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Article

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Beyond Nostalgia: Making the Most of the EU's Defence Spending Boom

For decades, the EU's defence posture rested on two unspoken assumptions: that threats were distant, and that the United States would always be there to protect us. This dual comfort zone resulted in chronic underinvestment and a fragmented defence landscape across EU member states. Defence remained largely a national matter, and industrial integration was seen as a secondary concern. But Russia's full-scale invasion of Ukraine in 2022 shattered illusions about the permanence of peace on the European continent. At the same time, the United States has grown increasingly reluctant to underwrite Europe's security unconditionally. This shift is not simply rhetorical. The second Trump Administration sees the EU through a transactional lens: as both a free rider and a market whose increased military expenditure will, at least for the years to come, disproportionately benefit the US defence industry, which is not only more technologically advanced than its European counterpart but also more integrated, allowing for greater economies of scale and therefore lower prices.¹

In response, the EU has begun to rethink its role in defence with a level of political seriousness not seen before. For the first time, a Commissioner has been appointed with an exclusive portfolio for defence – a symbolic but also operational shift that acknowledges the need for central coordination. This institutional innovation has been accompanied by substantive proposals. The White Paper on European Defence Readiness 2030, launched in March 2025, sets out a geostrategic roadmap to rearm Europe and reduce its dependency on non-European suppliers. It promotes greater joint procurement, industrial consolidation and the accelerated integration of Ukraine into the EU's defence industrial base.

The financial arm of this strategic shift is the ReArm Europe initiative. Structured around five pillars, it aims to mobilise substantial national and EU-level resources to scale up defence investment across the Union. First, it provides for the activation of national fiscal escape clauses, allowing member states to temporarily deviate from fiscal targets in order to accommodate increased defence expenditure. Second, it establishes a new €150 billion EU loan instrument, the Security Action for Europe (SAFE), designed to facilitate access to affordable financing for strategic defence projects. Third, it encourages the reallocation of existing EU funds, notably from cohesion policy, to support military mobility and industrial capacity in the defence sector. Fourth, it proposes an expanded role for the European Investment Bank (EIB) in financing dual-use infrastructure and technologies. Finally, it seeks to mobilise private capital through the Capital Markets Union, in the hope of attracting additional investment into the broader defence ecosystem.

Yet while the architecture of ReArm Europe reflects political momentum, its financial underpinnings are neither coherent nor fit for purpose. The activation of national fiscal escape clauses, originally conceived as emergency tools, is being stretched to cover a structural and permanent policy shift – one that demands long-term budgetary planning and coordination, not ad hoc national discretion. Similarly, the SAFE loan instrument, though sizable, offers limited value added beyond marginal borrowing cost advantages. Loans do not create fiscal space; they merely shift the burden forward in time, and not all member states have the same capacity or appetite to absorb additional debt. The reallocation of cohesion funds and the extension of the EIB's mandate are welcome signals but unlikely to move the needle significantly. These instruments are already overburdened by other pressing investment needs – from green and digital transitions to infra-

¹ Arnal, J., & Feás, E. (2024). *Competitiveness: the widening gap between the EU and the US*. Real Instituto Elcano.

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structure resilience. Meanwhile, the mobilisation of private capital, while desirable in principle, cannot be the cornerstone of defence financing. Defence procurement markets are structured as quasi-monopsonies, with governments as the dominant (and often only) buyers. Unless defence firms can count on predictable public orders, private investors will not step in. Public funding, therefore, remains the indispensable backbone of any serious European defence strategy.²

This financing model represents a missed opportunity. A common EU-level funding instrument would not only have sent a strong signal of unity and long-term commitment – it would likely have acted as a catalyst for greater coordination of national defence industrial policies, encouraging convergence in procurement standards, interoperability and supply chain integration. Without such a mechanism, aligning member states' defence efforts will become more difficult.

Ironically, the euro area already possesses a financial instrument capable of providing mutualised support: the European Stability Mechanism (ESM). With a lending capacity exceeding €420 billion, the ESM could – if politically reformed – be repurposed to support public investment in defence across member states. Its unused firepower and governance structure offer a ready-made framework that could be adapted to meet Europe's strategic needs, but the political will is lacking. Moreover, the ratification of the reformed ESM Treaty remains blocked by the Italian Parliament, which has so far refused to endorse it.³ Reframing the ESM as a tool for strategic investment in defence – rather than crisis management or financial conditionality – could help unlock this political impasse and give new relevance to a dormant but institutionally robust mechanism.

That said, there are structural and political reasons why the Commission has not been able to push further. First, the EU budget is under severe pressure, not least because of the impending repayment of the joint borrowing under NGEU. Second, appetite for mutualised financing is waning in some capitals, especially given that NGEU funds have so far been used mostly for national projects, with limited cross-border impact. Third, revisiting the newly reformed EU fiscal rules to introduce a golden rule for defence investment would have been politically unviable. And fourth, reforms of existing euro area instruments have repeatedly stalled: the Commission's 2017 proposal to transform it into a European Monetary Fund was never seriously discussed by member states, reflecting a broader reluctance to transfer fiscal sovereignty to the European level. The clearest sign that a coordinated, EU-level approach is no longer on the table came when Germany announced it would move forward unilaterally, reinforcing a national rather than collective dynamic.

While the EU's financial architecture for defence may be suboptimal, the scale of investment now underway must be harnessed effectively. Spain and Italy, in particular, have a role to play. Although they remain below NATO's 2% spending benchmark, they have shown operational commitment by contributing to NATO air and naval missions – something smaller member states, despite higher defence-to-GDP ratios, have been less able to do due to more limited capabilities. Their fiscal space may be limited but having received a disproportionate share of solidarity under NGEU, Spain and Italy are now expected to show the same spirit. Otherwise, other member states may begin to question the balance of mutual commitments. A visible and credible contribution to Europe's defence preparedness is not just a strategic imperative but also a matter of political legitimacy. Defence-washing will not go unnoticed.

More broadly, coordination is essential. Without a common funding vehicle, aligning national procurement choices is more difficult – but all the more necessary. Fragmentation would erode the value of new investments, while better coordination could reduce costs, enhance interoperability and strengthen the EU's industrial base. Ultimately, the composition of defence spending will matter as much as its volume. If unity of purse cannot be achieved, unity of purpose must be.

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² Arnal, J., & Blockmans, S. (2025). From free-riders to front-loaders. *CEPS Policy Brief*.

³ Arnal, J. (2023). Why holding up the ESM Treaty's ratification is a missed risk sharing opportunity for the Banking Union. *CEPS Explainer 2023-17*.