

How Do You Pay for Rearmament?

Europe Has Found the Will to Spend. It Has Not Yet Found a Permanent Way to Finance It.
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IDEA IN BRIEF

THE COMMITMENT

Europe has pledged to spend €800 billion on defense by 2030, and the political will to do so is real. NATO’s new target is 3.5% of GDP by 2035, rising to 5%. For most member states, this means roughly doubling current defense budgets.

THE PROBLEM

The financing architecture is temporary, unequal, and contested. The national escape clause—which provides the bulk of fiscal flexibility—expires in 2028. Five member states have debt above 100% of GDP and limited room to borrow. Defense competes with green transition, ageing, digital infrastructure, and rising debt service for every percentage point of fiscal space. And the EU’s own instruments—SAFE, EDF, EDIP—total less than €200 billion, a fraction of what national budgets must deliver.

THE QUESTION

Europe has found emergency fiscal mechanisms, but it has not yet built a permanent financing architecture for the level of defense spending the security environment demands. That architecture—not the money itself—is the binding constraint.

The numbers are staggering. EU-27 defense spending reached three hundred and eighty-one billion euros in 2025, up sixty-three percent from 2020. Germany has reformed its constitutional debt brake to unlock an estimated four hundred billion euros for defense through the mid-2030s. The European Commission’s ReArm Europe plan aims to mobilise eight hundred billion by 2030. NATO’s new spending commitment, agreed at The Hague in June 2025, sets a minimum of 3.5 percent of GDP by 2035, with an ultimate target of five percent.

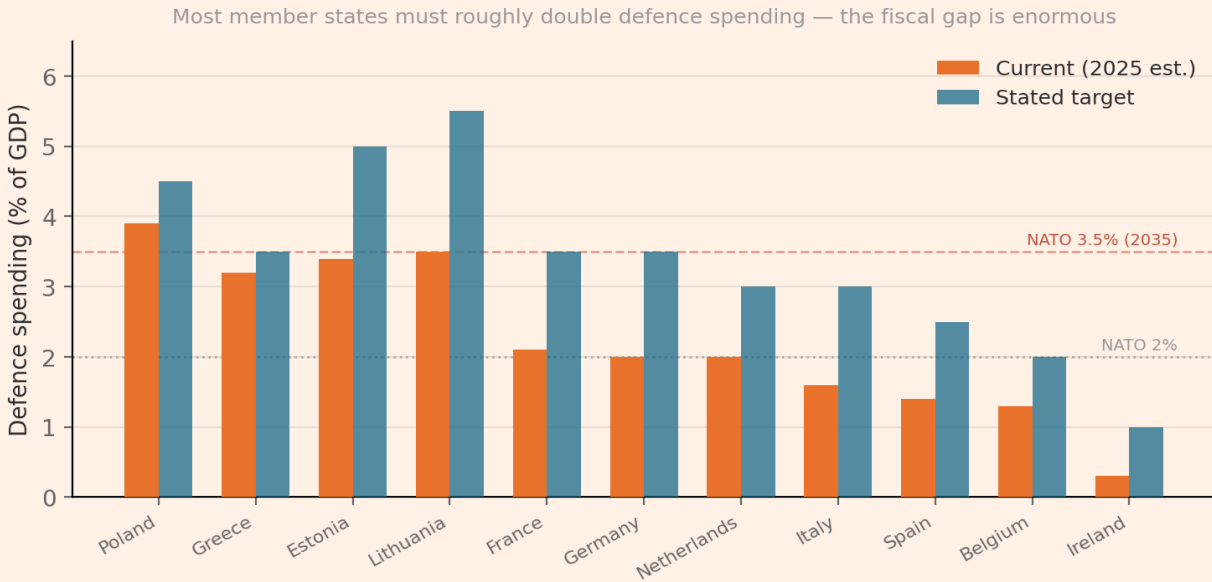
These are not simply aspirational figures. Seventeen of twenty-seven member states have already activated the national escape clause of the Stability and Growth Pact to begin spending above normal fiscal limits. The SAFE loan instrument—a hundred and fifty billion in EU-backed credit—was adopted in

May 2025 and is operational, against a political consensus that European rearmament is broader and deeper than at any point since the Cold War.

But political consensus does not amount to fiscal architecture. The question is no longer whether Europe wants to spend more on defense; it does. Rather, the question is whether it can sustain the spending levels the security environment demands—and whether the financing mechanisms currently in place can survive the transition from being an emergency response to being a permanent structural commitment.

The answer, at present, is that the mechanisms are temporary; the fiscal space is radically unequal across member states; and defense is only one of several enormous claims competing for the same constrained budgets.

The Spending Gap: Current vs Target



Sources: European Defense Agency, NATO, national government pledges. Current spending (2025 estimates) versus publicly stated national targets. The gap between current and target is the fiscal problem in miniature.

THE FINANCING ARCHITECTURE

Europe's current defense financing operates through five principal mechanisms, each with different scales, constraints, and expiry dates.

The national escape clause is by far the largest instrument. Activated under the Stability and Growth Pact, it allows member states to increase defense spending by up to 1.5 percent of GDP without triggering excessive deficit procedures. If all twenty-seven member states used the full allowance, this would create fiscal space of roughly six hundred and fifty billion euros over four years. In practice, seventeen have activated it so far. The clause is available from 2025 through 2028— for four years. After that, normal fiscal rules resume, and any defense spending above the endorsed expenditure path must be financed within standard fiscal constraints.

The SAFE loan instrument provides up to a hundred and fifty billion euros in EU-backed loans, raised on capital markets and disbursed to member states based on national defense investment plans. SAFE is focused on joint procurement, meaning that member states which buy together get preferential

terms. The instrument runs until 2030, and importantly it is debt, not grants: member states must repay the loans, adding to national liabilities even if the borrowing costs are lower than sovereign rates for some countries.

Germany's debt brake reform is the single largest national commitment. The spring 2025 constitutional amendment exempts defense spending above one percent of GDP from the debt brake, creating cumulative capacity of approximately four hundred billion euros through the mid-2030s. This is on top of the hundred-billion-euro special defense fund established in 2022, which is expected to be exhausted by 2027. Germany's reform is structurally significant because it is permanent rather than temporary—but it applies only to Germany.

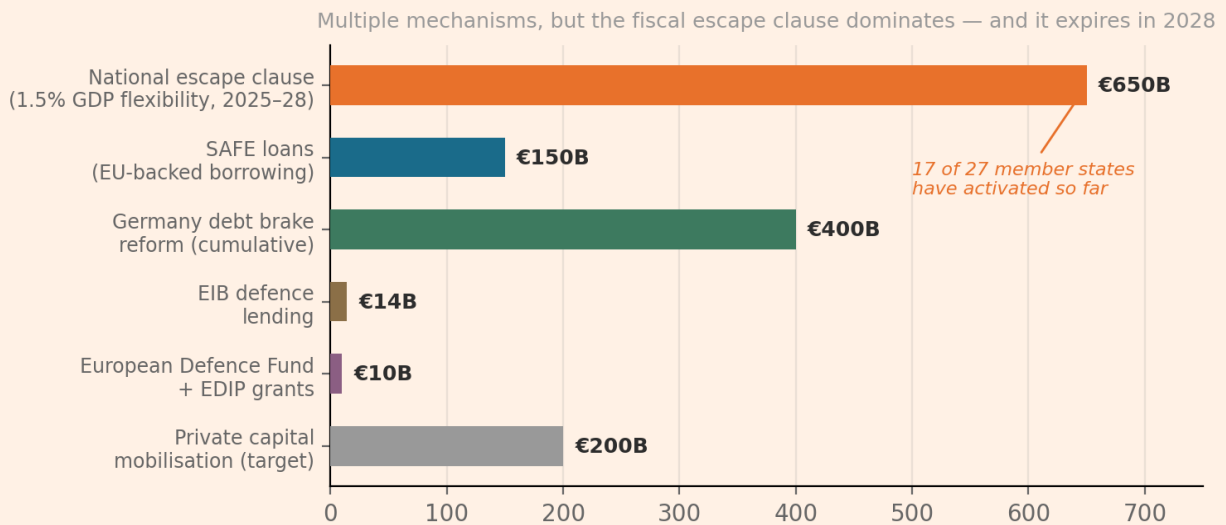
EU-level instruments —the European Defense Fund, EDIP, and EIB defense lending—are real but comparatively small. The EDF commits roughly eight billion euros across 2021–2027 for collaborative R&D. EDIP adds 1.5 billion in grants for 2025–2027. The EIB, having revised its lending rules to cover defense, plans 3.5 billion per year. These are important for coordination and signalling, but they

are a rounding error against the hundreds of billions required at national level.

Private capital mobilisation is the most speculative channel. The European Commission has proposed public guarantees that could leverage up to two hundred billion euros in private investment across defense, security, and dual-use technology. But

Europe’s defense sector has historically faced significant barriers to private capital: ESG exclusions, fragmented regulatory environments across twenty-seven jurisdictions, and investor caution about a sector where the customer is a government with unpredictable procurement timelines.

The Financing Architecture for European Rearmament



Approximate scale of principal financing mechanisms for European defense, 2025–2030. The national escape clause dominates but expires in 2028. Germany’s debt brake reform is permanent but applies only to Germany. Sources: European Commission, Consilium, Bundestag, EIB.

*The escape clause is a four-year bridge.
Europe has not yet decided what is on the other side.*

THE FISCAL SPACE DIVIDE

The most distorting feature of European defense financing is the radical inequality in fiscal capacity across member states. The escape clause offers every country the same percentage flexibility—up to 1.5 percent of GDP—but the ability to use that flexibility depends entirely on where each country starts.

At one end of the spectrum, Estonia, Bulgaria, Luxembourg, Denmark, and Sweden all carry government debt below thirty-five percent of GDP. Therefore, these countries have substantial borrowing capacity. Estonia’s debt is just twenty-four percent of GDP; it could double its defense spending through borrowing without approaching the Maastricht threshold.

At the other end, five member states (Greece, Italy, France, Belgium, and Spain) carry debt above a

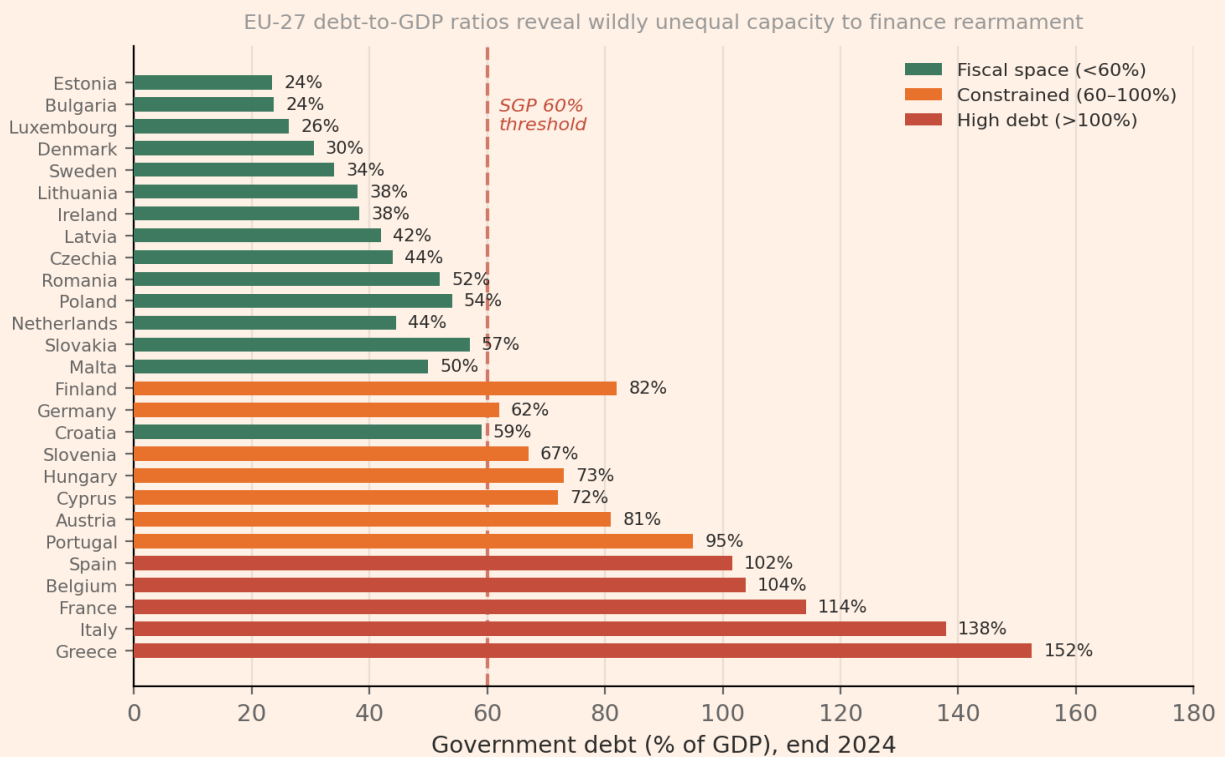
hundred percent of GDP. France is already running a deficit of nearly six percent. Italy's debt stands at a hundred and thirty-eight percent. These countries face a genuine fiscal trilemma: they cannot simultaneously sustain existing social spending, service their debt, and ramp up defense expenditure without something giving way.

The irony here is unforgiving, in that some of the countries with the greatest fiscal space—the Baltics, the Nordics, much of Central and Eastern Europe—are already among the highest defense spenders as a share of GDP, driven by proximity to Russia. The countries with the least fiscal space—France, Italy,

Belgium—are the ones being asked to make the largest absolute increases in spending to meet NATO targets, and they are the ones least able to borrow their way there.

Germany occupies a unique intermediate position. Its debt-to-GDP ratio of sixty-two percent is manageable, and the debt brake reform has created genuine long-term capacity. But Germany's solution is constitutionally specific—it required a two-thirds supermajority in the Bundestag—and cannot be replicated across the EU through any existing mechanism.

The Fiscal Space Divide



Government debt as a percentage of GDP, end 2024. Fifteen member states are below the SGP 60% threshold (green). Twelve are above, of which five exceed 100%. The countries with the least fiscal space face the largest absolute spending increases. Sources: Eurostat, European Commission.

THE COMPETING CLAIMS

Defense is not the only large structural spending commitment Europe faces. The green transition requires sustained public investment in energy infrastructure, building renovation, industrial decarbonisation, and adaptation. The European Commission's own estimates imply additional green

investment needs of 0.5 to 1.5 percent of GDP annually. Demographic pressures are intensifying across most member states, driving rising pension, healthcare, and long-term care costs that will add an estimated 0.8 to 2.0 percent of GDP in additional spending over the next decade.

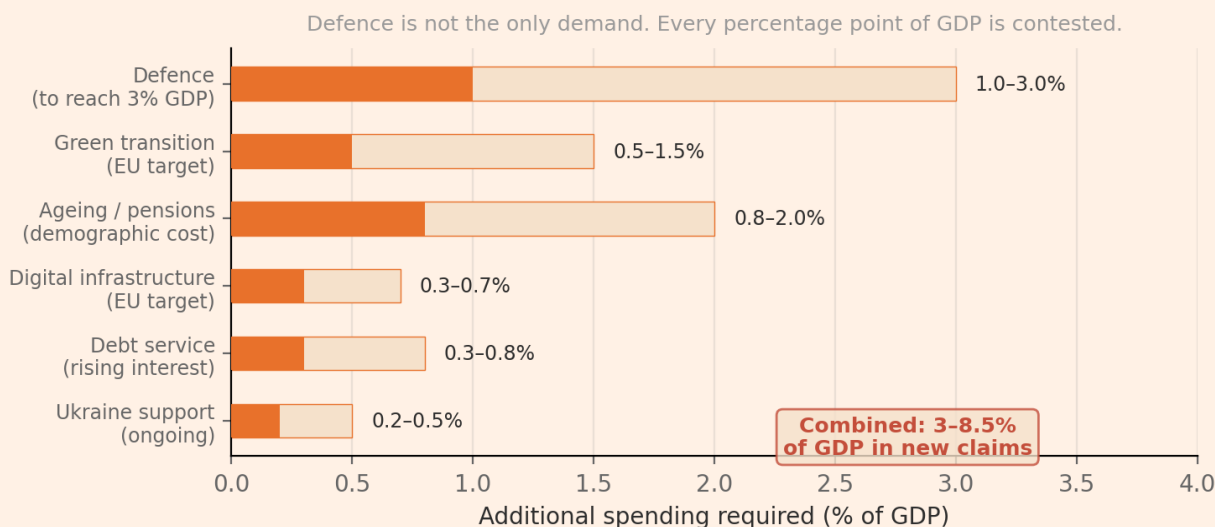
Digital infrastructure, including broadband, AI capabilities, and cybersecurity, represents a further

claim of 0.3 to 0.7 percent of GDP. Debt service costs have risen to their highest level since the Great Financial Crisis, consuming an increasing share of government revenues. And ongoing support for Ukraine—military, economic, and humanitarian—represents a further open-ended fiscal commitment.

When these claims are aggregated, the total additional spending pressure on European governments runs between three and eight percent of GDP; the escape clause only provides 1.5 percent for four years. Thus, the arithmetic does not resolve.

This is not an abstract accounting problem; it is a very real and urgent political economy problem. Every percentage point of GDP allocated to defense is a percentage point not available for pensions, healthcare, climate, or education. In democracies, these trade-offs are made visible at the ballot box. Governments that raise defense spending at the expense of social services face electoral consequences. Governments that borrow to avoid the trade-off face bond market consequences. Put clearly, there is no painless path.

The Competing Claims on European Fiscal Space



Estimated additional spending requirements across major structural commitments, expressed as a percentage of GDP. Ranges reflect variation across member states and time horizons. Combined claims of 3–8.5% of GDP vastly exceed available fiscal flexibility. Sources: European Commission, OECD, Ageing Report, national estimates.

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AFTER THE ESCAPE CLAUSE

The national escape clause expires at the end of 2028. At that point, unless the fiscal framework is reformed, member states will need to finance

defense spending within the standard Stability and Growth Pact rules. For countries already in excessive deficit procedures—France, Italy, Slovakia, Romania among them—this means that

any additional defense spending will require equivalent cuts elsewhere or additional revenue.

There are, broadly, five paths forward.

Permanent fiscal carve-outs for defense. The most straightforward option would be to permanently exempt defense spending from fiscal rules, as Germany has effectively done at the national level. This would require amending the Stability and Growth Pact—a politically fraught process that would reopen arguments about fiscal discipline, moral hazard, and the credibility of the EU’s fiscal framework. Northern European creditor states would likely resist any permanent weakening of fiscal rules, even for defense.

EU-level joint borrowing for defense. The SAFE instrument already represents EU-level borrowing on behalf of member states. A more ambitious version—permanent EU defense bonds, analogous to the pandemic-era NGEU borrowing—would allow the EU to raise capital at scale and distribute it to member states. This would be transformative for high-debt countries, but it faces the same political resistance that every proposal for common European debt encounters: northern states fear that they are underwriting southern profligacy. The precedent of NGEU may make this marginally easier, but the political barriers remain formidable.

Revenue-side reforms. Some member states may choose to finance defense through higher taxes rather than borrowing. Defense levies, windfall taxes, or reallocation of existing revenues are all technically feasible. But tax increases are politically toxic in most European democracies, and defense spending increases are already unpopular with electorates that prefer social spending. Revenue-side solutions are available in principle but highly constrained in practice.

Expenditure reallocation. Governments could shift spending from other areas into defense. In practice, the politically feasible candidates for cuts—development aid, administrative costs, cultural programmes—are too small to matter at the large scale required. The areas large enough to provide meaningful reallocation, such as pensions, healthcare, and education, are politically untouchable in most member states.

Efficiency through coordination. The final option is to generate more capability from the same spending by eliminating duplication and consolidating procurement. As the companion paper

on European defense procurement argues (“Europe’s Defense Problem Isn’t Spending”), the fragmentation of twenty-seven national systems imposes an enormous hidden cost. Joint procurement, standardisation, and consolidated production runs could dramatically improve the ratio of capability to expenditure—in effect, making each euro of defense spending go further. This of course does not solve the financing problem, but it does reduce the amount of financing required to achieve a given level of capability.

THE ARCHITECTURE PROBLEM

The financing challenge facing European defense is ultimately an architecture problem.

Europe has found emergency mechanisms (the escape clause, SAFE, the German debt brake reform) that provide short-term fiscal space, and these mechanisms are real and are working: defense spending is rising sharply.

But they are temporary, nationally fragmented, and structurally insufficient for the level of spending that European security now requires on a permanent basis. The escape clause bridges four years, while SAFE runs for five. Germany’s reform is permanent but applies to one country. Private capital remains speculative, and the EU’s own grant instruments are measured in low single-digit billions against a problem measured in hundreds of billions.

What is missing is a permanent European fiscal architecture for defense: a mechanism that allows member states with different debt levels, different fiscal traditions, and different political constraints to sustain defense spending at three to four percent of GDP without periodic crises of fiscal sustainability.

Building that architecture will require confronting questions that European leaders have spent decades avoiding: Should the EU borrow jointly for defense on a permanent basis? Should fiscal rules be permanently redesigned to accommodate structural security spending? Should burden-sharing mechanisms redistribute the cost from high-debt to low-debt states? Each of these questions touches the foundations of European fiscal governance.

The urgency is real. The escape clause expires in less than three years. If no permanent mechanism is in place by then, European defense spending will collide with the same fiscal rules that constrained it for the previous two decades. The era of

rearmament will have lasted four years—and the financing architecture will have been a bridge to nowhere.

In short: Europe has found the will to spend, but it has not yet found a permanent way to pay for it.

This article draws on two formal frameworks: coordination architectures and adaptive bandwidth (from “Institutions as Coordination Architectures”) and architecture lag and premature markets (from “Market Formation as a Systems Engineering Problem”). Companion article: “Europe’s Defense Problem Isn’t Spending.” Contact: s@sinead.co