal constraints. India faces a challenge due to its relatively low general government spending—27% of GDP in 2024—compared to the emerging market average of 31% and the advanced economy average of 40%, which limits its capacity for substantial increases in defence expenditure. Secondly, India's high debt-to-GDP ratio of 81% further constrains its fiscal space. In contrast, countries like Sweden, Botswana, Philippines, Mexico, Indonesia and Australia which maintain low levels of general government debt, possess greater fiscal flexibility to expand defence expenditure. South Africa, Germany, and Morocco's moderate debt levels provide them with some fiscal flexibility. Germany's low borrowing costs also acts as an added advantage. Colombia, Chile, and South Korea already have relatively high defence expenditure, but their moderate debt levels offer some fiscal buffers. Although countries like Ecuador, Bangladesh, and Nigeria have relatively low debt levels, their limited access to finance significantly constrains their fiscal capacity. (Refer to Exhibit 10)



Source: World Bank



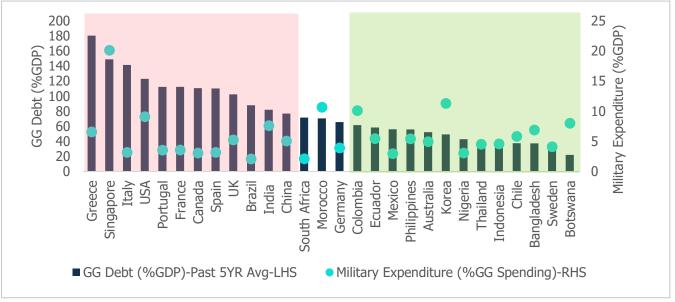


Exhibit 10: Countries with high debt have low fiscal space for extra military spending

Source: SIPRI, IMF, CGIL

Additionally, the way these rising budgets are financed carries important long-term implications. Broadly, three main approaches are used:

- 1. Increasing Taxes- Rising defence spending can be financed through higher taxes, which may have a moderate impact on overall debt levels. However, increased taxation could dampen private sector spending and potentially hinder economic growth. Additionally, most advanced economies already have a high tax-to-GDP ratio, leaving limited room for further tax increases. Conversely, emerging economies face low GDP per capita, which constrains their ability to increase tax revenues.
- 2. **Debt-Financed Defence-** Financing defence through increased borrowing—whether on-budget or off-budget—can lead to long-term fiscal vulnerabilities. Off-budget borrowing, in particular, often lacks transparency and accountability. Historically, many nations have relied on borrowing to meet rising military expenditures, notably during periods such as World War II and the Cold War, which contributed to elevated debt burdens. For instance, Sweden's Parliament has approved additional borrowing of SEK 300 billion (approximately USD 31 billion) to increase the military budget to 3.5% of GDP by 2032, from its current level of 2%. Germany plans to allocate up to 1% of its GDP to defence spending, with the remainder (2.5% of GDP) to be financed through off-budget borrowing mechanisms.
- **3. Reallocation from Other Public Spending-** Governments may also prioritise defence by reallocating funds from other sectors, such as education, healthcare, or infrastructure. This crowding out of critical social and economic investments can hinder long-term development and growth. For example, the UK's commitment to increase military spending has involved reductions in international aid.

Ultimately, the method of financing defence budgets plays a crucial role in shaping a country's fiscal sustainability and broader economic outcomes over time.

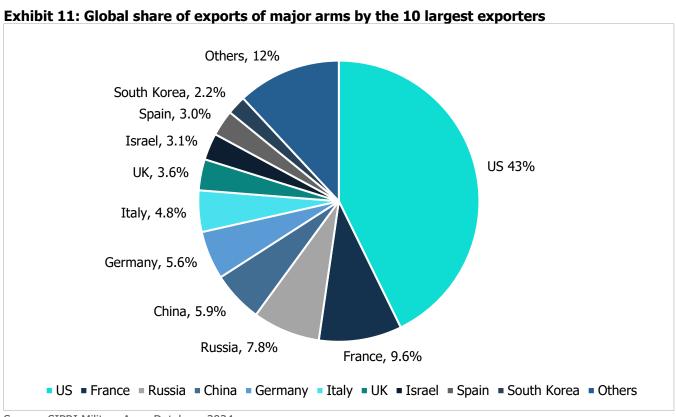


The Economic Impact of Rising Defence Budget

The economic multiplier effect of increased defence expenditure hinges on whether countries strengthen their domestic industrial and research and development (R&D) capabilities rather than importing defence goods. Investing in homegrown production and innovation can yield positive spillovers into the private sector, enhancing broader economic growth. For instance, Germany is shifting toward a more expansive fiscal stance through higher defence spending, which is expected to reflect in rising economic growth. The European Commission estimates a 0.75% to 1.25% increase in economic growth by 2035.

Meanwhile, countries with established arms industries—such as the U.S., France, Russia, and China—are well-positioned to leverage rising global defence demand through exports, thereby boosting their economic growth (Refer to Exhibit 11). Emerging economies with developing defence sectors offer insightful examples. India's defence exports have surged dramatically, rising from about Rs 686 crore in 2013-14 to Rs 23,622 crore (≈USD 2.76 billion) in 2024-25, a 34-fold increase that positions India among the top 25 global arms exporters. This growth reflects coherent policy action with streamlined export procedures, enhanced private sector engagement, FDI reforms, and strategic investment in R&D.

In contrast, countries lacking in-house defence capabilities and relying heavily on imports are less likely to experience meaningful growth from elevated defence spending.



Source: SIPRI Military Arms Database 2024



Conclusion

One of the defining global trends in the post-COVID era is the sharp increase in defence spending, driven by escalating geopolitical tensions and renewed commitments to national security and allied support. Notably, within defence budgets, there is a clear shift away from current expenditures toward military modernisation and capacity building.

While all regions have experienced consistent growth in military spending, the increases in Europe and the Middle East have been particularly pronounced. Europe's rapid rise in defence expenditures presents both significant opportunities and challenges for the continent.

Given that many countries already have fragile debt situations and rising debt-servicing costs, governments face the difficult task of balancing defence priorities with other fiscal objectives. A sustained shift toward prioritizing defence spending carries long-term implications for sovereign debt levels and economic growth. For instance, research indicates that military spending exceeding 3% of GDP has negative implications for both debt and economic growth (Abbasov, 2024). Although we believe the immediate impact on sovereign credit ratings may be limited, the evolving fiscal dynamics driven by increased defence outlays remain a critical factor to monitor.

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