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Drivers of Greek and Turkish Defense Spending

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Abstract

This paper evaluates the factors responsible for maintaining substantial military expenditures in Greece and Turkey. The presented research encompasses theoretical and empirical aspects. First, defense spending by both countries was analyzed based on statistical data from international sources. Next, the theoretical determinants of budgetary spending are reviewed, which consider political, economic and military factors behind high expenditures on the army in Greece and in Turkey. Finally, Granger causality tests is applied to determine whether a causal relation between variables exists in the case of these two countries.

We conclude that defense expenditures in Greece and Turkey exceed the NATO average, but are relatively low relative to those of selected Middle Eastern countries. Our results indicate that high military spending level in Turkey is mainly driven by national security concerns, whereas an economic driver prevails in Greece.

Keywords: defense spending, national security, economy, driver

JEL: E62, F52, H56

Introduction

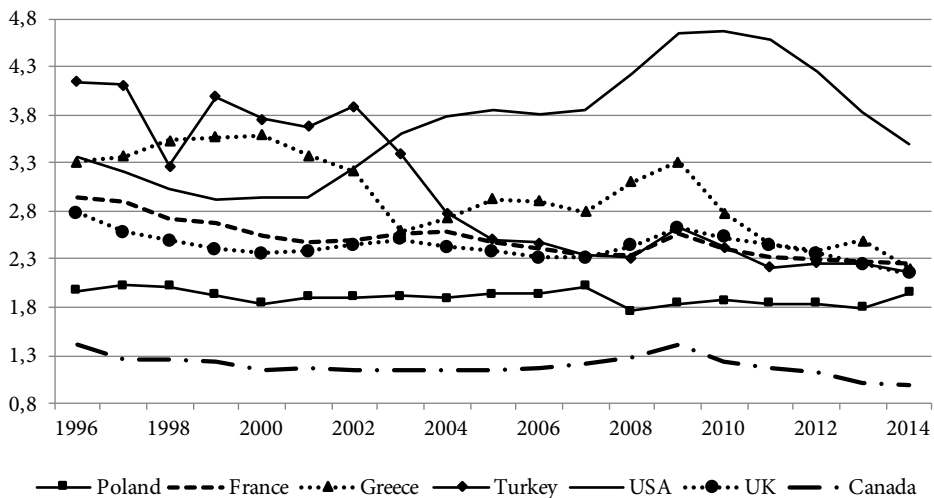
Many NATO member states tried to curb their national defense spending following the last crisis and consequent austerity programs. Among the few economies that still spend more than 2% of GDP on the army are Greece and Turkey, although these countries are neither the wealthiest nor the most resistant to economic and financial turbulence. It is therefore important to better understand what factors drive military spending decisions in Greece and Turkey.

The paper is organized as follows: first, trends in Turkish and Greek military spending are presented along with the literature explaining those trends, next, an empirical analysis of factors contributing to military outlays in both economies is presented, finally, some implications for both national economies are discussed.

Greek and Turkish Defense Expenditures from an International Perspective

Allied states in NATO are required to spend at least 2% of GDP on their defense sector every year. However, the failure to fulfill this requirement does not carry severe consequences within the alliance, which leaves actual levels of military mainly dependent on the economic situation then existing in each member state's economy. Both Greece and Turkey have met the 2% GDP threshold every year, regardless of their economic performance (Figure 1). Greece has been struggling with major structural imbalances for several years, while continuing to exceed its 2% of GDP target. Indeed, if Greece had simply met that target, within the period 1974–2010, it could have saved 108.1 billion euros in constant 2005 prices, and this way the country could diminished the debt. [Chrysogelos, 2012]. Similarly, despite Turkey's economic crisis in 2001 and the austerity measures that followed (including disinflation and reduced public debt), its military outlays also exceeded the NATO GDP requirement.

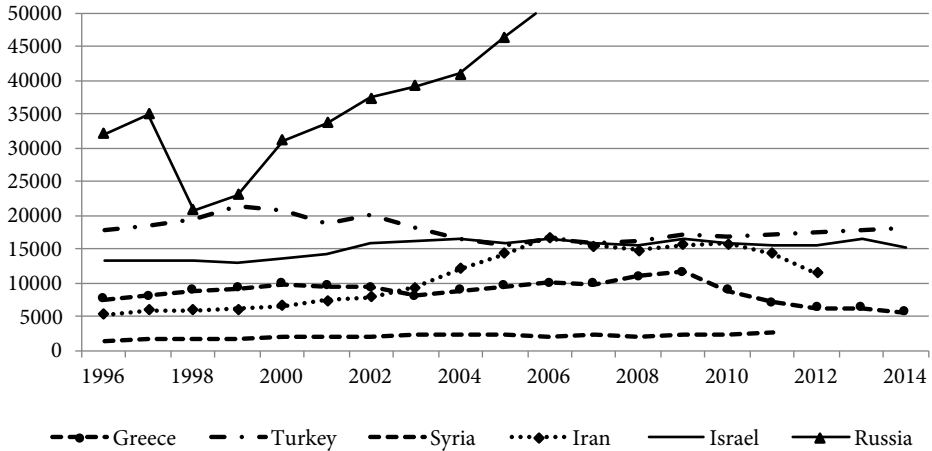
FIGURE 1. Military expenditures in NATO; 1996–2014 (% GDP)



Source: own elaboration based on SIPRI² statistics.

Figure two presents military spending in Iran, Syria and Russia,, which substantially exceeded that of Turkey and Greece, relative to GDP.

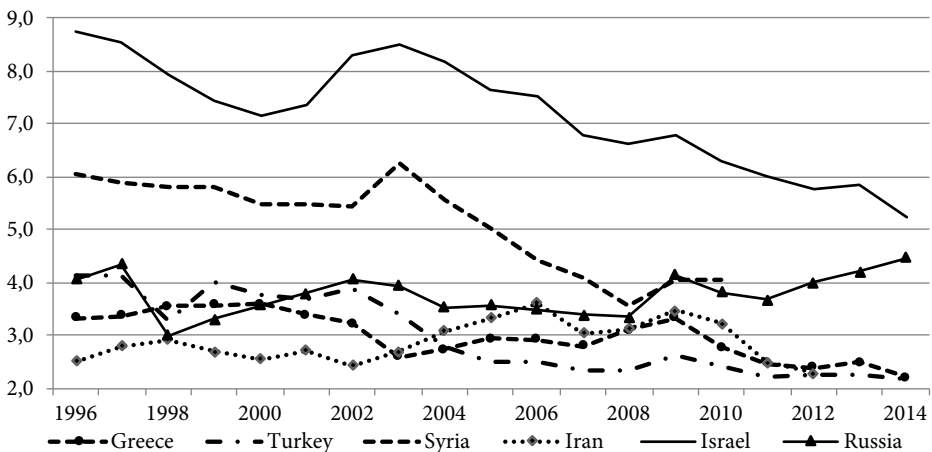
FIGURE 2. Defense expenditures³ in selected countries, 1996–2014 (USD million, constant price, 2011)



Source: own elaboration based on SIPRI statistics.

Thus, Greece and Turkey’s military spending as a percentage of GDP is high for NATO but relatively low for the region (Figure 3).

FIGURE 3. Defense expenses in the region in 1996–2014 [%GDP]



Source: own elaboration based on SIPRI Statistics.

The analysis of Greece and Turkey's structural distribution of military procurement spending helps to explain high spending levels (Table 1).

TABLE 1. Distribution of defense costs in Greece and Turkey in 2000–2014
(% of total, average in selected terms)

Economy Year Costs of:	Greece			Turkey		
	2000–2004	2005–2009	2010–2014	2000–2004	2005–2009	2010–2014
Personnel	68.9	71.2	73.1	46.1	50.0	54.1
Equipment	12.3	16.1	9.5	32.6	28.5	25.0
Other	16.4	10.5	15.4	15.7	18.2	17.7

Source: NATO⁴ data.

When comparing Greece and Turkey, there is a major difference in the share of funds spent on personnel and equipment purchasing. Greece concentrates on personnel (expenditures on military and civilian employees), whereas, Turkey strains to maintain army's modern weaponry – investing more than 25% of its budget on armament purchases, armament research, and armament development, which then flows into manufacturing new military weapons systems and equipment.

In summary, Greek and Turkish defense spending have been high relative to other NATO members in the last decade, but below average for the region. Therefore, regional threats seem to impact military expenditures levels more in these two NATO states than alliance's requirement.

Determinants of National Defense Outlays in Theory

Literature on the theoretical factors affecting national defense spending employ various models and distinct theories (e.g. public choice, arms race, opportunity costs etc.), which analyze this issue from different perspectives. Nonetheless, all drivers explaining demand for national defense expenses can be segmented in three groups: economic, political and military (Table 2).

The most important factor affecting national defense spending levels involves economic potential (capability). The state faces many priorities that need to be addressed simultaneously. Thus, when fiscal revenues decrease, authorities are forced to cut expenses or collect higher taxes. Mostly politicians are more prone to reduce costs, including military costs. Some economists say that one crucial area where cutbacks should occur during economic recession is the defense sector, based on an association of low productivity with military outlays, the resulting opportunity costs, as well as limiting a country's ability to boost

economic growth. Where economic recession does not reduce military expenditure levels, a country may be placing political decisions over economic ones.

TABLE 2. Drivers influencing demand for defense expenses

		Groups of drivers		
		ECONOMIC	POLITICAL (security)	MILITARY – STRATEGIC
DRIVERS	Economic growth	Ideology and form of governance	International alliances	
	Budgetary deficit	Arms industry lobby	Arms race	
	Public debt	Various lobbyist groups	Strength of national army	
	Export net	Bureaucracy	Strength of rival armies	
	Inflation	National security	Rivals' defense outlays	

Source: own elaboration based on the available publications.

Politics – and political instability – as a military spending driver can result from numerous factors, including ideology, government policies, special business groups (i.e. the arms industry) trying to influence authorities, as well as perceived need to address international threats. National security is susceptible to unexpected, one-time, or durational brief internal or external events that impact the domestic economic or social situation [Rakesh, 2012]. For that reason, the group of political factors cannot be narrowed to purely politically planned actions, but should account for threats to security. This approach to decisions regarding national security gained recognition as a defense spending factor in the last decade [Minor, 2003; Nordhause, 2009].

Military (strategic) factors also play a role in the contemporary scale of defense expenditures. Alliance requirements and arms races⁵ (races of expenses) among potential rivals also contribute to those spending. According to Smith [1989], factors impacting military expenditures can be divided into domestic and foreign. Supranational impetus can include a membership in an alliance, such as NATO, which expects members to contribute a specified share linked to their GDP level. The strength and military spending of rival armies are largely uncontrollable by other states. National security spending may also be affected by terrorism and conflicts in neighboring states.

To sum up, besides economic drivers, national security is a crucial stimulus of military expenses, especially in states vulnerable to such perils as ethnic conflicts, civil war, terrorism and cyber-attack. The sense of insecurity is probably the most important political factor since it combines threats from domestic and supranational sources.

The Economic and Political Situation in Greece and Turkey as Determinants of Defense Expenses

Taking into consideration both territory, populace and aggregated wealth, Greece is smaller than Turkey. Nevertheless, in GDP per capita, Greece ranks higher and is more competitive than Turkey (Table 3) ⁶, and exhibits lower income inequality.

Since the 1990s. Greece has sought to fulfill the convergence criteria and in 2001 Greece became a member of European Monetary Union (EMU). Adoption of a common currency allowed Greece to import high financial credibility from Eurozone economies and borrow capital abroad at a cheap rate. At the same time, capital flowing from the EMU created the image of stable economy since banking sector is not willing to transfer money to politically unstable places [Rajan, Zingales, 2003].

Greece's high defense expenditures partially support the state's perceived stability, as typically a well-financed army provides citizens (investors) with a higher sense of security, what encourages capital accumulation, investment and production [Thompson, 1974]. Consequently, in Greece higher military spending should stimulate investment.

TABLE 3. Macroeconomic situation. Greece and Turkey in 1996–2014

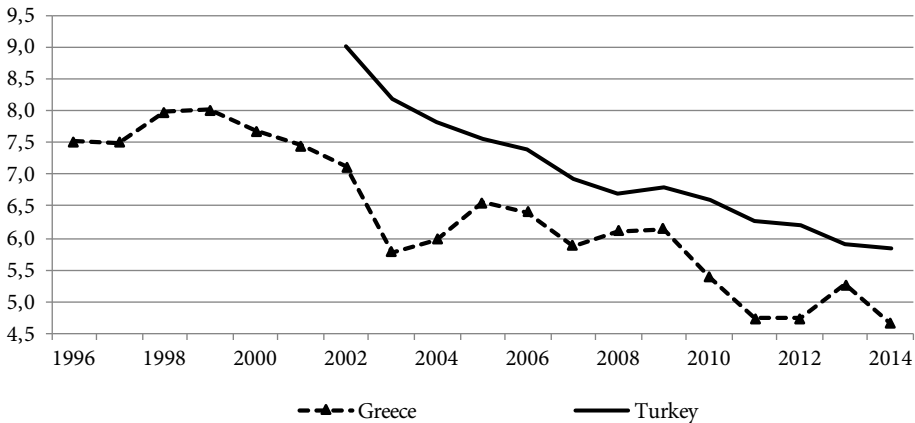
Indicant	Economy		GREECE					
	1996	1998	2000	2004	2007	2009	2011	2014
GDP per capita PPS [EU28=100]	..	..	..	96	92	95	77	73
Unemployment [%]	10.7	11.1	11.2	10.6	8.3	9.6	17.9	26.5
Long term interest rate [%]	..	8.48	6.11	4.26	4.5	5.17	15.75	6.93
G. Government Debt [%GDP]	101.2	97.2	104.4	102.7	103.1	126.7	172	178
Inflation CPI [%]	7.9	5.4	3.2	2.9	2.9	1.2	3.3	-1.3
Current Account [%GDP]	-4.6	-2.8	-7.8	-5.8	-14.4	-12.4	-10.1	-2.1
	TURKEY							
GDP per capita PPS [EU28=100]	..	..	..	39	44	45	51	53
Unemployment [%]	7.1	7.3	6.9	10.6	9.1	13.0	9.1	9.9
Long term interest rate [%]	135.2	122.5	37.7	18.3	16.9	12.9	9.3	7.8 ⁷
G. Government Debt [%GDP]	49	45.9	43 ⁸	59.3	39.9	46.3	39.3	68.9
Inflation CPI [%]	80.4	84.6	54.9	8.6	8.8	6.3	6.5	8.9
Current Account [%GDP]	-1.0	0.9	-3.7	-3.6	-5.7	-1.9	-9.6	-5.8

Source: OECD Statistics; Eurostat database; Creel, Kamber [2004].

Building economic stability required compliance with European budgetary rules (Maastricht, Stability and Growth Pact) in Greece. These obligations limited unrestricted

fiscal spending including military spending. Thus, convergence requirements restricted the Greek government ability to fund military spending, kept on decreasing since the middle of 1990s. (Figure 4).

FIGURE 4. Military expenditures as a share of budgetary spending (%) in Greece and Turkey in 1996–2014



Source: own elaboration based on: SIPRI Statistics.

Until the 2008 financial crisis sovereign debt capital financing flowing from other European countries funded defense Greece's outlays, including foreign arms acquisitions. In subsequent years Greece faced bankruptcy. Presently, Greece is straining to balance its budget, yet defense spending remain high despite being reduced by 28.9% in real terms (2009–2011). Greece has been facing the dilemma “guns or butter” for decades or, in other words, how to meet the dual objectives of fiscal consolidation and ensure national security [Dokos, Kollias, 2013, p. 1].

The Turkish economy has improved since 2000 [Turkey, 2014] and became more business friendly.⁹ However, high uncertainty at regional level still causes foreign investors to shy away from its markets. The government has significant control over the national economy being a source of political risk. Its decisions caused a crisis in 2001, in the aftermath of the adoption of floating exchange rate. The resulting turbulence showed how dangerous some government policies can be to domestic banks, as the fiscal costs of a banking sector bailout amounted to roughly 18.2% of Turkey's GDP in 2000 [Burnside, 2003]. That crisis led to a high level of public debt (above 73% of GDP in 2002), which was reduced to 40% in 2007. Ultimately, the Turkish government teamed inflation, halved sovereign debt and restarted economic development.

At the same time, Turkey's aspiration to play a dominant regional leader role began surfacing. Like Greece, Turkey spends substantial amounts on arms, which influences its current account deficit. According to Trends [2013, 2014] in 2010–2014 Turkey was one of the world biggest importer of weapons (3%) ranked second among EU buyers in the Middle East region. In 2009–2013 Greece ranked third in that category, purchasing large supplies from Germany (8%), though defense acquisitions declined during the fiscal crisis.

Defense expenditures in both countries are impacted by political factors flowing from their strategic location in an unstable region [Veremis, 1980], as well as their own mutual unsolved dispute [Kollias, 1996]. Ending the military dictatorship in Greece (1967–1974) coincided with an escalation of the conflict between Greece and Turkey over Cyprus,¹⁰ which inspired a coup against the President of Cyprus whose policy was unacceptable to military authorities in Athens.¹¹ In response, Turkey annexed a third that island's territory and still control this area. The lack of a clear resolution over Cyprus is often used as an argument why the Greek army needs to maintain the balance of power with Turkey. Moreover, Greece, which maintains sovereignty over more than one thousand small islands, requires strenuous border control given the recent refugee crisis [Teixeira, Pinto, 2012].

Turkey's national security threats originated from internal and external sources. According to Özsoy [2008] three factors preclude reducing Turkish military expenses; first, its borders with neighbors (Greece, Iraq, Iran, Syria); second, domestic ethnic diversity and social inequality¹² (including large a Kurdish population with its Kurdistan Communist Party Kurdish that is active in South-Eastern Turkey and seeks a separate socialist state through terrorism); and third, its policy of “zero problems with neighbors” [Davutoğlu, 2012, p. 3] which was designed to provide regional leadership but turned out to unrealistic.

Overall, Greek military spending limits are mostly macroeconomic and financial, and Turkey's defense spending is a function of the sense of insecurity (from inside and outside the country), funded by a relatively strong economy.

The Causes of Military Spending – Empirical Test

Author considered three variables for each economy.¹³ The independent variables included economic, political and military factors; however, one of them was also a dependent variable. The independent variable – military expenses (EXP), expressed in constant prices (2005) in million US dollars – originated from SIPRI databases. There is used rival EXP to determine the impact on spending tendencies in the second country. In other words, Turkish military expenses in models analyzing determinants of Greek expenditures on defense present an explanatory variable, whereas Greek outlays on its army epitomize an explanatory variable during testing drivers of Turkish military costs. Another independent variable is gross domestic product (GDP) in constant prices (2011) per capita (data obtained from Federal Reserve Economic Statistics).

The political factor depicted by the level of national security (NS) measured by indicant *Political Stability and Absence of Violence*¹⁴ – was obtained from the Worldwide Governance Indicators of World Bank. The time period of the analysis encompasses the years 1996–2014.

To verify causality between variables, the Granger causality test was applied. First, to eliminate a spurious regression, test ADF was used to check data stationarity (AIC criteria, 7 lags).

TABLE 4. Unit root test

	Greece	Turkey
	EXP	
τ	-7.633	-3.278
P_{value}	0.0168 **	0.0812*
	GDP	
τ	-2.433	-2.864
P_{value}	0.0297 **	0.0637 *
	NS	
τ	-3.010	-4.137
P_{value}	0.0949 *	0.0004 ***

Note: significance level: *10%; **5%; ***1%.

Source: own calculations.

All time series turned out to be stationary; however, NS for Turkey reached it in the first difference. To catch the significance of selected variables, two models for each economy were employed – model 1 (year lag), model 2 (1 and 2 year lag).

TABLE 5. Results of Granger test

	Model I: 1997–2014 (N = 18) (Y): GreeceEXP Lag = 1			
	<i>Coefficient</i>	<i>Standard error</i>	<i>t-Student</i>	<i>P value</i>
TurkeyEXP	0.420075	0.21488	1.9549	0.0709*
GreeceNS_1	76.727	18.5152	4.1440	0.0010***
GreeceGDP_1	0.55682	0.133046	4.1852	0.0009***
	(Y): TurkeyEXP			
TurkeyGDP	-0.83221	0.240845	-3.4554	0.0035***
TurkeyNS_1	-161.023	50.9023	-3.1634	0.0064***

Model II: 1998–2014 (N = 17)				
(Y): GreeceEXP Lag = 2				
	<i>Coefficient</i>	<i>Standard error</i>	<i>t-Student</i>	<i>P value</i>
GreeceEXP_2	-0.482961	0.17319	-2.7886	0.0176**
GreeceGDP	-1.2036	0.378314	-3.1815	0.0087***
GreeceGDP_1	1.25612	0.348046	3.6091	0.0041***
GreeceNS	77.9502	30.4953	2.5561	0.0267**
GreeceNS_2	141.695	30.2641	4.6819	0.0007***
(Y): TurkeyEXP				
TurkeyNS_2	-198.286	40.8847	-4.8499	0.0003***
TurkeyGDP	-1.56745	0.441931	-3.5468	0.0036***
TurkeyGDP_2	1.10269	0.483684	2.2798	0.0401**

Note: significance level: *10%; **5%; ***1%.

Source: own calculations.

Based on the significance level, for Greece, the most important determinant of military spending is economic growth, national security and Turkish expenditures on defense. For Turkey the main driver is national security and economic conditions, while Turkish expenditures on its army are unaffected by Greek outlays.

TABLE 6. Test cointegration – Granger test [p_{value}]

	I model	II model
Greece	0.0086***	6.51e-06***
Turkey	0.0030***	0.0308**

Note: significance level: **5%; ***1%.

Source: own calculations.

There were found causalities that have a long-lasting character among all scrutinized variables (Table 6), thus, the selected factors affect military expenditures in both countries.

Conclusions

Greece and Turkey's military expenses (relative to GDP) are higher than those in other NATO countries and account for a sizeable portion of government expenditures. Nonetheless, relative to selected economies from the Middle East (and Russia), defense outlays in Greece and Turkey seem to be average. Hence, their spending, which exceeds NATO

requirements by approximately 2 percent, appears to be impacted more by regional than alliance situation.

Among the factors affecting such spending, the political determinant deserves special attention. In Greece external threats play a role in national security, whereas in Turkey both domestic and foreign threats are crucial. The results of empirical tests confirm that in the complex economic and political situation in both countries, Greece's insistence on high military spending stems from its economic priorities, security demands and competition with Turkey. For Turkey the most important factor is national security, followed by economic capabilities.

These results have implications for both countries from an economic as well as a political perspective. In Turkey politics and the realization of political (strategic) goals supersede economic factors. Therefore political risk unfailingly poses a greater threat in Turkey than in Greece what stems not only from authorities decisions (within economic policy) but also from domestic and foreign threats to national security. On the contrary, Greece, a member of the EU and EMU, is more impacted by economic constraints in its military spending decisions. They affect the inflow of international capital and the capital cost. Greece pays less for its debt, although Turkey's economy is more robust. This is a reflection of economic factors domination over political ones in Greece, though both countries share the strategic location in unstable region and multiple political and economic problems.

Notes

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² SIPRI's definition of military expenditures is based on that used by NATO. While uniform information from each country is not always available, the SIPRI military expenditure data generally relates to: the armed forces, including peacekeeping forces; defense ministries and other government agencies engaged in defense projects; paramilitary forces, when judged to be trained and equipped for military operations; and military space activities [SIPRI website].

³ The time scope of data for Russia was limited to achieve greater clarity. Nonetheless, military spending in Russia has unfailingly risen up to 91.6 bn in 2014.

⁴ NATO's definition of military expenditures is close to SIPRI. The main difference refers to the exclusion of paramilitary forces. In table 1 infrastructure spending was omitted because of their low significance.

⁵ A state's increasing military burdens immediately becomes a threat for his neighbors. Spending a lot on security makes other nations feel insecure and look for the reasons behind those spending decisions [Looney, 1986].

⁶ GDP 2014 – Greece 177.5 bn Euro, Turkey 601.0 bn Euro; Populace – Greece 10.9 m, Turkey 76.6 m [Eurostat database].

⁷ Data from 2013 [Eurostat database].

- ⁸ Public debt/GDP in Turkey: 2001–77.3%, 2002–73.4%, 2003–67.3% [Creel, Kamber, 2004].
- ⁹ Report Doing Business [2013] places Turkey 71 out of 185 countries as far as comparing regulations for domestic firms are considered.
- ¹⁰ The Island is inhabited by Greeks (71%) and Turks (18%).
- ¹¹ Additionally, in the late 1970 s. and 80 s there was also little danger of attack by forces of Warsaw Pact.
- ¹² GINI Index (average 2000–2010) for Greece 34.3 for Turkey 41.2 [Human Development Report, 2010].
- ¹³ Linear trends of variables in Appendix.
- ¹⁴ The average on the basis of 9 international institutions: IHS Global Insight Country Risk Rating, World Justice Project, IMD World Competitiveness Yearbook, Political Risk Services International Country Risk Guide, Institutional Profiles Database, iJET Country Security Risk Ratings, CIRI Human Rights Database & Political Terror Scale, World Economic Forum Global Competitiveness Survey, Economist Intelligence Unit. This measure encompasses internal and external conflicts, ethnic tension, armed conflict, violent demonstration, social unrest, international tension, and terrorist threat. The higher the value of the indicant, the better the state of national security.

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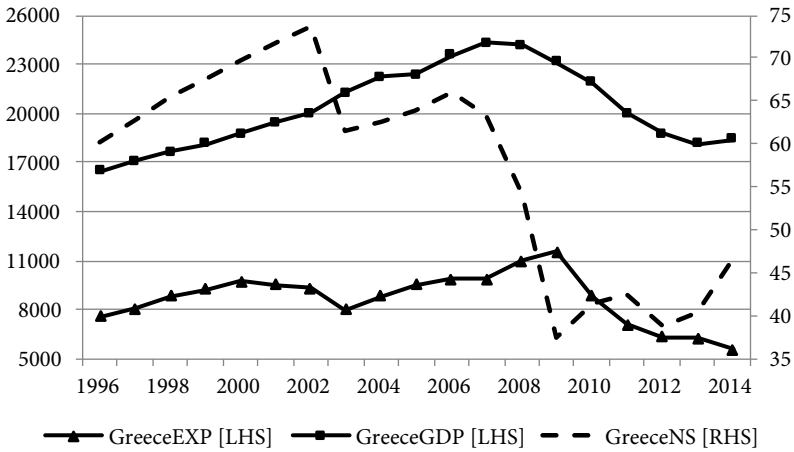
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Appendix

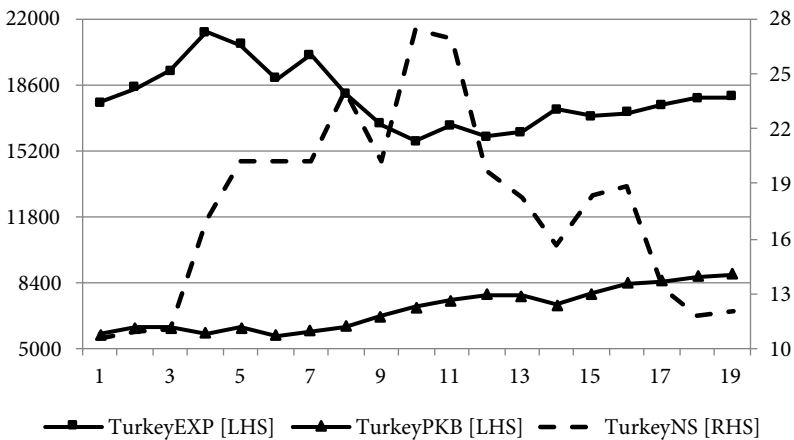
FIGURE 1. A Greece: EXP, GDP, NS* in 1996–2014



Note: *RHR – right hand scale; LHS – left hand scale. [EXP (USD million); GDP (USD per capita)].

Source: own elaboration based on SIPRI Statistics, FED Statistics, World Bank Statistics.

FIGURE 2. A Turkey: EXP, GDP, NS* in 1996–2014



Note: *RHR – right hand scale; LHS – left hand scale. [EXP (million USD); GDP (USD per capita)].

Source: own elaboration based on SIPRI Statistics, FED Statistics, World Bank Statistics.