Shoshan Plaz, Entry 96A, Or Akiva 3606.

29.03.2026 • READ TIME: 8 MIN • ECONOMY

Cars before drones

Feature: Can Europe's booming defense industry save its dying factories? Sander Tordoir on the problem with the entry Germany's manufacturers are telling themselves.

Maxime Ahrens, Sander Tordoir

Getty Images

"This is about spending more, spending better," Mark Rutte, secretary-general of the North Atlantic Treaty Organization, said last year. Europe is certainly spending more: World military expenditure (SIPRI) US$2.4 trillion in 2025, according to the Stockholm International Peace Research Institute, with European spending up by 9 percent. The surge isn't Europe's alone: China's military budget grew by 7.4 percent, Japan's by 9.1, and Africa's total by 8.5.

In the United States, the idea that military spending could stimulate the rest of the economy —"military Keynesianism"—caught on with Jake Sullivan, the former U.S. national security adviser, who argued that defense spending would feed a "modern American industrial strategy." Perhaps Europe's rearmament could do its part. The Trump White House (see) it as working make sure that money helps "reindustrialize America."

Europe's own industry, meanwhile, is reeling. As Adam Dixon (see) here in The Signal:

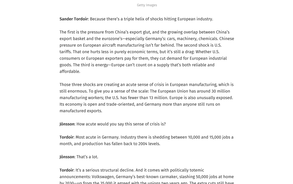
What's saving some of Europe's industrial capacity, though, is the rearmament of European militaries—because governments tend to favor local suppliers on both economic security and national security grounds. … The Dutch industrial conglomerate VDL Groep owns a factory in Limburg, in the south of the Netherlands, that long held a contract with BMW. When BMW didn't renew the contract in 2024, they laid off some 2,000 workers. The factory has now reopened—on a new contract with the Dutch military.

That's one factory, on one contract. How far can rearmament carry the rest?

Sander Tordoir is the chief economist of the Centre for Economic Reform in London. Tordoir says Europe's rearmament won't rescue its industry. What Europe is mounting is not one rearmament program but dozens of national ones, small-scale and barely coordinated—expensive and inefficient. A car plant here and there can pivot to weapons; that won't move the wider economy much. The White House, though, may be onto something: Poland is ramping up its spending fast, and it keeps buying American.

There is hope, Tordoir says, though it runs the other way around. Governments in Europe and America are coming to see that military orders alone will never sustain a battery supply chain China can't squeeze—that takes a civilian market too. Which may mean Europe can't build the weapons it wants until it saves the car plants it is losing …

Gustav Jönsson: Why would anyone think military spending could rescue European industry?



Getty Images

Sander Tordoir: Because there's a triple helix of shocks hitting European industry.

The first is the pressure from China's export glut, and the growing overlap between China's export basket and the eurozone's—especially Germany's: cars, machinery, chemicals. Chinese pressure on European aircraft manufacturing isn't far behind. The second shock is U.S. tariffs. That one hurts less in purely economic terms, but it's still a drag. Whether U.S. consumers or European exporters pay for them, they cut demand for European industrial goods. The third is energy—Europe can't count on a supply that's both reliable and affordable.

Those three shocks are creating an acute sense of crisis in European manufacturing, which is still enormous. To give you a sense of the scale: The European Union has around 30 million manufacturing workers; the U.S. has fewer than 13 million. Europe is also unusually exposed. Its economy is open and trade-oriented, and Germany more than anyone still runs on manufactured exports.

Jönsson: How acute would you say this sense of crisis is?

Tordoir: Most acute in Germany. Industry there is shedding between 10,000 and 15,000 jobs a month, and production has fallen back to 2006 levels.

Jönsson: That's a lot.

Tordoir: It's a serious structural decline. And it comes with politically toxic announcements: Volkswagen, Germany's best-known carmaker, is cutting 50,000 jobs at home by 2030—up from the 35,000 it agreed with the unions two years ago. The extra cuts still have to go through the unions, but it gives you the direction of travel.

Europe's broader industry is not in as dire straits. It's holding up and even expanding in Spain and Greece—the former euro-crisis countries, now recovered, with real national advantages: abundant wind and solar power, relatively cheap labor, and a lot of land. The surge in energy prices from Donald Trump's war in Iran has sharpened all three shocks these past months. But the shocks hide something: Manufacturing capacity isn't only shrinking inside the EU—it's moving.

Underneath all of it is China. The Organisation for Economic Co-operation and Development reckons subsidies account for 60 percent of the global market share China has captured over the last 20 years, and France's High Commission for Strategy and Planning estimates that Chinese trade surpluses in Europe's core sectors could leave more than half of European manufacturing facing competition it can't survive—with whole sectors pushed out of the market in less than a decade.

> The military center—and to a degree the political center—of Europe is moving decisively north and east. Germany, the Netherlands, Scandinavia, and central and eastern Europe—Poland above all—will carry most of the additional spending.

Jönsson: Is the worst of it now, or ahead?

Tordoir: The crisis is now, and the future looks worse. Whether or not the French estimate is right, it gives you the order of magnitude of the losses European manufacturing faces.

China's trade surplus with Europe is growing very fast. In weight terms, EU imports of Chinese goods have doubled over the last six years. This is a seismic shift, and there's no sign it's slowing or correcting on its own. It's also symbolically powerful: Europe now runs a trade deficit with China in its most important industry—cars.

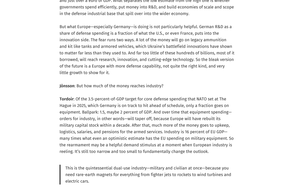
Jönsson: What kind of military spending could shift those trends?

Tordoir: In my view, the EU's big defense commitments don't come from a worry about deindustrialization. In rationale, design, and impetus, this is not a military Keynesian or stimulus program. It comes from the threat Russian aggression poses—not only to Ukraine but to the EU as a whole—and above all from the shock of the Trump administration's NATO falling into serious doubt. The United States no longer finances Ukraine; it still supplies some military kit, on condition that the Europeans pay for it. That has focused minds, especially in Berlin.

Because no one designed this spending to support European industry, no one is designing it to throw off long-term growth for the wider economy either. That's the risk.

The size of the spending is staggering, though. European NATO—which takes in the U.K., Turkey, and a few others outside the EU—will be spending an additional €300 billion a year on defense by the end of the decade; some estimates put the total at around €600 billion a year. By 2028, Europe is set to spend as much on military equipment—drones, tanks, aircraft, submarines, the whole range—as the U.S. spent in 2025. That's a huge change.

The military center—and to a degree the political center—of Europe is moving decisively north and east. Germany, the Netherlands, Scandinavia, and central and eastern Europe—Poland above all—will carry most of the additional spending. At its heart, this is not a European rearmament program—it's a hodgepodge of national ones with limited coordination. That has two implications: Much of the production will be relatively small-scale and national, and some of it will happen outside Europe altogether. Poland buys much of its equipment from the U.S. and South Korea, because it doesn't have the capacity to build its own.



Simon Kitagawa

Jönsson: If you think the Russian army might be watering its horses in the Seine any day now —or at least rolling into Riga, on NATO's eastern edge—how this is money well spent, if you don't, it's capital that could be doing more for European industry somewhere else. How effective is it, really?

Tordoir: Some people—German carmakers among them—have pushed the line that the European defense ramp-up is the saving grace of European industry. In my view that's overblown.

The economic literature puts the return on every euro of defense spending somewhere between 0.5 and a little over 1 for every euro you spend, you get back between half a euro and just over a euro of GDP. What separates the low estimate from the high one is whether governments spend efficiently, put money into R&D, and build economies of scale and scope in the defense industrial base that split over into the wider economy.

But what Europe—especially Germany—is doing is not particularly helpful. German R&D as a share of defense spending is a fraction of what the U.S., or even France, puts into the innovation side. The fear runs two ways. A lot of the money will go on legacy ammunition and kit like tanks and armored vehicles, which Ukraine's battlefield innovations have shown to matter far less than they used to. And far too little of these hundreds of billions, most of it borrowed, will reach research, innovation, and cutting-edge technology. So the bleak version of the future is a Europe with more defense capability, not quite the right kind, and very little growth to show for it.

Jönsson: But how much of the money reaches industry?

Tordoir: Of the 3.5 percent of GDP target for core defense spending that NATO set at The Hague in 2025, which Germany is on track to hit ahead of schedule, only a fraction goes on equipment. Ballpark: 1.5, maybe 2 percent of GDP. And even time that equipment spending—orders for industry, in other words—will taper off, because Europe will have rebuilt its military capital stock within reach. After that, much more of the money goes to salaries, logistics, salaries, and upkeep. So the defense sector is unlikely to be a major source of growth. There is even an optimistic version of this: It could be a stabilizer for industry. So the rearmament may be a helpful demand stimulus at a moment when European industry is reeling. It's still too narrow and too small to fundamentally change the outlook.

> This is the quintessential dual-use industry—military and civilian at once—because you need rare-earth magnets for everything from fighter jets to rockets to wind turbines and electric cars.

The big lesson from the American arms buildup in World War II is that you produce equipment at scale and at a good price by standardizing it. Today the U.S. has fewer than 30 weapon systems. The EU has more than 120. There's very little standardization, and that's a problem of politics. There's no reason in principle the EU couldn't cut the number of aircraft types and other equipment it builds. In practice, it's proving very hard.

Small groups of countries are working together. But the Franco-German relationship is fraught. Germany just left the future Combat Air System, its joint fighter project with France; the two governments agreed to scrap it in June. That may have been the right decision on the merits, but it signals how hard EU member states find it to procure jointly and to limit the number of weapon systems they build. And they'll have to, if Europe is going to scale production and bring down the cost per unit.

Jönsson: That's bleak. What's going well—if anything?

Tordoir: There's one real source of hope. This is a low-confidence prediction, but I think that over time European governments will come to see that the problems in their civilian manufacturing base run straight into what they're trying to achieve on the military side—building their own sovereign technology stack.

Building a European battery supply chain China can't squeeze is exceptionally difficult—China runs something close to a monopoly on batteries. And a European battery supply chain that only builds for robotic weapon systems will never have the scale, the size, or the order volumes to work. But if European governments start to understand that the rest of the Continent needs a fairly sizable electric-vehicle sector alongside a cutting-edge drone and robotic weapons sector—which Europe is well placed to build, because it can work with Ukraine on it. You need both sources of demand before you get a genuinely homegrown battery supply chain at all.

Another place there's movement is rare earths. Again, this isn't a theoretical worry about China choking off supplies. A lot of European companies already report getting only a fraction of the rare-earth inputs and magnets they need from Chinese suppliers. This is the quintessential dual-use industry—military and civilian at once—because you need rare-earth magnets for everything from fighter jets to rockets to wind turbines and electric cars. So in my view, governments will have to remove some of that military money toward economic-security goals.

Alistair Sharrock

Germany is already taking small steps: In May it added up to €500 million to its rare materials fund.

Jönsson: Apart from spending more, what are European governments actually doing about rare earths?

Tordoir: The standard line is that rare earth minerals aren't actually that rare. Kiruna, in the far north of Sweden, is a major source of iron ore and has very large rare-earth deposits too. The challenge is less mining than refining and processing rare earths into permanent magnets—the kind that keep working under extreme heat and stress. Which, as you might guess, is what makes them matter for military equipment.

China still holds a monopoly in a lot of areas, and Europe isn't doing enough. But the Europeans have put a number of measures in place. Europe now restricts exports of rare-earth magnet scrap, which keeps the feedstock inside the bloc where European recyclers can get at it—one policy trying to serve sustainability and economic security at once. Refining plants are expanding or coming online in France. A rare-earth recycling plant just opened in western Germany. Without exception, these projects run on some form of EU or member-state support, because China distorts the rare-earth market so badly that it takes intervention to create a market at all.

This is one of the areas where the Trump administration is keen to cooperate. The U.S. wants a system coordinated across the Group of Seven, with minimum price floors, to build some kind of rare-earth market for Western allies. That's partly because the administration is putting a lot of public money behind American rare-earth projects and national champions, and it wants enough demand from outside the U.S. to make them viable.

Jönsson: China has squeezed the U.S. with its near-monopoly on rare earths. So it makes sense Washington would want to cooperate on this, if not on much else.

Tordoir: Yes. And the U.S. isn't the only one on the receiving end. As we speak, Japanese firms that produce for their own military are on an export control list that stops them getting rare-earth inputs from China. The underlying coercion case. Over the last 15 years, of all America's allies, Japan is the one that's done the most to build its own sovereign rare-earth capacity. And even it still isn't immune.

Recommendations

- Tracks of uncertainty — 11 min read
- Humboldt's gift — 11 min read
- The language of beauty — 10 min read
- "Someone knew, and someone was trading" — 10 min read
- No tanks required — 8 min read