War vs. warming – will rising defence spending slow climate progress?

In Europe, defence and security have moved to the forefront of political and economic priorities. Some security-related projects, such as sustainable infrastructure, may support the green transition but rising geopolitical tensions risk diverting attention and resources from climate targets. Indeed, green investment momentum appeared to slow in 2024, and we should not be surprised if it slows further in the years to come.

The analysis was originally published as a part of Swedbank Economic Outlook, read it here (pdf).

Analysts:
Emma Paulsson, emma.paulsson@swedbank.se, +46 73 083 47 32
Greta Ilekyte, greta.ilekyte@swedbank.lt, +370 620 15270

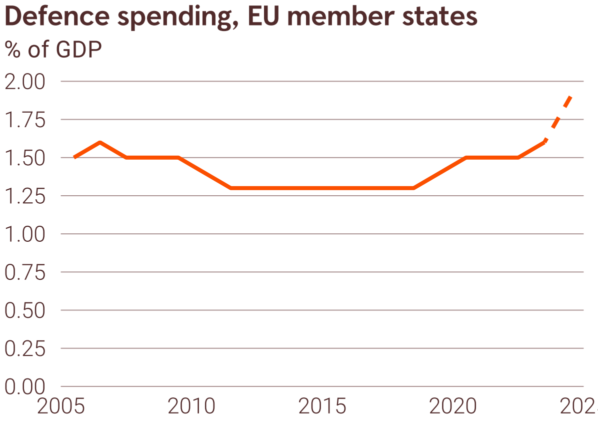
Europe's military spending surge

Despite Russia's ongoing invasion of Ukraine, only 22 of 32 NATO member states met the 2% of GDP target for military spending last year. Five years ago, only six countries met this target, indicating chronic underinvestment and, in many cases, freeriding.[1] In most European countries, however, defence expenditures have risen rapidly in the past few years, and the US disengagement from Europe under Trump has spurred ambitions even higher.

The US, which spends more on defence than all other NATO allies, is important to European security. Uncertainty about US commitment to NATO leaves Europe in a vulnerable position, prompting countries to urgently ramp up military spending. The Baltic states, with Russia and Belarus on their doorstep, have been at the forefront in their defence spending, committing to reach 5% of GDP within a few years, while Sweden is aiming for 3.5% of GDP in 2030.

In recent months, a series of significant new announcements across Europe has also been made. These include Readiness 2030, which aims to mobilise more than EUR 800 billion to strengthen Europe's defence, and Germany's loosened "debt brake," which allows a substantial increase in military spending.

[1] Benefitting from a collective good, without bearing a fair share of the costs.



Sources: Swedbank Research & Macrobond

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Militarisation will increase GHG emissions and risk crowding out green investments

While defence spending is essential in the current circumstances, the risks of its negative impact on the green transition are heightened. Increased military activities will cause a direct increase in greenhouse gas emissions. Armed forces require significant energy to operate military bases, power aircraft, tanks and other machinery. Additionally, heightened demand for weaponry leads to expanded defence manufacturing, which is a highly energy-intensive sector – particularly due to its reliance on key inputs such as metals. As demand rises, so do emissions. A recent paper indicates that a one-percentage-point increase in the share of military spending results in an almost 2% rise in total emissions in NATO countries.

On top of this, higher military spending risks slowing the green transition by crowding out green investment and innovation. As funding and priorities shift towards defence, governments, companies and research institutions focus on military-related advancements rather than climate solutions, thereby disrupting financing for the green transition. The defence sector then also attracts top engineering and scientific talent, diverting expertise away from sustainable technology development and potentially also leading to a decline in climate change mitigation. This decrease may also stem from a more widespread slowdown in innovation.

Hence, the concept of the green peace dividend becomes crucial – during periods of stability, reduced military expenditures can free up financial and human resources for other priorities, including the green transition. By reallocating defence budgets towards renewable energy, sustainable infrastructure and climate innovation, governments can accelerate their decarbonisation efforts.

The energy transition is a security matter

Although increased militarisation comes with increasing emissions and pollution, the general push for resilience may indeed benefit the energy transition as a potential window of opportunity for some green investments. Germany's decision to loosen up the debt brake and to earmark EUR 100 billion for climate protection investments would have been impossible to get through Parliament just weeks earlier. In economies where public debt is at relatively low levels and where the costs of underinvestment in infrastructure and green technologies are high, a new, looser fiscal policy could be appropriate.

The energy transition and energy security go hand in hand. The risk of relying on fossil fuel imports was striking at the beginning of Russia's war on Ukraine, when European energy prices surged, and imports were restricted. Shifting away from fossil fuels and broadening the mix of energy sources strengthens security, as discussed at Davos earlier this year. Renewable energy sources are mostly domestically produced, which means a lower risk of import disruptions. The RePowerEU plan to boost renewable energy came into place after Russia's full-scale invasion of Ukraine started in 2022. Official data is lagging, but recent numbers from Eurostat confirm a "record-breaking" increase in renewable electricity in the EU during 2023. As a share of the EU's final energy use, renewables have increased by about 1.5 percentage points since 2022, to 24.5% of energy consumed. This is almost three times higher than in 2004.

Investment needs are substantial but partly overlap across sectors

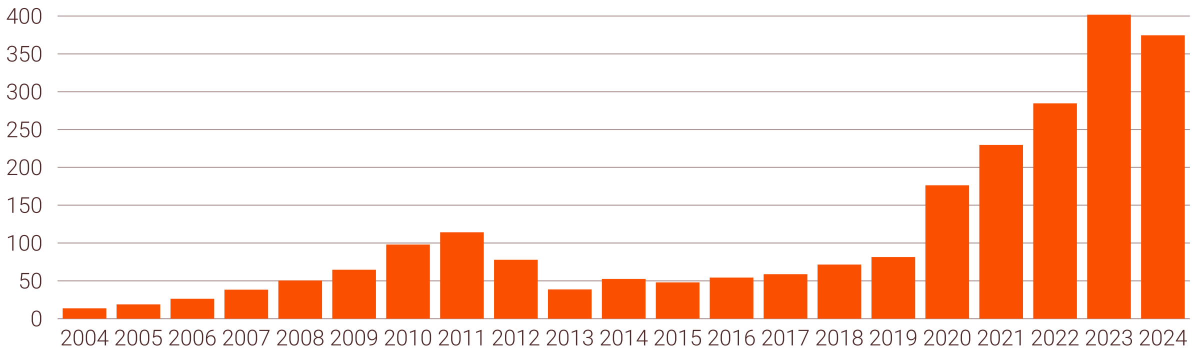
Europe will have to invest sizeable amounts until 2030 to support the green transition and meet its target of a 55% GHG emissions reduction. Estimates on the annual investment need within the EU vary between EUR 738 billion and EUR 1240 billion. The higher end of the range is based on the European Commission's estimates and is equivalent to some 8% of GDP, substantially overriding the projected military expenses. Between 2011 and 2020, an average of 5.1% of the EU's GDP was directed to green investments (using a broad definition of the term). The lion's share of the required investments is in the transport sector, even if major investments are needed in other sectors as well.

An increased investment focus on security could thereby have synergies with the energy transition. Investing in infrastructure such as grid lines, rail and even road transports could have a positive impact on the climate, with shorter routes, improved electricity transmission and more rail connections. This could mean lower emissions compared to a scenario where those investments are not made. For example, the Rail Baltica project reduces transport emissions and facilitates goods transport, including military goods. Rail Baltica was not a military project when it began, but still serves as a good example of where climate and defence interests overlap.

However, investments in the energy transition seem to have declined somewhat in the EU during 2024, according to a BNEF study, and the outlook may be dampened further by heightened uncertainty and the focus on military upscaling. The study also found that climate tech lost market shares to artificial intelligence, in terms of venture capital raised in 2024. This could indicate a reduced focus on climate tech and the energy transition. So far there is little evidence to indicate that climate initiatives have recently been prioritised down (or up). Still, Simon Stiell, Head of the UNFCCC, urged Europe not to forget about the climate crisis amid the re-armament process in a recent speech.

Total EU energy transition investment

USD bn



Sources: BNEF - Energy Transition Investment Trends 2025, Swedbank Research & Macrobond

The majority of the green investment needs are required primarily via the private sector. According to the ECB, about 83% of the additional climate-related investment needs would be covered by the private sector. Military expenditure, on the other hand, is primarily a field of public investment. It is unclear how much of the needed green private investments will be crowded out by increased public borrowing.

If the public sector maintains climate-related targets and regulations without making frequent changes, investors and companies will remain confident in what applies in the long term, making it more likely that private investment in green technologies will continue to grow. However, even if it doesn't have to follow a one-to-one relationship, it appears more likely that green investments and the green transition will ultimately slow down, as countries' main focus will be security from a military, not energy and climate, perspective, at least for the next few years.

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Swedbank C&I, Swedbank AB (publ), SE-105 34 Stockholm.

Visiting address: Malmskillnadsgatan 23, 111 57 Stockholm.