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**Sergio De Nardis**

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**NATO summit and new European commitments.** The conclusions of the NATO summit in The Hague (June 24-25), in line with the requests of the US Administration, commit the countries adhering to the Atlantic Alliance, first and foremost those of the EU, to increase defense spending up to 5% of GDP within ten years. This amount, to be reached in 2035 with progressive growth starting from the current year, is composed of two categories. The first concerns “core” defense spending aimed at guaranteeing the so-called NATO capability targets. It must be equal, in 2035, to 3.5% of GDP and concerns weapons, ammunition, military vehicles, operating costs (including salaries), pensions of armed forces personnel and military missions abroad. An important aspect for EU countries is that military aid to Ukraine is incorporated into this category. This spending component will be subject to closer monitoring with the preparation of annual plans by the member countries to verify credible progress towards the objective. The second category, equal to 1.5% of GDP in 2035, refers to the maintenance and improvement of civilian infrastructure essential for the functioning of military activity (electricity plants and networks, telecommunications, airports, roads, bridges, railways), police forces, medical facilities in case of nuclear-bacteriological attacks, as well as spending on innovation for defense purposes. For these expenses, a verification is expected in 2029 regarding the congruence of the trajectories with respect to the objective.

It is clear that in this subdivision the most compelling component for the financial effort of the member countries is that of spending at 3.5% in 2035. In the 1.5% category, expenses already foreseen in the current financial programs of the countries could also be classified. It should be noted, however, that this component also includes those types of military spending on technology, research and innovation that would be of greatest interest to European countries, being characterized by strong potential for civil repercussions. Since these expenses fall into the category for which less control is exercised, it is likely that they are the ones that are most easily sacrificed, especially in countries subject to a stronger financial constraint.

It is therefore the 3.5% target that we must look at above all. Two questions arise in this regard: 1) Is the EU equipped, in terms of strategies and application tools, to deal with such a commitment in the most effective way for its member states? 2) What burden does pursuing the spending target entail for countries already conditioned by high public debts and what risks are there for the other budget items that must permanently make room for the new commitment?

**Is the EU equipped?** The answer to this question can only be, at present, negative: the EU is not equipped. It is not equipped, first and foremost, in terms of strategy. As underlined by many observers and recently reiterated by the Governor of the Bank of Italy, European defense is a common public good that requires investments, strategic choices, governance and common, coordinated and, in most cases, centralized funding. European defense is not the sum of national defenses, coordinated ex-post in the

event of an emergency. The Commission's orientation is instead based on national funding and European loans (which increase national debts), rather than on continental-level expenses supported by transfers, financed by common debt, in favor of the countries that must implement them in accordance with EU directives. Such investments, moreover, should above all concern - with a view to defensive effectiveness that does not betray, even in the new geopolitical context, the peaceful option on which the European Union was founded - technological developments, innovation and research, that is, the issues that are most neglected by the NATO agreement.

As a direct consequence of this strategic deficiency, the EU does not appear equipped even with the tools that should support the increased defense spending. Last autumn, member countries presented their Structural Budget Plans (SBPs), which outline the profile of their public finances for the medium-long term. Those in infringement proceedings for excessive deficits have committed to following an evolution of the net public spending parameter consistent with the objective of an appreciable reduction in the debt/GDP ratio. Now, faced with the need to increase defense spending, they have two alternative paths: to support the increased disbursements, accepted at the NATO meeting, with corresponding spending cuts and increases in revenue while maintaining the commitments in reducing public debt unchanged, or to postpone this inevitable choice over time (expenses for weapons are permanent) and resort to greater debt for a period, deviating from the recovery paths included in the SBPs on the basis of the flexibility clauses prepared by the European Commission to address what are indicated as new and exceptional security conditions. The problem is that these clauses are inadequate to allow many countries to pursue NATO targets, in terms of duration and amount. The national safeguard clause, which allows for deviation in the exceptional circumstances indicated, provides for eligible countries the possibility of deviating from the recovery paths over the 2025-28 four-year period, at most with an extension of a further year, but it does not go beyond that. In addition, the extent of the deviation from the net spending path can be at most 1.5% of GDP, a ceiling that realistically seems to put the 3.5% target out of reach for several economies, not to mention the overall target of 5%. Ultimately, with its flexibility clause the EU is assuming a financial effort that is more concentrated in time than that envisaged by the NATO agreement and of a more limited amount, although still significant. There is therefore a potential collision course between commitments made at the NATO meeting and the margins of flexibility envisaged by the EU fiscal pact that will sooner or later have to be dealt with, for example, by several of the economies that have already requested access to the safeguard clause: there are 16, but others could be added (Italy does not intend to request it).

**What effects on public budgets?** The impact on national budgets of an effective commitment to follow the NATO targets is expected to be significant. In the current European framework made up of financing by countries and possible EU loans that in any case weigh on sovereign debts, most of the economies that will actually pursue NATO objectives will find themselves facing significant challenges in the medium term regarding recomposition and, at the same time, tightening of the public budget, with adverse effects on economic growth for a prolonged phase. An example of this is the case of Italy, a country in excessive deficit procedure that has formally made its own, like the other EU economies (with the exception of Spain), the commitments to greater spending. Italy starts with defense spending, in the NATO definition, equal to 1.5% of GDP in 2024, or approximately 33 billion euros. To reach the 3.5% target in 2035, defense spending will have to rise in that year (taking into account the simultaneous increase in GDP) to over 100 billion euros, approximately 60 billion more than what would be sustained by remaining fixed (in 2035) at the current 1.5%. Making the same assessments for the 5% target, overall Italian defense spending would be over 150 billion euros in 2035, over 100 more than the outlay that would be made if the current spending percentage were maintained. These would

not be temporary changes (to be clear, such as the effects of the superbonus): the defense target, once reached, would then become a permanent commitment, leading to substantial changes in the composition of the public budget.

But wouldn't such an injection of public spending have positive Keynesian effects on growth and therefore, by extension, on public finance ratios, making them less burdensome? To answer this question, the estimates of the Parliamentary Budget Office (PBO) come to the rescue, which in the recent Report on Budget Policy simulates, with different models, the macroeconomic and public finance impact of a progressive increase in defense spending in the 2025-2028 four-year period (the period for which the activation of the EU clause is expected) until reaching about 3% of GDP at the end of the period (2028), with an expansionary maneuver compared to the baseline scenario of almost 40 billion. Well, there is naturally a stimulus to the economy following such an injection of public demand, but it is halved compared to the amount of expenditure incurred (the average fiscal multiplier is equal to 0.5) and temporary (it quickly fades after the fiscal impulse has run out). In fact, these expenses have a high import component (especially from the United States) that subtracts large portions of demand (60% in the Parliamentary Budget Office's hypotheses) from the formation of GDP, thus benefiting foreign exporters. One can envisage, as has been done at one point of the European discussion, the application of minimum national content clauses for the goods purchased. But this is a hypothesis that is not very credible in the ongoing trade negotiations between the US and the EU, in which the purchase of weapons (as well as gas) ends up constituting an important object of exchange.

Given the very muted and transitory effects of defense spending on economic growth, the result is a significant deterioration of public finances. The debt/GDP ratio, according to the PBO simulations, would be very far from the current recovery path, between 135 and 140% of GDP well beyond 2028, therefore not falling from current levels for the entire time span of the simulation (which extends over 15 years). In the current European governance framework, this evolution would naturally not be allowed, in addition to being very likely sanctioned by international investors. It would therefore have to be promptly corrected. In other words, much more drastic post-deviation adjustment measures would be necessary than those contained in the current Italian plan. Interventions that would have to be prepared starting from the 2028 SBP and which could only concern, at that point, the reduction of expenditure (including social expenditure) and the increase in taxes. The consolidation aimed at bending the trend dynamics of the debt would depress growth for several years, making the path extremely difficult. It is therefore no coincidence that the Minister of Economy has clearly kept himself away from a decision that was taken by the head of government, also reiterating that Italy will not resort to the safeguard clause.

**Worrying choices and risky prospects.** Overall, the assessment of the new defense spending commitments accepted by EU countries at the NATO meeting is worrying. European governance appears inadequate, in terms of strategy and tools, to address the new needs in a unified, coordinated and coherent manner. The perception is that in The Hague, in the context of all-out negotiations and more or less veiled threats (the activation of Article 5 on collective defense in the event of an attack on an ally), the implementation of directives external to the real interests of organizing European defense and coordinating with its other objectives (first and foremost, the fight against climate change, which has disappeared from the radar of policies but is increasingly present in everyday life) has taken place. In the emerging picture, the gaps between countries are amplified as spending needs grow due to their different financial conditions. The outlook for countries currently engaged in public finance adjustment processes is obviously the most problematic, both for the balance of public finances and for the correct

functioning of democracy. The choices being discussed imply, in fact, not only the concrete possibility in a few years of severe adjustment maneuvers to the detriment of growth to bring public debt dynamics back under control, but also recompositions of future public budgets currently not included in the programmatic documents and therefore not made explicit to public opinion, which should instead be called upon to express its opinion. The picture that emerges is potentially so disruptive that it is driving several observers to think that the agreement made at The Hague should not be taken literally, that it is written on paper only and is actually devoid of the binding effects that accompany it. They count on benevolently accepted accounting tricks (for example, for the Minister of Economy, Italy is already at 2% in 2025 considering a variety of disbursements other than the "core" ones of the NATO objective), postponements, political changes and compromises that are always possible in the era of "great negotiation". It may be and we hope, at this point, that it is so. But choices have been made that have effectively led to a new path full of risks.