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**Article**

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Daniel Fiott

## The Challenges of Defence Spending in Europe

There can be no doubt that Russia's war on Ukraine has led to a sea change in the way that Europeans view defence. For more than three decades, European states have neglected their defence. This is not to say that they were militarily inactive, as the European Union (EU) in particular embarked on a series of crisis management operations over this thirty-year period. Rather, member states neglected making sizeable investments in key military capabilities and ensuring that the defence technological and industrial base in Europe was fit for purpose. This purpose has become glaringly obvious over the past two years, with deficiencies in how fast (and in what quantity) Europe could produce basic military equipment such as ammunition. For example, even though the EU pledged one million 150mm ammunition rounds to Ukraine over the past year, the reality is that only half this amount was delivered (Pugnet, 2024a).

Europe's defence manufacturing shortfalls are found not only in the production of ammunition, however; there have also been delays in the production of strategic capabilities such as main battle tanks. This has allowed external suppliers to provide Europeans with the equipment they need over the shorter term, such as South Korea's rapid delivery of Howitzers and K2 tanks (Poland Presidency, 2022). This realisation has led to fundamental assessments of how Europe's defence industry should be shaped in the coming years. At the EU level, political leaders have made clear that Europe not only needs to continue to support Ukraine with armaments, but that Europe's defence technological and industrial base is a core element of Europe's overall defence (European Council, 2022).

The realisation that Europe's defence industry needs political support has taken some time, but it is now an important point of consensus between EU member states and political groupings in the European Parliament. Yet, as this contribution to the Forum argues, defence expenditure is an intensely political affair, which makes our ability to assess the

quality of defence investments harder. As we will see in this contribution, defence investment is a necessary factor for stimulating the long-term health of the defence industry. We also discuss how defence spending is assessed and managed in a NATO context in order to underline the specific nature of the EU's own process of encouraging defence investment among its member states.

### The importance of sustained defence investment

There are many ingredients needed to ensure that Europe can build back its defence technological and industrial base after years of neglect. There is a need to attract and retain human capital in defence industrial production processes and critical raw material inputs. The issue of skills gaps in the defence industry, for example, is in fact a structural issue that has long affected European defence (Rand Corporation, 2024), but it has become an even more salient challenge following the increase of defence investments since the war on Ukraine. Technologies and efficient management processes are also vital to ensuring that Europe can produce military equipment in a timely and high-performance fashion. Nevertheless, the majority of ingredients require intense and sustained defence investments, as has become abundantly clear since Russia's war on Ukraine (Fiott, 2022).

Put simply, defence can only truly thrive when it benefits from a consistent source of investment over multiple years and decades. Kick-starting a virtuous defence industrial cycle, where militaries can procure cost-effective and high-performance equipment and systems, requires long-term planning and investments. For one thing, the defence innovation required to develop and test the technologies that are integrated into systems (i.e. sensors integrated on fighter jets) takes many years (Fiott, 2019). The development of systems themselves can take multiple decades. Yet, for many pieces of defence equipment, several European governments are still planning for their needs over the next two years rather than developing a multi-year approach to procurement and investment (Aries et al., 2023).

However, the clear need for sustained defence investments is not a simple case of an increased government defence spending from year to year, regardless of how desirable this may be from a defence perspective. Instead, in national budgets, governments are constantly weighing how much investment to dedicate to defence as compared to health, education, social services and more. This has historically been called the "guns vs butter" or "war vs welfare" dilemma.

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ma. The reality, however, is that the decision is never simply a case of defence or social welfare, but rather how much defence and how much welfare a government can afford at any given time. In any case, some may even argue that defence is a form of welfare, as it aims to guarantee the most basic human instinct: survival.

### The politics of defence spending

Defence investment is always an intensely political issue, especially in an alliance context. To be sure, the question of burden sharing between the United States and European NATO countries has been a mainstay of alliance management and politics. However, in recent years burden sharing has become a polarising issue, with former President Trump calling on European allies to increase defence spending beyond the 2% of GDP pledge or otherwise do without American security guarantees via NATO. The NATO Secretary General Jens Stoltenberg led the charge against President Trump with claims that the former president was undermining deterrence and defence through his comments (Sabbagh, 2024). Alternatively, however, one can see former President Trump's comments as a new, more robust, form of communicating a long-standing bugbear of the US on the lack of European defence investments (Kroenig et al., 2024).

In practice, the issue of whether Europeans invest enough in defence has become a sort of bellwether for the Republican Party's commitment to the alliance. As the US seeks to centre its defence policy on China, Europeans are starting to learn that down payments on defence are an effective symbol of their own commitment to NATO. The combination of pressure from the US and the war in Ukraine is having a positive effect on defence expenditure in Europe. NATO's own calculations on defence spending in the alliance demonstrate that 23 out of 31 allies are meeting the 2% of GDP pledge in 2024 (NATO, 2024a). This is a big change from a decade ago in 2014 after the Wales Summit, when only three allies met the pledge (the US, Greece and the UK). Interestingly, in 2024 a further five allies spent more than the 2% guideline, with Poland investing 4.12% of GDP in defence, Estonia 3.43%, the US 3.38%, Latvia 3.15% and Greece 3.08% (NATO, 2024a, p. 4).

The issue in this regard is how far Europe is prepared to move beyond the 2% of GDP pledge, especially as allies at the Vilnius Summit recognised "that in many cases, expenditure beyond 2% of GDP will be needed in order to remedy existing shortfalls and meet the requirements across all domains arising from a more contested security order" (NATO, 2024b). In this sense, today the 2% pledge should be considered as a baseline rather than a ceiling. This evolution in thinking on defence spending anticipates

that the Alliance may have to aim for 3% or 4% of GDP in the coming years, depending on who is in the White House in 2025. Doing so will be a challenge for many allies, even though the majority have increased to 2% already. In fact, analysis suggests that while some countries, e.g. Germany, are investing enough in the short term to meet the 2% pledge, the money is likely to dry up after 2026 and leave a potential funding gap of €30 billion (Mölling & Schütz, 2024).

### The EU's approach to defence expenditure

We should recall that the EU is not bound per se by the 2% of GDP pledge agreed upon by NATO allies. In fact, no like-for-like official pledge has been agreed upon at the EU level so far, although one can argue that those EU member states that are part of NATO are de facto bound by the spending pledge. Even so, the EU itself has not neglected the issue of defence spending targets. Back in 2007, ministers at the European Defence Agency (EDA) agreed to four collective benchmarks including a need to invest: first, 20% of total defence spending on equipment procurement (including research and development, R&D/research and technology, R&T); second, 35% of total equipment spending on European collaborative equipment procurement; third, 2% of total defence spending on defence R&T; and fourth, 20% of total defence R&T spending on European collaborative defence R&T. However, there are no timelines associated with these benchmarks and they are entirely voluntary and optional (EDA, n. d.). It is, therefore, no surprise that the EU member states have routinely failed to meet these four benchmarks.

Not even the establishment of Permanent Structured Cooperation (PESCO), agreed in 2017 to boost EU defence cooperation on military capabilities, has significantly altered the EU's approach. Indeed, the 20 binding commitments agreed to by participating PESCO member states only restate the four benchmarks as objectives and the first binding commitment calls for "regularly increasing defence budgets in real terms, in order to reach agreed objectives" (PESCO, n. d.). This is hardly compelling, and there is no mention of 2% or any target. Nevertheless, PESCO did push back against the idea of voluntary and optional benchmarks, and PESCO does introduce timelines for when member states should deliver on their spending pledges. This does not mean that the EU has developed a sanctioning tool for those member states that do not spend enough on defence, but the need to submit national implementation plans to the EU to show how each state will meet its obligations is a relatively new feature of EU defence spending politics.

This PESCO process is complemented by the Coordinated Annual Review on Defence (CARD), which sees individual member states share their defence planning horizons with

the EDA. Although this is a secretive dialogue where each member state's shortfalls remain undisclosed, a CARD report is released each year to give a collective picture of Europe's defence commitments. For example, the 2022 report indicated that EU member states had collectively increased defence spending since Russia's war, and the largest share of planned investments fall in the air (34%), maritime (14%) and land (14%) domains (EDA and EU Military Staff, 2022, p. 3). Again, nothing in CARD compels member states to spend more on defence, and it is certainly not true that reported increases in defence expenditure are the result of EU processes such as CARD. Nevertheless, such processes do allow EU institutions to have a better, more granular, understanding of where EU and NATO members will invest their defence budgets over the coming years.

### What does and does not get counted?

The truth of the matter, however, is that defence spending guidelines in NATO and the EU can only be an abstract exercise designed to provide a generalised overview of a state's commitment to defence. Yet, even abstract guidelines do matter as they allow political leaders to collectively pressure one another on defence spending. We must, however, recognise that abstract figures such as a defence spending-to-GDP ratio hide much of the intricacies of defence spending in Europe. So, while European NATO members and Canada have added an extra US \$200 billion in defence spending between 2014 and 2024 (to a total of US \$430 billion in 2024), this hides the fact that the US still spends the most on defence across NATO (US \$755 billion in 2024; EDA and EU Military Staff, 2022, p. 5). What is more, the abstract data hides the differences between EU member states in terms of where they invest the bulk of their defence budgets. For example, Belgium, Bulgaria, Croatia, Greece, Italy and Portugal dedicate 50% or more of total spending on personnel. In contrast, the bulk of spending in Estonia, Finland, Hungary, Luxembourg and Sweden goes towards operations, maintenance and major equipment purchases (EDA and EU Military Staff, 2022, p. 6). Such differences force us to appreciate the quality rather than quantity of defence spending in Europe.

In the EU, defence spending, as measured against the NATO 2% pledge, has always been lacklustre. For example, the EDA calculated in 2022 that the EU collectively invested 1.5% of its total GDP on defence (EDA, n. d.). Nevertheless, in the EU there is more of a fixation on how best to invest European defence spending together rather than any active plan for achieving an abstract or overarching objective of a defence spending-to-GDP ratio. This is not to say that increased defence spending in the EU is not important, as it clearly is, but the EU as a set of institutions recognises that they have limited political power to compel govern-

ments in what remains a sovereign decision to spend on defence. This is why the EU frequently relies on the mantra of "spending more, spending better, spending European" (European Commission, 2024). Stressing the European dimension here is designed to point to the structural constraints facing the European defence sector.

As the new European Defence Industrial Strategy indicates, joint procurement "will help speed up in a collaborative manner the adjustment of industry to structural changes" (European Commission/High Representative of the Union for Foreign Affairs and Security Policy, 2024, p. 9). This focus on using increasing levels of defence investment on joint procurement and joint development of capabilities is based on sound logic. Analytical studies have confirmed that it will become increasingly difficult for individual nations to develop their own national, single, defence systems. Even though some nations may insist upon developing national platforms, for Europeans the costs are high as individual national development programmes face stiff international competition. The logic that has gripped the EU, therefore, is that it is better to invest European defence budgets into collaborative European platforms, equipment and technologies. In this way, it is argued, a virtuous cycle can be established whereby Europeans invest in their own defence technological and industrial bases in order to help produce cost-effective, autonomous systems en masse (Briani, 2013; Bellais & Fiott, 2017).

Yet, in addition to this drive to enhance joint defence development and procurement, a lot of the EU's existing – and relatively newer – sources of defence expenditure do not get included in national, EU or NATO reporting on defence expenditure. For example, through the EU budget, a figure of €8 billion is being invested in defence innovation and prototyping via the European Defence Fund (EDF). An additional €1.5 billion is dedicated from the EU budget to military mobility. Under the European Peace Facility (EPF), which the EU has been using to support Ukraine (e.g. through ammunition deliveries) and to conduct "train and equip" missions, the member states have dedicated an additional €17 billion. Finally, an additional €2 billion from the EU budget has been found for ammunition production and joint procurement. In total, therefore, approximately €30 billion in financial sources at the EU level is supporting defence, but none of this is considered to be part of Europe's contribution to defence (including Europe's contribution to NATO burden sharing).

True, at this precise moment, a figure of €30 billion would be a negligible amount of the EU's overall contribution to defence investment. Yet, the EU is increasingly engaged in defence, and there are plans to significantly increase the Union's investments. Indeed, under the planned European

Defence Industrial Programme (EDIP), which is currently being negotiated by EU member states, ambitious investment levels are being called for. At least one European Commissioner has argued that €100 billion be assigned to the EDIP from 2028-2034 (Pugnet, 2024b). Inspired by the Union's ability to borrow money under the NextGenerationEU mechanism, which was designed to take on debt to help Europe's economic recovery after the COVID-19 pandemic, the idea is now to replicate this process for defence investments at the EU level.

## Conclusion

Of course, it remains to be seen whether the EU will agree to a joint debt for defence, not least because the German government is directly opposed to financing defence through debt. Not only are there constitutional considerations for Germany, but ideology and industrial interests mean that there is a reluctance to borrow money for EU joint procurement efforts. Time will tell how wise this policy by Germany is. To be sure, however, Germany is not alone in its reservations, and French industry has also raised concerns about the idea of joint procurement in certain capability areas. Both France and Germany are locked in a first-mover dilemma, whereby any communitarianisation of defence investments at the EU level may be perceived as harmful to national defence industrial competitiveness. Paris and Berlin would prefer that European customers buy directly from them, or, at the very least, not set in motion EU frameworks that will favour the other side industrially. On top of this are concerns about technology sharing and agreeing on what types of military equipment should be prioritised. It could be that this disagreement between France and Germany is enough to derail any EU efforts to boost joint defence procurement. Again, time will tell.

What is clear is that the EU's defence investments will not be enough to placate personalities such as Donald Trump, who would be largely unaware – or uninterested – in what the EU does or does not achieve. Should Trump emerge victorious in the forthcoming US presidential election, defence spending will again become a core feature of alliance politics. The EU will not be fully immune from these headwinds, and there may even be a return to the same position that the EU advanced during the first Trump presidency: namely, hedging against US retrenchment in Europe by re-energising the EU's defence efforts. If this is coupled with a political hollowing out of NATO by Trump, then defence spending will be but one among many major challenges for European security. In advance of the US presidential election, Europe can only keep up its political messaging on its defence investments. Where Europe goes beyond investing 2% of its GDP on defence remains to be seen.

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