October 2024. Defence sector update

The war on Ukraine's territory has forced European governments to radically change their defence thinking. With Russia dramatically increasing its military-industrial capacity, Europe still lags miles behind, asleep at the wheel.

Russia has methodically transformed its military-industrial complex: Russian military equipment production now exceeds battlefield losses in Ukraine and outpaces all of NATO, produces and refurbishes over 1,000 tanks annually; and dedicates 30% of its national budget to defence, translating to more than $120 billion annually. It has been speculated that current production rates could enable Russia to build a force equivalent to the entire German military in just six to twelve months. This has started to focus European governments and NATO which palpably have failed. Defence spending reductions have left the continent's military-industrial base weakened and outdated. For example, Germany, Europe's largest economy, allocated only 13 % of its defence budget to equipment until 2019 and, despite recent increases, Italy and Spain still have not reached NATO's minimum 2% GDP target for defence spending.

Things are changing. Slowly. In March 2024, the European Union proposed a new European Defence Industrial Strategy (EDIS) to increase "EU readiness through a responsive and resilient European defence industry." The new strategy has ambitious goals: increasing intra-EU defence trade to 35% of the EU defence market by 2030, ensuring that 50% of EU countries' defence procurement comes from within the EU, and requiring that EU countries procure at least 40% of defence equipment collaboratively.

European institutions are slowly realizing that bureaucracy and overregulation is suffocating the continental defence industry. Not before time, the European Investment Bank removed its ban on defence company financing and has now allowed the investment in dual-use technologies. The EU has also launched a €175 million fund, the Defence Equity Facility, to support private equity and venture capital participation through co-investment. The plan is for this fund to reach €500 billion within three years.

In conclusion, the days of thinking about 2% defence spending targets are fading away. Major powers are now considering more substantial commitments - potentially 3 or 4% of GDP - to match historical Cold War spending levels. With Trump now at the helm in the US and the subsequent possibility of a reduction in US defence support, even more substantial European spending would be required.

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