

Financing Defence in Europe – the Way Ahead

Presidency Issues note for the April Informal ECOFIN Council

Introduction

The EU has taken significant steps in recent months to increase defence funding in response to growing geopolitical tensions. In March 2025, the European Council held two summits, on the 6th and 20th, focusing on strengthening the EU's defence capabilities. A major outcome was the endorsement of the "ReArm Europe" initiative, a five-point plan aiming to mobilize up to €800 billion in defence spending over the next four years. Leaders also urged the Council and the Parliament to quickly advance new proposals on defence funding and procurement.

New initiatives of defence financing in Europe

The ReArm Europe Plan presented by the European Commission outlines several key methods for financing increased European defence spending. One of the key components is the **Security Action for Europe (SAFE)**, a loan mechanism worth up to €150 billion aimed at supporting joint procurement. Additionally, the plan proposes **using flexibility of the EU fiscal rules**, thus providing Member States with more room to spend on defence. In the communication published on 19 March, the European Commission proposed the possibility of coordinated use of the national escape clause (NEC) of the Stability and Growth Pact by all Member States due to the exceptional circumstances of Russia's aggression against Ukraine and the deteriorating security environment. The Commission encourages states to submit NEC applications still in April and anticipates that the Ecofin Council could adopt the relevant recommendations in July.

Another aspect of the plan is the exploration of **more flexibility of the European Regional Development Fund within cohesion policy**, to support defence-industrial production. However, public funding alone will not be sufficient to meet the scale of Europe's defence needs. This is why one of the supplementing elements of the European plan is the **mobilization**

of private capital to increase investment in defence. Historically, European defence companies have faced challenges in accessing private financing due to several factors. Many institutional investors have been hesitant to fund defence industries because of reputational concerns. In particular, until recently, the European Investment Bank (EIB) excluded nearly all defence-related financing. Additionally, regulatory complexity has discouraged long-term private investment in this area. Therefore, **the recent change in the EIB's lending policy has become crucial** for engaging the EIB in defence and security financing and sending a strong signal to the markets that investments in defence are just as legitimate as those in infrastructure or any other priority projects.

Furthermore, **the Polish Presidency is committed to simplifying regulations**. This means not only improving rules specific to the defence sector but also reviewing broader EU policies that, even if not directly related to defence, make it harder for the European defence industry to respond quickly to our security needs. The Defence Omnibus Simplification, which will be published in June, should contribute to this process.

Are our efforts enough?

The Polish Presidency has commissioned Bruegel to prepare an analysis assessing the adequacy of the recent efforts and proposing additional solutions to the existing challenge of insufficient defence financing.

According to Bruegel's assessment, ambitious rearmament goals set by the EU need improved governance and fiscally feasible financing. The procurement and production processes suffer from limited scale and low competition, which leads to high costs for weapons and other military equipment. Europe's defence industry is fragmented, and the development timelines for advanced technologies are lengthy. As they note, **military burdens are unevenly distributed**, with significantly higher defence spending in countries located on the EU's eastern border, particularly those sharing a border with Russia and Belarus. This trend is evident in the figures, as in 2024, the US fell to third place in NATO military spending as a percentage of GDP, following Poland and Estonia.

As Bruegel stresses, greater cooperation, joint procurement, and reduced fragmentation of the European defence market are essential to lowering the cost of planned rearmament. Although the authors acknowledge progress in the EU's efforts to strengthen Europe's defence capabilities (in particular by strengthening the supply of military goods – EDF, ASAP and coordinated procurement demand – EDIRPA, ReArm Europe Plan), they remain moderate in their assessment of how effectively these measures will help overcome the current weaknesses of the European defence market and achieve the goal set by EU leaders at the European Council summit in March, which is to ensure Europe's defence readiness by 2030.

According to the authors, the interest rates on loans under the SAFE mechanism will not be a significant incentive for many EU countries. Any potential savings, and thus the motivation to use this instrument, will be limited. The authors also expect that the NEC will have limited impact on increasing the defence expenditure. Moreover, according to Bruegel, under ReArm, the cost of higher defence spending would be *entirely (or in the case of high yield countries borrowing through SAFE, almost entirely) borne at the national level*. This may further discourage coordination and lead to higher prices. Finally, the authors argue that the new EU proposals do not address the challenges of delivering large-scale projects such as strategic enablers, nor do they tackle what is referred to as “free riding” on frontier countries. The authors suggest two possible approaches to addressing the current shortcomings in European defence policy. The **incremental approach** focuses on strengthening existing institutions for procurement and funding to achieve better coordination. It suggests reinforcing EDA to **centralize procurement and capability planning** and PESCO as a framework for coalitions willing to develop “strategic enablers”. It would include also a so-called **"SURE Plus" funding mechanism**, which would involve not only EU budgetary headroom, but also guaranties of the participating states. In order to significantly increase available financial resources, it could extend EU-based lending to non-EU countries.

The second approach, called by the authors a **transformational** one, proposes creating a **European Defence Mechanism**, a new intergovernmental institution, to centralize procurement and financing. Its membership would comprise the largest European countries,

including the UK, as well as other willing European countries. Members would adhere to defence single market rules and refrain from national procurement in areas where joint procurement has been agreed. The borrowed funds would be allocated for joint procurement in critical areas, financing and ownership of European strategic enablers and defence-related lending for Member States, with lending available through two channels: a standard option accessible to all members and a subsidized option reserved exclusively for "frontline states." Member States would pay for the assets procured through the EDM upon delivery or via a leasing model. Under this model, the EDM would acquire the assets and lease them to Member States. The "share" of assets allocated to each state would be determined either by the offtake-share agreed at the beginning of the procurement project or by the capital key for projects in the area of strategic enablers. The EDM could also own defence assets that generate shared benefits, such as highly costly strategic enablers, and charge usage fees to its members, thereby reducing the budgetary impact of rearmament.

The Bruegel paper represents the sole responsibility of its authors but should serve as a candid and constructive basis for discussion among ministers.

Questions for discussion

- *Do you agree with Bruegel's assessment that placing the cost of increased defence spending almost entirely at the national level may discourage cooperation and drive up the cost of planned rearmament?*
- *What are your thoughts on the proposals presented in the analysis?*