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INVESTING IN EUROPEAN DEFENCE INDUSTRY: THE CASE FOR A SOVEREIGN DEFENCE INVESTMENT FUND

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AUTHOR'S PRESENTATION

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ABSTRACT

Sovereign funds designate institutions or instruments aimed at financing long-term public policies via an investment of public funds which, leverages financial markets to ensure private investment. In response to the growing urgency of EU and NATO European members to improve their investments to insure their security and the persistent fragmentation of the European Defence Technological and Industrial Base (EDTIB), this paper makes the case for a European sovereign wealth fund dedicated to defence. Such a fund would complement existing subsidy and investment instruments by enabling long-term equity investment, industrial consolidation, and strategic autonomy. It would help secure critical assets and technologies, support SMEs, and finance dual-use innovation and strategic stockpiles.

Keywords : European Union | Defence | Defence Industry | Sovereign Funds

INTRODUCTION

The war in Ukraine, the return of great-power competition, and the prospect of a reduced U.S. security commitment to Europe have upended the European strategic landscape. Since 2022, defence has returned to the heart of the European agenda—but decades of underinvestment have left the continent unprepared, both militarily and industrially, to respond to a high-intensity conflict. To reduce fragmented demand, supply bottlenecks, and persistent financing gaps, the EU has launched a series of instruments—grants, loans, guarantees—to stimulate investment and joint procurement. Yet most of these initiatives rely on public subsidies or debt, and many are constrained by the limits of the EU budget and the Stability and Growth Pact.

In this context, new tools are needed to crowd in private capital, generate returns, and provide long-term equity to strategic sectors. One such proposal—long on the table but never fully explored—is the creation of a European sovereign wealth fund dedicated to defence. First floated by Emmanuel Macron in 2017 and echoed by Ursula von der Leyen in 2022, the idea has recently regained momentum amid growing calls for strategic autonomy and a more investment-driven approach to sovereignty.

This paper revisits that proposal. It argues that a European Sovereign Defence Investment Fund could help secure critical assets, foster industrial consolidation, support dual-use innovation, and build strategic stockpiles—thereby unlocking a virtuous cycle of public-private investment. Beyond its financial leverage, such a fund could offer political and strategic value by signalling Europe's determination to act collectively and proactively in support of its security.

The paper proceeds in four parts. It first maps the current ecosystem of European defence financing. It then outlines the rationale and structure for a sovereign fund. The third section identifies four priority areas for investment. The final section addresses the governance, funding, and feasibility questions that such an initiative would need to resolve. It also reflects on the possibility of expanding the fund's scope—over time—to a broader strategic security agenda, including critical raw materials and dual-use technologies.

FINANCING DEFENCE COMPANIES IN EUROPE - OVERVIEW OF EXISTING INSTRUMENTS

The question of defence resources and financing lies at the heart of every European rearmament strategy. In 2014, following Russia's annexation of Crimea, NATO members pledged to spend at least 2% of their GDP on defence.[1] After decades of shrinking military budgets—commonly referred to as the "peace dividend"—this marked a significant shift for European nations. Yet, on the eve of Russia's full-scale invasion of Ukraine in 2022, only seven European countries had met this target[2]. The consequences of underinvestment quickly became apparent: Europe's limited preparedness emerged as a critical and dangerous shortcoming. Defence industry leaders had been warning of this vulnerability for years, along with the chronic difficulties they faced in securing private investment to support their activities[3]. Since then, the number of instruments available to support defence industry financing has expanded significantly, as table 1 illustrates.

On 5 March 2025, the President of the European Commission presented a "Rearm Europe" initiative aimed at mobilising up to €800 billion for defence-related investment. The package includes a range of measures: activating an exemption clause within the Stability and Growth Pact to give member states greater fiscal leeway for defence spending; creating a new instrument—SAFE—to facilitate cheaper sovereign borrowing for defence purposes; expanding the scope of European Investment Bank (EIB) financing in the defence sector; and increasing the mobilisation of private capital[4]. These proposals were detailed in the Joint White Paper released on 19 March[5]. This defence package is designed to address two urgent strategic risks: the enduring threat posed by Russia—regardless of how the war in Ukraine unfolds—and the growing prospect of a rapid and radical disengagement of the United States from European security, particularly in light of Donald Trump's return to the presidency.

[1] Wales Summit Declaration, Issued by the Heads of State and Government participating in the meeting of the North Atlantic Council in Wales, 5 September 2014 -

[2] Tardy, T. & Matelly, S. 2023. "European defence Part 1 : budgets", *Infographic*, Paris: Jacques Delors Institute, October. https://institutdelors.

[3] GICAT (2020), *Comment les nouvelles contraintes du système bancaire français mettent en péril notre industrie de défense et de sécurité*, 19 October 2020 - ASD Considerations on Sustainability and the European Defence Industry, ASD Position Paper, 6 October 2021 - https://www.asd-europe.org/industry/resources/asd-position-papers/sustainability-and-the-european-defence-industry/

[4] Santopinto F. (2025), The ReArm Europe Plan: Squaring the Circle Between Integration and National Sovereignty - IRIS, 12 March 2025,

[5] European Commission/HRVP, "Joint White Paper for European Defence Readiness 2030", *JOIN(2025) 120 final*, Brussels, 19 March 2025, p.2 See: https://defence-industry-space.ec.europa.eu/document/download/30b50d2c-49aa-4250-9ca6-27a0347cf009_en?filename=White%20Paper.pdf

It complements a broader set of initiatives, ranging from the European Defence Fund to the more recent European Defence Industrial Strategy (EDIS) and its operational counterpart, the European Defence Investment Programme (EDIP), both unveiled in March 2024[6]. All of these efforts converge on the same imperative: initiate European cooperation to lead to defragmentation, strenghten EDTIB and so reinforce strategic autonomy by promoting joint acquisitions. Notably, the 2021–2027 Multiannual Financial Framework was the first to include dedicated funding for defence and security, marking a turning point in the EU's approach to strategic autonomy.

Table 1 - European initiatives to strengthen defence companies cooperation

Instrument / initiative	Date	Purpose	Terms and conditions	Budget in €
European Defence Fund (EDF)	2021-2027	Collaborative research and development of defence technologies by consortia from at least three EU countries	Grants covering up to 100% of eligible costs	7.9 billion
Act in Support of Ammunition Production (ASAP)	Since 2023	Increasing ammunition and missile production, replenishing stocks and supporting Ukraine	Grants	500 million
European Defence Industry Reinforcement through Common Procurement Act (EDIRPA)	2023-2025	Facilitating joint procurement by EU member states, reducing market fragmentation, and strengthening the EDTIBProjects must be jointly submitted by at least two EU member states	Grants	300 million
European Defence Industry Programme (EDIP)	2025-2027	Enhancing competitiveness and responsiveness of the EDTIB, ensuring availability and supply, and promoting cooperation with Ukraine	Grants (FAST operates through other financial instruments)	1.5 billion
EU Defence Innovation Scheme (EUDIS)	Since 2022 (EDF umbrella)	Reducing entry barriers for SMEs and innovators, encouraging dual-use technological innovation and civil-military cooperation, and strengthening industrial resilience	Grants + capital support via European Investment Fund (EIF)	1.46 billion from EDF + 400/500 million from other sources
Fund to Accelerate Defence Supply Chain Transformation (FAST)	2025-2027 (within EDIP)	Strengthening supply chain resilience, accelerating industrial capacity transformation, supporting SMEs and mid-caps, and facilitating access to finance	Loans, equity investments and guarantees	See EDIP
Security Action for Europe (SAFE)	From 2025?	Providing loans to EU governments for investments and acquisition of new defence capabilities (proposal under discussion)	Loans to EU governments (proposal)	150 billion

[6] European Commission (2024) 'Proposal for a Regulation establishing the European Defence Industry Programme and a framework of measures to ensure the timely availability and supply of defence products', *COM(2024) 150 final*, see https://defence-industry-space.ec.europa.eu/edip-proposal-regulation_en

Strategic European Security Initiative (SESI)[7]	Since 2022 (EIB initiative)	Supporting European defence and security through EIB loans and guarantees for the defence industry	Loans and guarantees from the EIB	8 billion
Defence Equity Facility (DEF)[8]	2024-2027 (within EUDIS)	Stimulating innovation in dual-use technologies, facilitating access to finance for SMEs and start-ups, mobilising private investment, and enhancing strategic autonomy	Equity & investments	100 Mn from EDF + 75 from EIF

These initiatives have had the clear advantage of expanding financing opportunities for defence companies—from SMEs to major industrial groups, and across both production and innovation. They also aim to foster greater cooperation between European firms and, ultimately, to strengthen the European Defence Technological and Industrial Base (EDTIB). However, it is worth noting that most of the instruments currently in place rely heavily on the EU's common budget, which remains structurally limited, or on public spending and debt-financed mechanisms—such as the SAFE instrument—that ultimately depend on fiscal capacity and must be repaid. These instruments generally take the form of grants or subsidies to companies and/or Members States rather than investments designed to generate returns.

This paper defends this idea that to increase the volume of financial resources available for defence—and to make them more sustainable over time—Europe must strengthen investment-based mechanisms, whether public or private. Initiatives such as the Defence Equity Facility and FAST are important first steps in this direction but a European sovereign wealth fund dedicated to defence could also form a cornerstone of this investment-driven approach.

EUROPEAN SOVEREIGN WEALTH FUND DEDICATED TO DEFENCE: WHAT ARE WE TALKING ABOUT?

An investment fund is a pool of financial assets managed by professional investors on behalf of multiple stakeholders. It reduces transaction costs, generates economies of scale[9], and enables greater diversification than any individual investor could typically achieve. As a result,

[7] https://www.eib.org/fr/projects/topics/innovation-digital-and-human-capital/sesi/index
[8] The European Commission and the European Investment Fund join forces to boost investment in defence innovation through the Defence Equity Facility Brussels, European Commission press release 12 January 2024 https://ec.europa.eu/commission/presscorner/api/files/document/print/en/ip_24_145/IP_24_145_EN.pdf
[9] Examples include pension funds, which are investment funds that collect employees' savings and invest them with a view to paying their pensions once they have retired.

such funds can secure higher returns on initial capital and better manage financial risk through diversified portfolios.

Sovereign wealth funds (SWFs) are state-owned investment funds that manage national financial assets over the long term. Many were initially established to invest surplus revenues from the export of exhaustible natural resources—particularly hydrocarbons, as seen in the Middle East and Norway—or from sustained export surpluses, as in Singapore or China. The earliest of these funds date back to the 1950s, when large commodity-exporting countries sought to invest their growing foreign exchange reserves in ways that would prevent *Dutch disease*—that is, the harmful appreciation of their currency caused by sudden foreign capital inflows, which would undermine export competitiveness and harm the broader economy[10].

These SWTs also aim to distribute the wealth generated from natural resource rents across time and generations. They channel export revenues into profitable investments that produce regular returns, which can then be used—partially or fully—to finance public spending[11]. At the same time, these funds serve as tools to diversify government portfolios, protect national economies against financial volatility, and promote long-term development by investing in projects or companies that stimulate growth, technological progress, and employment[12]. The world's 100 largest sovereign wealth funds together hold more than $14 trillion—nearly 30 percent of global market capitalization—while the five biggest[13] have each accumulated over $1 trillion in capital. Due to their size, purchasing power, and state backing, sovereign wealth funds can exert significant influence on companies and financial markets. Governments may use this influence to align investments with strategic policy goals—supporting future-oriented sectors such as clean energy, green transition, or high-value research and innovation.

When considering the idea of a sovereign wealth fund dedicated to the defence industry, every word matters. What does it mean to ensure sovereignty—now and in the future? The answer is complex and involves the entire defence value chain: from access to critical raw materials to the ability of firms to raise capital to invest, innovate, manufacture, and export;

[10] Dutch Disease describes an economic mechanism in which the rapid expansion of one sector of activity penalises the rest of the economy. It was first described in 1977 to illustrate the adverse impact of the discovery of the Groningen gas field in the Netherlands on the rest of the country's economy. The export success of this new activity led to a rise in the value of the currency, which penalised other exports by increasing their cost.

[11] Norges Bank Investment Management's Government Pension Fund Global, for example, gives 3% of its returns back to the Norwegian government (a total of €214 billion in 2024, or €6.5 billion back). Created in 1990, this Norwegian sovereign fund was endowed with 1981 billion Norwegian kroner (around €179 billion). It now holds 20,000 billion Norwegian kroner and around 1% of the world's capitalisation - See Annual Report 2024.

[12] To take the example of the Norwegian sovereign wealth fund, in 2024, it held shares in more than 9,000 9,000 companies, with 71.4% of its capital invested in equities, 26.6% in fixed income, 1.8% in real estate and 0.1% in renewable energy infrastructure, 57% in North America, 25% in Europe and 14% in Asia.

[13] Norway Government Pension Fund Global, China Investment Corporation, SAFE Investment Company, Abu Dhabi Investment Authority and Kuwait Investment Authority

and ultimately, to the capacity of armed forces to deploy and maintain the equipment they acquire[14].

The *European* dimension of such a fund raises particularly sensitive political questions. Defence remains primarily a national prerogative across the EU and NATO, and the troubled history of European defence cooperation reflects this. European sovereignty is sometimes perceived as a dilution—or even a forfeiture—of national sovereignty, and when it comes to defence, such perceptions can trigger strong resistance from member states. Nevertheless, a growing body of evidence[15]—including numerous reports and analyses, as well as the findings of the recent Joint White Paper[16] —underscores the deep fragmentation of Europe's defence landscape, both in industrial and financial terms. That said, important questions and obstacles remain. These include not only the design and governance of a potential European sovereign wealth fund, but also how such a fund would coordinate with the broader ecosystem of existing instruments.

INTEREST AND LIMITS OF A SOVEREIGN WEALTH FUND TO FINANCE THE EUROPEAN DEFENCE INDUSTRY

A European sovereign wealth fund dedicated to defence could serve as the missing link between public subsidy schemes (such as the European Defence Fund, STEP, and Horizon Europe in its defence components) and investment mechanisms (such as the European Investment Fund and the Defence Equity Facility). Its purpose would be to convert fragmented public spending into productive assets capable of generating returns that can be reinvested.

Could this serve as a textbook case—and even a first pilot—for a broader European sovereign wealth fund? Several arguments support this idea:

[14] Arms export control rules are in fact strict, controlling the end use of military equipment sold. In the US, for example, items exported under the ITAR (International Traffic in Arms Regulations) cannot be transferred to third parties or used in unauthorised contexts without the prior written approval of the State Department. This requirement is stipulated in transfer agreements such as Technical Assistance Agreements (TAAs) and Manufacturing License Agreements (MLAs).

[15] See the reports Draghi and Letta
European Commission, "The Future of European Competitiveness: Report by Mario Draghi", 9 September 2025, p. 67. See: https://commission.europa.eu/document/download/ec1409c1-d4b4-4882-8bdd-3519f86bbb92_en?filename=The%20future%20of%20European%20competitiveness_%20In-depth%20analysis%20and%20recommendations_0.pdf
Letta E (2024), Much more than a market, speed, security, solidarity, Empowering the Single Market to deliver a sustainable future and prosperity for all EU Citizens, April 2024 -

[16] European Commission/HRVP, "Joint White Paper for European Defence Readiness 2030", *JOIN(2025) 120 final*, Brussels, 19 March 2025, p.2 See: https://defence-industry-space.ec.europa.eu/document/download/30b50d2c-49aa-4250-9ca6-27a0347cf009_en?filename=White%20Paper.pdf

- Sectoral focus would avoid dispersion and provide the scale needed to address the capability shortfalls identified in the Joint White Paper. The logic would be one of priority and leverage, rather than rigid budgetary quotas[17]. However, it will still be necessary to consider how this new instrument will dovetail with other European initiatives, including the European Defence Fund.
- Capital injection would help secure the ramp-up of critical supply chains. For dual-use SMEs, it could provide essential seed equity to unlock access to debt and venture capital.
- As an active and offensive tool, the fund could act as a temporary (or not?) anchor shareholder in cases where strategic firms are targeted by non-European investors.
- By co-investing in specialist private equity funds[18], it would reduce perceived risk and help reassure cautious institutional investors. By assuming the first-loss position, the fund could attract private capital and significantly amplify each euro of public money.
- At the early venture stage, the fund could identify promising technologies—such as embedded AI, compact energy systems, or quantum sensors—before they are drawn across the Atlantic in search of funding, as has too often been the case over the past two decades.
- In the medium term, returns from a sector whose market capitalisation would have already grown by over 60% since 2024[19] could feed a virtuous cycle: more resources, more investment, and ultimately a larger, more innovative, and more resilient European Defence Technological and Industrial Base (EDTIB).

In short, a sovereign wealth fund focused on defence would be a tool of sovereignty, an industrial accelerator, and a magnet for European private capital. It would give concrete form to the idea of European preference by transforming public money into shared technological power. What is more, this is probably the ideal moment to design such instruments: rising military spending in Europe, combined with a "buy-European" preference, may open up new markets and outlets on the continent for defence firms; the recently revived plan for a Savings and Investment Union should help recycle within Europe one of the world's largest pools of

[17] One example of this leverage effect is the Defence Equity Facility, whose aim is to stimulate the development of an ecosystem of private funds investing in defence innovation. This €175 million initiative is expected to attract additional private investments in the funds it supports, thereby mobilising, in total, around €500 million in support of European companies.

[18] Tikehau Capital and Weinberg Capital, for example, for financial players; Safran Corporate Ventures, Airbus Ventures and Thales Corporate Venture for companies; and Definvest for Bpifrance, the French public investment bank.

[19] https://www.bloomberg.com/news/articles/2025-03-03/european-defense-stocks-jump-as-leaders-show-support-for-ukraine?utm&embedded-checkout=true

capital; and the vicissitudes of U.S. politics are prompting investors to look for fresh investment terrain elsewhere.

However, in recent years, numerous studies have highlighted the financing challenges faced by companies in the European defence sector. While many point to ESG (Environmental, Social, and Governance) criteria as a major factor behind these difficulties, they are far from the only reason.[20] Other frequently cited factors include the relatively small size of the sector, a long-term trend of declining defence procurement by governments over the past three decades, the fragmentation of national demand and the perception that investing in defence carries disproportionate risk—especially reputational ones—relative to the expected return on investment.[21] Creating a sovereign wealth fund dedicated to defence could make the sector more attractive and reassure private investors by partly addressing these shortcomings. Nevertheless, it must also be structured to work around certain obstacles such as diverging public investment cultures among Member States that could slow decision-making or even block deal-flow, some legal constraints – the Fund must comply with EU State-aid rules for example, Governance credibility – politicisation of investment choices would undermine portfolio performance and market confidence (a professionally independent investment committee is therefore a pre-condition), the objectives in terms of returns as defence projects often have long pay-back periods and binary outcomes.

Moreover, despite recent policy shifts, many European institutional investors still face restrictive mandates on defence; the Fund can mitigate but not eliminate this headwind. Last but probably not least, such an instrument may avoid duplication with existing tools at national or EU level. Indeed, without tight coordination with EU initiatives such as EDF, EDIRPA, FAST but also with national promotional banks or institutions, there is a risk of overlap and dilution of scarce public expertise.

[20] Matelly S. (2023), Articulating ESG Criteria and the Financing of the EDTIB: A Prospective View, Ares Policy Paper, https://www.iris-france.org/174577-articulating-esg-criteria-and-the-financing-of-the-edtib-a-prospective-view/ ; Schütz T. (2020), Covid-19 and the German Defence Technological and industrial base: Impact and policy responses, Ares Comment #55, June 2020 -

[21] Matelly S., Belin J., Devaux J.P., Freland J. J. (2019), Le financement des entreprises de défense : comparaison des BITD allemandes, américaines, britanniques, italiennes et françaises, les cas des États-Unis, Allemagne, Royaume-Uni, France et Italie?, Étude prospective et stratégique n°2018-23, octobre 2019.

WHAT INVESTMENTS SHOULD A EUROPEAN SOVEREIGN WEALTH FUND MAKE?

The significant increase in defence budgets since the start of the war in Ukraine—combined with Europeans' determination to strengthen their Defence Technological and Industrial Base (DTIB)—is creating new opportunities for companies (new markets, new orders, new financing options) as well as for investors, as reflected in the recent rising valuations of European companies on the financial markets. A sovereign wealth fund dedicated to defence should be positioned to leverage this momentum. The key question is how public capital invested through such a fund can take advantage of these dynamics and, ultimately, contribute—alongside other initiatives and instruments—to supporting the strengthening of the European DTIB. We propose four avenues, which are by no means exhaustive, but can help align these two objectives: The list of potential areas for action is extensive, but this paper focuses on four key priorities (which are only suggestions and ideas aimed at stimulating debates and initiatives):

- Taking equity stakes in defence companies to protect strategic assets
- Fostering European industrial consolidation by investing in new entities to strengthen both their organic growth and their capacity for external growth
- Investing in companies, programmes or projects aimed at the development of dual-use activities and technologies
- Investing in strategic stocks or supporting investments in such stocks

Taking equity stakes in defence companies to protect strategic assets.

For several years, European defence companies have been the target of foreign investors. Governments across Europe have grown increasingly aware of the risks associated with foreign ownership in the defence sector. As a result, they have established mechanisms to screen foreign direct investment (FDI). Although these mechanisms differ in scope and enforcement across member states, defence-related companies are systematically listed among the sectors subject to heightened scrutiny. At the EU level, a common FDI screening framework was adopted in 2019. While limited in practice to information-sharing between member states, it nevertheless reflects a growing awareness of the strategic risks posed by foreign acquisitions—and the recognition that a collective European approach is needed. However, despite this important structural shift, actual investment blockages remain rare, largely because there are few viable alternatives to foreign capital.

A European Sovereign Wealth Fund could serve as an active guardian of strategic assets, with the capacity to intervene at three critical stages in the life cycle of a sensitive company:

Before a crisis, the fund could inject equity to prevent a strategic technology firm from seeking non-European buyers due to liquidity constraints—precisely the link that was missing in the 2019 Latécoère case[22]. During a crisis, it could provide a government with a fallback option: rather than outright blocking a foreign takeover, the state could call on the fund as a co-investor—following the example of Germany's intervention in Hensoldt—to secure a blocking minority while preserving the company's growth trajectory[23]. After the rescue, the fund could help structure the exit: either by selling its stake to a long-term European industrial partner (as Leonardo did with Hensoldt), or by opening the company's capital to the markets once its strategic direction has been stabilised—as was the case with the IPO of Exosens[24].

This "protect–transform–value" approach addresses two major shortcomings in the current system. First, Europe lacks capital willing to finance long-cycle strategic and/or disruptive technologies. Second, while FDI screening mechanisms are essential, they are inherently defensive: they can block a threat, but they do not solve the financial fragility of the company in question or provide the investment needed for its future growth.

With its own resources and the capacity to co-invest alongside institutional players (such as the EIB, national promotional banks, or insurance funds), a sovereign fund could unlock European savings that are still hesitant to flow into the defence sector.

[22] In 2019, U.S. private equity firm Searchlight Capital launched a takeover bid for Latécoère, a key French aerospace supplier, valuing the company at around €365 million. Given Latécoère's involvement in sensitive defence and aerospace programmes, the French government subjected the bid to strict foreign investment screening. Paris required binding commitments to preserve strategic activities, jobs, and R&D in France. Once these conditions were met, the acquisition was approved, marking a landmark case in France's efforts to safeguard economic and defence sovereignty.

[23] Hensoldt was created when Airbus sold its defence electronics division to an American investment fund, Kohlberg Kravis Roberts & Co (KKR), in February 2017. In 2020, faced with the threat of Hensoldt being broken up, the German state acquired a 25.1% stake in the company. A few months after the German government acquired its stake, the Italian group Leonardo announced that it was acquiring 25.1% of Hensoldt's shares. In April 2024, Hensoldt acquired Elektroniksystem- und Logistik-GmbH (ESG), a German company specialising in defence electronics and logistics. This example is interesting for a number of reasons: it demonstrates the risks that purely financial investments (KKR) pose for strategic assets, whereas the acquisition of a stake by the German government has enabled the company to refocus on its industrial strategy, attracting an investor capable of supporting this industrial strategy (Leonardo, which also has an interest in the Europeanisation of the company's capital) and enabling the company to pursue an external growth strategy.

[24] Exosens (formerly Photonis) is a French company specialises in night vision and holds more than 130 patents useful to special forces, anti-drone warfare, medical research, industrial control and the circular economy, making it the only ITAR free company in all these technologies. In 2020, in search of financing to invest, it turned to U.S. company, Teledyne but the French government imposed a veto under its foreign investment control rules, preferring the French HLD investment. Under this new management, the company has diversified its activities beyond the military sector, particularly in the fields of healthcare, industry and scientific research. In September 2023, Photonis was renamed Exosens, reflecting this strategic diversification. In June 2024, after several investments and takeovers (including 2 European SMEs, Xenics and ProxiVision), Exosens successfully floated on the stock market, achieving a valuation in excess of €1 billion, i.e. nearly 3 times its 2020 value. Since the IPO, the share price has risen by more than 60% (price raised on 2 May 2025).

In fact, public equity participation in strategic sectors is already standard practice in many European countries. In Central and Eastern Europe, for example, Slovenia—where the state holds the highest number of public stakes in the EU—along with Slovakia, Bulgaria, and Croatia, maintained control over 85 state-owned enterprises in 2020[25]. In Romania, the state and local authorities jointly hold equity in over 1,400 companies and infrastructure entities[26]. In Denmark, the state-owned company Energinet systematically acquires electricity and gas infrastructure assets whenever they are put up for sale. Similarly, the Irish government holds stakes in energy operators in the gas and electricity sectors. In Finland, a law passed in March 2019 allows the government to acquire land in order to block strategic purchases by foreign entities. In Germany, in July 2018, the public development bank KfW acquired a 20% stake in the high-voltage grid operator 50Hertz, effectively blocking a proposed acquisition by the Chinese group State Grid. The government justified the move by pointing to national interest, and in 2019 it officially included this type of intervention in its National Industrial Strategy 2030, assigning KfW the role of executing such strategic holdings[27]. These examples reflect a renewed interest among states in public shareholding, linked to the emerging issue of critical dependencies. This interest is not limited to the defence sector—though, as illustrated by France’s Definvest fund, the stakes and opportunities in this area are very real.

A well-designed pooling of these practices at the European level—through a sovereign wealth fund—could provide a coherent and proactive framework to strengthen the European Defence Technological and Industrial Base (EDTIB).

Fostering European industrial consolidation by investing in new entities to strengthen both their organic growth and their capacity for external growth

In 2023, Europe counted 17 defence companies among the world's top 100, compared to 40 from the United States, including all of the top five[28]. China, by contrast, had only 9, yet three of them ranked in the top ten. Of the European firms on the list, only three are genuine multinational consortia—Airbus (aeronautics), MBDA (missiles), and KNDS (land systems) [29]. Given the urgency of rearmament, the scale of the Russian threat, and the growing risk of

[25] OECD (2020), Acquisition- and ownership-related policies to safeguard essential security interests: Current and emerging trends, observed designs, and policy practice in 62 economies p.121, http://www.oecd.org/investment/OECD-Acquisition-ownership-policies-security-May2020.pdf and for a list of these entities, refer to the State Property Management Act 2018 https://narodne-novine.nn.hr/clanci/sluzbeni/2018_06_52_1023.html

[26] Emergency order no. 109/2011 on the management of public companies

[27] Berlin takes 20% of 50Hertz from Chinese State Grid, https://www.challenges.fr/monde/berlin-prend-20-de-50hertz-que-convoitait-le-chinois-state-grid_603889

[28] To which we could add 6 British companies and 1 Ukrainian. The SIPRI Top 100 arms-producing and military services companies in the world, 2023 https://www.sipri.org/visualizations/2024/sipri-top-100-arms-producing-and-military-services-companies-world-2023

[29] It is interesting to note that these three companies occupy the 12(th) (Airbus), 30(th) (MBDA) and 45(th)(KNDS) places in the ranking. Of the 13 other European defence companies in the ranking, only 6 are in the top 45.

American disengagement, the creation of new European-level industrial entities is more essential than ever.

A European sovereign wealth fund could act as the *financial architect* of such consolidations by taking, for example, equity stakes in the new entity. By supporting mergers and integrations, the fund would help reduce fragmentation, enhance industrial capabilities, and strengthen the European Defence Technological and Industrial Base (EDTIB). It would facilitate the emergence of companies large enough to meet growing demand, sustain longer production runs, and benefit from economies of scale—ultimately fostering both competitiveness and innovation. These consolidation efforts concern not only large firms but also smaller and medium-sized companies.

By attaching a public “label” to consolidation operations, the fund would reassure national shareholders, mitigate political risk, and provide essential transitional capital to facilitate mergers, acquisitions, or spin-offs—without depending on non-European investors. In major defence mergers, it could act as a pivotal minority shareholder, providing a structured equity stake to stabilise governance and ensure that decision-making centres remain within Europe.

In the case of SMEs, the fund could provide the working capital needed to bridge the gap between the announcement of cooperation/consolidation and the ramp-up of industrial production—a time lag that often proves fatal for smaller players due to liquidity constraints or misaligned national interests. For these smaller firms, mergers and consolidations would help achieve the critical mass required to shift from a defensive duality—producing limited military output to remain afloat—to an offensive duality, where defence production becomes a driver of innovation, investment, and growth. Moreover, such operations would become a powerful vector for Europeanisation, particularly in the context of transnational consolidations.

Investing in companies, programmes ot projects aimed at the development of dual-use activities and technologies

The steady decline in military spending across Europe over the past four decades has had a particularly severe impact on small and medium-sized enterprises (SMEs). Faced with the specific constraints of defence production and limited profitability, many have opted to exit the sector altogether. In most European countries, the network of SMEs—and even mid-sized enterprises (ETIs)—serving as subcontractors to major defence primes has significantly eroded[30]. An investment vehicle such as a European sovereign wealth fund could help reverse

[30] Dassault chief warns Europe’s defence industry will take decades to build, Financial Times, Mar 6 2024, https://www.ft.com/content/546179b7-8376-46b6-8231-f53ad2419eb5?utm

this trend. By offering targeted equity support, the fund could provide SMEs with the liquidity they need to remain active in defence, countering the long-term erosion of industrial capacity and reducing overdependence on a handful of large contractors. It could also encourage new entrants into the sector by easing access to capital.

In fact, several civilian companies —some of which were formerly involved in defence through automotive or mechanical subcontracting, are now considering re-entering the market. Notable examples include the potential conversion of Audi's Brussels plant and the acquisition of Fonderie de Bretagne by Europlasma[31]. Moreover, the counter-cyclical nature of defence—often resilient during economic downturns—and the high levels of innovation, including disruptive technologies with dual-use applications, make the sector increasingly attractive to private investors. A sovereign wealth fund could serve as a catalyst, crowding in private capital by reducing risk and demonstrating public commitment. It could co-invest with regional authorities in dual-use technology clusters, fostering synergies across sectors such as defence, healthcare, space, and energy transition. Examples of cross-fertilising technologies include embedded artificial intelligence, low-signature energy systems, and flash radiography. The fund could also support the reactivation of strategic sites—such as the Elling ammunition plant in Denmark[32] —to secure European supply chains and reduce reliance on emergency purchases from outside the EU.

Investing in strategic stocks/supporting investments in such stocks/support for ramp up procurement

Europeans have become increasingly aware of their deep dependence on critical raw materials, particularly in the defence sector, where inputs such as rare earth elements, tungsten, magnesium, and titanium are essential for the production of radars, guidance systems, and other strategic equipment. Commodities are expensive, their prices highly volatile, and shortages are frequent, creating uncertainties and risks for companies. They can also be attractive financial assets Today, the European Union is 100% reliant on imports for 19 of these materials, with China serving as the primary supplier for roughly one-third of them.

[31] In Belgium, the Audi Brussels plant in Forest, which has been closed since the end of February 2025, could become a production site for armoured vehicles and light tanks if its takeover by the Walloon industrial group John Cockerill goes ahead. The Belgian company acquired the French company Arquus in 2024 and intends to take advantage of the expansion of the European defence sector to increase its diversification. The company moved away from steel in 2002 and now produces turrets for light and medium armoured vehicles, as well as simulation equipment and firing systems. With Arquus, its aim is to manufacture light tanks capable, in particular, of fighting drones.

[32] The Danish Defence Minister, Troels Lund Poulsen, revealed on 28 February 2025 that the Norwegian company Nordic Ammunition Company (Nammo) had been selected to relaunch the historic ammunition factory in Elling. "This will make a difference to the security of supply in Denmark, the Nordic region and Europe", said the Danish defence minister, admitting on 19 February that it had been a mistake to close the factory in 2020 after several years of decline. It is due to start production in 2027.

In response to this vulnerability, the EU adopted the Critical Raw Materials Act (CRMA) in May 2024[33]. The regulation sets ambitious targets for 2030: to extract at least 10%, process 40%, and recycle 25% of the EU's annual consumption of critical raw materials. It also aims to limit dependency on any single non-EU country to a maximum of 65% per strategic material.

A European sovereign wealth fund dedicated to defence could play a decisive role in securing these strategic supply chains by buying components or raw materials at the right time and later resell them to companies or EU countries that need them. It also can support vertical integration—through mergers or equity stakes in companies engaged in the extraction, processing, recycling, or storage of key materials (such as special alloys, composites, or rare earths). The fund could also invest in the creation of pooled rotating strategic stocks at the European level, particularly for critical materials required for weapons systems and sensitive electronic components. These stockpiles, backed by consolidated industrial players, would serve a dual purpose: first, as a buffer in times of crisis; second, as a market-stabilising instrument during peacetime, helping to absorb price volatility and mitigate the impact of geopolitical disruptions.

In synergy with the European Investment Bank's new €2 billion initiative on critical raw materials (to be mobilised by 2025), the sovereign wealth fund could co-invest with public and private partners in joint ventures while ensuring alignment with strategic objectives. It would also contribute to reducing market fragmentation by reinforcing linkages between materials producers, the defence industry, and public procurement authorities. Ultimately, this strategy of upstream consolidation and industrial security could transform the European Defence Technological and Industrial Base (EDTIB) from a fragile archipelago into a coherent, robust, and responsive system.

Beyond raw materials, the war in Ukraine has highlighted the importance of strategic stockpiles of ammunition and key components. The difficulties encountered in rapidly supplying the Ukrainian armed forces have demonstrated that, in periods of extreme demand pressure, the ability to deliver from existing stock is critical—particularly while waiting for production lines to scale up under a war economy footing.

In this context, the European Defence Investment Programme (EDIP) has proposed the establishment of a European Military Sales Mechanism[34], modelled on the United States'

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[33] https://single-market-economy.ec.europa.eu/sectors/raw-materials/areas-specific-interest/critical-raw-materials/critical-raw-materials-act_en

[34] Proposal for a regulation of the European Parliament and of the Council establishing the European Defence Industry Programme and a framework of measures to ensure the timely availability and supply of defence products ('EDIP'), COM(2024) 150 Final 2024/0061(COD), Brussels, 5.3.2024 - see article 14 https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX%3A52024PC0150

Foreign Military Sales (FMS) system. It is important to note that FMS in the U.S. operates effectively because it is backed by Pentagon-held inventories—a lesson that Europe may need to internalise if it wishes to build a credible and responsive military-industrial posture.

Finally beyond equity, the Fund could also perform a transaction-bridging function. Participating governments would be allowed to channel a share of their advance procurement payments through the Fund. This mechanism would accelerate cash-flow to prime contractors and SMEs while mutualising the budgetary impact over the Fund's balance sheet and, where relevant, co-investing Member States.

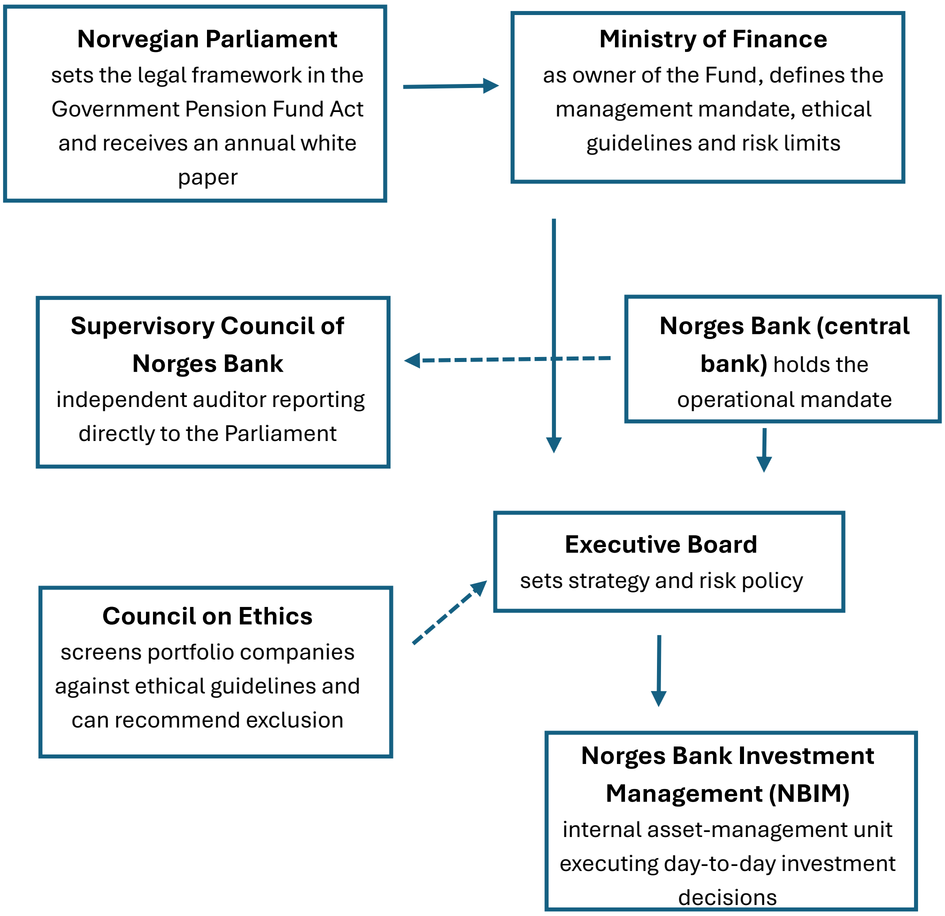
Doing so, the Fund could underwrite Letters of Intent (LoI) or Commitment Letters issued by Member States for clearly identified capability priorities. These LoIs would constitute a quasi-sovereign purchase guarantee, enabling manufacturers to scale production with full visibility on off-take and giving commercial lenders the comfort needed to provide working-capital facilities at lower cost. When combined with existing instruments (EDIRPA, EDIP-FAST), this bridge-financing window could shorten production lead times, reduce financing costs, and further crowd-in private capital, thereby amplifying the Fund's leverage effect on Europe's defence-industrial ramp-up.

WHAT GOVERNANCE AND FUNDING FOR A EUROPEAN SOVEREIGN DEFENCE INVESTMENT FUND?

This paper has explored the potential value of a sovereign European defence investment fund as a means of strengthening the Defence Technological and Industrial Base (DTIB) through long-term, strategic investments. It has also identified several critical design questions — governance, funding, legal framework, political feasibility — which must be addressed to move from concept to implementation.

Governance will be central to the fund's credibility. The fund must be capable of taking sensitive decisions (industrial consolidation, public equity participation in strategic firms, mergers) while preserving professional, independent investment management. A clear separation of roles is essential: a political body (steering board) should set the fund's strategic direction, while an independent investment committee — composed of financial, industrial, and strategic experts — should assess and select projects based on transparent criteria. The Norwegian Government Pension Fund Global offers a useful reference in this respect.

Table 2 – Governance of Norway's Government Pension Fund Global



Funding mechanisms will shape governance. If financed predominantly through direct Member State contributions, the fund will likely adopt an intergovernmental structure similar to the EIB or ESM. If funded via EU-level debt issuance, budget contributions, or revenues from frozen Russian assets, a more supranational governance will be necessary, with involvement of the Commission and European Parliament oversight. Importantly, governance and funding must be co-designed to ensure both political legitimacy and operational efficiency.

Scope of participation should be addressed pragmatically. While an EU-27 fund would be ideal to ensure cohesion and scale, a "coalition of the willing" may be a more realistic starting point in the current political context. Building on existing EU-level and national instruments can accelerate deployment while testing governance arrangements and demonstrating added value. A phased approach, incorporating regular performance reviews and adjustments, would allow the fund to evolve in step with political convergence.

Finally, while pursuing strategic objectives (sovereignty, resilience, technological leadership), the fund will need to adhere to sound financial principles. A credible business model, with reasonable expectations of return on investment, will be required to secure sustainable political and financial support. This will also be key to ensuring compliance with EU competition and state aid rules and to maintaining market confidence.

In sum, delivering an effective European defence investment fund will require moving beyond conceptual debates to address concrete institutional design choices. Governance, funding, legal feasibility, and political dynamics must be aligned. A pragmatic, phased, and performance-driven approach offers the most credible path forward — helping to ensure that Europe’s ambitions for strategic autonomy are matched by the necessary industrial and financial capabilities.

CONCLUSION: UNLOCKING A VIRTUOUS INVESTMENT CYCLE FOR EUROPE’S DEFENCE

By providing targeted capital at critical moments — whether to support industrial consolidation, secure strategic assets, finance disruptive dual-use technologies, or stabilise strategic supply chains — the Fund could de-risk investments and send clear market signals. This in turn would attract institutional investors, private equity players, and sovereign savings that today remain hesitant to enter the defence sector, held back by perceived political, regulatory, or financial risks.

These investments, if structured properly and deployed professionally, can thus exert a powerful leverage effect. By acting as an anchor investor or taking a first-loss position in selected projects, the Fund would help crowd in private capital, magnifying the impact of each euro of public money. The Defence Equity Facility and similar instruments provide useful templates, but a sovereign fund would add scale, continuity, and the strategic capacity to act swiftly when market dynamics or geopolitical shocks demand it.

Moreover, the fund’s ability to generate returns — in a sector where valuations have already risen sharply and demand is set to remain strong — would create a self-reinforcing loop. Profits could be reinvested to support new priorities, while demonstrating to governments and taxpayers that strategic investment in Europe’s security can also deliver tangible economic value. This would further strengthen political and public support for a robust, investment-driven approach to European sovereignty.

Finally, a well-governed, credible fund would signal Europe's determination to act collectively and strategically — offering a concrete, market-facing counterpart to more traditional grant-based instruments. In a time of heightened geopolitical risk and accelerating rearmament, the EU must not only spend but also invest — and do so wisely.

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