DANMARKS NATIONALBANK

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Higher defence spending may increase capacity pressures moderately

Russia's invasion of Ukraine has prompted Denmark and other European countries to significantly boost their military spending. A scenario analysis suggests that meeting the new NATO target of 3.5 per cent of GDP in core defence spending from 2026 onwards may add moderately to capacity pressures in the Danish economy over the next few years. The impact on capacity pressures will depend on several factors including how quickly defence spending is increased and how much of the funds will be spent abroad.

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Defence spending is increasing amid geopolitical tensions

Russia's invasion of Ukraine in 2022 has raised concerns regarding the adequacy and readiness of European defence capabilities. As a result, Denmark and other European countries have decided to increase their defence spending significantly. According to current plans, Danish defence spending will temporarily increase to around 3 per cent of GDP in 2025-26 as part of the Acceleration Fund agreement.

Higher defence spending may stimulate economic activity

A scenario analysis suggests that meeting the new NATO targets for core defence spending from 2026 onwards may increase the output gap in the Danish economy by around 1 per cent in each of the years 2025-29 compared to a baseline where defence spending is kept unchanged at its 2022-level. Consumer prices increase by almost 1 per cent by 2029. The effect on both activity and prices was small in 2023-24 as higher defence spending in these years largely reflected transfers to Ukraine.

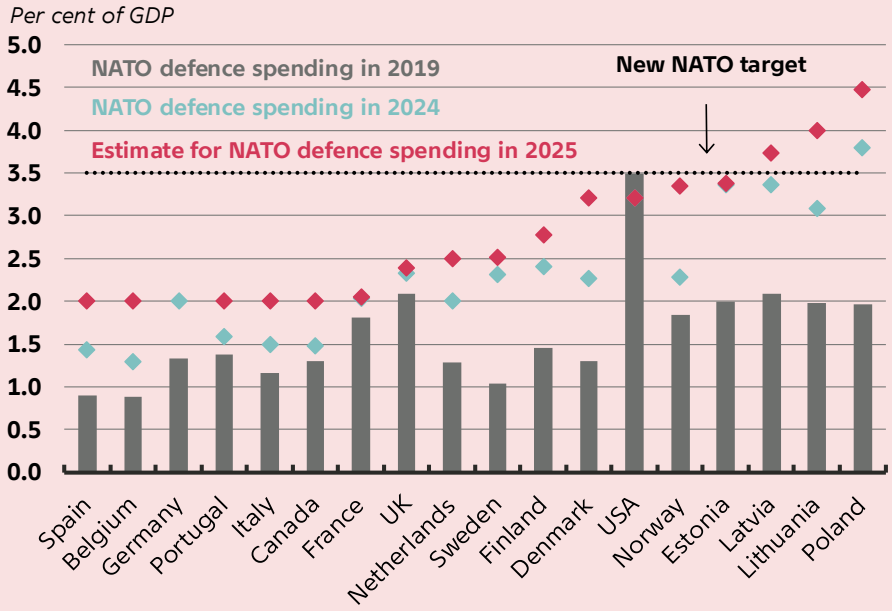
Capacity pressure may make it necessary to prioritize overall fiscal spending

Meeting the new NATO targets for military spending in Denmark can be financed within existing fiscal plans in the medium-term. Yet, capacity pressure may be a constraint on the economy that makes it necessary to prioritize overall fiscal spending, even if there is available fiscal space.

Why is this important?

Russia's invasion of Ukraine in 2022 and increased geopolitical tensions have raised concerns about European defence capabilities, prompting Denmark and some other European countries to increase their military spending significantly. Understanding the potential implications of higher defence spending for the Danish economy supports Danmarks Nationalbank's main objective of price stability.

Main chart: Defence spending has increased in several European countries



Note: The new NATO target is 3.5 per cent of GDP in core defence spending plus 1.5 per cent of GDP in broader security-related expenditures by 2035. Data for 2025 is a NATO estimate. German data is not available for 2025.
Source: Macrobond and NATO.

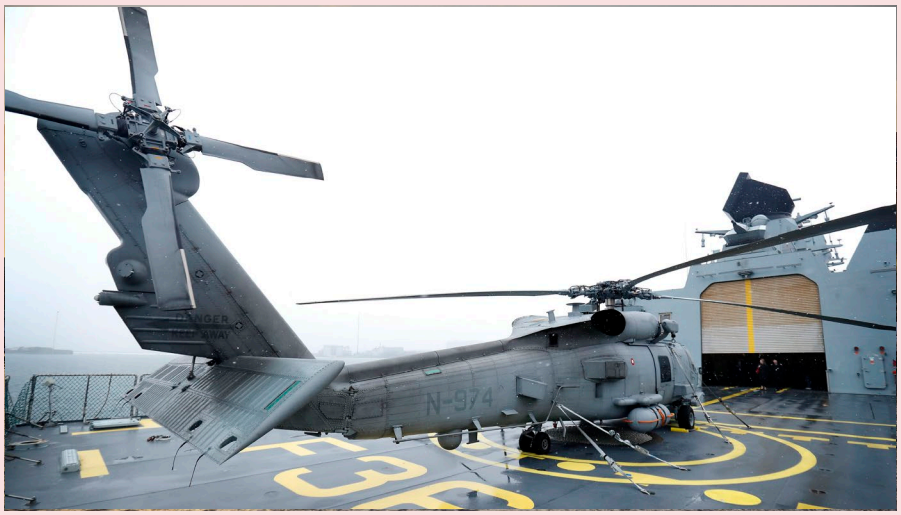


Photo: Jens Dresling/Ritzau Scanpix

Keywords

Economic activity | Fiscal policy | International economy

01
Defence spending increases amid geopolitical tensions

Russia's invasion of Ukraine in 2022 and the changing focus of traditional allies have prompted a sudden reassessment of the security risks faced by Europe. The deteriorating geopolitical environment has caused Denmark and other EU countries to ramp up their defence spending significantly, reversing the trend of diminishing military budgets relative to GDP that has persisted since the end of the Cold War in the early 1990s. Aside from the new geopolitical landscape, increasing defence spending also constitutes a major economic event which will influence the outlook for growth and prices.

How will higher defence spending impact the economy in Denmark and Europe?

Having benefited from a peace dividend for decades, Denmark's defence spending declined after World War II and fell short of NATO's 2 per cent of GDP target until 2023-24, when it rose substantially, see chart 1. With total defence spending including donations to Ukraine[1] standing at 2.3 per cent of GDP in 2024, the Danish government has recently announced plans to temporarily raise it to around 3 per cent of GDP in 2025-26 in response to intensifying security threats, see Danish Ministry of Defence (2025a).

Defence spending in Denmark will increase to around 3 per cent of GDP in 2025-26

Higher defence expenditures are not only a Danish phenomenon, given that several other EU countries have also embarked on a process of rearmament, especially Poland and the Nordic-Baltic countries, see chart 2. In the NATO alliance, all 31 reporting allies met or exceeded the current target of spending at least 2 per cent of GDP on defence in 2025, compared to only six allies before Russia's invasion of Ukraine.[2] At the June 2025 summit, the NATO members agreed to increase core defence spending to 3.5 per cent of GDP by 2035 and to use 1.5 per cent of GDP on broader security-related expenditures such as infrastructure, civil preparedness and resilience, see NATO (2025b). The target for total spending on defence and security is thus 5 per cent of GDP. This indicates that global defence spending is set to increase further in the coming years.

Sovereign nations engage in defence spending to protect their borders from external threats and ensure the freedom of their citizens. While the ongoing rearmament in Denmark and Europe is primarily geopolitical, it may also have wider macroeconomic implications in both the short and long-run which warrant the attention of central banks. This analysis aims to clarify how higher defence spending in Denmark and Europe will impact the outlook for growth and inflation, thereby contributing to Danmarks Nationalbank's main objective of stable prices. To answer this question, part 1 first documents trends in defence spending, while part 2 presents a scenario analysis exploring its short-run impact

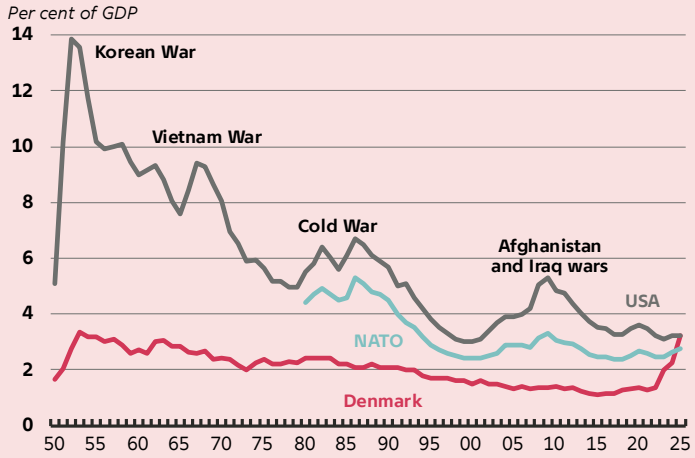
[1] According to the definition of NATO defence expenditures, military and financial assistance provided by one ally to another should be included in the defence expenditure of the donor nation, see NATO (2025a).
[2] Germany has not reported data for 2025. However, its defence spending was 2 per cent of GDP in 2024. Iceland is a NATO member, but it is not included in NATO's calculation of the number of allies meeting the 2 per cent target because it does not have a traditional defence budget.

on the economy. Finally, part 3 discusses the potential longer-run effects of defence spending.

CHART 1

Denmark's defence spending has risen since Russia's invasion of Ukraine

Defence spending in Denmark, USA and NATO

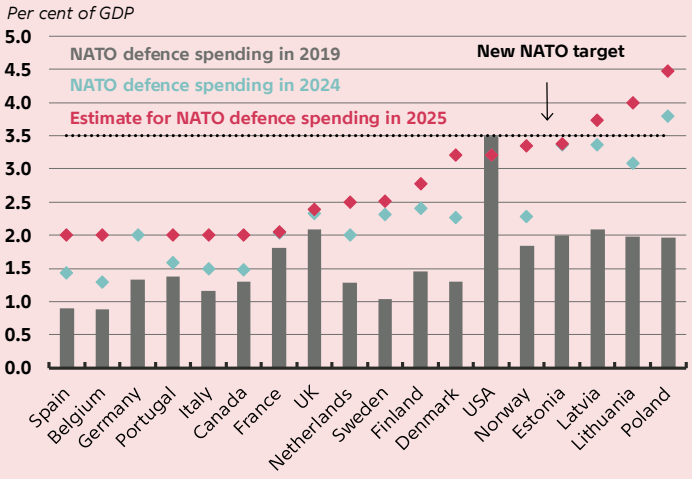


Note: Data on defence spending up to 1980 is from Stockholm International Peace Research Institute and from NATO thereafter. Data for 2025 is a NATO estimate.
Source: Macrobond, NATO and Stockholm International Peace Research Institute.

CHART 2

Several European countries have increased their defence spending significantly since Russia's invasion of Ukraine

NATO defence spending



Note: The new NATO target is 3.5 per cent of GDP in core defence spending plus 1.5 per cent of GDP in broader security-related expenditures by 2035. Data for 2025 is a NATO estimate. German data is not available for 2025.
Source: Macrobond and NATO.

Defence spending is heterogeneous across Europe

As a first step towards exploring the macroeconomic effects of higher defence spending, this section presents some key facts to support the scenario analysis in part 2. Although Europe has generally embarked on a process of rearmament since Russia's invasion of Ukraine, defence spending is still characterized by significant differences across individual countries. The highest level of defence spending is found in Poland and the Baltic countries, whereas Spain has the lowest defence expenditures relative to the size of the economy among the major European countries. There are also notable differences in defence spending growth from 2019 to 2025. For example, Denmark, Poland and the Nordic-Baltic countries are among the European countries with the highest increases in defence spending, while e.g. France has seen a more moderate expansion of its defence budget.

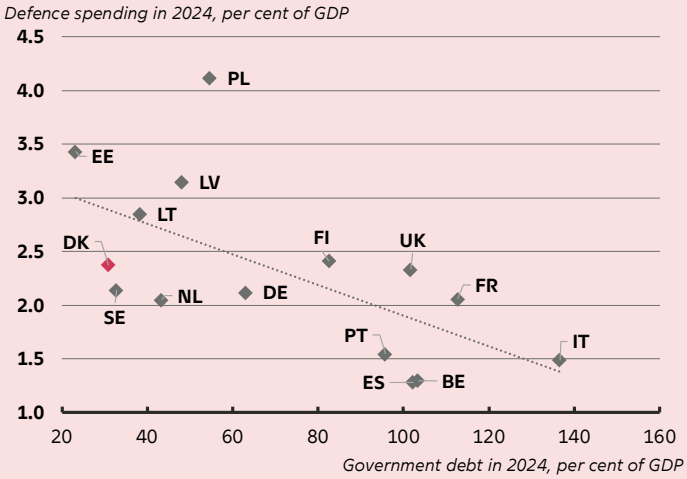
There are two factors that are correlated with the varying degrees of rearmament in Europe. Firstly, defence spending across European countries tends to decrease when government debt levels are higher, see chart 3. Secondly, it increases with proximity to Russia, see chart 4. These observations suggest that available fiscal space and the perceived threat to national security are influencing decisions on defence spending. They may also help explain why the increase in Danish defence spending has so far been larger than in some

other European countries, considering Denmark's low debt level and its distance from Russia.[3]

CHART 3

Defence spending is generally lower in European countries with high debt ratios

Defence spending versus government debt ratio

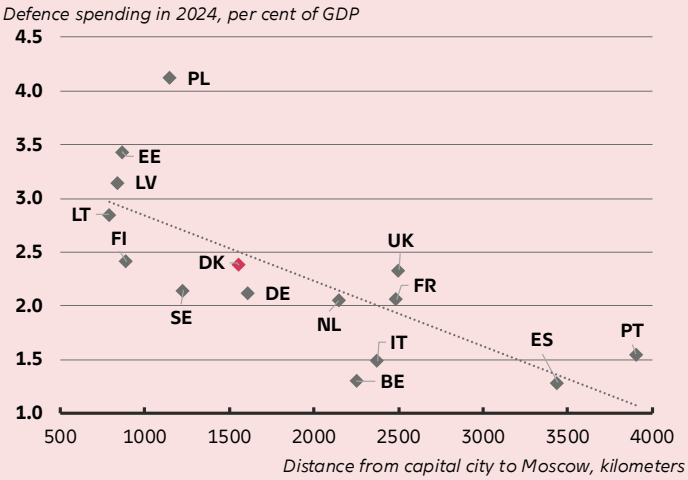


Note: The cross-country correlation between government debt and defence spending in 2024 is -0.63.
Source: Macrobond, NATO and European Commission.

CHART 4

Defence spending is typically higher in European countries closer to Russia

Defence spending versus distance from Russia



Note: The cross-country correlation between distance from capital city to Moscow and defence spending in 2024 is -0.73.
Source: Macrobond, NATO and www.distancetofrom.net

Substantial donations to support Ukraine dampen the economic effects of higher defence spending in Denmark

Support provided to Ukraine is another major factor driving the surging defence spending across Europe, particularly in Denmark and other Nordic-Baltic countries which have made substantial donations. Danish commitments to Ukraine in the form of military, financial, and humanitarian backing amount to more than 3 per cent of GDP from 2022 to 2025, making Denmark one of the largest bilateral supporters of the Ukrainian war efforts relative to the size of the economy, see chart 5. The realization of the committed Danish military support to Ukraine will take place in the period 2023-2028, with around half of the allocated amount materializing in 2025 or thereafter, see Danish Ministry of Foreign Affairs (2025). From an economic point of view, the distinction between higher defence expenditures spent on donations to Ukraine and at home is important, given that they have significantly different cyclical effects on the domestic economy. When viewed in isolation, the substantial Danish donations to Ukraine will reduce the overall impact of higher defence spending on Denmark's economy.

[3] The EU has launched a series of initiatives in its *Rearm Europe Plan* to give EU countries more flexibility in financing defence spending. These include, among other things, an activation of the national escape clause embedded in the Stability and Growth Pact, allowing for a deviation of 1.5 per cent of GDP from the agreed expenditure path in 2025-2028. In Denmark, the government has activated this escape clause. A EUR 150 billion *Security Action for Europe* (SAFE) loan instrument backed by the EU budget has also been launched to stimulate defence investment, while the EIB is widening the scope of its defence lending.

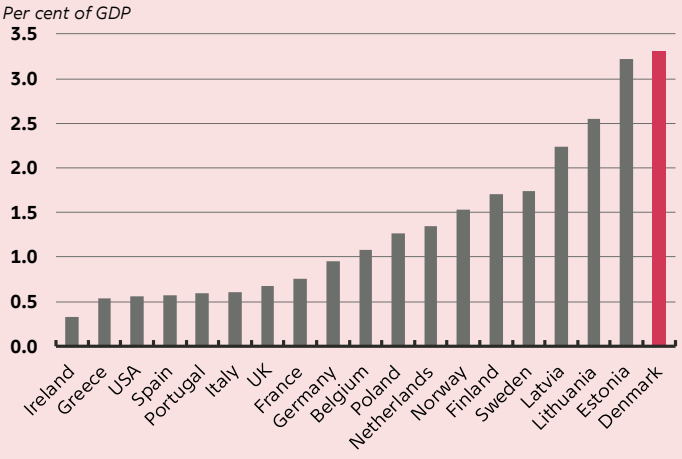
It is not only the magnitude of defence spending but also its composition that matters for the economy, reflecting the fact that the size of the fiscal multiplier differs across spending categories. In 2023, more than half of Danish defence spending consisted of wages and intermediate consumption, while transfers abroad were also sizeable because of support provided to Ukraine, see chart 6.[4] This marks an important difference compared to the euro area where defence spending is mainly geared towards compensation of employees and intermediate consumption. In the coming years, it is plausible that the composition of Danish defence spending will pivot towards investments in new military equipment purchased abroad which could reduce the impulse to the domestic economy. In the statistics underlying chart 6, investments cover e.g. military weapon systems, tanks and military buildings according to Eurostat (2013), whereas intermediate consumption includes fuel and other energy, supplies used in training and operations, as well as services purchased by the military.

Higher compensation of employees due to an increasing number of personnel and intermediate consumption supplied by local producers will have a larger impact on the domestic economy than other categories of defence spending, such as investments in military equipment purchased abroad.

CHART 5

Denmark and other Nordic-Baltic countries have made large donations to support Ukraine

Donations to Ukraine from 2022-25

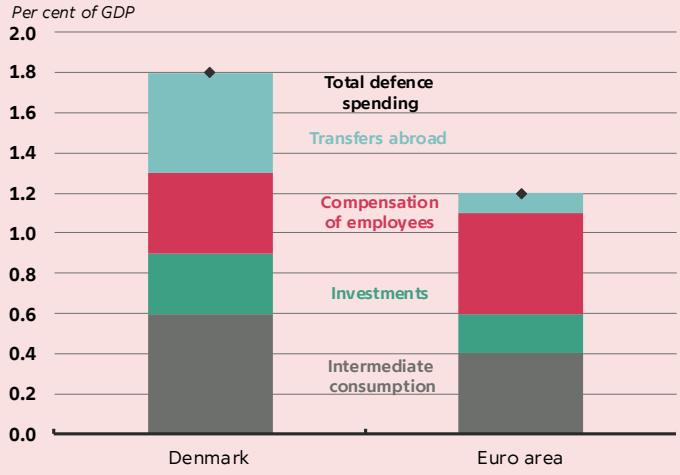


Note: Bilateral financial, humanitarian and military allocations to Ukraine including countries' share of EU donations from 24 January 2022 to 30 June 2025.
Source: Kiel Institute for the World Economy.

CHART 6

Defence spending in Denmark is geared towards intermediate consumption, wages and transfers abroad

COFOG defence spending in 2023



Note: COFOG spending on defence by general government in 2023. COFOG data on defence spending is not identical to NATO data, see footnote 4 for details.
Source: Eurostat.

[4] Chart 6 is based on COFOG data for defence spending which is not identical to NATO data. For example, down payments for military equipment affect the NATO figures immediately, whereas in the COFOG data the impact of the same equipment will materialize later at the time of delivery (cash versus accrual-based accounting). There are also some differences in the coverage of defence expenditures.

The origin of military equipment purchases will help determine the effect of higher defence spending on the Danish economy

The macroeconomic effects of higher defence spending in a given country will depend on whether new military equipment is purchased domestically or imported from abroad. Globally, the largest arms-producing companies are based in the USA rather than Europe, see chart 7. There is currently no major Danish defence industry, and the USA has traditionally been Denmark's largest supplier of military equipment, accounting for 79 per cent of arms imports in 2020-24, see Stockholm International Peace Research Institute (2025). This is somewhat higher than the average over the past couple of decades which may be related to purchases of new F-35 fighter aircrafts. In 2025, the Danish government has decided to spend DKK 58 billion (around 2 per cent of GDP) on new air defence systems from various European arms producers up until 2032, see Danish Ministry of Defence (2025c). This implies that future Danish arms imports can be pivoted more towards Europe than it has been historically.

Due to the current need for rapid procurement of sophisticated weapon systems, it is far from feasible for countries like Denmark to fully pivot their military equipment purchases toward domestic producers. If a high import content of military equipment purchases is maintained, it will reduce the domestic growth impact of increased defence spending, assuming all other factors remain constant. However, in the longer-term, some domestic companies may be able to adjust their production towards military equipment or new arms-producing companies could emerge. This might include companies producing dual-use products. Such a shift could reduce dependence on external suppliers which would imply greater effects of new military equipment purchases on the domestic economy. Nevertheless, it is neither possible nor efficient for a small economy like Denmark to be fully self-sufficient in all types of arms and military equipment.

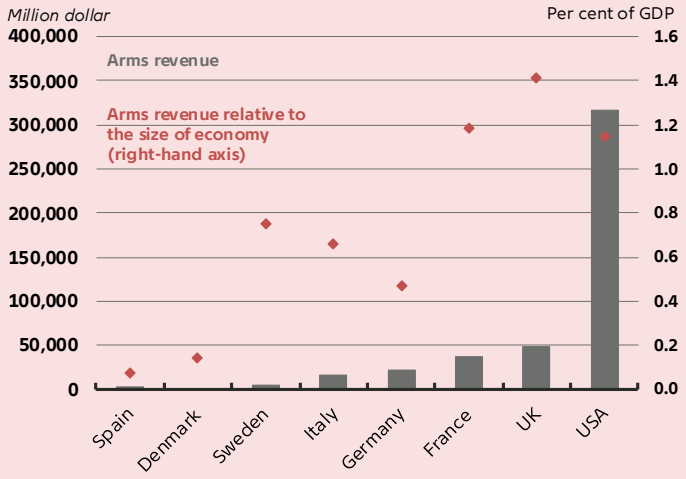
Despite the US dominance in global arms production, there is still a relatively large defence industry in parts of Europe, especially in France, United Kingdom, Sweden, Italy and Germany. These countries will likely experience a somewhat stronger demand boost as a result of the rearmament in Europe than those countries with a small existing defence industry such as Denmark. So far, equity prices of European defence companies have soared in anticipation of expanding defence budgets, see chart 8. Whether these defence companies can ramp up production sufficiently fast to meet the stronger demand will shape the macroeconomic effect of higher defence spending, as mounting capacity constraints could lead to higher prices.

European defence stocks have risen by more than 300 per cent since 2022

CHART 7

The largest arms-producing companies are located in the USA rather than Europe

Revenue from arms producing and military service companies



Note: The chart shows arms revenue in 2023 for the world's top 100 arms-producing and military services companies split by country. Data for Denmark is based on the report AxcelFuture (2023) that estimates an annual revenue of DKK 4 billion in Danish defence companies.
Source: Stockholm International Peace Research Institute, AxcelFuture, Macrobond and own calculations.

CHART 8

European defence stocks have soared in anticipation of higher defence spending

Equity prices of European defence companies

Note: European defence stocks refer to the STOXX Europe Total Market Aerospace & Defense index, while European stocks refer to the EuroStoxx600 index.
Source: Macrobond.

An expansion of military personnel can amplify existing labour shortages

The rearmament in Denmark and Europe will likely lead to an increasing number of military personnel. In the context of already strong labour markets with low unemployment, a rapid build-up of the armed forces can potentially amplify existing labour shortages through a reduction in the labour supply available to the rest of the economy. In principle, this could put upward pressure on wages and inflation. The Danish government has, among other things, decided to extend the length of conscription service from 4 to 11 months, increase the number of conscripts from 4,600 in 2025 to 6,500 people in 2033 and to introduce conscription for women in 2026, see Danish Ministry of Defence (2025b). Additionally, it has been decided to increase the number of employees within the Danish military by 5,000 persons towards 2033, see Danish Defence (2025). These measures alone are unlikely to significantly impact overall labour market tightness in the coming years. However, meeting the new NATO target for core defence spending may further increase the number of employees within the Danish military beyond current plans. For now, the number of military personnel in Denmark is small compared to the size of the labour force, see chart 9.[5] Outside Denmark, military personnel make up a much larger share of the labour force in Poland and Finland.

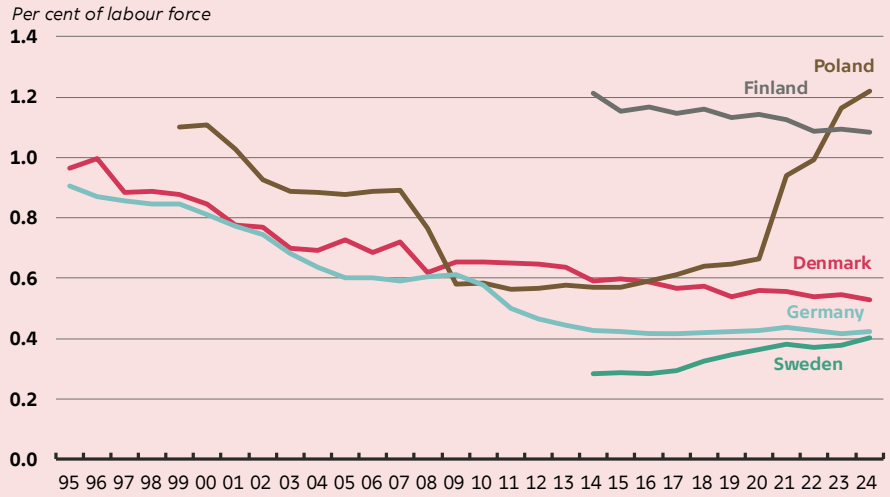
[5] In addition to military personnel, there are also civilians employed by the Danish military. The total number of employees was almost 25,000 persons in 2024 or 0.8 per cent of the labour force according to Danish Ministry of Defence Personnel Agency (2025). There were 22,000 employees in 2022.

It is not only the recruitment of military personnel that impacts general labour market conditions but also the other way around. The strong labour market in Denmark with high demand for both skilled and unskilled labour can lead to challenges for the military buildup, influencing the extent to which military staff can be recruited or retained.

CHART 9

Military personnel in Denmark and other European countries make up a relatively small share of the labour market

Military personnel



Note: Military personnel refers to the peacetime strength of military personnel which excludes trained reserves held at high readiness.
Source: NATO, Eurostat and Macrobond.

Military personnel account for 0.5 per cent of the labour force in Denmark

02

Higher defence spending may increase capacity pressures moderately

Drawing on the insights of part 1, part 2 will estimate the short-run impact of higher defence spending on the economy using scenario analysis based on macroeconomic models. The estimates suggest that meeting the new NATO target for core military spending of 3.5 per cent of GDP from 2026 onwards could increase activity in Denmark. If the simultaneous rearmament across Europe increases capacity pressure in the euro area to such a degree that it warrants a monetary policy response from the ECB, it will carry over to Denmark due to the fixed exchange rate vis-à-vis the euro. To the extent that Danish capacity pressures deviate significantly from those of the euro area due to higher defence spending, fiscal policy can be used as a stabilization instrument if needed.

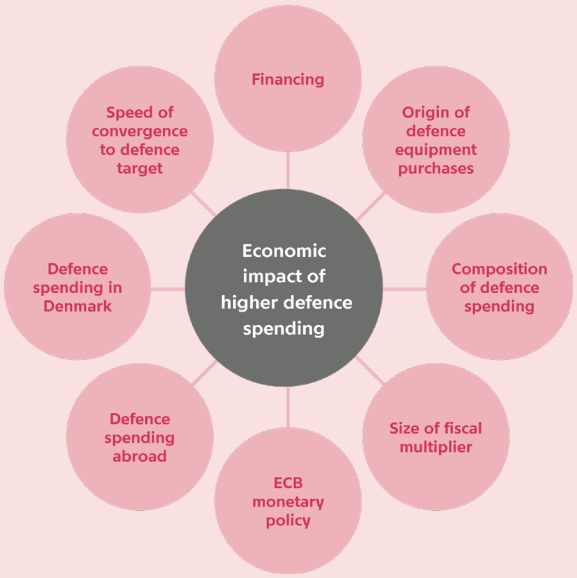
The short-run economic effects from higher military spending depend on a range of factors

The short-run economic effects from higher military spending are subject to considerable uncertainty and depend on several factors, see chart 10. These include the realized amount of additional defence spending in Denmark, spillovers from military spending abroad as well as the choice between debt and tax-financing. Moreover, both the composition of defence spending - including donations to Ukraine - and the extent to which new military equipment is imported are also important factors to consider when evaluating the economic impact of defence spending. This is because the specific composition of defence spending may influence the size of the fiscal multiplier. Similarly, an increase in military personnel may also impact the domestic economy more than e.g. purchasing new equipment.

CHART 10

The short-run economic effects of higher defence spending in Denmark depend on several factors

Factors impacting the economic effects of defence spending



Source: Own illustration.

The analysis presents two scenarios with different import content to estimate the isolated economic impact of higher defence spending in Denmark

When calculating scenarios to evaluate the macroeconomic effects of increased defence spending, it is necessary to make explicit assumptions about several of the factors highlighted above. Most importantly, it is necessary to pin down the speed of convergence to a new spending target and how much of the funds will be spent abroad.

In the scenario in this analysis, it is assumed that defence spending increases permanently to 3.5 per cent of GDP from 2026 onwards. This scenario is subsequently compared to a baseline where defence spending is kept unchanged as a share of GDP since 2022. Graphically, the change in defence spending is represented by the difference between the two lines in chart 11. The scenarios thus aim to capture the total effects of increasing defence spending since Russia's invasion of Ukraine in 2022, i.e. part of the scenario has already materialized. It should also be noted that the baseline is not identical to Danmarks Nationalbank's latest economic projection.

As highlighted in part 1, the NATO members agreed in June to increase core defence spending to 3.5 per cent of GDP by 2035 and to use 1.5 per cent of GDP on broader security-related expenditures. This leaves the target for total spending on defence and security at 5 per cent of GDP. The scenarios in this analysis focus on core defence spending. There may also be additional government spending related to broader security.

The scenario reflects, among other things, current government plans including the agreed donations to Ukraine, the Acceleration Fund and the 2023 Defence Agreement. However, it has been necessary to supplement these with a range of

more detailed assumptions to map the higher defence spending into the macroeconomic model, MONA. In particular, the scenario is based on various technical assumptions regarding the composition of defence spending, which comprises a mix of intermediate consumption, compensation of employees, investments and transfers abroad reflecting Denmark's committed donations to Ukraine. The specific assumptions regarding the composition of defence spending in 2025-29 are illustrated in chart 12. The composition of defence spending reflects that the number of employees in the Danish defence – part of compensation of employees in the chart – is assumed to increase more gradually than overall defence spending, which is initially tilted towards investments, intermediate consumption and transfers abroad.

The import content of the additional defence spending is a crucial factor for the domestic economic impact, given that a high import content will reduce the effect on capacity pressures. The analysis therefore contrasts two different scenarios for the additional Danish defence expenditures that differ with respect to their assumed import content. In the first standard import content scenario, higher defence spending has the same import content as the expenditure categories in the macroeconomic model, MONA. This implies that intermediate consumption has an import content of 23 per cent, while it is 28 per cent and 12 per cent for machinery and building investments, respectively. These assumptions might be reasonable for intermediate consumption and investments in defence buildings such as new barracks. Yet, it is likely that the import content of investments in new military equipment will be substantially higher than suggested by the standard import share. Consequently, a second high import content scenario is also considered, with an import content of 50 per cent for both intermediate consumption and investments.

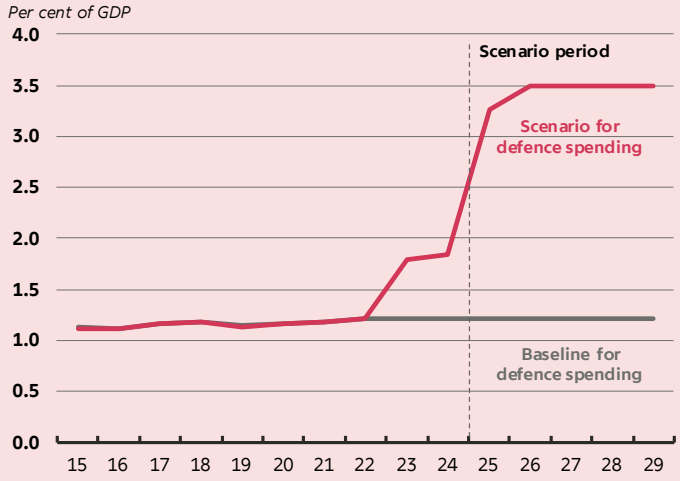
In both the standard and high-import scenario, the import content of machinery investments is 80 per cent in 2025-26. This reflects that the Acceleration Fund is geared towards military equipment purchases abroad. Consequently, the composition of new defence investments is tilted towards machinery rather than buildings in this period. For the purpose of this scenario analysis, it is assumed that 90 per cent of the new defence investments will be in machinery and 10 per cent will be in buildings. By contrast, from 2027 onwards, the new defence investments are divided equally between machinery and buildings as a technical assumption.

In both scenarios, it is assumed that the higher defence spending is financed by debt issuance. Moreover, the scenarios focus on an isolated increase in Danish defence spending. This approach reflects that new defence spending included in both ECB's and the European Commission's macroeconomic projections for the euro area has so far been relatively limited, see ECB (2025) and European Commission (2025a) for further information. It will be discussed later how a substantial increase in defence spending in the euro area may affect the Danish economy, as well as whether it is possible to finance higher defence spending in Denmark within existing medium-term fiscal plans.

CHART 11

The scenario assumes that defence spending in Denmark increases in the coming years

Danish defence spending in scenarios

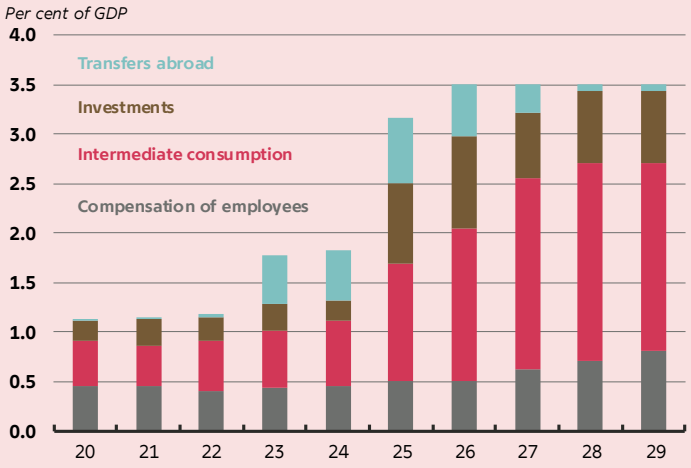


Note: The change in defence spending in the scenario is the difference between the red and grey line. Data for 2025-29 is a scenario.
Source: Own calculations.

CHART 12

The scenario assumes that Danish defence spending will be tilted towards investments, intermediate consumption and transfers abroad in 2025-27

Composition of defence spending in scenarios



Note.: Data for 2025-29 is a scenario.
Source: Own calculations.

Meeting the new NATO target for higher defence spending from 2026 onwards can increase capacity pressures in Denmark

Estimations based on Danmarks Nationalbank's macroeconomic model, MONA, suggest that higher defence spending will increase real GDP by around 1 per cent in each of the years 2025-29 in the standard import-content scenario, see chart 13. Assuming no impact on potential GDP, this implies that the output gap will increase correspondingly.

The peak effect on real GDP occurs in 2028 before diminishing towards 2029. Capacity pressures generally decrease as the resulting higher wage growth reduces competitiveness among Danish export firms, partly crowding out economic activity. Moreover, the level of consumer prices increases by almost 1 per cent in 2029, see chart 14. The effect on both activity and prices was small in 2023-24 as higher defence spending in these years largely reflected transfers to Ukraine.

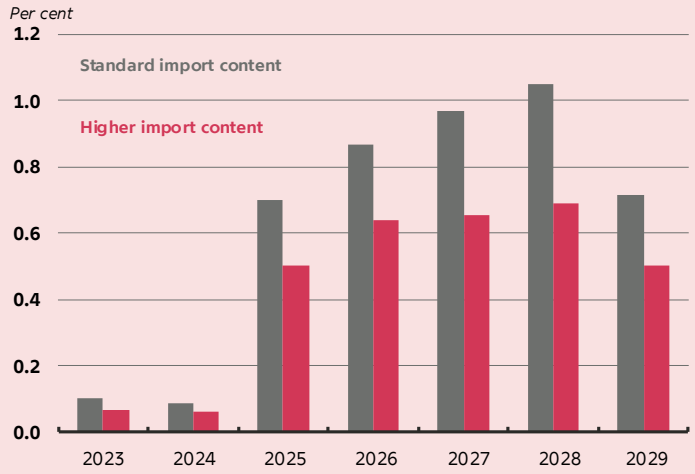
If a larger share of defence spending is oriented towards imports, it can decrease the effect on capacity pressure and prices compared to the estimated effects in the first scenario. In the high-import-content scenario, the estimated effect on real GDP drops to 0.7 per cent in 2028. This highlights that the assumed import content influences the estimated economic impact somewhat. In either of the two scenarios, the output multiplier of military spending is relatively modest in line with findings in the academic literature, see box 1 for a detailed review.

In the high-import-content scenario, the effect on consumer prices is smaller than in the standard import-content scenario. This reflects that the effect on economic activity is lower when a higher share of defence spending is spent on purchases abroad.

CHART 13

Meeting the new NATO defence target from 2026 onwards can increase capacity pressures in Denmark

Impact on real GDP

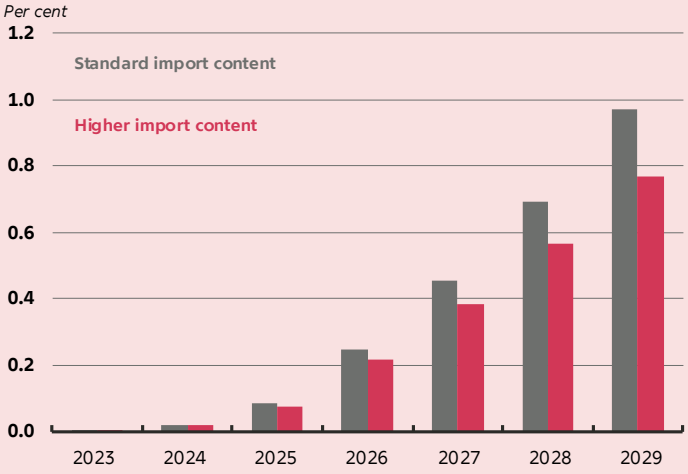


Note: The chart shows real GDP as deviations from baseline.
Source: Own calculations based on MONA.

CHART 14

Higher defence spending can increase Danish consumer prices

Impact on consumer prices



Note: The chart shows consumer prices as deviations from baseline.
Source: Own calculations based on MONA.

Increased military spending in the euro area can also impact Denmark

Aside from the direct impact of higher Danish defence spending, capacity pressure in Denmark is to some extent also affected by how defence spending develops in the euro area, see box 2 for some illustrative scenarios estimating the economic impact of a substantial increase in defence spending in the euro area. Increased military spending in the euro area will tend to stimulate the Danish economy via stronger foreign demand. Yet, these spillover effects may be smaller than usual, as Denmark has relatively little production of military equipment and euro area imports will be directed more towards military procurement.

As a second-order effect, inflationary pressures from higher military spending in the euro area might be mitigated by a tighter monetary policy by the ECB. Such a monetary policy response, which, all else being equal, will be followed by Danmarks Nationalbank due to the fixed-exchange-rate policy, will mitigate most of the positive spillovers on Denmark through lower export market growth and slower growth in the domestic Danish economy. As there are no indications that the effect of monetary policy differs significantly between Denmark and the euro area[6], increased military spending will only result in higher capacity pressure in Denmark if the initial economic impact of defence spending is stronger.

A relative increase in Danish defence spending vis-à-vis the euro area can potentially lead to a stronger economic impulse in Denmark

Differences in military spending patterns can give rise to asymmetric business cycle effects in Denmark and the euro area because Danish monetary policy is being imported from the ECB to maintain a fixed exchange rate against the euro, i.e. it cannot address idiosyncratic economic fluctuations.

[6] See Andersen et. al. (2024).

It is likely that the new NATO target for defence spending will be implemented faster in Denmark than in the euro area. This suggests that the resulting economic impulse may be stronger in Denmark, although large donations to Ukraine and foreign military equipment purchases will tend to reduce the impact on Danish economic activity. Additionally, several euro area countries have larger defence industries than Denmark and may benefit more from the stronger demand resulting from rearmament in Europe.

To the extent that Danish capacity pressures deviate significantly from those in the euro area due to higher defence spending, fiscal policy can be used as a stabilization instrument if needed, see Spange (2022) for a more detailed discussion.

While higher defence spending can largely be financed within medium-term fiscal plans, capacity pressures may make it necessary to prioritize fiscal spending

The fiscal framework in Denmark has a solid medium-term orientation which focuses on meeting the targeted structural budget balance of -0.5 per cent of GDP in 2030. According to the latest medium-term projection from the Danish Ministry of Finance, real government consumption can on average increase by 3.1 per cent per annum from 2025 to 2030 without breaching the target for the structural budget balance, provided that government revenues develop in accordance with its forecast, see Danish Ministry of Finance (2025). In the years 2026-27, most of the available fiscal space has already been allocated to other initiatives. However, in the medium term the Danish government has available fiscal space to prioritize new political initiatives in the areas of taxation or expenditure, should it deem it appropriate. This means that the increase in Danish defence spending to 3.5 per cent of GDP per year in the medium term can be financed within the already budgeted medium-term increase in real government consumption. In this case, higher defence spending will not significantly increase the government debt ratio. Nevertheless, capacity pressure may be a constraint on the economy that makes it necessary to prioritize overall fiscal spending, even if there is available fiscal space.

BOX 1

Academic studies point to modest short-run growth gains from military spending

The academic literature provides reasonably consistent evidence on short-run military spending multipliers, with most studies finding values below unity in the range of 0.4-0.8, meaning each additional krone spent on defence generates less than one krone in economic output.

A US-based study by Ramey and Zubairy (2018) analyses 126 years of historical data (1889-2015) and consistently finds military spending multipliers between 0.6-0.8 across major conflicts and peacetime periods. Barro and Redlick (2011), examining U.S. defence spending over 1917-2006, estimate multipliers between 0.4-0.7, with lower values during peacetime and higher values during wartime mobilization.

European evidence also suggests modest multipliers which may be particularly relevant for Denmark. Beetsma and Giuliodori (2011) find fiscal multipliers around 0.5-0.9 for EU countries but crucially demonstrate that "the stimulating effect is weaker for the more open EU economies, consistent with larger leakage effects". This is directly applicable to Denmark's highly open economy where spending flows substantially to imports. Cwik and Wieland (2011) reinforce this, showing that fiscal multipliers in highly open economies like Denmark are significantly smaller than in closed economies.

Denmark's current economic position suggests defence spending multipliers might be at the lower end of these estimates. Operating near capacity with low unemployment, increased defence spending would likely crowd out other demand categories rather than mobilise idle resources. The limited domestic defence industrial base means significant military spending increases would involve substantial equipment purchases from foreign suppliers, creating import leakage that further reduces multiplier effects. As Auerbach and Gorodnichenko (2012) show, fiscal multipliers are much smaller during economic expansions (0.6) compared to recessions (2.5), reinforcing expectations of modest multiplier effects given Denmark's strong current economic performance.

While the literature on military spending multipliers is well-developed, there is limited direct research on the inflationary effects of increased defence expenditures.

BOX 2

Higher defence spending can lift economic growth and inflation in Europe

As a small open economy, Denmark relies heavily on trade with other European countries, implying that the simultaneous rearmament across Europe may provide an additional impulse to the Danish economy. To give an idea of its significance, this box presents scenarios that illustrate the potential economic impact of increased defence spending in the largest euro area countries.

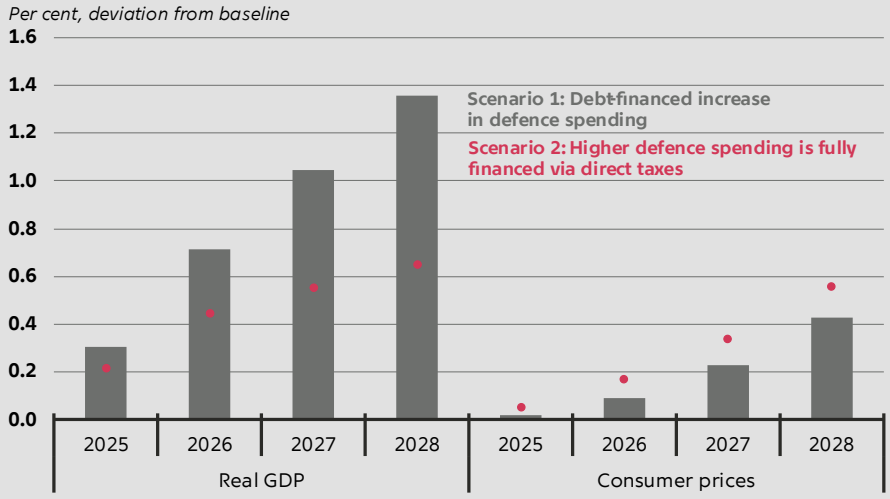
The scenarios generally assume that defence spending in the euro area countries converges to 3.5 per cent of GDP in 2028 from a starting point of 1.9 per cent of GDP in 2024, although with some extra constraints on annual increases in countries with high debt ratios, see note to chart 15 for details. Given that the deadline for NATO's new target is not until 2035, the scenarios represent a very swift increase in defence spending. The change in defence spending is then mapped into an effect on GDP and consumer prices using a set of *Basic Model Elasticities* which are collected by the European System of Central Banks (ESCB) to provide a rule-of-thumb assessment of the economic impact from changes in exogenous assumptions.

The results suggest that a debt-financed expansion of defence spending can increase the level of GDP in the euro area by around 1.4 per cent in 2028 relative to a baseline with defence spending fixed at its 2024-level, while consumer prices rise by 0.4 per cent.[1] In an alternative scenario where the additional defence spending is instead fully financed by higher direct taxes, the positive effect on euro area GDP diminishes but remains positive. This is due to the government spending multiplier being larger than the tax multiplier. Despite a smaller effect on GDP, the inflationary effect is slightly stronger in the alternative scenario which may reflect that higher direct taxes increase unit costs, encouraging some firms to raise prices. These illustrative scenarios assume that all other economic developments and policies remain unchanged. The economic impact can consequently turn out to be more muted if for example the ECB tightens its monetary policy stance to neutralize price pressures, or defence spending increases less rapidly than assumed. Nevertheless, the scenario analysis indicates that there may be some impulse to the Danish economy from rearmament abroad, even if the absence of large defence companies in Denmark will tend to dampen its impact on export growth.

Chart 15

Scenario analysis indicates that a significant rearmament in the euro area will increase economic activity and to a lesser extent consumer prices

The economic impact of higher defence spending in the euro area



Note: The scenarios generally assume that defence spending in the euro area converges to 3.5 per cent of GDP in 2028 from 1.9 per cent of GDP in 2024. Yet, annual new defence spending is capped to ensure consistency with the 1.5 per cent of GDP Stability and Growth Pact flexibility in 2025-28, meaning that some countries with a relatively low level of defence spending and high debt ratios do not reach 3.5 per cent already by 2028. The euro area is proxied by an average of Germany, France, Italy, Spain and the Netherlands. The change in defence spending is calibrated to match COFOG data in 2023, consisting of consumption, investments and transfers abroad.

Source: Own calculations based on ESCB Basic Model Elasticities.

[1]Other analyses have produced estimates ranging from a 0.5 to 1.5 per cent boost to EU GDP if defence spending increases by 1.5 per cent of GDP, see European Commission (2025b) and Ilzetzki (2025).

03
The evidence on long-term growth impact of military spending is mixed

Turning from the short-run demand effects discussed in the previous section, the long-term economic effects of increased military spending on the economy's supply side present a complex picture. While evidence from past studies can illuminate some potential channels, the academic literature documents both positive and negative impacts on potential growth. The positive channel operates through technological spillovers, research and development (R&D) externalities, and human capital formation. By contrast, the negative channel works through opportunity costs and misallocation of skilled labour as well as capital to activities that may not fully utilize their productive potential. As such, the mixed empirical evidence suggests that the long-term growth impact of higher defence spending in Denmark is inherently uncertain.

Studies find that research and development is the primary source of positive spillovers

One piece of evidence for positive long-term effects centres on defence R&D investments. Moretti, Steinwender, and Van Reenen (2025) demonstrate that government-funded defence R&D crowds in private research, with a 10 per cent increase in government defence R&D generating a 5-6 per cent increase in privately funded R&D. These spillovers operate through multiple channels, as defence R&D tackles fundamental technological challenges with broad civilian applications, from advanced materials to communications systems.

However, the magnitude of these R&D spillovers likely depends on the size of a country's defence industry. The evidence primarily comes from US studies, where a substantial domestic defence industrial base facilitates technology transfer between military and civilian sectors. For countries like Denmark with limited domestic defence industries — as highlighted in part 1 — the applicability of these findings becomes more questionable. Much of Denmark's defence spending flows to foreign suppliers, potentially limiting domestic R&D spillovers compared to countries with larger defence industrial bases.

Public R&D expenditure on defence in the EU decreased to just 0.02 per cent of GDP in 2023, compared to 0.3 per cent in the US, see European Commission (2025), illustrating the limited scale of European defence R&D investments relative to the American experience underlying much of the positive spillover evidence. Research has shown that the design of government procurement processes can significantly influence the likelihood of positive spillovers, with more open procurement approaches that allow suppliers to propose creative solutions leading to greater technology adoption and commercial innovation, see Howell et al. (2021).

Studies show mixed effects of military service on human capital development

Increased military spending typically requires expanded personnel, drawing workers from the civilian labour market and affecting overall human capital allocation. European evidence shows varied outcomes: Bauer et al. (2012) found no impact on lifetime earnings in Germany, while Imbens and van der Klaauw (1995) documented 5 per cent lower earnings for Dutch conscripts. However,

Grönqvist and Lindqvist (2016) demonstrate that Swedish military officer training significantly increased civilian managerial position attainment.

For Denmark and other countries with a highly educated workforce, the opportunity costs may be substantial if skilled workers are not deployed in roles that fully utilize their capabilities. Olejnik (2023), examining NATO's Eastern flank countries, finds that military expenditure generally leads to slower long-term economic growth, with personnel expenditures being particularly important channels of negative influence. This suggests that human capital misallocation can indeed dampen long-term productivity.

Higher defence spending might reduce productivity through resource misallocation

The potential negative effects operate through resource misallocation and crowding out of more productive investments. When economies operate near capacity, increased military spending diverts resources from alternative uses that might generate higher returns. The magnitude depends on whether military spending displaces low-productivity activities or crowds out high-productivity civilian investments. Higher defence spending might imply a shift in public spending towards investments that could boost potential growth, though such effects are likely dampened when investments consist primarily of military equipment purchased abroad, as is typical for countries like Denmark without substantial domestic defence industries.

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