Investing in Security: How EU Fiscal Rules Undermine European Strategic Autonomy

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Introduction

Europe has been caught unprepared by strategic shocks twice in recent memory – by the return of large-scale conventional war in 2022, and by the energy-dependency crisis that this war exposed. In both cases, the warning signs were visible well in advance, and in both cases the response came late, at high cost, and under conditions of acute pressure. The standard response has been to identify capability gaps and call for increased spending. This diagnosis, I argue, is incomplete. The gaps are a symptom of a deeper and more structural problem, namely the manner in which European democracies make long-term investment decisions.

Electoral cycles penalise deferred costs, and EU fiscal rules do not distinguish strategic investment from ordinary current expenditure in a stable, long-term and systematic way. The mechanisms that do accommodate strategic investment are the product of emergency response rather than long-term design. The rearmament now underway is real, but it rests on temporary fiscal flexibility rather than on a permanent mechanism, which means that the underlying bias remains in place. Unless that architecture is altered, Europe will continue to arrive at each crisis underprepared, regardless of how many capability targets it sets for itself. Targets express ambition; they do not, by themselves, change the incentives of the governments asked to meet them.

This document maintains that the appropriate remedy is institutional rather than rhetorical. I propose a Security Investment Rule, embedded in EU fiscal governance, that would legally protect a minimum level of long-term strategic investment and remove it from the annual budgetary bargaining that consistently erodes it. The argument proceeds in four steps. First, I show that European underinvestment is a recurring pattern rather than a post-Ukraine anomaly. Second, I set out the political mechanism that produces it. Third, I explain how the EU's fiscal rules reinforce, rather

than correct, this mechanism. Fourth, I present the proposed rule, address the principal objections to it, and identify the moment at which it could realistically be adopted.

Problem

A recurring pattern

European strategic underinvestment is not a failure of intent. It is the predictable output of short-term political behaviour, and it has recurred after every reduction in perceived threat. The "peace dividend" of the post-Cold War period is the clearest illustration. Average European defence spending fell from roughly 2.5% of GDP in the early 1990s to around 1.4% at the time of Russia's annexation of Crimea, the year in which just three European NATO allies (i.e. Estonia, Greece, and the UK) met the agreed 2% target (CGD, 2025; NATO, 2026). This decline was not the result of a single decision. It was the cumulative effect of many individually defensible budget choices, each of which deferred a little more investment to a future that seemed unlikely ever to require it.

The surge that followed the full-scale invasion of 2022 is equally real and considerable in scale. European allies reached 2.3% of GDP in 2025, all of them now exceed the 2% threshold, and at the 2025 Hague summit, they committed to a new target of 5% of GDP, 3.5% for core defence and a further 1.5% for broader security to be met by 2035 (NATO, 2026). The increase is visible not only in headline budgets but in their composition. Equipment spending, i.e. the investment component that NATO tracks through its guideline that at least 20% of defence outlays be devoted to major equipment and research and development, has risen disproportionately, from roughly 20% to around 30% of European defence spending since 2022, with Poland now allocating some 54% of its budget to equipment (Jack, 2026; NATO, 2025).

This does not, in my view, refute that the EU member states de-prioritise strategic investment. It confirms it. The increase is crisis-driven, and the historical record indicates that such efforts reverse once the threat recedes from political salience. Spending surges when the threat is acute, which suggests it is also the first thing to be cut when the threat fades. The pattern is therefore cyclical rather than linear: long periods of erosion punctuated by short, expensive bursts of catch-up, in which governments pay premium prices for capabilities they could have built steadily and more cheaply.

More importantly, much of the present increase is being delivered not through a durable rule but through a temporary loosening of the fiscal framework, which lets member states spend more on defence outside the normal deficit rules until 2028. The incentive to cut strategic investment once the pressure passes has therefore not been removed but merely suspended. This matters particularly for industry. Defence-industrial ca-

pacity, like energy infrastructure, is built over many years and requires a predictable flow of demand. Firms are unlikely to expand production lines on the strength of a fiscal exemption that may lapse before the first contracts are fulfilled.

The political mechanism

The mechanism behind this pattern is, in essence, a problem of political time horizons (Nordhaus, 1975). Governments operating under electoral pressure systematically undervalue strategic public goods, because the benefits of preparedness are diffuse and accrue long after the costs are paid, whereas the costs of unpreparedness fall on later governments and a later electorate. Strategic investment, therefore, loses, predictably, to expenditure whose returns are visible within the electoral cycle. This is best understood as an agency problem between voters, governments, and future generations, and it operates irrespective of the intentions of any single administration. In good times, the sense of urgency is absent, and in bad times, the resources are scarce.

A further asymmetry compounds the problem. Successful preparedness is largely invisible: a deterred attack or an averted supply shock leaves no record that a government can point to. Unpreparedness, by contrast, becomes visible only once it is too late to correct cheaply. A government that invests prudently thus receives little political credit, while one that cuts strategic investment to fund visible priorities rarely bears the eventual cost itself.

This mechanism is not merely theoretical. Governments tend, empirically, to shift spending away from defence and towards social consumption in the run-up to elections, and the trade-off is largest precisely where no salient threat concentrates voters' minds (Bove, Efthyvoulou & Navas, 2017). The way elections affect defence spending has itself changed. During the Cold War, governments tended to increase military budgets before elections, because security won votes. Since then, they have tended to cut it, because security no longer decides elections – a reversal confirmed across more than two hundred estimates (Klomp, 2023). The implication is uncomfortable but important: the current political salience of security is itself a temporary condition, and a framework that relies on it will weaken as it fades.

How the fiscal rules reinforce it

The EU's fiscal architecture does not correct this bias. It entrenches it. The Stability and Growth Pact, reformed in 2024, now governs national budgets through a single operational indicator – a multi-year net-expenditure path calibrated to place public debt on a downward trajectory (Regulation (EU) 2024/1263). The framework draws no permanent distinction between, for instance, a semiconductor plant and a current transfer competing for the

same fiscal space, and it does not exempt investment programmes from the path (Bruegel, 2025). A multi-year defence-procurement contract is counted against the expenditure ceiling in the same way as any other outlay. The consequence is that whenever consolidation is required, which is often, strategic investment is among the easiest items to reduce, precisely because its returns fall outside the horizon of those making the reduction.

The EU is aware of this difficulty but has so far addressed it only on a temporary basis. In March 2025, as part of the ReArm Europe / Readiness 2030 package, the Commission invited member states to activate the "national escape clause", which permits additional defence spending of up to 1.5% of GDP outside the normal expenditure path. By the middle of 2025, the Council had activated it for more than fifteen member states, including Poland, for the four years from 2025 to 2028 (European Commission, 2025; Council of the EU, 2025). This is a patch rather than a structure. It is capped, time-limited, and discretionary, and once it lapses, the default treatment of strategic investment returns unchanged. It also covers defence alone, leaving other strategic categories, such as critical-infrastructure resilience and energy independence, exposed to the same pressures as before.

This vulnerability is not peculiar to defence. The wider evidence on fiscal consolidations shows that public investment is cut most sharply and earliest, while politically salient consumption such as pensions and healthcare is shielded (Jacques, 2025). Investment is, in this sense, the most flexible part of the budget, and flexibility under fiscal pressure means exposure. The remedy proposed in that literature is itself institutional, i.e. fiscal rules that protect investment by its composition rather than leaving it to absorb the adjustment (IDB, 2022; De Mello & Jalles, 2026). It is such a rule, applied to strategic investment, that I set out below.

The proposal

I propose that the EU convert this temporary flexibility into a permanent Security Investment Rule within its fiscal-governance framework. Under this rule, each member state would be required to maintain a minimum annual investment of 0.5% of GDP in qualifying strategic categories. By qualifying strategic investment, I mean expenditure on defence-industrial capacity, dual-use research and development, critical-infrastructure resilience, and strategic energy independence.

This floor would be scored as a distinct category within the Stability and Growth Pact, treated as capital investment rather than current consumption, and accommodated within the net-expenditure path rather than competing against it. In practical terms, qualifying expenditure up to the floor would not force offsetting cuts elsewhere in the budget, but neither would it be exempt from the Pact's broader limits. The rule would thus change the relative position of strategic investment in the budgetary queue without changing the overall level of fiscal discipline.

To prevent the term "strategic" from being stretched, qualifying expenditure would be defined jointly by the European Defence Agency and the Commission and tied to agreed capability priorities and to the categories already used under the European Defence Fund and PESCO. Building on these existing categories has two advantages. It avoids the creation of a new and contested taxonomy, and it anchors the rule in priorities that member states have already endorsed collectively. The list would be reviewed periodically, so that it can follow changes in the threat environment without being reopened every year.

Compliance would be monitored through the existing European Semester. Member states would report qualifying expenditure as part of their regular fiscal reporting, and the Commission would assess it alongside the net-expenditure path. Persistent shortfalls would be flagged in the country-specific recommendations, and spending that failed to meet the eligibility or additionality criteria would simply revert to its ordinary treatment under the Pact. This approach relies on machinery that already exists, which keeps the administrative burden low and the procedure familiar.

The rule would not prescribe what governments should buy; that remains a national prerogative, but it would lift a minimum level of strategic investment out of the annual budgetary auction that currently eliminates it whenever short-term fiscal pressure arises. It functions, in effect, as a commitment device. By binding themselves collectively and in advance, governments protect strategic investment from their own future incentives, in much the same way that independent central banks protect price stability from the temptations of the electoral cycle.

The choice of the EU rather than NATO as the venue is deliberate. NATO sets targets but has no means of enforcing them beyond peer pressure, and its targets apply to defence alone. The EU, by contrast, already possesses a legally binding framework of fiscal surveillance, and the strategic categories proposed here extend beyond the military domain into energy and infrastructure, where the Union has direct competence. The two frameworks would therefore complement rather than duplicate each other.

Objections

A binding floor of this kind invites several reasonable objections, each of which the design must answer.

Financing

The first objection concerns financing and holds that 0.5% of GDP is a considerable sum. The figure, however, is calibrated to be material but modest. It sits well within commitments that member states have already made, far below the 2% NATO floor that every ally now meets, and further still below the 3.5% core-defence target agreed at The Hague (NATO, 2026). For most states, the problem has never been whether they can afford such spending,

but that nothing protects it from being cut when budgets tighten. The rule does not add a new obligation on top of what states have already promised; it simply protects part of it. For states already investing above the floor, the rule would require no additional outlays at all; its effect would be felt only when a future government attempted to cut below it. The floor is meant to be a minimum that survives the next period of fiscal tightening, not a ceiling on national ambition.

Fiscal discipline

A second objection holds that the rule would simply exempt defence spending from the deficit rules. This is partly true, and deliberately so, but it operates within an established logic rather than as a loophole. The reformed Pact already differentiates investment in practice, allowing the fiscal adjustment period to be extended from four to seven years in exchange for investment and reform commitments, and the Union has spent the past year accommodating defence outside the expenditure path through the national escape clause. The proposed rule would simply make that permanent, open, and capped, rather than temporary and case-by-case. Counting a defined floor as capital is a deliberate design choice, not a way around fiscal discipline: the 3% deficit and 60% debt limits would still apply. Indeed, a clear and capped rule is arguably more disciplined than the present arrangement, under which flexibility is granted through discretionary activation and its limits are renegotiated under pressure.

Gaming and substitution

The third, and in my view the most serious, objection is that states could attempt to game the rule. This concern is not hypothetical. The European Fiscal Board's first review of the new rules found that the Commission had allowed states to count defence increases already made between 2021 and 2024 as headroom, thereby freeing budgetary space for non-defence spending (Filbien & Foucault, 2026). This is precisely the risk of relabelling and substitution that the design must close: a state could otherwise reclassify existing spending as "strategic", finance it through new debt, and divert the resources thus freed towards consumption. For this reason, the rule must rest on the principle of additionality. Spending should count towards the floor only to the extent that it rises above a multi-year baseline, checked jointly by the European Defence Agency and the Commission, so that the rule rewards genuinely new effort rather than relabelling.

Theoretically, this safeguard secures the rule. However, it is not bullet-proof, and Germany's special fund for infrastructure and climate protection is a useful recent example. Introduced in 2025, it carried an explicit additionality clause, written into the Basic Law, requiring its money to finance investment over and above the regular budget rather than in place of it. Yet, according to the Ifo Institute, of the 24.3 billion euros in additional debt

raised under the fund in 2025, public investment rose by only 1.3 billion euros – the rest freeing room in the core budget for current spending, a finding the Federal Court of Auditors echoed (ifo, 2026; Bundesrechnungshof, 2026). In other words, additionality is not self-enforcing. It fails when the baseline is set too low, measured against budget plans rather than actual outturns, and left without consequences.

The German case therefore offers not a reason to abandon the principle but a guide to designing it properly. Three conditions follow. First, the baseline should be calculated on the basis of actual outturns over several preceding years, not on planned figures that governments can adjust in advance. Second, the assessment should be carried out by actors outside the national budgetary process, here the Commission and the European Defence Agency, rather than by the government whose spending is being measured. Third, failure must carry a consequence: expenditure that does not pass the additionality test should lose its favourable treatment and be counted against the net-expenditure path in the normal way. With these conditions in place, relabelling becomes costly rather than free.

Sovereignty and neutrality

A final objection concerns national sovereignty, and in particular the position of member states with traditions of military neutrality. A binding floor on strategic investment could appear to impose a common defence posture by the back door. The breadth of the qualifying categories addresses this concern directly. Because the floor covers critical-infrastructure resilience, strategic energy independence, and dual-use research alongside defence-industrial capacity, a state can meet it without increasing military spending at all. The rule obliges governments to protect a minimum of long-term investment in their own resilience; it does not tell them what form that resilience must take.

Conclusion

The window for action is both narrow and identifiable. The national escape clause expires in 2028, after which strategic investment reverts to its ordinary and vulnerable status under the Pact. The post-2027 Multiannual Financial Framework and the early implementation of the reformed fiscal rules are being negotiated now, while threat perception, and therefore political will, is at its height. This combination is unusual. Institutional reforms of this kind are rarely possible when they are least needed, and they become harder to agree once the sense of urgency has faded – which is precisely the dynamic that the rule is designed to counter.

Embedding a permanent Security Investment Rule before the temporary flexibility lapses is the difference between consolidating the current rearmament and allowing it to decay on the timetable of the previous three decades. Capability targets adopted without an accompanying institutional

floor will continue to be eroded, because the incentives that eroded them before remain unchanged. The floor is the structural correction that the present rules lack. It would not guarantee that Europe is ready for the next crisis, but it would ensure that preparedness no longer depends on the crisis arriving first.

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