

Tamás Csiki Varga¹ – Zsolt Lázár²: Filling the two percent gap – An update on Hungarian defense spending trends

Executive Summary

- The 2022 Hungarian defense budget constitutes a 28.9 per cent year-on-year increase in nominal terms, reaching 1,003 billion HUF (2.78 billion EUR).
- Previously, defense spending hit rock bottom in 2014 with 256.75 billion HUF, after which a period of dynamic growth began: defense spending quadrupled in nominal terms since then, with double-digit increases in 6 out of 8 years, and more than 25 per cent increases in 4 years.
- The drivers of this change had been the deteriorating security environment externally, and as a result, the long-delayed comprehensive defense modernization program that was initiated in 2016, internally.
- NATO registered defense input in terms of GDP at 1.25% for 2019, an estimated 1.79% for 2020 and 1.60% for 2021.
- Measured against the 2% GDP threshold and adjusted for inflation, the 'missing dividend' not invested in defense was a sum of 4,764.0431 billion HUF (ca. 16.43 billion EUR) between 2004-2018.
- Considering the initial price tag of the ongoing 'Zrínyi' Armed Forces Modernization Program – 3500 billion HUF in ten years –, it can be stated that the Hungarian government simply puts back the funds that were not spent on defense in the past decade and a half.

Introduction

The 2022 defense budget proposal, requesting a 225 billion HUF cap to the current 778 billion, totaling 1,003 billion HUF (2.78 billion EUR) for 2022 has been approved by the Hungarian Parliament on June 25, 2021.³ This constitutes a 28.9 per cent year-on-year increase in nominal terms, continuing the generally increasing trend since 2015 and adding the fourth consecutive year of resource expansion, driven by the 'Zrínyi' Armed Forces Modernization Program. Following upon the scenario modelling⁴ in which we argued in 2019 that the previously politically committed annual increase of 0.1% of the gross domestic product (GDP) must be surpassed to meet NATO commitments, now we provide a reality check and update to the trend analysis. Furthermore, we point out how the gap to the 2 per cent NATO commitment, or the 'missing dividend' is being filled after a decade of neglect.

Defense spending as a measure of allied contribution

At the 2006 Riga summit, NATO defense ministers agreed to spend a minimum of 2% of their GDP on defense to ensure the alliance's military readiness.⁵ But soon the 2008/2009 financial and economic crisis took a heavy toll on allies' defense expenditures, thus a downward trend became widespread even among the greatest spenders, including the United States.⁶ The strategic shocks of the Russian aggression targeting Ukraine, the ascension of Daesh and subsequent strategic terrorist attacks, as well as the 2015 migration and refugee crisis began to shift political commitment and resources back to security and defense. Thus, at the 2014 Newport Summit NATO member states recommitted themselves to increasing their defense spending to reach at least 2% of GDP by 2024,⁷ later reinforced by subsequent summit meetings in Warsaw (2016), London (2019) and

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³ 2021. évi XC. törvény Magyarország 2022. évi központi költségvetéséről. [online], 25 06 2021 Source: *Magyar Közlöny*, No 120/2021 [25 07 2021], pp. 5102-5295.

⁴ Tamás CSIKI VARGA: *Explaining Hungarian defense policy I. – Defense spending trends*. [online], 13 02 2019 Source: svkk.uni-nke.hu [25 07 2021]

⁵ *Funding NATO*. [online], 13 02 2019 Source: nato.int [25 07 2021]

⁶ CSIKI Tamás: *A gazdasági válság hatása a Magyarországgal szövetséges államok védelmi reformjaira és stratégiai tervezésére*. *Nemzet és Biztonság – Biztonságpolitikai Szemle*, Vol. 7. No. 2/2014, pp. 77-100.

⁷ *The Wales Declaration on the Transatlantic Bond*. [online], 14 09 2014 Source: nato.int [25 07 2021]

Brussels (2018 & 2021) – lately even despite the severe economic effects of COVID-19. For some under-performers, just like for Hungary, this meant undertaking a radical increase within a decade that could be achieved only if both economic performance and threat perception trends supported it.⁸

Acknowledging the usefulness of the debate surrounding the 2 percent benchmark as a measure of allied commitment,⁹ also sharing much of the criticism, like it does not measure spending in real terms or actual output,¹⁰ we still believe that providing adequate funding for national capability development constitutes the foundation of any allied contribution. Therefore, assessing individual member states' spending performance in this regard offers us a starting point for more elaborate analysis. Next, we provide an update on these trends and point out how the gap to the 2 per cent NATO commitment, or the 'missing dividend' has gradually been filled in Hungary since 2015, after a decade of neglect.

Nominal defense spending trends¹¹

As shown in Figure 1, the trend of Hungarian defense spending was not only 'flat' after 2004 (once both NATO and EU accessions had been completed), but the 2008/2009 crisis had a severe detrimental effect.

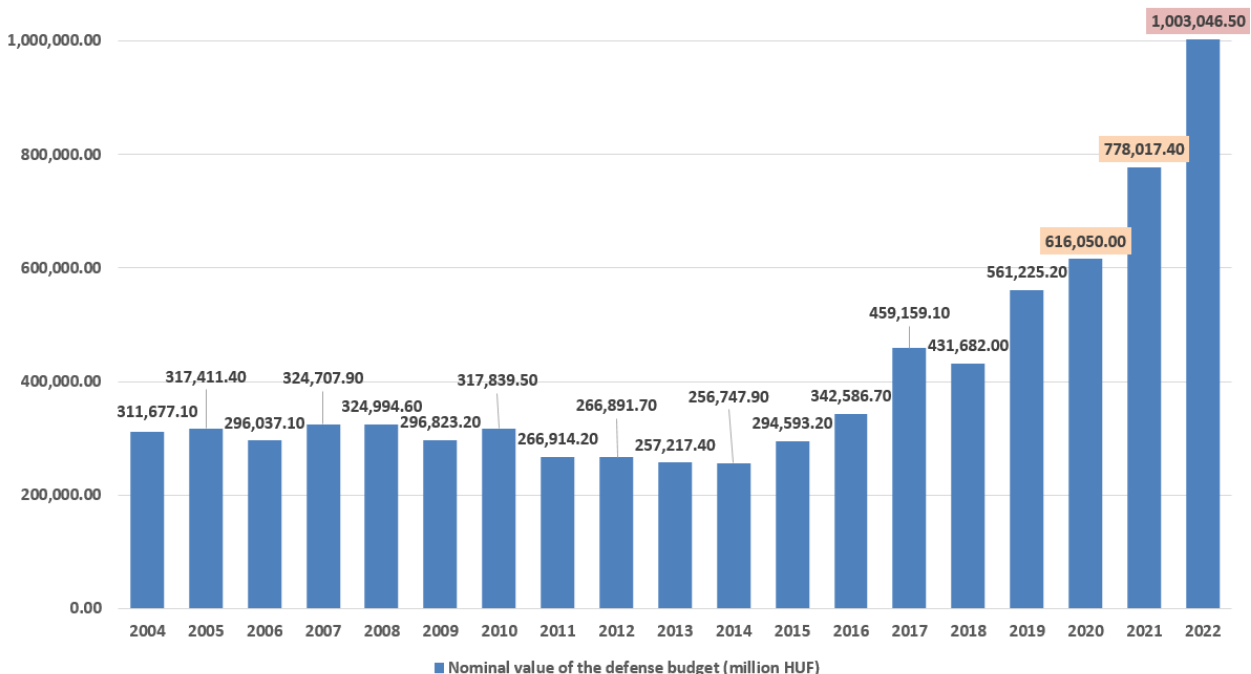


Figure 1. The nominal value of the Hungarian defense budget, 2004-2022.¹²
(Edited by the authors.)

As pointed out earlier, 'despite the increased burden of international engagement on the Balkans and in Afghanistan, defense expenditures were moving in the following years in a +/-10% threshold on average, and six years later, in 2010, were still standing around the same level (317.8 billion HUF) as in 2005.

⁸ Tamás CSIKI: Breaking the Dual Spiral of Diminishing Capabilities. In: Peter BÁTOR – Róbert ONDREJCSÁK (szerk.) Panorama of global security environment 2015-2016. STRATPOL, Bratislava, 2016, pp. 101-111.

⁹ Derek CHOLLET – Steven KEIL – Christopher SKALUBA: [Rethink and replace two percent](#). [online], 14 10 2020 Source: atlantic-council.org [25 07 2021]

¹⁰ Jan TECHAU: [The Politics of 2 Percent: NATO and the Security Vacuum in Europe](#). [online], 02 09 2015 Source: carnegieeurope.eu [25 07 2021]

¹¹ It is worth to note that even though various international sources are available with estimates on Hungarian defense spending – such as NATO's or the EU's own aggregated defense data, the SIPRI Military Expenditure Database, or the Military Balance yearbook –, we consider national data the most accurate as enshrined in budgetary legislation. Therefore, we rely on defense data in this paper derived from official State Budgets and Final Accounting Acts.

¹² Source of data: respective annual state budgets' Final Accounting Acts for FY 2004-2019. For FY 2020-2021 (highlighted in yellow) data from the approved State Budget are indicated as no Final Accounting Act has been adopted yet, FY 2022 (highlighted in pink) is the latest approved future budget.

The effects of the financial and economic crisis had been realized with a shocking 16% drop of funds in 2010, and the slightly decreasing trend in nominal terms lasted until 2014. Ten years after the Hungarian EU accession, nominal defense funds were 17.6% lower than in 2004 – not mentioning the real value loss attributed to (defense) inflation.¹³

Defense spending hit rock bottom in 2014 with 256.75 billion HUF, after which a period of dynamic increase began. The drivers of this change had been the deteriorating security environment externally and as a result, the long-delayed comprehensive defense modernization program that was initiated in 2016, internally. In the following years, defense spending quadrupled (!) in nominal terms compared to 2014, soon surpassing a thousand billion Forints (2.78 billion EUR) in 2022.

As Figure 2 shows, year-on-year growth has also been substantial since 2015 with double-digit increases in 6 out of 8 years, and more than 25 per cent increases in 4 years.

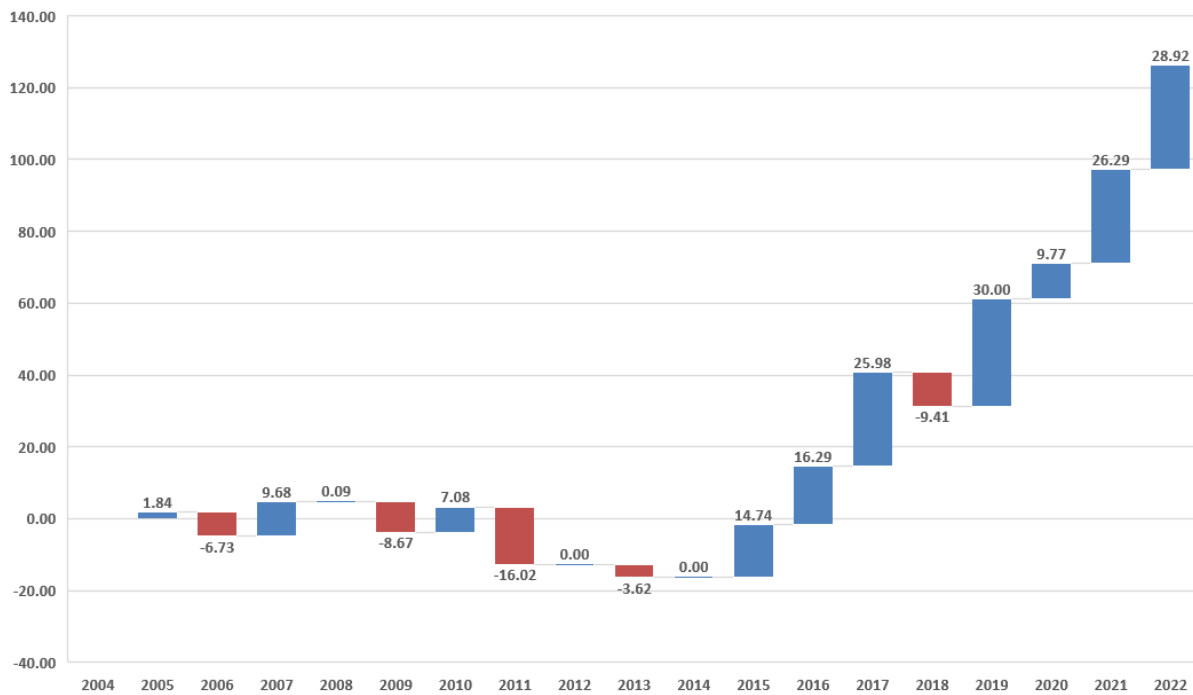


Figure 2: Year-on-year changes (percentage compared to the previous year) of Hungarian defense spending, 2004-2022.¹⁴ (Edited by the authors.)

Defense spending in terms of GDP

The normalization and then the gradual shift to an increasing path started in 2012, when Government Decree No. 1046/2012¹⁵ was adopted to stop the decline at least by keeping the nominal value of the defense budget of 2012 for the years 2013-2015, and then increasing the budget by 0.1% of the GDP annually. Thus, reaching 1.39% of the GDP in sum by 2022 was the plan. As troublesome events in Hungary's security environment unfolded, the government authorized the Ministry of Defense to draft plans for the 'Zrínyi' Armed Forces Modernization Program and adopted Government Decree No. 1273/2016¹⁶ to sustain the annual 0.1% increase in terms of GDP for years 2017-2026, aiming to reach 1.79% of GDP by the end of the decade-long development period. The positive trend was in line with

¹³ Tamás CSIKI VARGA: [Explaining Hungarian defense policy I. – Defense spending trends](#), p. 3.

¹⁴ Source of data: respective annual state budgets' Final Accounting Acts for FY 2004-2019. For FY 2020-2021 (highlighted in yellow) data from the approved State Budget are indicated as no Final Accounting Act has been adopted yet, FY 2022 (highlighted in pink) is the latest approved future budget.

¹⁵ 1046/2012. Kormányhatározat a honvédelmi kiadások és a hosszú távú tervezés feltételeinek megteremtését szolgáló költségvetési források biztosításáról. [online], 29 02 2012 Source: kozlonyok.hu [25 07 2021], p. 5340.

¹⁶ 1273/2016. Kormányhatározat a honvédelmi kiadások és a hosszú távú tervezés feltételeinek megteremtését szolgáló költségvetési források biztosításáról. [online], 07 06 2016 Source: net.jogtar.hu [25 07 2021]

NATO's 2014 Defense Pledge, though the pace of growth did not provide for meeting the 2% by 2024. To fulfill political commitment and the resource-demand of the 'Zrínyi' Program Government Decree No. 1283/2017¹⁷ was adopted aiming at higher annual increases to ensure that the Hungarian defense budget reaches the 2% benchmark of the GDP by 2024. Furthermore, from 2025 onwards the achieved level should be sustained.

As argued earlier through the assessment of four indicative scenarios, based on pre-COVID GDP-growth trends and the planned continuous increase of the defense budget, independent of the (forecasted) GDP growth rate, the 2% target in terms of GDP would be met only if more intensive resource surplus would be provided for the defense sector. Prior to the detrimental effects of COVID-19, it was clearly visible that in case of a 0.2% annual increase scenario, the 2 percent benchmark could be reached by 2025 in a low GDP-growth scenario and by 2026 in a high GDP-growth scenario.¹⁸ Since we do not have adequate data on the effects of COVID-19 on the Hungarian state budget for 2020, nor reliable forecast for 2021 and beyond, one can only offer an intelligent estimate that a sustained double-digit increase in annual ratio will be necessary, also surpassing the 0.1% of GDP.

Despite the dynamic annual nominal increase, it was the GDP-ratio of defense spending that still has not reflected that Hungary is swiftly delivering upon the political commitment (Figure 3) until 2018, because the economy, thus the total GDP had also been extending since 2013.¹⁹ This indicator is also expected to improve – once the necessary national data will become available –, as NATO registered 1.25% for 2019, an estimated 1.79% for 2020 and 1.60% for 2021.²⁰

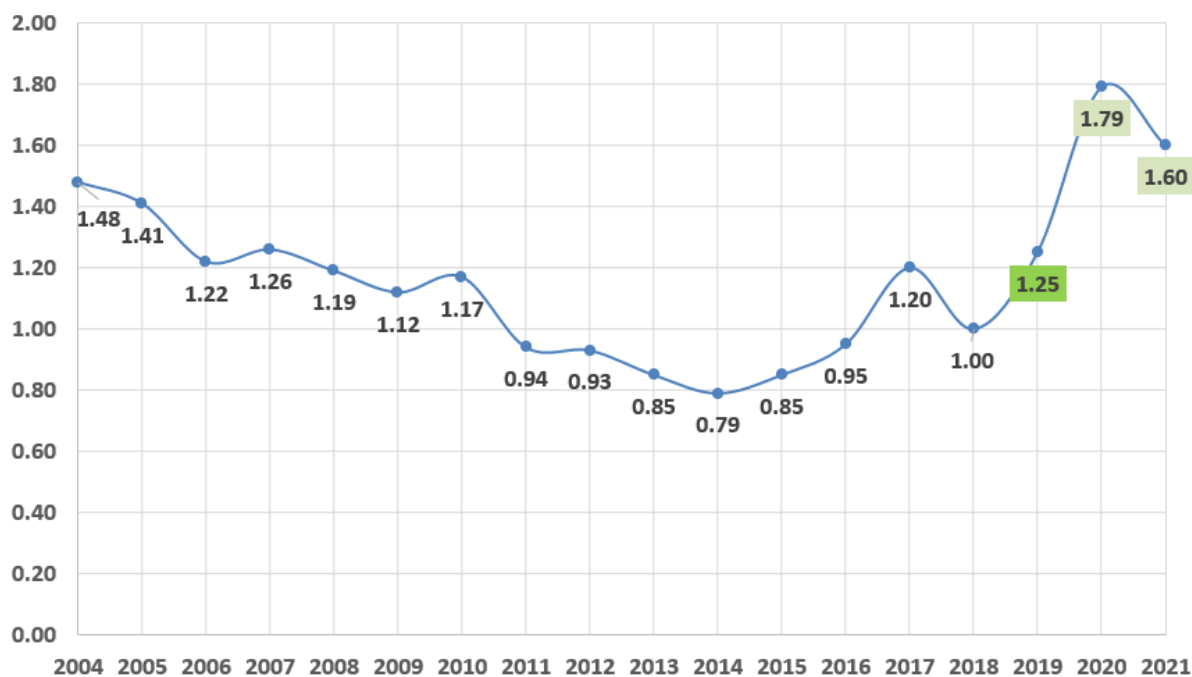


Figure 3: Hungarian defense spending as a ratio of GDP, 2004-2021.²¹ (Edited by the authors.)

¹⁷ 1283/2017. Kormányhatározat a honvédelmi kiadások és a hosszú távú tervezés feltételeinek megteremtését szolgáló költségvetési források biztosításáról szóló 1273/2016. Kormányhatározat módosításáról. [online], 02 06 2017 Source: net.jogtar.hu [25 07 2021]

¹⁸ Tamás CSIKI VARGA: Explaining Hungarian defense policy I. – Defense spending trends, pp. 6-7.

¹⁹ Based on the GDP dataset of the Hungarian Central Statistical Office. See: A bruttó hazai termék (GDP) értéke, volumenindexe és implicit árindexe (1995–). [online], 2021. Source: ksh.hu [25 07 2021]

²⁰ Defense Expenditure of NATO Countries (2014-2021). [online], 11 06 2021 Source: nato.int [25 07 2021], p. 8.

²¹ Source of data: the GDP dataset of the Hungarian Central Statistical Office. See: A bruttó hazai termék (GDP) értéke, volumenindexe és implicit árindexe (1995–). [online], 2021. Source: ksh.hu [25 07 2021]; as well as respective annual state budgets' Final Accounting Acts for FY 2004-2018. For FY 2019 (highlighted in green) NATO official data, for FY 2020-2021 (highlighted in light green) NATO estimated data are shown. Defense Expenditure of NATO Countries (2014-2021), p. 8.

Re-investing the 'missing dividend': the 'Zrínyi' Armed Forces Modernization Program

What has been shown so far, puts the 'Zrínyi' Armed Forces Modernization Program, bearing an initial cost label of 3500 billion Forints for 2016-2026,²² into context: the defense spending had been decreasing in the period of 2004-2014 in Hungary, neglecting operation and maintenance, not to mention modernization costs. In other words, before the comprehensive modernization program began, the Hungarian defense expenditure had been way below NATO requirements, even below 1% of GDP for six consecutive years (2011-2016), and occasionally standing as low as 0.79% (2014).

Therefore, besides the actual annual defense expenditure data, the resources that were not spent on defense, or the 'missing dividend' are also noteworthy. This is an important aspect to answer the question: how much money has not been allocated for defense throughout the years – especially since NATO's 2% political commitment has formally been reinforced?

There are two approaches to address this question. The simple solution is to calculate the gap between the actual annual defense spending and the 2% GDP threshold (Figure 4). This method can give a raw estimate of the 'missing' funds. While the total defense spending between 2004 and 2018 was 4,765.293 billion HUF (as a result of adding up annual defense budgets), the missing funds were very close to this amount: 4,161.9677 billion HUF (as a result of adding up the annual missing dividends up to 2% GDP level). To put it bluntly: half of the defense budget was missing between 2004-2018.²³

However, the more accurate method involves adjusting these results for annual inflation. The inflation rate was fluctuating between 7.8% and -0.2% between 2004 and 2018.²⁴ Calculating adjusted values shows that the total sum of funds spent on defense was 5,720.4953 billion HUF (ca. 19.73 billion EUR²⁵) between 2004 and 2018. Meanwhile, the gap to reach the 2% threshold extended to 4,764.0431 billion HUF (ca. 16.43 billion EUR) over the 15-year period.

Considering the total value of the ongoing 'Zrínyi' program – 3500 billion HUF –, it can be stated that the Hungarian government simply puts back the funds that were not spent on defense in the past decade and a half. In fact, this initially estimated total value of the program is still less than the total value of the 'missing' resources.²⁶

Simply put, it is clear that the defense sector was neglected in the past decade and a half, and it is a legitimate argument to say that the current development program it is nothing more than filling in the otherwise missing resources. Therefore, 'Zrínyi' Armed Forces Modernization Program and the increasing defense spending can simply be justified by the fact that these investments are not only necessary to modernize the country's defense capabilities, but also to provide for the 'missing dividend' after more than a decade of neglect.

²² HECKER Flórián: *Jóval többől van szó fegyverbeszerzésnél.* [online], 11 09 2020 Source: vg.hu [25 07 2021]

²³ As indicated in the previous assessment, we consider available data 'complete' only until 2018, therefore this calculus spans until that year.

²⁴ Data for inflation adjustment relies on the annual consumer prices index for Hungary, as provided by the World Bank. See: [Inflation, consumer prices \(annual %\) – Hungary.](https://data.worldbank.org) [online], 2021 Source: data.worldbank.org [25 07 2021]

²⁵ Using a 290 HUF / EUR exchange rate that was the average for 2004-2018. See: [Hungarian Forint.](https://tradingeconomics.com) [online], 2021 Source: tradingeconomics.com [25 07 2021]

²⁶ Not to mention the full three-decades-long period since the change of regime in 1989, after which – due to the end of the Cold War – defense spending rapidly started to decline, going under 2% of GDP, well ahead of Hungary's NATO accession.

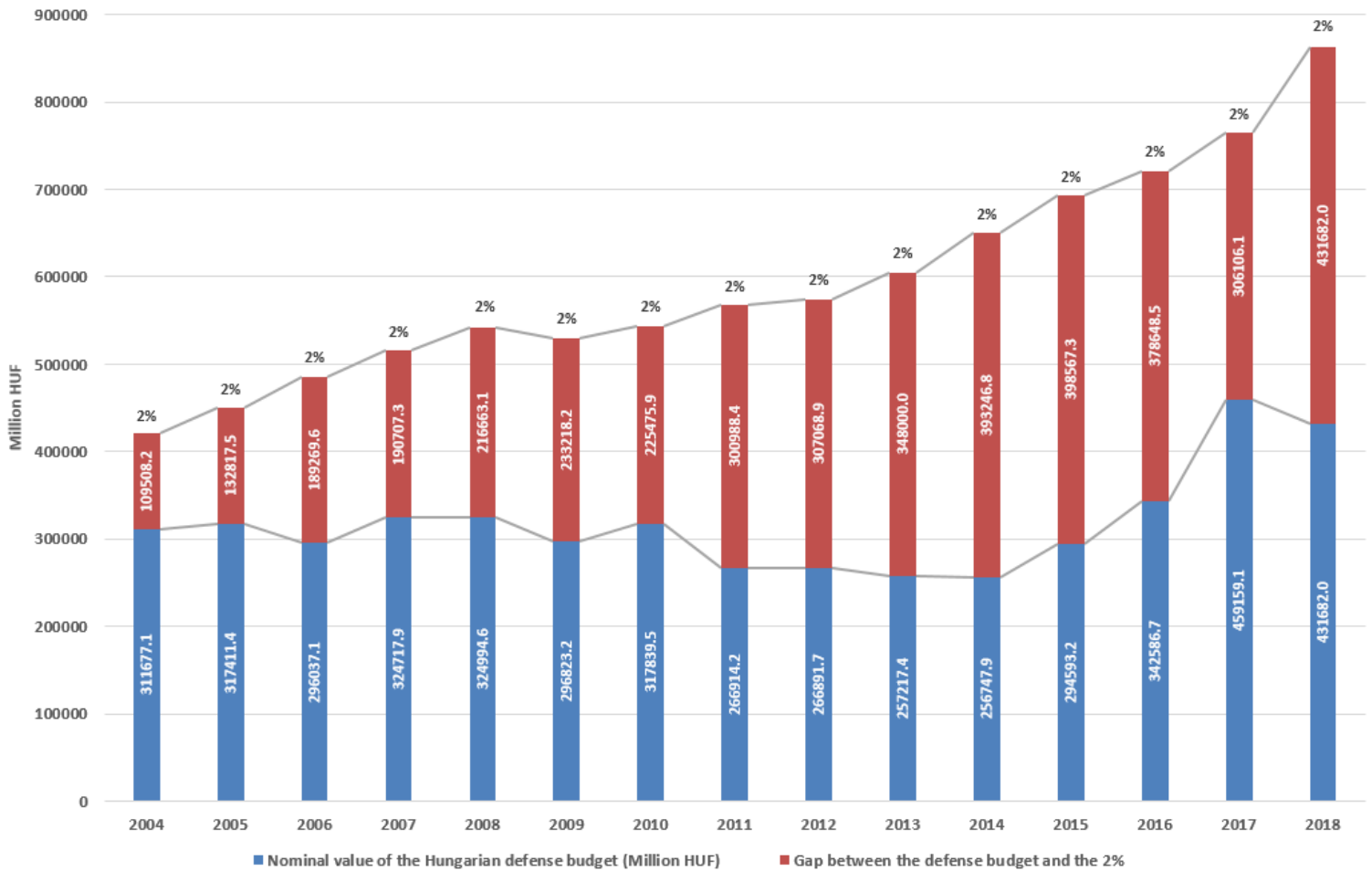


Figure 4. The annual defense budget in Hungary versus the nominal value gap to 2% of GDP, 2004-2018.²⁷ (Edited by the authors.)

²⁷ Showing equal nominal values for 2018 as 'provided' and the 'gap to 2%' is not a mistake, as defense spending according to national data stood at 1% of GDP, that is half of the NATO threshold.



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