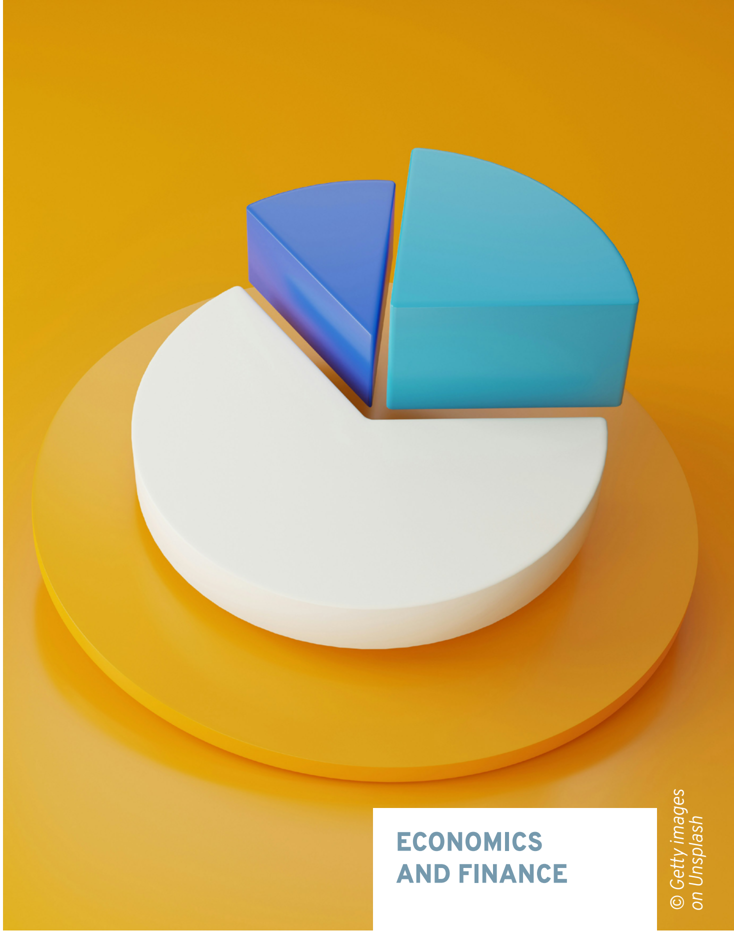

Europe's "rearmament" and the programmed obsolescence of its fiscal framework

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On 6 March 2025, the Extraordinary European Council approved most of the package of measures proposed by the European Commission President Ursula von der Leyen, aimed to finance an estimated €800 billion increase in military spending[1] . The key decision is to allow Member States to derogate from Community's budgetary rules under the "safeguard clause", which can be activated by Member States in the event of "exceptional circumstances beyond their control having a major impact on public finances". The "rearmament" effort echoes Donald Trump's call for the European Union (EU) to increase its military spending to 5% of GDP. In an interview published in the *Financial Times* on February 14, President Macron described as the budgetary rules "obsolete" ("from another age", he had already declared in 2019 in an interview with *The Economist*)

I • Increase the resources allocated to a genuine European defence policy

The purpose here is not to enter into the debate on the advisability of giving in to the injunctions of the President of the United States on the "existential" risks facing Europe as a result of the announced withdrawal of US of support for Ukraine, a possible challenge of the NATO shield or even an imminent threat from Russia on its borders[2]. However, a few figures may shed some light on the issue. Since the invasion of Ukraine, EU countries have already substantially increased their military spending which, according to the European Defence Agency (EDA) will reach 326 billion euros in 2024, an increase of more than 30% since 2021. For the 23 European countries members of NATO, this represents on average 2% of GDP,

1 "European Council conclusions on European defence, press release dated 6 March 2025.
2 For a more detailed analysis of the case for increasing European military spending, see Frédéric Mauro: "*Défense européenne: compter les dollars ou défendre les valeurs*", Note IRIS - Europe/Stratégie & Sécurité Programme, February 2025.

the target set by NATO in 2014 (ranging from 4% in Poland to 1.3% in Belgium).

It should be noted that the EU's military spending in 2024 was almost three times that of Russia, estimated at 98 billion euros in 2024[3]. Admittedly, Russia continues to invest heavily and plans to increase its defence budget to 126 billion euros in 2025. But European countries are not standing still. In the case of France, in particular, the 2024-2030 military programming law adopted in August 2023 includes a budget of 413 billion euros to "transform the armed forces to enable France to deal with the new threats (…)"[4]

The huge and precipitous growth of military budgets raises the question of how to allocate and optimize these resources, and even more so how to coordinate the defence policies of Member states, given the heterogeneity of their equipment and their dependence on external suppliers (in particular the United States)[5]. The reports by the European Defence Agency (EDA) and the European External Action Service(EEAS) on the "*Strategic Compass for Security and Defence*" set out objectives and roadmaps, but in the absence of a political consensus, the EU still lacks a common doctrine nor the and the impetus to move decisively towards an politically autonomous defence (not to mention a European pillar of NATO aimed at shifting the balance of power vis-à-vis the United States).[6]

II • Economic and financial challenges of the transition to a "War economy"

Let's look again at the financial implications of a massive increase in defence budgets, assuming an alleged increase to 3.5% of GDP equivalent to 250 billion a year for the EU. For France, this would mean an increase of €43 billion which would be difficult to reconcile with the current (and future) state of its public finances, given that its public debt is expected to reach 117% of GDP in 2026 (according to the latest forecasts by the European Commission) and to exceed 120% by the end of the decade.

Some politicians invoke the inevitable transition to a "war economy "to justify the near doubling of the defence budget. It is tempting to quote Albert Camus ("*To misname things add to the world's misery*"). A war economy implies sacrifices in the allocation of resources and the sharing of income, implying painful trade-offs that our political leaders are unwilling to make. Apart from raising taxes (an option President Macron has rejected a priori, and which would have other drawbacks), it would mean decisive cuts in social budgets, which in France represent almost 60% of public spending[7], as well as education and health spending, not to mention investment in the climate transition, which seem to have taken the back seat…

The massive and "imperative" rearmament thus seems incompatible with other budgetary commitments (including the preservation of a costly "social model"), nor with keeping public debt on a sustainable path. Two solutions, which are not mutually exclusive, are currently being put forward to resolve this trilemma.

3 However, the gap is smaller in purchasing power parity terms. For the record, Ukraine's military budget would have reached 44 billion euros by 2024 (source: Ukrainian Ministry of Finance).
4 "*La loi de programmation militaire 2024-2030: les grandes orientations*". Ministry of Defence, October 2023.
5 See Jean-Pierre Maulny : "*The Impact of the War in Ukraine on the European Defence Market*" IRIS / Europe - Defence & Security, September 2023 and Bertrand de Cordoue : *"L'Union Européenne et l'Industrie de la défense*" Infographie, Institut Jacques Delors, December 2024.
6 See Bertrand de Cordoue : "A White Paper on the future of European defence: what for?", Blog post of the Jacques Delors Institute - Notre Europe, February 2025 and Nicole Gnesotto: "Defence 25: thinking outside the box", Policy Paper - the Jacques Delors Institute - Notre Europe, January 2025.
7 See Julien Damon : "*Dépenses militaires versus dépenses sociales ?*", Telos, 25 February 2025.

III . A new EU loan for defence?

The first option proposed by President Macron was to resort to a new Community loan, along the lines of the Recovery and Resilience Programme – Next Generation EU (NGEU) launched in 2020 at the time of the Covidien pandemic, to finance the increased spending deemed necessary to rearm Europe. This raises the issue of the financial closure of such a loan, at a time when a large part of the contributions originally earmarked to repay the NGEU programme seems compromised: the Carbon Border Adjustment Mechanism (CBAM), already challenged because of the risks of circumvention and competitive distortion, is now being questioned by European industries under the pressure of the tariffs announced by Donald Trump and their possible collateral effects (in particular Chinese imports). What's more, the withdrawal of the United States from the OECD/G20 agreement on minimum taxation of multinational companies means that the revenue expected under this heading has been written off. As for other contributions, such as those based on non-recycled plastic waste, they are behind schedule and will remain marginal. To sum up, the repayment of a new Community's own resources is far from guaranteed, and the risks ultimately fall on the Member States, which are the guarantors and for whom it represents a long-term off-balance sheet commitment

Secondly, the transfer of national expenditure to the Community, while providing transitional budgetary relief to the Member States, is only justified if it aims at financing objectives of common interest implying close coordination and/or actions of a federal nature (as in the case of climate transition). According to this logic, the pooling of military expenditure through a community loan must form part of a common defence policy and a genuine strategic autonomy, otherwise it amounts to a debudgeting gimmick aimed at easing the constraints of over-indebted Member States.

Finally, a political consensus in favour of pooling new budgetary expenditure is unlikely in the context of growing divergences in member states' public finances and the recurring divide between "spendthrift" and "frugal" States. This is why, in the absence of a new NGEU-type loan, Europe's leaders have retained the Commission's proposal for a loan facility limited to €150 billion guaranteed by the European budget. It will therefore be up to the Member States to shoulder the bulk of the budgetary effort needed to achieve the claimed goal of an €800 billion increase in military spending.[8]

IV . "Easing (even more…) the European budgetary rules?

The second option, initially proposed put forward by Ursula von der Leyen and President Macron and finally endorsed by the EU Council on March 6, is to widen national fiscal room for maneuver by relaxing European budgetary rules, which raises a number of questions. The Stability and Growth Pact (SGP) came back into force in 2024 in a reformed version after a four-year suspension due to the pandemic and the aftermath of the war in Ukraine. This reform reflects a laborious compromise between the member states and had the dual objective of simplifying and "appropriating" rules that had previously been little respected (one in five in the case of France or Italy…). The generic references of 60% and 3% of GDP for public debt and deficits (accompanied by standards set on primary structural balances) have been maintained. The main innovation was the introduction of multiannual medium-term expenditure targets specific to each country which provide a "plausible" guarantee of the sustainability of its debt over a four-year horizon (or 7 years, subject to the implementation of structural reforms to support its potential growth and the Union's objectives)

However, the objective of simplification is far from being achieved, and the indicator of public expenditure, now called the "central

8 Other possible sources of funding were mentioned, including coming from the European Investment Bank - EIB (which would have to extend its mandate to include the financing of military expenditure), or even the use of cohesion funds from the European budget

operational variable", leaves one perplexed as to its economic relevance. Excluding interest on debt and expenditure financed from European funds, it is also supposed to be immune to cyclical fluctuations (while only the cyclical component of unemployment expenditure is excluded); it is also adjusted for "one-off" or "temporary' expenditure", which exposes it to the risk of various accounting manipulations.

The experience of a first year of implementation provides some clues of how the new SGP will be applied[9]. Since September 2024, the Commission has examined twenty-two Medium-Term Structural Budget Plans (MTFSPs). Twenty of them have been validated (the Hungarian plan is still pending). The only plan rejected has been that of the Netherlands, and it is interesting to draw a parallel with that of France (approved even before Its budget for 2025 was voted). The public debt in the Netherlands was 44% of GDP in 2024 (the lowest in the EU after Luxembourg and Estonia), compared with 112.7% in France; its structural primary balance is limited to –0.5% of GDP, compared to –4.0% in France, which is under the excessive deficit procedure. However, the Commission rejected the Dutch plan on the grounds that the announced spending strategy may bring the debt to the 60% reference value in 2033. At the same time, it validated the French plan on the basis of a hypothetical slowdown in its annual rate of its nominal public expenditure from 4% (the trend observed since 2021) to 1% by 2029, supposed to bring its deficit down to 3%[10], while its public debt would continue to rise from 112.7% to 122.6% over the same period.

The simplification claimed by the SGP reform is clearly not forthcoming. Moreover, we are touching here on the limits of the objective of "national ownership" of a mutual surveillance framework that gives States Member broad prerogatives in defining and controlling their own spending. In this case, instead of encouraging symmetric budgetary adjustments and the emergence of a common economic policy orientation, a country wishing to make use of its budgetary room for maneuver is punished while the programme of a country whose debt is drifting dangerously out of control is validated[11] . The experience of this first year of management of the SGP illustrates the limits of its reform, and more particularly those of its "central operational variable" conceptually debatable and difficult to interpret. The exclusion of new military expenditure from this indicator, without a precise and commonly accepted definition of its nature (investment in equipment, maintenance, operations, etc.) risks further weakening a budgetary framework that lacks a common compass.[12]

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To conclude, an increase in the EU's military budgets, over and above the considerable resources already mobilised by the Member States from 2022 onwards, is justified if it allows the emergence of a European defence capable of addressing the geopolitical challenges of the day. However, its financing raises the question of how to control public spending at a time when Europe will also have to make massive investments to cope with the climate transition and stem its economic decline.[13]

In the absence of a consensus on the launch of a major Community loan financed by its own resources (at a time when those earmarked for the NGEU programme are no longer guaranteed), the EU's "rearmament" effort

9 See N.E. Boivin and Darvas: "*The European Union's new Fiscal Frameworks: a good start, but challenges loom*", Bruegel Policy brief, February 2025.
10 It should be noted that the 3% of GDP threshold for the public deficit is often wrongly presented as the long-term reference objective, whereas it is actually around –1% to –1.5% for the structural balance in order to preserve the countercyclical margins for maneuver in budgetary policies.
11 French sovereign debt was downgraded at the end of 2024 by Moody's and given a "negative outlook" at the end of February by Standard & Poor's. The spread on France's 10-year sovereign debt is now on a par with that of Spain and Portugal, and only around 30 points lower than that of Greece and Italy.
12 See Pierre Jaillet : "*Un pacte d'instabilité ?*", Telos, January 2024.
13 See Mario Draghi's report, "*A competitiveness strategy for Europe*", September 2024.

will place a heavy burden on the finances of Member States that are (for the most part) already highly indebted. It will entail painful budgetary trade-offs and cannot serve as a mere alibi for relaxing Community rules, which the reform of the SGP has already made very flexible. The experience of the first year of its implementation already casts doubt on its ability to keep public debts on sustainable and mutually compatible paths. Far from being "obsolete", the need for a sound and reliable fiscal framework is more relevant than ever in order to reactivate the process of economic convergence and to promote a common economic policy orientation which, as much as its military capabilities, must enable the EU to face the challenges of a more conflict-ridden world.

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