7.2 Luxembourg's new defence strategy

Luxembourg's new budget law proposal outlines the country's future military spending, committing to 2% of Gross National Income (GNI) by the end of the year and a further increase to 5% by 2035, in line with North Atlantic Treaty Organization (NATO) objectives. The EUR 1.2 billion spending planned for 2026, representing a 56% year-on-year increase, comes at a time when many nations are activating EU fiscal flexibility measures. In addition to Luxembourg's traditional defence expenditures on large aircraft and substantial foreign military aid, the government aims to increase the share of the budget devoted to investments, prioritising domestic projects that are expected to generate stronger economic returns.

Military spending to reach new heights

Heightened geopolitical tensions have persisted over the last years and show little signs of de-escalation in the near future. The ongoing Russian invasion of Ukraine, coupled with recent breaches of NATO airspace by Russian aircraft and drones, has accelerated a shift in European defence policy and objectives.

At the annual NATO summit this year, allies have collectively agreed to increase each nation's military spending contribution from 2% to 5% of their Gross Domestic Product (GDP) by 2035. Of this amount, 3.5% is planned to be directed toward core military needs, while 1.5% supports critical infrastructure. Unlike other NATO members, Luxembourg's defence contribution is measured as a percentage of Gross National Income (GNI, rather than GDP), the former being hence recognized by NATO as statistical measurement reference. This distinction is important as Luxembourg's GNI is substantially lower than its GDP.[1]) As a result, Luxembourg's required defence spending is about 35% lower than it would be if calculated relative to GDP.

This spending commitment marks the most significant military buildup since the Second World War for many European nations that have long enjoyed the benefits of the post-war peace dividend.[2] In parallel, the European Commission has launched the "ReArm Europe" plan, which aims at mobilising EUR 800 billion for defence investment expenditures funded by the national budgets of member states.[3] It is, however, important to note that this spending is not in addition to the 5% target that NATO members have already agreed upon.

Luxembourg currently spends around 0.9% of GDP on defence which translates to around 1.3% of GNI. According to recently published figures from the National Council of Public Finances, Luxembourg's new defence commitment would require a significant increase in spending, rising from EUR 1.18 billion (2% of GNI) in 2025 to around EUR 4.6 billion (5% of GNI) in 2035, assuming a linear increase and an average annual GNI growth rate of 4.9% between 2031 and 2035.[4]

1 This is on the one hand due to the large number of cross-border workers – whose income is counted in GDP but not in GNI – and the high net capital income paid abroad, that means also subtracted from GDP.

2 The "peace dividend" refers to the economic and fiscal benefits European nations enjoyed from reduced defence spending after the Cold War.

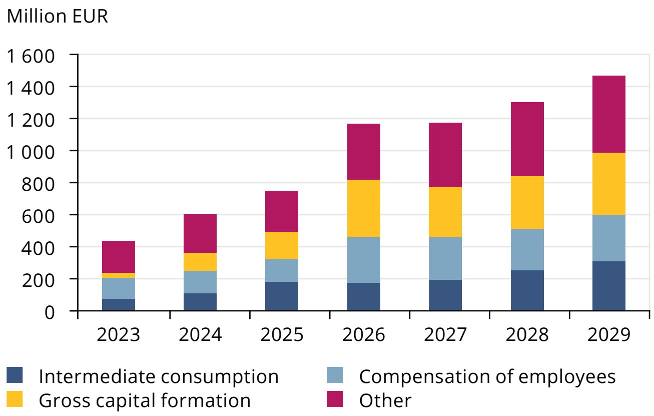
3 https://ec.europa.eu/commission/presscorner/detail/hu/qanda_25_790

4 https://cnfp.public.lu/dam-assets/documents/informations/notes/2025-analyse-depenses-defense.pdf

Illustrating this commitment, on the 13th of May, Prime Minister Luc Frieden had already announced national military spending to reach 2% of GNI by the end of this year in the State of the Nation Address. To reach this target, Luxembourg plans to invest EUR 105 million in the GovSat-2 satellite, EUR 46 million in Research and Development (R&D) projects including drone development and contribute to the National Defence Fund. Military support for Ukraine will rise to EUR 120 million, with EUR 30 million added to meet the 2% goal, while all ministries identified EUR 115 million in security-related spending that will count towards the defence total.[5]

Further evidence of this ambition can be seen in the 2026 budget proposal submitted to Parliament in early October. As can be seen in the Graph A, 2025 military spending is set to reach EUR 750 million, marking a 24% year-on-year change. The multiyear budget submitted to Parliament also includes spending projections until 2029. Military spending is expected to surpass EUR 1 billion a year for the first time in 2026 and reach EUR 1.47 billion by the end of the decade.[6]

Graph A
Military spending multiplied by 4



Sources: Eurostat (2023-2024) ; State budget proposal (“Budget de l’État”, 2025-2029)

Financing increased military spending

Given the scale of the new defence spending commitments within NATO and the European Union (EU), some EU nations may struggle to come up with the needed financing while complying with fiscal rules. To cope with binding constraints and promote the development of a European defence industry, the EU has foreseen a national escape clause that permits member states to “temporarily deviate from budgetary requirements in response to exceptional circumstances beyond their control”.[7] When activated, this clause allows EU member states to cover additional defence spending of up to 1.5% of GDP per year for a period of up to four years (2025–2028), without being considered in breach of the fiscal rules.

Luxembourg is not at risk of violating European fiscal rules due to a low debt-to-GDP ratio (26.3% in 2024) and stable public finances. The country has therefore declined the opportunity to activate the EU escape clause. Furthermore, on the 6th of October 2025, Luxembourg approved the creation of a “Defence Bond Framework”.[8] These bonds should raise EUR 150 million and allow Luxembourg to finance a small part of eligible investment categories such as space systems, aviation and vehicles.

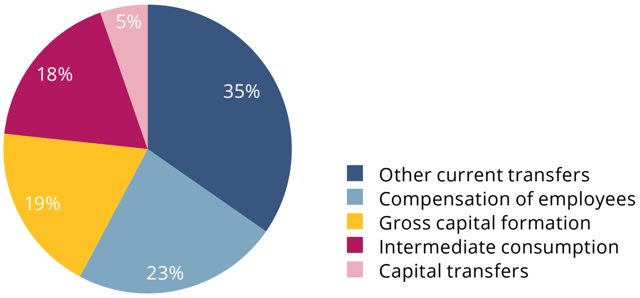
5 https://defense.gouvernement.lu/en/actualites.gouvernement 2024+fr+actualites+toutes_actualites+communiques+2025+05-mai+16-backes-plan-defense.html

6 Only the 2025 and 2026 figures are legally binding. Budget data rely on the “Budget 2026 – Volume 2 : Projet de loi de programmation financière pluriannuelle pour la période 2026–2029” (https://budget.public.lu/dam-assets/lb/budget2026/links-dokumenter/bu-2026-volume-2-pour-web-v1.pdf). The figures are extracted from the following sections of the document: Section 01.05 “Direction de la défense” (pp. 128–131) ; Section 01.06 “Défense nationale” (pp. 131–133) ; Section 31.05 “Direction de la défense” (pp. 330–331) ; Section 31.06 “Défense nationale” (pp. 331–332) ; and “Fonds d’équipement militaire” (pp. 411–413).

7 https://www.consilium.europa.eu/en/policies/national-escape-clause-for-defence-expenditure-nec/

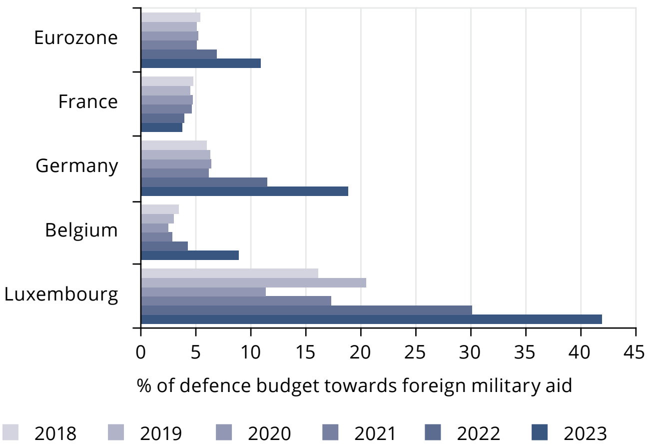
8 https://gouvernement.lu/dam-assets/images-documents/actualites/2025/10/08-defence-bond-framework/defence-bond-framework.pdf

Graph B
Transfers dominated military spending in 2024



Source: Eurostat

Graph C
Security through solidarity



Source: Eurostat

Atypical split of defence expenditure for Luxembourg

COFOG[9] data from Eurostat illustrates how Luxembourg is currently allocating its defence budget. According to the latest quasi-final figures for 2024, around 40% of the military budget went towards capital transfers and other current transfers. These transfers largely consisted of military aid being sent to Ukraine to fund the war effort against Russia and other multinational NATO projects. While the Eurozone, on average, spends 43.5% of its defence budget on military salaries, Luxembourg spends only 23%. France and Germany spent more on wages (40% and 34% respectively in 2023) and less on foreign military aid (4% and 19% respectively) than Luxembourg.[10] The rest of the defence budget can be divided between investments, which cover spending on long-term assets like infrastructure and equipment, at 19%, and intermediate consumption, which includes goods and services used up in the provision of public services, at 18% of the budget. These proportions have remained relatively stable over the years.

Domestic investment ambitions

Luxembourg has stressed the desire for an economic return on its defence expenditure, although it has struggled to achieve it in the past, mostly due to the absence of a specific defence industry. Typically, military investments in the form of gross fixed capital formation are associated with a positive fiscal multiplier due to the second-round effects of an increase in government consumption. However, the extent of this multiplier depends on the size and capabilities of a nation's domestic defence industry. The openness of the economy also matters, since more open countries like Luxembourg often import a larger share of goods, services and labour, leading to greater leakages that limit the domestic economic impact. The United States of America (USA), for example, benefit significantly from increasing domestic military expenditures due to their leading military position, illustrated by the high equipment exports including weapons, munition and vehicles, which boost domestic employment.

9 COFOG (Classification of the Functions of Government) is a system used by the EU and other international organisations to categorise government expenditures according to purpose, such as defence, health, or education.

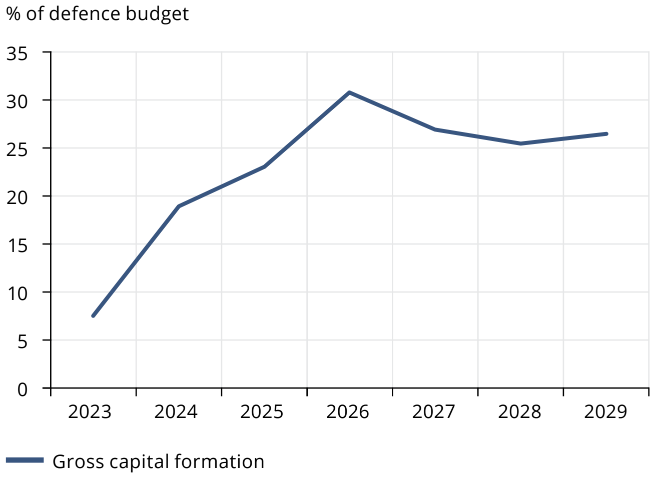
10 Source: Eurostat.

Luxembourg, to date, has not had the opportunity to benefit from a domestic defence industry and the economic benefits that it could provide. Historically, a large share of purchases such as military aircraft have come from abroad offering little return on investment. However, the initiative "Lux4Defence" has recently been launched by several Luxembourgish firms in cooperation with the Chamber of Commerce to create links between domestic companies and the wider European defence field. By putting forward ten concrete recommendations, they "aspire to offer the Luxembourgish government the opportunity to utilize the defence budget for national projects that improve innovation and promote job creation".

Furthermore, Luxembourg is set to significantly increase the proportion of its military budget devoted to investments rather than transfers, as outlined in the latest budget law proposal.[11] In 2023, investment-related expenditure accounted for approximately 7.5% of the total defence budget, whereas by 2029 this share is projected to exceed one-quarter of all military spending. These emerging investments may very well raise Luxembourg's defence fiscal multipliers in the near future, and they signify a prominent change in Luxembourg's defence policy. Some of these projects include expanding satellite and surveillance capabilities by launching GovSat-2, a government and military communications satellite following the original GovSat-1, as well as supplying NATO with cybersecurity services.

Graph D

Permanently higher share in investment spending



Sources: Eurostat (2023-2024) ; Budget law proposal (2025-2028)

11 These figures result from grouping, as for official Eurostat COFOG data, all defence-related budget items into four categories: personnel expenditure, gross capital formation, intermediate consumption, and transfers. All figures also include expenditures financed through the military equipment fund.

Size constraints

Luxembourg's armed forces consist of slightly more than 1 000 active personnel, civilian and military personnel included, making it the smallest NATO army in absolute numbers. Even when accounting for population size, Luxembourg counts around 1.3 soldiers per 1 000 inhabitants in 2024, the lowest ratio of any NATO country and 2.65 times lower than the NATO average (NATO countries collectively had about 3.5 soldiers per 1 000 inhabitants).

Many NATO members have increased their military headcount over the past decade, particularly those near the Russian border. For example, Poland more than doubled its personnel from 99 000 in 2014 to 216 100 in 2024, raising soldiers per 1 000 population from 2.6 to 5.9, while Lithuania's forces grew from 8 600 to 18 500, with soldiers per 1 000 population climbing from 2.9 to 6.4. Latvia also saw a near doubling, from 4 600 to 8 400 personnel. In contrast, the United States reduced its headcount slightly, resulting in a drop from 4.1 to 3.8 soldiers per 1 000 population. As a result, several European nations have now surpassed the USA in terms of soldiers per capita, highlighting the European effort to strengthen defence capacities.

In Luxembourg, between 2018 and 2023, the total defence budget increased by around 76%, while compensation of employees in defence grew by 57%. This underlines that recent spending increases have primarily funded equipment and vehicle purchases as well as foreign military aid rather than troop expansions.

Army officer salaries in Luxembourg are substantially higher than those of most other European countries in nominal terms. Entry-level pay is slightly lower but is still among the top-paying European forces in terms of purchasing power.[12] Despite Luxembourg offering some of the highest military salaries in Europe, its share of the defence budget devoted to personnel remains relatively low at around 30%. By comparison, personnel costs accounted for 57% of total military expenditure in Belgium, 40% in France, and 34% in Germany for 2023.[13]

To match the NATO average of 3.5 soldiers per 1 000 inhabitants, Luxembourg would need to increase its personnel from 880 soldiers to approximately 2 323. A preliminary estimate of the budgetary impact can be derived by scaling Luxembourg's 2024 expenditure on military personnel compensation (EUR 139.7 million) by the same ratio, raising personnel costs by around EUR 370.2 million, or 0.65% of GNI in 2024.

12 https://euromil.org/wp-content/uploads/2020/02/Working-Paper-Major-GS-Ren%C3%A9-Schulz-with-Annex.pdf

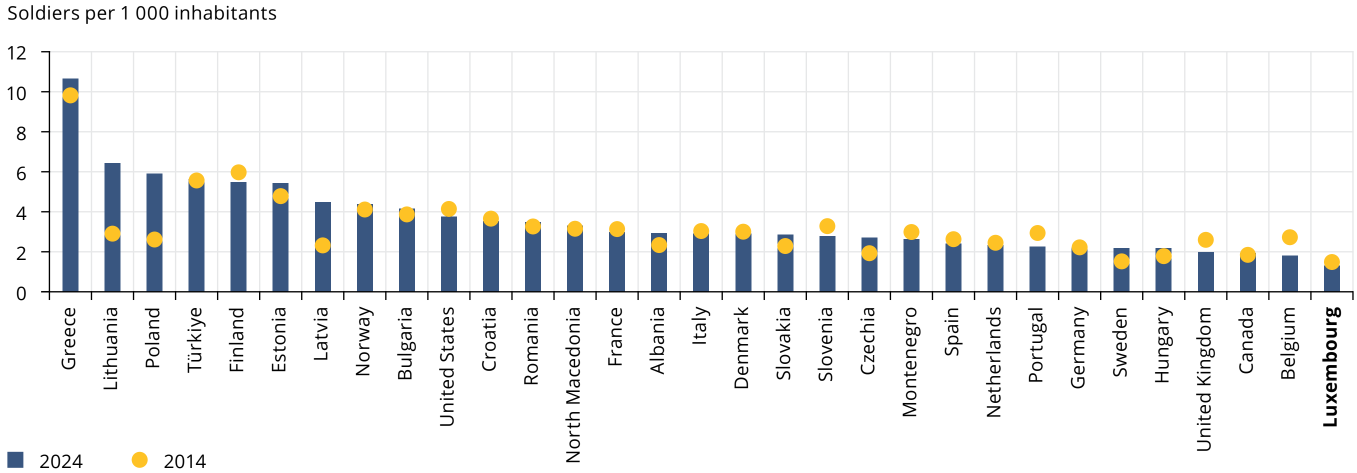
13 Conjoncture Flash July 2025.

Assuming other factors remain constant, such an increase would likely reduce the share of defence spending allocated to equipment, which in 2025 is projected to represent more than half of Luxembourg's defence budget (the second-highest share among NATO countries, behind Poland).

Luxembourg's persistently low troop numbers reflect a defence policy that is limited by personnel size, but targets contributions in future projects that require specific expertise such as cybersecurity and satellite imagery.

Graph E

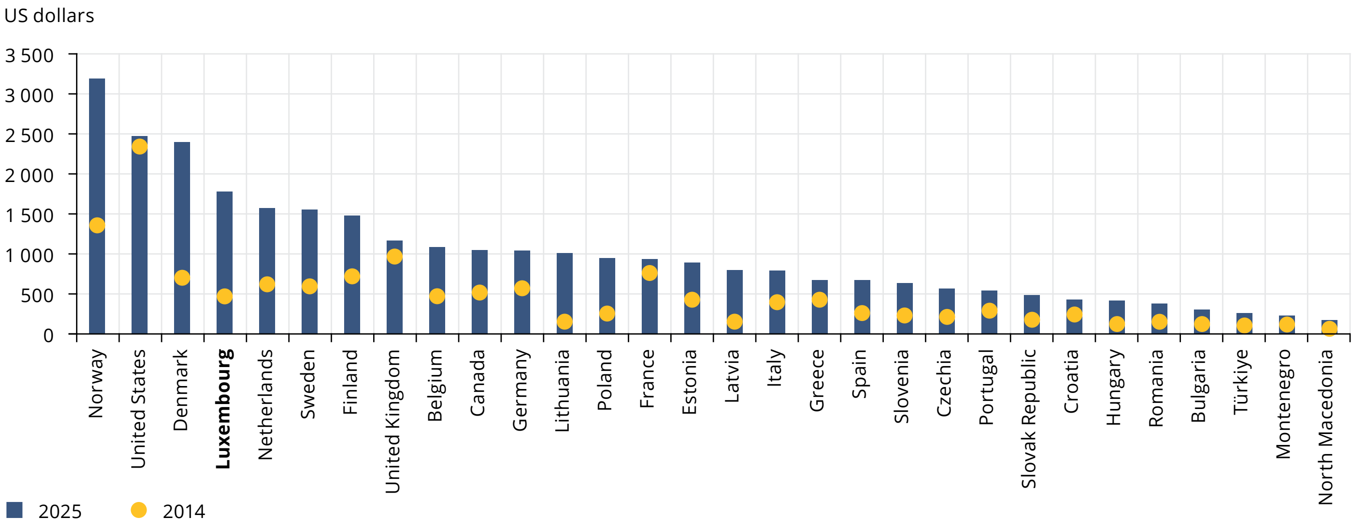
NATO's smallest army in absolute and relative terms



Sources: Eurostat (population except US, UK, Canada: population.un.org); NATO (military headcount, 2024 being an estimate).
Remark: Eight out of the top half of NATO nations have mandatory military service. Only two out of the bottom half have mandatory military service.

Graph F

Defence expenditure per capita (US dollars)



Source: NATO (https://www.nato.int/nato_static_fl2014/assets/pdf/2025/8/pdf/250827-def-exp-2025-en.pdf).
Remark: 2025 is an estimate and figures for Germany are for 2024.

Summary and outlook

Overall, European defence spending is ramping up to levels not seen since World War II, with NATO members planning to progressively dedicate 5% of their GDP towards defence-related expenditure. Luxembourg's budget law draft for 2026 confirms this trend as it commits to spending 2% of its GNI on defence by the end of the year. For Luxembourg, this signifies well over a billion EUR annually towards military personnel, investment and foreign military aid.

The government tries to put emphasis on domestic investment and innovation aimed at generating an economic return and stimulate activity and job creation. To achieve this, future expenditures shall be focussed on high value-added and knowledge-intensive defence sectors such as space systems and cybersecurity.

It is relevant to note that the new budget law only outlines defence expenditure for 2026, actual expenditure may vary, and subsequent years serve merely as indicative projections rather than legally binding commitments. This means that future developments could alter the planned spending trajectory.

Further studies could try to evaluate the public spending multiplier derived from military expenditures, and hence try to examine whether Luxembourg could effectively deliver on its economic return objective, keeping in mind the openness of the economy and strong reliance on cross-border workers.