FINANCING FREEDOM: FUNDING EUROPE'S SECURITY IN A TIME OF WAR

Eoin Drea, PhD
Wilfried Martens Centre for European Studies

Abstract:

Initial assessments suggest an increase in European defence spending of about 250 billion euros annually (to around 3.5 percent of GDP) is warranted in the short term. However, most of this additional expenditure will be implemented at a national level for national needs. This paper highlights that Europe remains a wealthy continent characterised by greater cash reserves, higher household savings and a significantly higher rate of mortgage free homeowners than the United States. Europe possesses ample financial resources to support higher levels of defence spending. Italian households alone save approximately 400 billion euros annually, with the majority of these savings resting in low yielding bank deposit accounts or insurance policies. Across Europe, trillions of euros of household savings remain underutilised. In this context, this paper highlights that European households should be better incentivised to participate in national level investment accounts that offer additional tax and financial benefits. These accounts can be specifically constructed to channel household savings into long term security and defence investments. Europe's capital markets must be built at the national level before grander European plans become politically achievable. The UK ISA model in identified as a template in this regard.

Keywords: defence spending, capital markets, investment, savings and investment union

Introduction

Europe is in the early stages of its rearmament. This has already returned defence spending to the forefront of the political agenda. Yet, it is not enough to just support Europe's higher spending on defence. What is also required is a plan to ensure the Eurozone's financial stability can be maintained. Otherwise, Europe's much needed spending drive risks becoming a disjointed rush into action. In desperately seeking to boost military readiness while simultaneously supporting Ukraine, Brussels proposals must not ignore the long-term stability of the Eurozone.

As noted recently, two-thirds of NATO allies upped their individual NATO spending to 2 percent of their GDP in 2024.[1] Total defence expenditure of member states rose by more than 30 percent between 2021 and 2024, collectively reaching an estimated 326 billion euros (around $340 billion). Perhaps deemed peripheral in current political discussions, economic stability remains the only guarantee of implementing the EU's expanded expenditure programmes in the future. And in an unfinished monetary union - like the Eurozone - this stability should not be taken for granted.

Already, politicians in Europe are warning that increased spending on defence will require cuts in social spending.[2] This implies that Europeans high reliance on public spending as their principal source of social protection (e.g. payments in times of unemployment, pensions and publicly funded health systems) is at risk from higher security and defence spending.

General government expenditure in the EU on social protection stood at 3,309 billion euros, or 19.2 percent of GDP, in 2023.[3] However, this is a level of spending that varies considerably even within the EU. Datasets from the Organisation for Economic Cooperation and Development (OECD) illustrate that France (30.6 percent of GDP) and Germany's (27.9) level of social spending in 2024 was significantly higher than both the OECD average (21.2) and fellow EU member Estonia (17.2).[4]

This paper analyses whether the EU's member states have the financial capability to spend significantly more on security and defence, while simultaneously maintaining their existing levels of social spending. To achieve this objective the following structure is applied. Part one offers an assessment of the EU's financial resources. In particular, this paper focuses on the unused savings and associated household wealth of EU member states. Part two provides Italy as a case study.

Part three set out the political realities associated with achieving Capital Markets Union (CMU) in Europe and argues for a shorter-term strategy involving the development of capital markets at a national level through the introduction of national investment products. Individual Savings Accounts (ISAs) in the UK are illustrated as a relevant template. Part four concludes.

Lack of Money is Not Europe's Problem

Member states of the EU are not financially constrained when it comes to financing their future security (or climate change or digitalisation) needs. Contrary to the prevailing political narrative, Europe possesses ample financial assets to finance higher spending in the future. Lack of money is not Europe's problem. Rather, the real issue is the allocation of capital across the economy. Europe is

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1 Anchal Vohra, Europe's looming guns vs. butter decision, *Foreign Policy*, 4 March 2025.

2 Laura Kayali, Belgium warns defence spending boost will hurt welfare, *Politico*, 16 April 2025. state

3 Eurostat, Government expenditure on social protection, 21 March 2025.

4 OECD, Social Spending, 5 May 2025.

characterised by a risk-adverse hoarding of savings arising from Europe's twentieth century history. This is a history of repeated financial upheavals associated primarily, but not exclusively, with the Great War of 1914-18 and the Second World War. A historical context aggravated by the Great Financial Crisis of 2008, particularly evident in Southern Europe and Ireland.

Europe remains a very rich continent. Total household savings account for over 33 trillion euros in the EU.[5] Remarkably, EU households and household-related non-profits hold 34 percent of their assets in deposits and currency, compared to just 14 percent in the US.[6] In addition, households in the EU save significantly more money than their counterparts in the US. In Quarter 2, 2024 average household savings rates were 15.7 per cent across the EU compared to just 2.2 per cent in the US.[7]

Even allowing for the impacts of the pandemic, pre-Covid savings rate averages were more than double in the EU (12.3 per cent) compared to the US (6.1 per cent). As noted by the European Commission, this shows that „US households seem to have a more favourable attitude towards current spending than European consumers, as they tend to value spending today more than saving for the future".[8]

European households are therefore characterised by larger cash savings and higher savings rates than households in the US. However, how do European resources compare if we include housing costs? This is important as housing is generally the single largest expense facing all citizens today. Do housing costs offset some of the very high cash savings of Europeans? The answer is a resounding „no". In fact, the data is clear in illustrating how housing wealth in Europe has further strengthened households overall financial strength.

Across Europe – in 2022 – just under 70 per cent of Europeans owned their own home while less than 25 percent has mortgages.[9] Although wide variations are evident across EU member states, data from the OECD highlights that 56 percent of EU households own their properties outright (with no related mortgage debt). This compares to an OECD average of 46 percent and under 25 percent in the US.[10] The US has the third lowest percentage of households that own their own homes without mortgages.[11] Similarly, just under 19 percent of EU homeowners have a mortgage compared to 25 percent across the OECD and over 40 percent in the US.

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[5] Rebecca Christie et al. EU savers need a single-market place to invest, *Bruegel*, 25 April 2024.

[6] Ibid.

[7] European Commission, Household saving rates in the euro area and in the US: a counterfactual analysis, 15 November 2024.

[8] Ibid.

[9] Geoffrey Ditta, Generation Z may not need mortgages, here's why, *The Conversation*, 14 February 2024.

[10] Organisation for Economic Co-operation and Development (OECD), Affordable housing database, data from 2022.

[11] John Wake, U.S. Has 3rd Lowest Percentage Of Households That Own Their Homes Without Mortgages, *Forbes*, 31 March 2023.

This data is clear in highlighting that more European households – on average – have no mortgage debt when compared to their peers in the United States. As previously noted, European households also have higher cash savings – and save at a higher rate than those in the US.

Italian Dreams

Italy is a good example of how a seemingly highly indebted country has ample financial savings to finance higher defence expenditures in the future. The prevailing narrative is that Italy is drowning in a sea of its own debt. And while its Central Government Debt as a percentage of GDP is the second highest in the Eurozone at over 130 percent, this does not tell the full story of Italy's real financial position.[12] That is because while debt is concentrated at the government level – primarily associated with the provision of public services, pensions and social protection – the data at household level provides a better indication of Italy's real financial capacities. Italian households' overall wealth amounted to 5.2 trillion euros in 2023: 80 billion euros more than the previous year and 552 billion euros more than 2019. This wealth corresponds to two and a half times the national GDP (2.1 trillion), and nearly twice as high as the value of the public debt (2.9 trillion).[13]

The Governor of the Bank of Italy Fabio Panetta noted in 2024 that „annual private savings in Italy exceeds €400 billion, a fifth of the national income". He also underlined that only a portion of those savings finance investments in the country. 30 percent of Italian household savings continues to be held in bank accounts or cash; 20 percent in insurance policies; 26 percent in single stocks; 13 percent in mutual funds, ETF and actively managed funds; and 7 percent in bonds.[14]

Italy is therefore characterised by – not a shortage of cash – but a misallocation of its significant capital reserves into non-productive and low yielding investment products. In turn, debt has been disproportionally allocated to the central government level, rather than being better distributed between public and private levels. Italian households focus on investments with low, but secure, returns. 90 per cent of Italian households' assets are concentrated on properties, bank accounts, and state bonds. In the last two years alone, long-term treasury bonds 'Btp' (Buoni del tesoro poliennali) have attracted of 240 billion euros from Italian household savings.[15]

These immense savings are also partnered with very low levels of household debt. Data from Eurostat for 2023 highlights a Gross Debt to Income Ratio of

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[12] International Monetary Fund (IMF), Central government debt as a percentage of GDP, 2023.

[13] Gianluca Mercuri, How much do Italians save? More and more, but one euro in three remains stuck in current accounts, *Corriere della Sera*, 1 November 2024, reporting research by the Federazione Autonoma Bancari Italiani ((Autonomous Federation of Italian Bankers).

[14] Ibid.

[15] Guido Gozzano, The mind-boggling wealth of Italians, a people of savers without a compass, *Corriere dell'italianita*, 2 December 2024.

just 57% in Italian households in 2023. This compares to figures of 95% in France, 78% in Germany, 110% in Finland and 184% in the Netherlands.[16] In addition, this is complemented by very low levels of mortgage debt in Italy. Only 14% of Italian homeowners have a mortgage, compared to 61% in the Netherlands.[17]

Overall, the data is clear in highlighting that Italy has ample financial resources for higher defence spending in the future. Rather, it is the concentration of debt at central government level which has created the impression that Italy is lacking available capital. At a household level, more than ample resources exist to fund a level of defence expenditure consistently at 3 per cent of GDP and above.

Immediate national financing requires immediate national investment tools

In the short-term most of the additional expenditure on defence will be implemented on a national level for national needs. And while the European Commission is correct in highlighting the potential of the trillions of euros in household savings lying in low interest deposit accounts, it is not realistic to expect the immediate construction of a European Capital Markets Union (CMU).[18] CMU is a long-held political plan to create a single market for capital. The aim is to get money – investments and savings – flowing across the EU so that it can benefit consumers, investors and companies, regardless of where they are located.

However, the lack of political will to implement CMU over the last decade highlights the structural challenges facing its implementation. The reality is that even relatively straightforward elements of CMU – such as cross-border banking consolidation or introducing a common bank deposit insurance scheme – remain subject to embedded national level opposition.[19] More fundamental measures, such as centralising the supervision of European capital markets, are still very politically contentious.

Nor is it reasonable to assume that the cultural and historic drivers of households' fiscal caution in Europe will be radically altered in the short-term. The socio-economic drivers of high savings rates, risk adverse investment preferences and a high level of government spending reflect a financial insecurity stepped in historical experience.

In this context, it is important to acknowledge that CMU is not a project that is politically deliverable in the short-term. Rather than waste valuable political momentum directly seeking to impose capital markets integration immediately, the EU should instead focus on more impactful measures that will deliver results in months, not years. Chief among these is enabling national capitals to tap their

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16 Eurostat, Gross debt-to-income ratio of households, 28 April 2025.

17 Geoffrey Ditta, Generation Z may not need mortgages, here's why, *The Conversation*, 14 February 2024.

18 Now commonly referred to as Savings and Investment Union.

19 Melissa Eddy and Bernhard Warner, Why Germany's Resistance to an Italian Bank Takeover Is Raising Eyebrows, *New York Times*, 1 November 2024.

domestic household savings more easily as a funding mechanism for higher defence spending.

Such an approach will ensure a much more sustainable model for achieving eventual CMU in Europe. Given the underdeveloped nature of most national capital markets in Europe, such a strategy will help to build CMU from the bottom up. This process can also take advantage of best practice at national level, accelerate the process of capital market deepening in member states and – perhaps most importantly of all – begin to change prevailing investment preferences at a local, household level.

There are examples in several EU member states of differing types of investment and savings products that could act as adjustable templates for other EU member states. They all possess potential to better utilise some of the trillion of Euros of underutilised savings sitting in bank accounts all across Europe. For the purposes of this paper, we highlight the example of the Individual Savings Account (ISA) product in the UK.

ISAs are an established part of the financial offer in the UK.[20] They are accounts that allows you to save or invest money in a tax-efficient way. Currently, you are allowed to save up to 20,000 pounds sterling per annum. There are 4 types of ISA including a Cash ISA, Stocks and Shares ISA, an Innovative Finance ISA and a Lifetime ISA. You can use a Lifetime ISA to buy your first home or save for later life. You can put in up to 4,000 pounds per year, until you are 50. You must make your first payment into your ISA before you are 40. The government will add a 25% bonus to your savings, up to a maximum of 1,000 pounds per year. The interest on cash ISAs is free from UK Income Tax. You do not pay UK Income Tax or UK Capital Gains Tax on potential earnings from the other types of ISAs.

Several characteristics of the ISA project range are vital for attracting consumer interest and savings. These are characteristics which are likely important to citizens across all European states. First, is that the product is available through locations which are accessible and familiar to consumers (Post Offices, bank branches and online). Second, these products offer a clear and easily understood tax incentive for investors. Third, ISAs also allow for long term/pensions savings with an added financial bonus from the government. Fourth, they are actively regulated by the appropriate authorities.

Such a model provides huge potential if specifically designed to invest in Europe's long-term security needs. In the medium-term this model could also be used to develop Europe's supplementary pension sector.

Conclusions

The latest research highlights that „European defence spending will have to increase substantially from the current level of about 2 percent of GDP. An initial assessment suggests an increase by about €250 billion annually (to around 3.5

[20] UK Government, Individual Savings Accounts.

percent of GDP) is warranted in the short term“.[21] This paper highlights that Europe possesses ample financial resources to support that level of defence spending for the long term. Italian households alone save approximately 400 billion euros annually, with the majority of these savings resting in low yielding bank deposit accounts. Across Europe, trillions of euros of household savings remain underutilised.

In this context, this paper highlights that CMU is not a project that is politically deliverable in the short-term. Rather, the EU should instead focus on more impactful measures that will deliver results in months, not years. Chief among these is enabling national capitals to tap their domestic household savings more easily as a funding mechanism for higher defence spending. CMU needs to be built from the bottom up by first developing national level capital markets. The UK ISA model is identified as a template in this regard for other European states.

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[21] Alexandr Burilkov and Guntram B. Wolff, Defending Europe without the US: first estimates of what is needed, *Bruegel*, 21 February 2025.