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Bertrand de Cordoue,
Advisor for Defence and European Armament, Jacques Delors Institute

BLOG POST

Proposals to meet the financial challenge of European rearmament

European countries are showing their determination to substantially increase their military spending (with a target of 3.5 to 5% of their GDP by 2035 announced at the last NATO summit). However, the realism imposed by budgetary constraints raises the question of the financial resources that would be needed to achieve this objective. It is in this context that a number of proposals have been put forward to increase the funds available to European States for defence investment (research and development, equipment production and maintenance).

What are the amounts involved? In line with a growing trend, budgets allocated by EU countries to investment in 2025 approached €130 billion (out of total defence expenditure of around €400 billion). These equipment appropriations therefore represent one third of total annual expenditure.With this expenditure currently standing at around 2% of GDP[1], reaching 3.5% would imply, for equipment appropriations alone and assuming that they continue to represent one third of the total, **an increase of €100 billion per year compared to the current level**. If we were to move to 5% of GDP, this would mean adding nearly €200 billion each year (then exceeding the current level of Pentagon investment appropriations).

This additional effort would, of course, have to be shared among the EU and its Member States and would logically weight first on those furthest from the 3.5% of GDP target (Spain, Italy, France and Germany, among the larger countries).

I • The EU's contribution to this unprecedented effort

Agreed at NATO under American pressure, the challenge of rapidly increasing funding for defence procurement was taken into account by the European Union as early as 2025 with the REARM Europe plan, combining **possible additional debt for Member States of up to €600 billion and a European loan of €150 billion: the SAFE programme**. Redistributed to Member States that have requested it, the SAFE envelope allows them to benefit from the EU's favourable borrowing rate and VAT exemption in return for European conditions (funds reserved for joint purchases of European equipment).

While it is still a little early to assess its impact, the SAFE mechanism has both advantages and limitations:

- The funds can be invested until the end of 2030, representing **an average annual amount of €30 billion**, which is significant compared to the €100 billion target, even if this money often replace national financing (as in the case of France).
- It is an à la carte programme, with each country free to propose the amount and content for which it wishes to subscribe, or not to participate at all (as in the case of Germany).
- The conditions for accessing SAFE are welcome incentives for the pooling of purchases by States on the one hand, and for European preference on the other.
- Designed to provide immediate support to Ukraine, it only finances the acquisition of equipment and does not contribute to research and development of future military capabilities, nor to the capital financing of companies in the sector.

Negotiations on the EU's future multiannual financial framework (MFF) will determine whether this mechanism, which weighs on the Union's debt level, should be renewed between 2028 and 2034, but the Commission's proposals are rather aimed at a substantial increase over this period in the share of the European budget devoted to the defence industry (which would increase from roughly 1 to 10 billion per year)[2]. Without anticipating the outcome, we can nevertheless expect the EU to cover through the MFF at least 10% of an additional annual effort of €100 billion. These European funds also have the advantage of leveraging national budgets, to which they are added, provided that they are spent in the frame of European cooperation and preference.

However, although beneficial in many respects, **the EU's financial intervention will in any case remain insufficient** to bridge the gap with the ambitious target of 3.5% of GDP, which applies to each country individually. It therefore seems necessary to devise other mechanisms, particularly for those furthest from the target and most indebted, who will not be able to increase their budget deficits any further.

In this context, the now shared priorities of European rearmament and its urgency have not escaped the attention of the financial world. Bankers, economists and investors have begun to take an interest, with undeniable creativity, in a sector that was previously considered unattractive, or even unsavory. Various mechanisms have been put in place or proposed to improve and increase public and private funding for defence activities.

II • Private finance in support of defence

Driven by governments, but also motivated by their own interests, many European players in the banking and private equity sectors are working to **create new tools for financing companies working for defence**, whether in the form of credit lines or venture capital. This financing helps to stimulate the innovation and production capacities of companies in the sector, particularly SME subcontractors. It strengthens the resilience and competitiveness of companies that depend on public procurement, sometimes subject to unpredictable demand and reluctant to take risks

The European Investment Bank's gradual opening up to the defence sector supports and stimulates these private initiatives. Similarly, measures taken to open up capital markets help to increase the investment capacity of companies and could have a useful effect in terms of consolidation. With regard to venture capital, the recent recommendations of the FIVE report[3], also point in this direction. Finally, some have suggested the creation of a sovereign institutional fund supported and governed at EU level and intended to invest in the defence sector[4].

Long hampered by ESG compliance rules that have now been largely blown apart by geopolitical realities, this **new openness of the financial world to the defence sector** is helping to make the industrial base more responsive and better able to meet increased demand. However, while it can significantly improve the return on government investment, this **development does not increase public military budgets *per se***.

III • Financing defence differently

At the public level, two types of proposals have been made to significantly help states increase their defence efforts:

- On the one hand, economists have noted that, as the **EU's debt capacity is far from reaching its limits**, there is a significant amount of liquidity that would be willing to invest in EU-guaranteed debt. Responding to the consensus on the need for defence funding, these economists propose **issuing Eurobonds specifically earmarked for Member States' military expenditure**, according to an institutional arrangement that would combine a structure responsible for issuing debt and an investment committee that would decide on the allocation of the amounts raised[5].

  This approach is mixing two objectives, that of common debt and that of rearmament, even though we know that the former is a subject of debate among States, unlike the latter. The **long maturity of the Eurobonds thus raised would also allow to direct funding towards preparing for the future** and R&D rather than immediate acquisitions (as SAFE already does). However, the terms and conditions for allocating the funds made available would need to be specified under an effective governance.

- DOn the other hand, some bankers, drawing on their experience in multilateral institutions, propose creating from scratch a European bank dedicated to rearmament[6] inspired by the EBRD model. In this case, the raising of funds would be backed by the bank's capital, to which States would be invited to subscribe, and their allocation would be proposed by the Bank and decided within an investment committee in which the latter would be represented. This would **concentrate in the hands of a single institution the financing, through loans, of military investment expenditure by the States that have subscribed to its capital**.

  Robust and financially stable, this new institution would have greater latitude to finance the entire spectrum of industrial armament activities, from upstream (R&D) to downstream (production and maintenance). It could also set up a line of capital investment in companies participating in the programmes it would finance.

Without going into detail about the rather elaborate mechanisms proposed by their promoters, and despite slightly different financial clauses, these two approaches have in common the fact that they **open up access to financing, through borrowing, of the additional €100 billion per year required for European defence investments**. They could also, through European conditionality, contribute to the industrial competitiveness of the sector: market decompartmentalisation, competition, European preference, joint purchasing, less dependence on budgetary fluctuations in Member States, technological innovation, dual-use exploitation, etc.

Neither contradictory nor mutually exclusive, the two options nevertheless raise a sensitive question of governance, particularly with regard to decisions on the allocation of funds, and would require an intergovernmental treaty to create them and lay down the rules for their operation. Providing a multinational response to a common challenge that is currently addressed at national level, they would require States to pool their defence funding to a certain extent and, consequently, the conditions for the use of these resources, which could go as far as the intervention of a new supranational level in their military investment choices.

The implementation of these instruments would therefore **require a sharing of sovereignty, which we know States are reluctant to do when it comes to defence**. This political objection can however be countered by the following argument: the use of the funds proposed by these new instruments would not be compulsory, **leaving each State free to use them according to its needs and priorities**. It should be added that, in the case of the Bank, states would remain free to invest in its capital and, conversely, it could be open to non-EU countries such as the United Kingdom (which also faces a significant defence funding shortfall).

Given their institutional dimension and the scale of the amounts involved, the establishment of either of these new financing structures would be revolutionary both for the methods of public arms procurement and for the defence industry in Europe. As the only ones capable of meeting the stake of an unprecedented increase in military budgets over time, they actually challenge Europe's ability to respond with cohesion. **But is there an alternative?**

FOOTNOTES :

[1] *See* Chiffre moyen pour l'UE, variant, en 2024, entre 1,3% (Espagne) et 4,1% (Pologne).

[2] *See* De Cordoue, Bertrand. *«* L'équation compliquée du futur budget de l'UE consacré à la défense », *Institut Jacques Delors*, Blogpost, (juillet 2025).

[3] *See* "Financing Innovative Ventures in Europe : Recommendations to close the scale-up financing gap, deepen the Savings and Investments Union and strengthen Europe's competitiveness", DG TRESOR, (janvier 2026).

[4] *See* Matelly, Sylvie. *« Investing in European defence industry: The case for a sovereign defence investment fund », Ares Group, (juillet 2025).*

[5] *See* Hildebrand, Philipp and Rey, Hélène and Schularick, Moritz « European defence governance and financing », *CEPR*, (novembre 2025).

[5] *See* Zettelmeyer, J. and Steinbach, A. and Wolff, G. « The proposed European Defence Mechanism: questions and answers », Analysis, *Bruegel*, (avril 2025).

[6] *See* Taylor, Paul. « Banking on Defence: Can a dedicated bank solve Europe's rearmament financing dilemma? », *European Policy Center*, (mai 2025).