



PIIE PETERSON INSTITUTE FOR
INTERNATIONAL ECONOMICS

European Rearmament: Reasons, Feasibility, Challenges, and Implications

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Agenda

- 1) What must Europe (e.g. EU + other “likeminded countries”) accomplish with rearmament?
- 2) What has to date been decided on European rearmament?
- 3) “What Is To Be Done” and the implications for the EU and Europe?

Europe's New "Two Front Problem"

Following the cutoff of aid/intel to Ukraine, Europe proceeding on the basis that US assistance vs. Russia might not be there... "We are all Gaullists now"!

European leaders prepare to face a potential Russian "testing of Art 5"

Trump + Putin compelling Europe to abandon its "peace dividend" and start rearmament

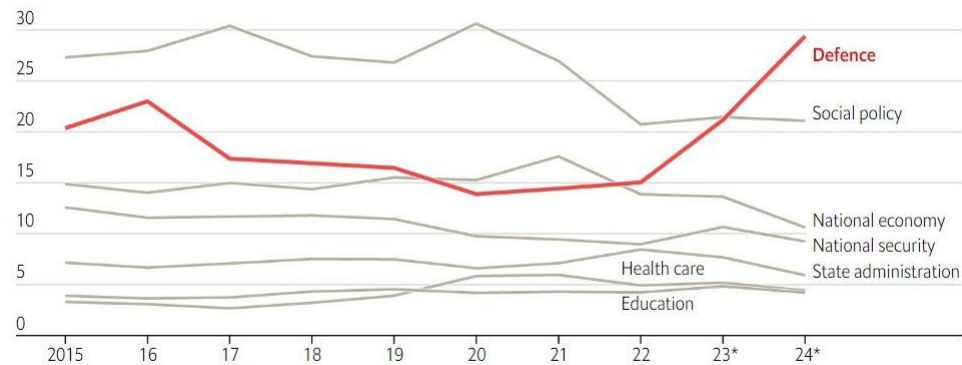


Russia Could Be Able To Attack NATO by 2030 – German Intelligence

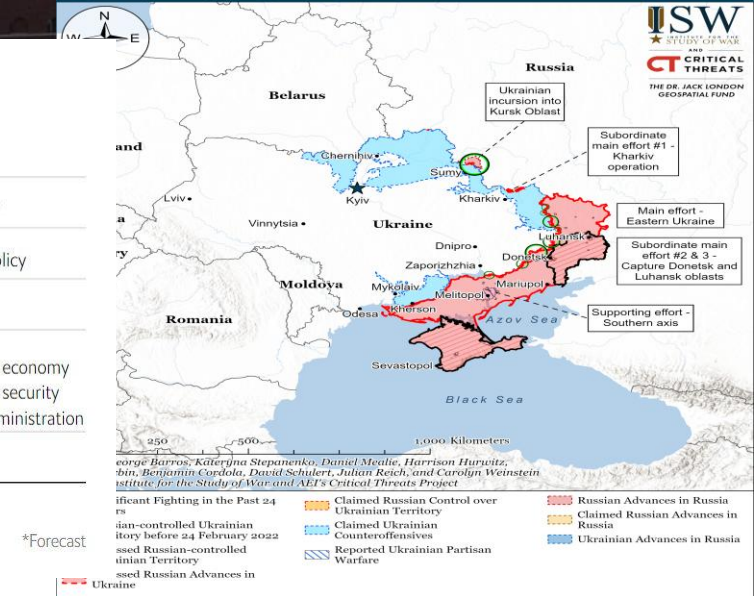
Assessed Control of Terrain in the Russo-Ukrainian War
April 8, 2025 at 1:30 PM EST

Everything needed for the front

Russia, federal budget spending, % of total



Source: Ministry of Finance

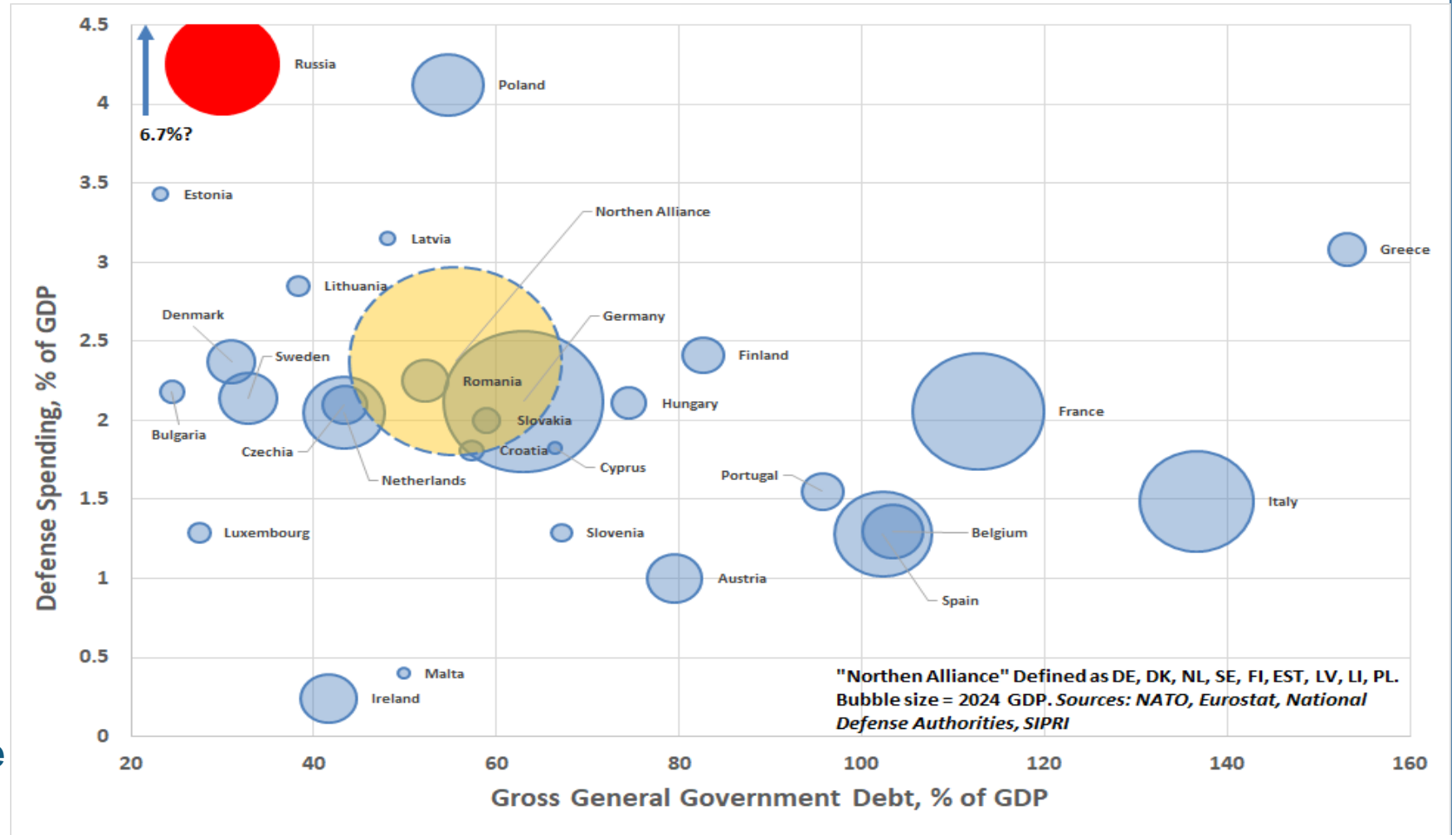


Europe Can Deter Russia – With Ukraine!

Russia today ≠ Soviet Union, but an economy roughly the size of Spain+Portugal

Ukraine currently fields an army of up to 750k, has annihilated the "Red Army weapon stocks" and is largely containing Russian offensives

Economically and militarily even "willing parts" of Europe (with existing nuclear deterrent) + Ukraine can contain Russia



Europe's "Bang For The Buck" Challenge

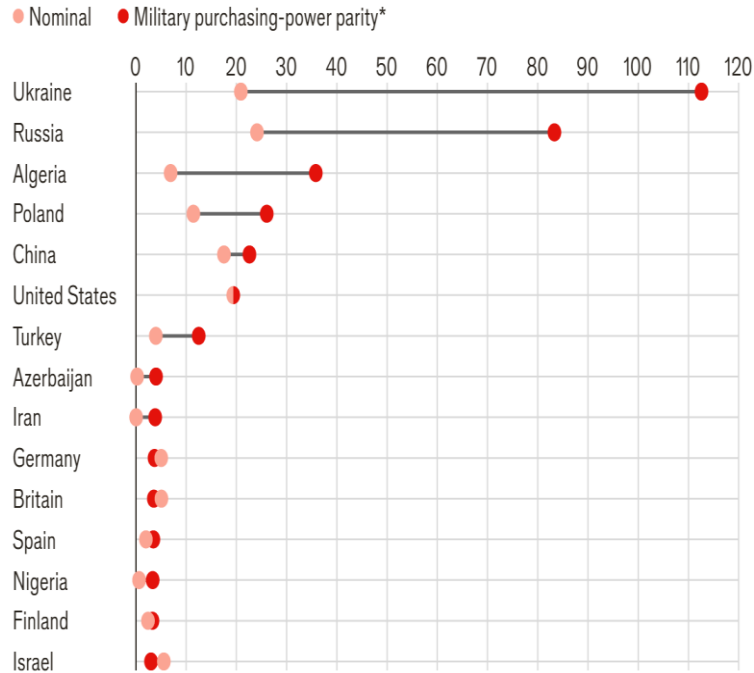
"Military PPPs" depend on R&D, wages and especially production numbers

Europe must overcome military "collective action problem" to get "common EU defense procurement"

Ukraine will offer low-cost production location and scale not just in drones

Stretching the budget

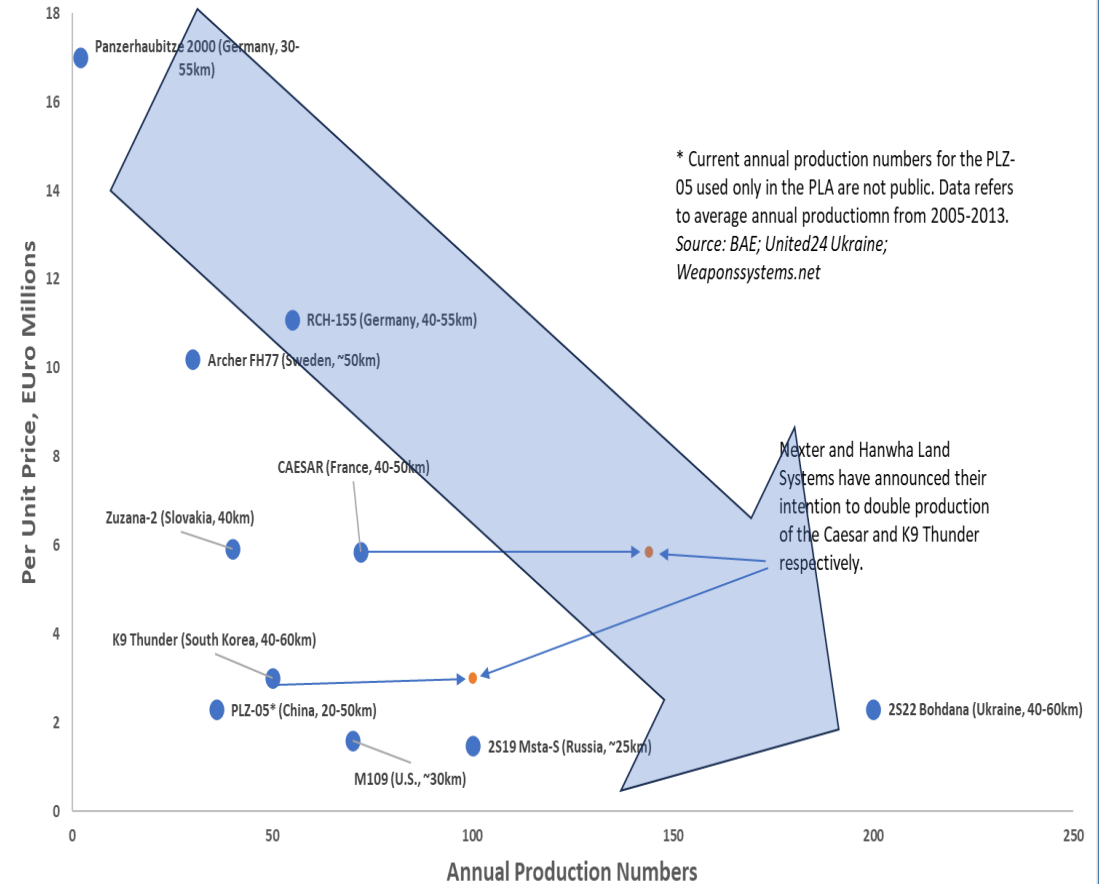
Increase in military spending, 2022-23, \$bn 2022 prices



*Adjusting spending to reflect cost and wage differences with the United States
Sources: SIPRI; Peter Robertson; *The Economist*

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Per Unit Price, Annual Production and Range of SPHs in 2024



What Has “Europe” Done To Date?

- European nations continue to support Ukraine militarily, financially and diplomatically – “no deal” in Ukraine far better for Europe (and Ukraine to date) than a “bad deal”
- European NATO members (and the Biden Administration!) directly finance domestic Ukrainian defense production via the “Danish Model” and an increasing number of EU defense producers starting production in Ukraine (note - upon full membership Ukraine will likely be the EU largest defense producer!)
- Dramatic announced increases in national defense expenditures across Northern Europe towards 3-3.5% of GDP, including an epoch-defining shift in Germany
- EU ReArm’s headline €800bn in common spending disappoints - €650bn in “assumed additional national expenditure” + €150bn in new common issued loans (at roughly average EU interest rates) that many member states to date has resisted

What Is Still To Be Done?

- 1) Most defense expenditures will remain national, but common funding for needed common defense capabilities must be created;
- 2) Institutional design remains uncertain, but;
 - I. "Coalition of the willing" basis – e.g. UK, Norway and others included in new European defense procurement institutions
 - II. "Common military capability needs" to be first identified and only then funded
 - a) Highly dependent on ongoing technological innovations in Ukraine
 - b) Highly dependent on long-term future of NATO and the possible European need to fully replicate US Intelligence gathering capabilities
 - III. Common funding must be grant-based, multi-year, and big enough to incentivize private production capacity expansion
 - IV. €200-250bn backloaded over next decade (and next MFF) not unrealistic

What Will Rearmament Mean Fiscally?

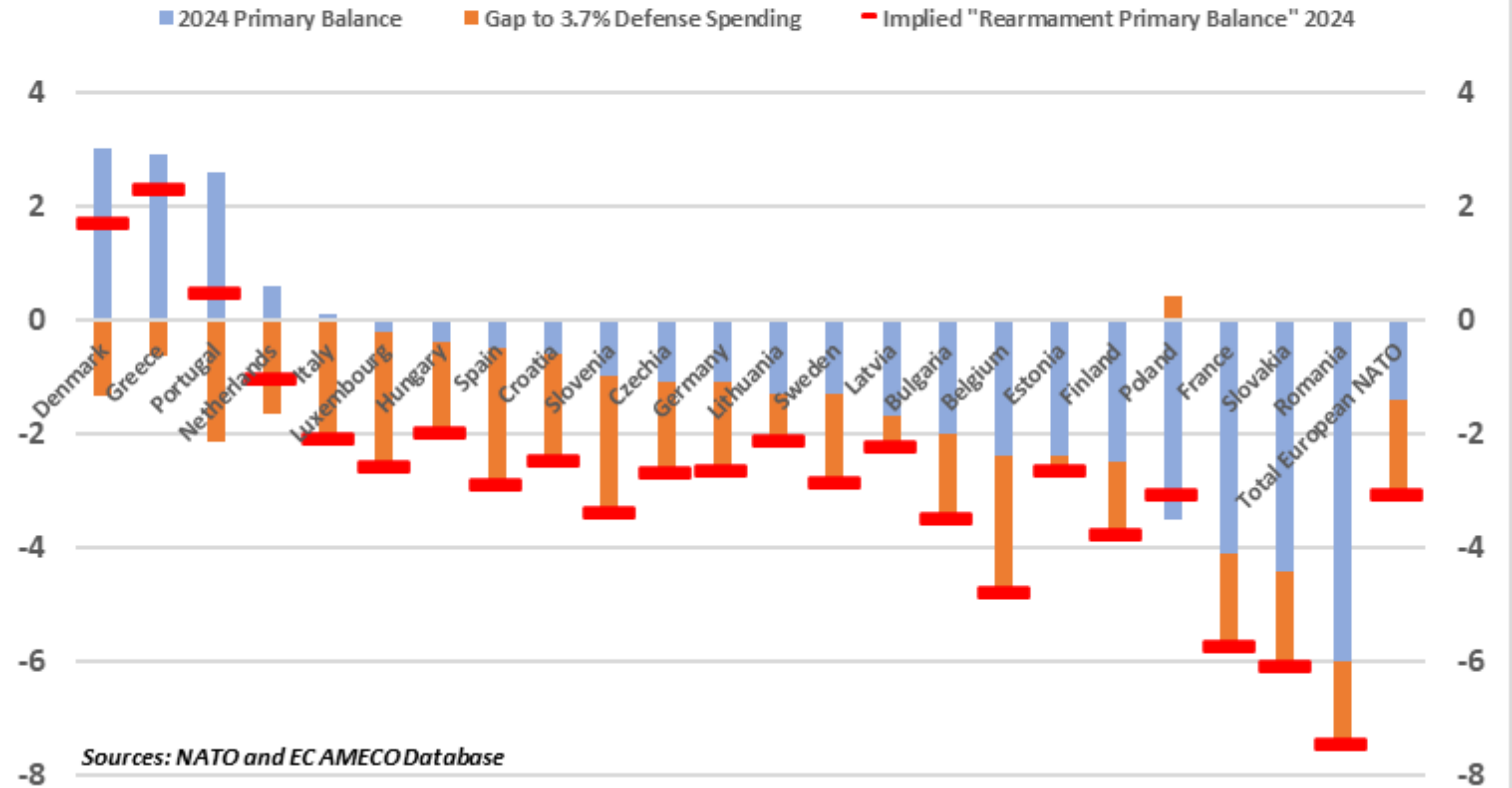
Rearmament will be a fiscal challenge in some EU members

Northern Europe can/will mostly debt finance 1-2% of GDP increase in national spending

Backloaded spending has potentially higher than usual growth stimulus from regional defense industry build-up

Limited inflation and monetary policy effects from expected scale of European rearmament

European EU and NATO Members, Primary Balance 2024 and Implied Rise in Defense Spending to 3.7 Percent Rutte Target, % of GDP



What Will Rearmament Mean For “Europe”?

- 1) “Two Front Challenge” will facilitate collaboration between EU and non-EU countries, through role of Turkiye uncertain
- 2) Ukraine pivotal to EU military deterrence, making full EU membership by early 2030s necessary (other candidate countries may follow)
- 3) Defense/Ukraine funding needs will see continuing gradual expansion of common EU debt issuance (.... and no early NGEU repayment either)
- 4) EU defense related tasks will accelerate “EU integration/slide towards statehood” in a manner reminiscent of how early US debt financing of wars boosted federal government power (Posen/Kirkegaard 2017)



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