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Analysis of today
Assessment of tomorrow

By: Paolo Surico

Bigger defense budgets are not enough to secure Europe

After years of underinvestment, Europe is finally beginning to increase defense spending.

Few have put the stakes more bluntly than former NATO Secretary-General George Robertson, who warned that decades of "corrosive complacency" have left the United Kingdom "in peril."

According to the European Defence Agency, the European Union's spending on defense-related research and development totaled just €13 billion ($15.2 billion) in 2024—about 0.07% of GDP—compared with $149 billion, or roughly 0.5% of GDP, in the United States.

Closing this gap will require not only more public R&D spending, but a fundamentally different approach to capital mobilization.

But money is not the main constraint. The real challenge is turning spending into technological capability.

Modern defense is less about troop numbers than about control of advanced technologies such as semiconductors, AI, quantum computing, and clean energy.

Military capability now hinges on how quickly these technologies can be developed and scaled.

Countries that move fast will be both more secure and more prosperous, while those that fall behind will be forced to rely on external providers at a time when geopolitical fragmentation makes such dependence increasingly costly.

This challenge is growing more urgent as competition over strategically important technologies intensifies.

The US combines deep capital markets with large-scale public support, while China directs state resources toward rapid deployment.

Europe, struggling to translate its research excellence into industrial capacity, risks falling behind both.

Europe's weakness is financial and institutional

The problem is not a lack of talent. Europe has no shortage of world-class universities or highly skilled workers, but too few innovative firms grow into large, globally competitive companies, and many are acquired or scale abroad.

Europe's weakness is financial and institutional. While the continent has abundant savings, it lacks sufficient risk-bearing capital.

This is no longer just a growth problem; it is a defense issue, as the ability to scale emerging technologies increasingly determines military capability.

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But while pension funds manage vast pools of long-term capital, especially in the defined-contribution schemes that now dominate retirement savings, they allocate only a small share to innovative, high-growth firms (mostly outside Europe), favoring safer assets over riskier equity investments.

Trustees and asset managers often view equity investments as illiquid, uncertain, and difficult to benchmark.

Performance is assessed over relatively short horizons, while liabilities extend over decades.

That mismatch creates strong incentives to favor liquid, low-volatility assets, even when long-term returns would justify greater risk-taking.

The result is a structural bias that makes it

harder for innovative firms to access the capital they need to scale.

Powerful incentives

While policymakers increasingly recognize this problem, existing measures remain too limited.

Initiatives like the UK's Defense and Security Accelerator have demonstrated the viability of public-private co-investment, but they have not meaningfully shifted institutional allocation decisions or built the confidence needed for broader participation.

A more effective approach would treat public spending as a catalyst rather than merely a funding source.

If governments matched private investment in strategic sectors, they could create powerful incentives to develop new technologies.

Downside risks would be shared, while project selection would remain in private hands.

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Such an approach would have two key effects. First, it would reduce the risk faced by institutional investors, making it easier for them to direct capital to illiquid and uncertain assets.

Second, it would crowd in additional investment, with each euro of public money mobilizing an equivalent amount of private capital. Public spending would thus be leveraged, not just deployed.

Over time, such arrangements could fundamentally change institutional behavior.

As investors gain experience, develop expertise, and build track records in these asset classes, perceived risks would diminish.

What begins as co-investment could then evolve into a more self-sustaining ecosystem, with private capital playing a larger role even without continuous public support.

Europe's strategic autonomy

Ultimately, Europe's strategic autonomy hinges on whether it can mobilize capital at scale and direct it toward domestic firms in critical sectors.

Without that capacity, Europe will remain dependent on foreign providers. Nowadays, that dependence implies costly risks, from supply disruptions to reduced influence over standards and production.

Crucially, greater exposure to high-growth assets need not conflict with the interests of savers.

It can improve diversification and long-term returns, provided that risks are well managed.

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The main obstacle is not a lack of willingness, but the way institutional incentives and portfolio rules are structured.

To achieve the necessary scale and predictability, co-investment mechanisms must be large enough to influence institutional

portfolios and be embedded in durable, multiyear public R&D commitments, such as those implemented by France and Finland.

Without that consistency, investors are unlikely to develop the necessary expertise and commit capital over the long term.

Moreover, a shift toward co-investment does not necessarily require a significant increase in public borrowing.

Europe already devotes substantial resources to innovation policy, just not in ways that mobilize additional private investment effectively.

Tax incentives like the UK's Patent Box, for example, are often costly, disproportionately benefit large incumbents, and frequently reward activity that would have occurred anyway.

Redirecting these resources toward co-investment and competitive R&D funding would support innovative firms, especially later-stage startups, for which capital constraints are most acute.

The broader lesson is clear: defense spending can no longer be separated from financial and innovation policies.

Countries that align public investment with private capital will be best positioned to develop the technologies on which both security and prosperity depend.

Those that do not will find that larger defense budgets alone are not enough to deliver economic prosperity or national security.

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