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Accommodating increased defence expenditure within the Stability and Growth Pact

1. Introduction

In a context of heightened geopolitical tensions, Russia's continued war of aggression against Ukraine and its threat to European and global security, Europe must urgently step up its defence capabilities. Europe needs to take responsibility for its security and defence, to ensure peace through deterrence. For this, we need to invest more on defence, invest better together, and invest more European. The ReArm Europe Plan, announced by Commission President von der Leyen on 4 March 2025, could mobilise close to EUR 800 billion for a safe and resilient Europe.

The necessary rebuilding of European defence following decades of underinvestment and the indispensable ramping-up of European defence industry production capacity require an urgent increase in European defence spending. Public funding must be the first driver of these efforts. Average EU expenditure on defence has significantly increased in the past 10 years, now collectively reaching the 2% of GDP NATO target. However, important differences remain across Member States and defence expenditure will have to further increase substantially to meet current and future security challenges. Moreover, this increased defence spending has only to a limited extent benefitted European manufacturers.

The impact of the transition to higher levels of defence expenditure on Member States' budgets can be accommodated, in the immediate future, through the flexibility provided within the existing EU fiscal framework. Such flexibility can be used for higher defence expenditure, provided that it does not endanger fiscal sustainability over the medium term. In particular, the framework provides flexibility to allow Member States to *transition* to a higher level of defence expenditure.

The impact of increased national defence expenditure, and in particular of expenditure for investment, can be amplified by Member States spending collaboratively and sourcing from within European industry. Aggregated defence demand ensures economies of scale that allow Member States to reduce costs and ensure interoperability from the outset. It also offers the predictability that the European defence industry needs to ramp up production capacity.

This Communication proposes a transparent framework for the application of flexibility under the EU fiscal framework. It defines the scope of the additional expenditure, including both investment and current spending, that can benefit from flexibility, as well as its overall amount and duration. The use of this flexibility is to be monitored by the Commission and Council, while the EU fiscal framework will continue to operate, including the monitoring of budgetary slippages caused by other expenditure or revenue categories. A controlled and transparent application of flexibility would support the credibility of the new rules and ensure predictability, also for financial markets.

2. A coordinated activation of the national escape clause

The reformed EU fiscal framework provides scope for Member States to address common policy priorities and respond to new challenges, including on defence expenditure. In particular, Member States with fiscal adjustment needs can implement a more gradual adjustment if they commit to a specific set of reforms and investments. This possibility has been used in five of the twenty-three national medium-term plans submitted so far. Furthermore, under certain conditions, the Commission can take into account so-called relevant factors in its assessment of whether to open an Excessive Deficit Procedure. One such relevant factor is the increase in defence investment[1]. Such relevant factors can also be taken into account when recommending a corrective path under the Excessive Deficit Procedure and when assessing compliance with that path[2].

In view of the current extraordinary situation, the Commission proposes to unlock additional flexibility for higher defence expenditure through a coordinated activation of the national escape clause (Article 26 of Regulation (EU) 2024/1263)[3]. The national escape clause allows for a deviation from the endorsed net expenditure path in the event of "*exceptional circumstances outside the control of the Member State with a major impact on its public finances, provided that it does not endanger fiscal sustainability over the medium term*"[4]. Russia's war of aggression against Ukraine and its threat to European security are exceptional circumstances outside the control of Member States, which have a major impact on Member States' public finances through the related incurred and/or planned increase in defence expenditure. **Given that all Member States are affected by this exceptional situation and with a view to maximising the impact on the EU's defence readiness and defence industry production capacity, all Member States are invited to make use of the flexibility in a coordinated manner.**

The activation of the national escape clause would allow Member States to deviate from the net expenditure paths set out in their medium-term plans or from their corrective path under the Excessive Deficit Procedure when this is due to higher defence expenditure. The national escape clause is activated by the Council upon a recommendation by the Commission, following a request by the Member State (Box 1). Upon activation, the Member State will be allowed to deviate from the endorsed net expenditure path or from the corrective path under the Excessive Deficit Procedure, with the exact amounts being determined when outturn data become available, to ensure that the additional flexibility is used only for its intended purpose[5]. In practice, the deviation for higher defence expenditure would be taken

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[1] For Member States with debt above 60% of GDP that breach the 3% of GDP deficit reference value, relevant factors can only be taken into account if the excess over 3% of GDP is small and temporary.

[2] The Council recommendations on the medium-term plans take into account expected spikes in net expenditures due to the specific statistical recording of this expenditure. Furthermore, unexpected spikes can be taken into account in the Commission's regular assessments of compliance.

[3] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L_202401263

[4] The activation of the general escape clause is instead linked to the existence of "*a severe economic downturn in the euro area or the Union as a whole*" (Article 25 of Regulation (EU) 2024/1263), which is not currently the case.

[5] This would be the case both for Member States whose medium-term plans have been endorsed and for those that still have to submit a medium-term plan.

into account when assessing compliance with the net expenditure path set under the preventive arm (Regulation (EU) 2024/1263), or when assessing effective action regarding compliance with the corrective path set under the corrective arm (Regulation (EC) 1467/97)[6] for Member States in an Excessive Deficit Procedure. There would be no need to revise the already-endorsed national medium-term plans.

If the national escape clause is activated based on the above conditions, and in case of an excess of the deficit over 3% of GDP or a deviation from the endorsed net expenditure path, resulting from of an increase in defence expenditure, the Commission and Council may decide not to reach a conclusion regarding the existence of an excessive deficit (Article 2(5) of Regulation (EC) No 1467/97). This is particularly relevant for Member States with debt above 60% of GDP, for which there are limitations to the consideration of relevant factors when assessing compliance with the deficit criterion. The decision on whether or not to open an Excessive Deficit Procedure should also take into account fiscal sustainability risks.

Apart from the additional leeway for defence expenditure, the EU fiscal rules will continue to operate normally. Deviations from the endorsed net expenditure paths other than those specified under the national escape clause would continue to be recorded in the control account (Article 22 of Regulation (EU) 2024/1263) throughout the period of activation of the national escape clause[7]. Moreover, in order to avoid double counting, an increase in defence expenditure benefiting from flexibility under the national escape clause cannot at the same time be considered a relevant factor under the Excessive Deficit Procedure, when assessing deviations from the net expenditure path not linked to developments in defence expenditure.

Box 1 – Procedure for the activation of the national escape clause under Article 26 of Regulation (EU) 2024/1263

The activation of the national escape clause is subject to three conditions, namely that: (i) there are exceptional circumstances outside the control of the Member State; (ii) these exceptional circumstances have a major impact on the public finances of the Member State concerned; and (iii) the deviation from the net expenditure path set by the Council does not endanger fiscal sustainability over the medium term.

The first step in activating the national escape clause is for the Member State to submit a request. These requests could be coordinated by the Council with a view to having joint requests by all interested Member States and help a smooth and speedy process.

Once the requests are received, the Commission will assess that the three conditions for the activation of the national escape clause are fulfilled for each Member State and prepare

[6] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:01997R1467-20240430

[7] Following the provision in Article 22(7) of Regulation (EU) 2024/1263, deviations due to higher defence expenditure, which are allowed under the national escape clause, would not be recorded as debits in the control account but would be tracked as a memo item.

Commission recommendations for Council recommendations activating the national escape clauses.

The Council may adopt the recommendations activating the national escape clauses within four weeks of the Commission recommendations, by qualified majority voting. In these recommendations, the Council has to specify a time limit for the deviation from the net expenditure path set by the Council. When the time limit for the deviation is reached and if the exceptional circumstances persist, the Council may extend by up to one year the period during which each Member State may deviate from the net expenditure path set by the Council. The Council can grant an extension more than once.

3. Delimiting the flexibility for higher defence expenditure

The flexibility for defence expenditure must be adequately framed to preserve the credibility of the EU fiscal framework and so as not to endanger medium-term fiscal sustainability. The framing concerns the scope of defence expenditure that would be eligible, the total amount and the time period of its application. The additional flexibility would cover defence expenditure, including that financed by loans provided by the Recovery and Resilience Facility and possible Member State contributions to (existing or future) EU instruments funding defence spending (e.g. European Defence Industry Programme).

The expenditure financed by loans provided by the new instrument for Security Action for Europe (SAFE) through the reinforcement of European defence industry will automatically benefit from the flexibility.

The scope of eligible defence expenditure

For the application of the national escape clause, the flexibility would cover the increase of total defence expenditure, including both investment and current expenditure. The EU fiscal surveillance framework relies on Eurostat statistics based on the European system of national and regional accounts. Therefore, for the coherent application of the national escape clause, it is essential to use national accounts data, in particular statistics compiled under COFOG division 02 – Defence. The application of the national escape clause will correspond to the entire statistical category of COFOG division 02 – Defence, which is a concept close to the aggregate used by NATO[8]. Under this approach, an increase in Member States' defence capabilities, whether done by putting in place new military equipment and infrastructure or by increasing military personnel and improving their training, would result in an increase in defence expenditure as measured by both the COFOG and NATO definitions. There could be temporary differences between the two series due to the time of recording of military

[8] The NATO defence spending definition is slightly broader than the COFOG defence definition as it includes pensions to retired military and civilian employees of military departments. It might also include, under certain conditions, some operations of other forces such as Ministry of Interior troops, national police forces, coast guards, etc. At the same time, the NATO definition excludes expenditure on civil defence, which is included in the COFOG definition. Furthermore, there could be differences due to the time of recording of expenditure, in particular military equipment, as the NATO reporting does not follow national accounts rules for the time of recording. More information on the respective definitions can be found in Eurostat's COFOG Manual and on NATO's website.

equipment: COFOG data are based on the national accounts and therefore consistent with the other statistical data used in economic and fiscal surveillance (notably government deficit and expenditure), while this cannot be ensured for NATO data[9]. Furthermore, COFOG data are available for all Member States. When procuring new military equipment or services, Member States are invited to privilege European industry and service providers so as to ensure that this increased spending contributes to the EU's autonomy and competitiveness, instead of reinforcing any excessive dependencies.

The availability of adequate data will be key. Eurostat, in close cooperation with the national statistical authorities, will establish a data collection process. The starting point should be COFOG Defence categories, while also considering the NATO definition and retaining the possibility to address anomalies that might be attributable to differences in the respective annual reporting systems. The process should be aligned with EDP reporting deadlines. The process should include a timely provision of input data from the relevant authorities, including Ministries of Defence and Ministries of Finance, to the National Statistical Offices. To ensure that all expenditures related to priorities set by the European Council benefit from the activation of the National Escape Clause, Member States should report to Eurostat all defence-related expenditures that should be accounted under the defence COFOG classification, and expenditures made under the SAFE Instrument under the categories "defence products" and "other products for defence purpose" as defined in the proposal for a Regulation establishing the SAFE Instrument. Where needed, Eurostat should develop further guidance on the reporting of these expenditures, in cooperation with the national statistical authorities.

The maximum amount of flexibility

The flexibility under the national escape clause should be capped at 1.5% of GDP, compared to the net expenditure path set by the Council, and should cater for increased defence expenditure. The increase of defence expenditure covered by the flexibility under the national escape clause would be calculated relative to the reference year (see below) up to a maximum of 1.5% of GDP for each year of activation of the clause. Increases beyond that amount would be subject to the normal assessments of compliance. Such a maximum is necessary to ensure that fiscal sustainability is not endangered, while allowing all Member States to benefit from the flexibility as they move towards a higher level of defence expenditure. The cap will be applied on the net expenditure path net of the impact of the debt sustainability safeguard and the deficit resilience safeguard. These safeguards were introduced by Regulation (EU) 2024/1263 to ensure that Member States implement a minimum fiscal adjustment, which may be stricter than what is required by the sustainability-based approach[10]. Not taking these

[9] In national accounts, the impact of military equipment on government expenditure and the deficit typically occurs at the time of its delivery, which marks a change in economic ownership, and not at the time of the cash payment.

[10] The sustainability-based requirements ensure that a Member State's net expenditure path: (i) puts or keeps general government debt on a plausibly downward path by the end of the adjustment period or remains at prudent levels below 60% GDP; and (ii) brings and maintains the government deficit below 3% of GDP over the medium term. In addition, the net expenditure path of a Member State with debt above 60% of GDP or deficit above 3% of GDP has to comply with a debt sustainability safeguard and a deficit resilience safeguard. The debt

safeguards into account when determining the flexibility that can be granted during the activation of the national escape clause would ensure that the sustainability condition of the national escape clause is applied equally to all Member States.

Duration of the activation of the national escape clause

The flexibility under the national escape clause for defence expenditure would be available for a period of four years, starting from 2025. Given the urgent need to substantially increase defence expenditure, while considering the time needed to carry out defence investment projects, a period of four years to transition to a structurally higher level of defence expenditure appears appropriate. After that period, Member States would have to sustain the higher spending level through gradual re-prioritisations within their national budgets, to safeguard fiscal sustainability. A period of four years for the activation of the national escape clause is also in line with the default duration of the national medium-term plans, reflecting the link between the national escape clause and those plans. The legislation allows for a review of the situation in advance of the expiry date, in view of considering the case for an extension.

At the same time, while contracts for military equipment may be signed during the period of activation of the national escape clause, delivery of some of that equipment may occur at a later stage, therefore impacting public finances only after the four-year period of activation of the clause. To cater for this eventuality, the flexibility granted under the national escape clause should also apply to defence expenditure linked to such later delivery, provided that the corresponding contracts were signed during the period of activation of the clause and based on a precise reporting from the concerned Member States. The additional defence spending would need to remain within the maximum of 1.5% of GDP mentioned above.

The reference year

The increase in defence expenditure since 2021 would be taken into account as that is the year immediately prior to the exceptional circumstances triggering the activation of the national escape clause. Using this reference year would ensure the equal treatment of Member States that have already ramped up their defence spending since the start of Russia's war of aggression against Ukraine. Therefore, when evaluating the excess of observed net expenditure growth over the net expenditure path adopted by the Council for the years 2025 to 2028, the Commission would take into account the increase in defence expenditure since 2021. If the excess of observed net expenditure growth could be entirely explained by an increase in defence expenditure and that excess remains within the maximum of 1.5% of GDP, the Commission would not recommend enforcement steps.

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sustainability safeguard requires that the general government debt-to-GDP ratio decrease by a minimum annual average amount of 1 pp of GDP as long as the government debt-to-GDP ratio exceeds 90% of GDP, or 0.5 pp of GDP as long as the general government debt-to-GDP ratio remains between 60% and 90% of GDP. The deficit resilience safeguard requires that a Member State continues its fiscal adjustment until it reaches a deficit level that provides a common resilience margin in structural terms of 1.5% of GDP relative to the deficit reference value of 3% of GDP. The annual improvement in the structural primary balance to achieve the required margin should be 0.4 pp of GDP, reduced to 0.25 pp of GDP in case of an extension of the adjustment period.

4. Conclusions

Member States are invited to come forward with their requests to activate the national escape clause by the end of April. These requests could be coordinated by the Council with a view to having joint requests by all interested Member States. The Commission stands ready to swiftly assess the requests received and adopt recommendations for Council recommendations in June, for adoption by the Council in July.