



# CREATING FINANCIAL RESILIENCE IN NATO: THE CASE FOR REVISITING ARTICLE 2

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Centre for Economic Security

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## FUNDING FUNDAMENTALS

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1. The EU has spent \$52bn on military support to Ukraine<sup>1</sup>, the UK \$9.8bn and the US nearly \$70bn. But with the US now looking to do a deal with Russia on ending the conflict without the UK, EU or Ukraine and reluctant to spend any money on European defence, the “E” element of DIME becomes very important.
2. Because we have sent so many resources to Ukraine we face severe shortages of equipment ourselves and this requires an increase in spending which is currently unaffordable – we need to think anew about our own credibility and capacity.
3. We are bound by our NATO treaty obligations to support collective defence and in the absence of guaranteed US support, this provides a military and financial imperative to do something.

### **SUBDUE YOUR ENEMY WITHOUT FIRING A SHOT**

NATO is a political and military alliance – it does not see itself as an economic one. Yet its goal is to protect its members in Europe and the US against any threat.

## SUBDUE YOUR ENEMY WITHOUT FIRING A SHOT

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Typically this has been seen as defending against the kinetic military threats but increasingly, it needs to see these threats as economic as well:

1. The institutions of the so-called International Rules Based Order as it has been understood since the end of the Second World War are no longer fit for purpose in a world where there is a need for non-kinetic warfighting as well as kinetic.
2. The weakness in these institutions and frameworks, alongside economies in Europe that are struggling to grow means that the capability to fund kinetic warfighting is undermined.
3. The capacity for governments to borrow from financial markets is limited by high levels of indebtedness post-pandemic. This situation has been significantly worsened by the energy price increases immediately after Russia's invasion of Ukraine placing the credibility of any threat under extreme strain because Europe has no capacity to scale finance at present and the US no desire to support European campaigns.
4. The extent to which we can maintain our economic deterrents (sanctions, export controls and technology/ dual use goods controls) is limited by the creation of alternative trade routes and payments systems (notably the Chinese CIPs payments system) that undermine the credibility of these threats as well.
5. Within this context, there is a need to consider ourselves in a state of hybrid or greyzone warfare – in other words, warfare that operates below the kinetic threshold to prevent an Article 5 trigger.



## INVOKING ARTICLE 2 TO CREATE A FINANCIAL ARCHITECTURE ACROSS NATO

The processes by which we can fight back against our adversaries economically or, indeed, build allegiance to a free market model of capitalism/ democracy is under threat. This undermines our capacity to fund kinetic warfare but also potentially undermining the very dominance of the US dollar in the international financial system. In short, deterrence is underwritten by financial, or funding resilience.

As a consequence we will not only be unable to fight kinetic warfare, we will also be unable to use traditional tools of economic statecraft as deterrents against our adversaries (as we have in Iran, North Korea and Russia). In fact, the extensiveness of those sanctions and export controls has undoubtedly accelerated the extent to which affected nations have started to look to find alternatives to the USD.

Against this backdrop, we should be looking carefully at the usefulness of Article 2 of the NATO Treaty:

1. Economic warfare is essentially another domain of hybrid or greyzone warfare
2. There is no definition of collective defence in this context – NATO members and its partners all reacted in lockstep after Russia invaded Ukraine but there was no obvious means of coordinating activity

3. NATO has argued it is not an economic entity, it is a defence and security one, but while it acknowledges and has means to address cyber threats and disinformation, it does not have similar tools in an economic security context.
4. This means it cannot defend itself to any form of economic threat (critical mineral supply chains or alternative payment systems that do not use the USD and can therefore get around sanctions as examples).
5. It also means that it cannot expect to be able to use its economic tools offensively through economic statecraft as it has in the past
6. It also means it cannot fund its own defence and security readiness or resilience.

There is an urgent need for NATO to address this by triggering collective defence measures under Article 2. In practical terms, this would mean building alternative financial models that can create a mechanism for funding defence and security, in Europe in particular, that can provide funding for economic security by providing support to critical national infrastructures, and that can be funded in a way that does not trigger severe adverse market reaction because governments are having to borrow more to fund their defence, security and resilience.

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## CREATING THE FINANCIAL ARCHITECTURES TO SCALE THE CAPACITY TO WARFIGHT

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In short, we need to have a robust argument that stops bond markets from severe adverse reactions when governments across Europe announce they are spending money they haven't got. The infrastructure side of things creates resilience/ effectiveness during war because it ensures that the supply side can scale and create capacity for war fighting. At the moment, the macroeconomics of this are so weak because of our current non-kinetic warfighting, that we can't scale quickly enough to meet the increased demands of war. We are not prepared for kinetic warfare and we need the economy to have the infrastructural/supply side capability to create that preparedness.



## SUMMARY AND RECOMMENDATIONS

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1. The EU/non US NATO members have to spend more money on their defence and security.
2. Bond markets will react if governments borrow more money – especially in the UK where the government is severely constrained by its own fiscal rules.
3. Rachel Reeves only has 2.3% of GDP marked for spending at the moment - the army says it has to go to at least 2.6% of GDP to stand still and avoid cuts. That 0.3% of GDP presents an additional expenditure over and above calculations of nearly £1bn.
4. By creating a Defence Security and Resilience bank money can be raised from capital markets at a triple A rating which makes borrowing cheaper and allows defence budgets to scale without creating an adverse market reaction.
5. Creating a Defence Security and Resilience Fund will take time and the short term needs are for the capacity of the industrial base across Europe to expand to meet demand for defence and security equipment and more broadly, to address the issues of supply chain resilience in critical national infrastructures. We propose a Security and Resilience Fund alongside the DSR which uses existing infrastructures and private finance to create growth finance
6. Alongside this we urgently need governments across NATO countries to look at the priorities of their national business support and export guarantee infrastructures so that they can focus on defence and security, including dual use goods and critical supply chains and infrastructures. By harnessing these structures the guarantee system at a national level can plug effectively into the structures emerging through the DSR so that the scalability of capacity is assured.
7. This create efficiencies and effectiveness in critical security and defence supply chains.



Most importantly of all, these structures support a growth agenda because of the multiplier effect. Average estimates for increases in defence spending) suggest a boost to GDP of \$1 for every \$1 spend on defence<sup>2</sup> if funded by government debt rather than by taxation. The blended finance approach – crowding in finance using existing infrastructures, using private credit and innovation funding to scale and providing a specific multilateral banking structure at the top of the pyramid to scale finance is the only way to create assured capacity and preparedness for kinetic warfare in terms where we are already fighting in non-kinetic terms.

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## REFERENCES

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1 [https://www.eeas.europa.eu/delegations/united-states-america/eu-assistance-ukraine-us-dollars\\_en?s=253](https://www.eeas.europa.eu/delegations/united-states-america/eu-assistance-ukraine-us-dollars_en?s=253)

2 <https://www.ifw-kiel.de/publications/news/guns-and-growth-the-economic-consequences-of-surg-ing-defense-spending/>

# CONTACT

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## ABOUT THE CENTRE FOR ECONOMIC SECURITY

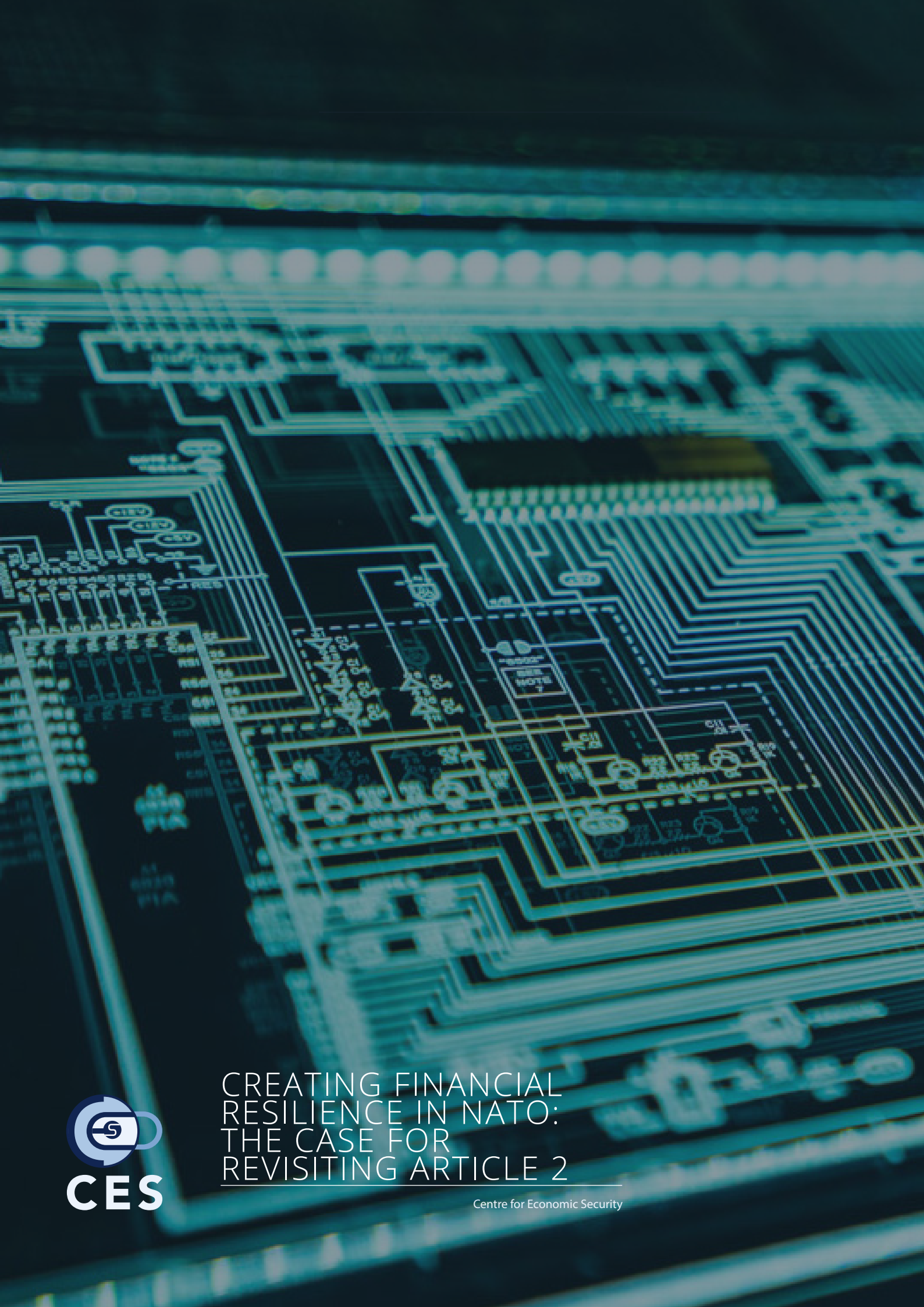
The Centre for Economic Security is a research and convening organisation that dedicates itself to three goals: first, raising awareness and understanding of economic threat, second, to establishing the operational tools to manage that threat and third to enabling policy makers, financial institutions and corporates to anticipate and deal strategically with those threats.

Our vision is to promote strategic economic readiness in a fragmented world. We do this by working with governments, financial institutions and corporates to formulate resilient and effective tools.

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