

Danuta Hübner

The Budgetary Implications of Increased Defence
Spending

DELPHI ECONOMIC FORUM XI

DELPHI, 23 APRIL, 2026

Europe is in the worst security situation since the end of the Cold War and Russia is the most important and urgent threat. Still, today, the security is global and all risks are interconnected. We need unity and the will to defend ourselves because we might not avoid the war. The window of opportunity is narrowing. There is the sense of urgency. It is not a panic, though. The Russian aggression, in combination with huge progress in technology and field experience, pushes European military sector toward developing capability to collect

huge amounts of data, process them, quickly adapt to changing situation, managing the risk and coordinate diversity.

But we also need political strategic leadership to look forward, scan the horizon, have vision, think big and wide, see context, be able to take decisions in uncertainty, be capable to manage risk without avoiding it. Can the current Europe's structures and institutions provide such a leadership?

For years in the context of crisis episodes the issue of European public goods has been emerging and in the current global context it has become a fundamental question. Taking into account the time pressure and rather different perception of the threat among member states, the question is whether the option to build defence as a European public good is feasible, in particular regarding politically sensitive issues. It would require deep coordination and exploitation of synergies

across the Union, as well as construction of European defence market. Knowing how slow Europe can be in orchestrating its decision making and where the security and defence competences sit, this approach would need time which Europe does not have. Should Europe therefore rather rely on decisions of member states across the Union or even of a smaller group of the leading states, with the largest effort and potential, including those with nuclear weapons ?

Common sense suggests that we do not have the luxury of choosing one of these options and in the short and midterm we should rather see all of them as mutually reinforcing long term processes. In the long term, it seems legitimate to insist on moving toward defence as a European public good.

Among many options, recasting public finance is a strategic choice, which to be effective would require a sustained political pressure. To meet the 2035 or an earlier deadline, the main constraint would be the political will. Economic constraints, in my view, might be less resistant, though the situation will most likely differ among member states.

In pragmatic terms, in most of the European countries fiscal space can be identified if accompanied by a reprioritisation. This might be in particular true in large economies like France, Italy, Spain where the debt level is high but manageable.

In Germany, Netherlands, Nordics and Poland there will be borrowing capabilities. One should, though, bear in mind Poland's constitutional debt limit of 60%.

The crucial thing is that while Europe is the second largest defence spender after the US, our military

capabilities are a fraction of others. Reducing the gap between investment and defence potential is the challenge. Efficiency matters.

The additional challenge which might be seen as facilitator of the rearming of Europe is that defence undertaking is seen as a crucial leverage for the industrial policy and contribute to growth, create innovation, bring new technologies, startups and scaleups. The potential to upgrade competitiveness of Europe is strongly linked with the defence spending. In the current context, the defence dividend is seen as a solution to all European problems in terms of competitiveness and security. That is why Europe needs to rearm fast and deeply. Among the recently activated enablers that might matter strongly is the new approach to competition policy. It extends the space for fusions and mergers, can accelerate scalingup, and building the European defence market.

Limited time does not offer the luxury of long road maps, phases, complex institutions. Investment in innovation must be massive and imminent. The commitment to accelerate implementation of the One Market initiative gives a chance to open new investment options.

This rather multidimensional context implies that the fundamental role in terms of long-term financing of defence and security will not belong to trade-offs within national budgets. Nevertheless, there are many ways and means that would reduce the urgency and political risk related to national budget instruments and thus would make national recasting feasible, in addition to political will and political energy. Some of them could have a direct role with others indirectly influencing it. I think it is important to see them jointly. I would start the list with the idea of defence as a European public good, both in terms of operational dimension of the process and its financing. Another crucial dimension would be creating

capabilities to crowding private investment in. This would require building of European capital market, making it both attractive to global investment and enabling channelling the biggest globally, European savings of 33 trillion euros, of which one third sleeps on bank accounts, to the places when investment funding is needed. It goes without saying that a sine qua non pre- condition for a fully-fledged, deep and liquid European capital market, European safe assets would be needed.

Joint European financing could be a real game changer for the long-term expansion of European defence market and potential. The role of the EIB moving toward higher risk space and becoming a European version of national development banks would be yet another amplifier in defence industrial financing. Carving defence out of deficit rules under SGP accompanied by both General and National Escape Clauses have been already tested by the system.

The need to reach out to multiple instruments and options will require good coordination, focus on exploiting synergies, sharing the power and competences between national and European level, which depends on political will and unity. Fundamental role will be played by enablers provided by efficient ecosystems that would include incentives coming from connecting all those multiple places where change will be rooted in and driven by.

In the EU, the state aid amounts to 1,4% of GNI, is therefore bigger than the MFF. The Report of Enrico Letta proposes to communitise state aid which would replace the missing European central fiscal capacity. It's worth underlining the importance of own resources. To respect the IIA signed in 2022 in the context of Covid related debt, its repayment which starts in 2028 should be financed from the own resources. Failure to have in place by 2028

sufficient own resources could negatively influence political will to move toward new debt. The decision on own resources requires unanimity and national ratifications. Enrico Letta has also proposed in his Report the idea of 28th regime that can become an unprecedented incentive for growth and innovation. The first step in this direction has been already made by the Commission and seems to get also the support of many member states in the form of the EU Inc. The corporate legal framework for the 28th regime, in particular for innovative startups and scaleups, but not only, was published in March by the European Commission and requires QMV to be approved in the Council. It is an unprecedented proxy for harmonization and once established in one member state could be operating across the EU.

Long awaited amendments to the European rule book for competition, mentioned above, would facilitate emergence of big global European companies.

We see also that initial approach to the simplification and Omnibus technology are evolving toward a new way of governance, targeting directly competitiveness and becoming de facto a governance reform. Hopefully, One Market Road Map will be agreed in the months to come and Europe will start moving toward European capital market.

Moving toward enhanced cooperation, if needed, would open new territories for comparative advantages of individual member states contributing more powerfully to European security and competitiveness. Using the MFF as a financial leverage to crowd in private capital, already emerging, inspired by the MFF, new sources and forms of financing, Commission's recommendations for member

states regarding introducing of individual investment accounts, would augment the added value of the MFF. Good news would be if discussions on a potential European Treaty on Defence and Security materialise, making Europe better prepared for post war security challenge and consolidating European NATO potential.

All those instruments, enablers, facilitators and game changers, which individually would have limited power to boost the desired potential, as they face different sensitivities and a variety of situations in member states, could be converted into a European ecosystem and generate powerful beneficiary effects. The Commission should be encouraged to build out of those pieces an incentivising ecosystem and move fast, if needed, toward enhanced cooperation.

Europe seems to know how to move fast in the time of urgency and emergency. In 2022, it managed to find a way

to engage deeply in the support for Ukraine, and reduce dramatically over a short period the Russian energy dependency and accelerate the enlargement process. In 2025, it managed to accelerate building new international relations. This time around, the challenge will be the courage of the Council and its readiness to share more generously security and defence related competencies with the Commission.

The option to base our security and defence potential on financing through national taxation and coping with consequences of spending trade-offs, might seem to some an encouraging path, it can, as well, become an imminent real bottleneck. Similarly, EU fiscal rules and their interpretation can become another bottle neck.

The question therefore is what is the way forward on the path toward higher taxes, cuts in welfare spending, more debt or a combination of all three. I would say that maybe

not all of them should get involved by default but in practise Europe might end up using all three levers in different combination, depending on the country and the political moment. There is not a single solution, a silver bullet, that would allow to avoid trade-offs. I would also see here as a faciliator the already mentioned Letta's report recommendation regarding communitisation of the state aid.

Higher taxes are very likely, but most likely selective, and rather indirect. Broad based tax hikes across the EU would be politically difficult. Governments would move rather gently toward broadening the tax base and reducing exemptions. There is a space for VAT adjustments, as well as for some targeted levies as the debate on own resources demonstrates. There is a history of windfall taxes or defence related direct contributions. But I would not expect large, visible tax increases, unless there is a clear and powerful security

shock. Even when taxes will need to rise, it is very likely that this will happen in an incremental way, maybe even somehow in a disguised manner.

Welfare spending is politically in Europe even more sensitive. In particular in this era of populism. The way to go could be rather not cuts across the board, but their slower growth. The populist narrative would immediately point to a rollback of the European social model.

Historically, member states used to exploit the option of adjustment through indexation, where benefits' growth would be slower than inflation or wages. European governments were not successful with pension reforms, increasing the retirement age or contribution periods, in order to reduce the pressure on national budgets. If some reprioritisations within the welfare were to take place, it would not be the welfare elimination, maybe its relative compression. It seems legitimate to expect that

to create some fiscal space in national budget, governments would do it in the least visible way.

In the short and midterm, having more debt seems unavoidable. If the US disengagement in NATO comes, the first lever to pull would be the debt. Also, due to the fact that markets tend to tolerate debt to finance security and defence. The borrowing spread will generate costs, and we will see different models of borrowing. Taxes will need some time to expand, and so will welfare. But situations in member states will be different. The whole Europe will be moving toward stable higher rate of defence expenditure to GNI but most likely we will see that debt alone is not enough, taxes alone will not be enough and welfare cuts alone will not be enough. Most likely, the path forward will be evolving toward higher taxes and higher debts with slower growth of welfare spending. I would not be surprised to see governments

delaying the most viable trade-offs and front loading borrowing.

It is rather likely that at least in some European countries there is a risk of potential backlash from citizens regarding defence spending trade-offs. This can be orchestrated by foreign interference or by populist far right parties to build their political capital, to generate political cost for the government and political instability. In some member states there is already a history of a similar situation.

This implies a good anticipating, preemptive campaign of communicating to the public at large the rationale behind the policy, its necessity and awareness raising. An important element of it could be a convincing presentation of the policy measures as aiming at maintaining peace, without going to the narrative of avoiding war. It will need to be a good public conversation

with the citizens about defence. Specific approach to younger audience will be needed. Mobilising public popular personalities can be a way to go. Efficiency of such communication will depend on specific situation which will vary across Europe, regarding awareness of risk and threats.

That implies not just selling threat to security as a product but embark on a dialogue with people.

Depending on political culture and ethics, it will matter strongly regarding younger audience. What will be fundamental is avoiding panic and destabilising emotions. Campaign might not be enough, the government will need first to take into account the potential trade off risks into account when choosing the strategy of the measures used in the trade off policy.

Link defence spending to the proximity of war and impact on the security, energy coercion, foreign interference , sabotage,

narrative about the link underlining that without security there is no welfare or it is not sustainable. Social protection requires national security. Still if cuts feel unfair it will be difficult to convince people. Fairness and equal treatment will matter to avoid long term erosion of the confidence and build the feeling of ownership of those difficult decisions. In a growing number of member states development banks have been recently established, that can finance defence through special funds and institutions through off budget financing. They benefit from state guarantees, hence borrow cheaper, provide long term loans and issue guarantees and blend public and private capital, allow front-loading of investment.

While they reduce financing cost indirectly, through risk pooling, absorbing part of it, lowering spread. They offer longer maturities, as infrastructure and defence projects are financed over decades. They also attract private

capital. They fit in particular the nature of defence financing, including the dual use infrastructure. EIB slowly and cautiously moves in this direction. One should consider moving toward establishing a European Defence Bank.

When Europe moves toward higher defence spending, a combination of national development banks, expanded role of EIB, and a possible new EU level defence financing vehicle might be a way to go.

It is too early to assess the role of the next MFF (2028-2034) in boosting defence spending and potentially easing the fiscal pressure on member states. It will not be a silver bullet due to its size: it is bigger than ever, still it is small, and at the end of negotiations might be even smaller. It is not yet clear whether its negotiations will be

concluded early enough to bring the new funding at the beginning of 2028. In its initial version, currently negotiated, this MFF was a good plan focused on the future and bringing a focus on Europe's future, with potential for leveraging, de-risking, synergising, crowding in capabilities, proposing new sources of funding and new financing models. Within the MFF there are instruments based on both national envelopes and competitive calls. Scaleup European Fund is a role model for public private partnership co-financing. The European Commission has issued recommendations for member states regarding individual investments accounts. There is a separate line on defence with close to 130 bn euros. With this MFF there is a chance to change the proportions between R&D expenditures at national and European level. There is also a chance to give a hard look to the defense investment from the Buy European perspective. This concept has to be approached with

strong cautiousness as it could bring a risk of cutting us off from top technology and losing the edge technologies spillover effect. This MFF is also the last chance to move toward the competitiveness rooted in and driven by sustainability.

We cannot look at MFF in isolation from Market Integration Package, steps toward creating European capital market and allowing for inviting private capital investment into financing defence investment. We don't know the outcome of MFF negotiations. In my view, we should exploit fully its function as a permanent financial lever. Similar to the InvestEU success.

This budget can expand and consolidate existing defence lines of financing, like the European Defence Fund (EDF)
It can

scale up joint R & D, strengthen interoperability, ensure support for Ukraine, boost European competitiveness also through substantial increase of funding within Connecting Europe Facility, focused on energy, transport and digital infrastructure, including the dual use infrastructure. It is too small to materially shift national defence burden on its own, hence the crowding in capabilities, enabling ppp projects. This is the way to support defence without increasing national deficits. It can provide guarantees and financial engineering, new sources and forms of financing. It has a lever high power. It can back the loans via EIB, or development banks, de-risk private financing for ammunition plants, strategic supply chains, defence SMEs and scaleups. Its role in enabling national spending, matters more than MFF itself. Coordination through MFF could help reducing fragmentation of weapon systems across Europe, reduce costs and wasteful duplications. In the defence policy

area there are many instruments already available or on the horizon, which individually have a limited power to boost the potential, but there are many enabling factors and maybe potential game changers. Bringing all those points of change together in a European ecosystem would help using comparative advantages of individual member states and generate beneficiary effects.