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Fiscal Implications of Meeting NATO's 5% Commitment



OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
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The Parliamentary Budget Officer (PBO) supports Parliament by providing economic and financial analysis for the purposes of raising the quality of parliamentary debate and promoting greater budget transparency and accountability.

This report examines the fiscal implications of Canada's commitment to meet the North Atlantic Treaty Organization defence spending pledge of 5 per cent of gross domestic product by 2035.

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Highlights

Despite indicating in Budget 2025 that accelerating investments will “put Canada on a pathway” to meet the North Atlantic Treaty Organization (NATO) 5 per cent commitment by 2035, the Government has not published supporting projection details.

PBO estimates that meeting the NATO 5 per cent commitment by gradually increasing core defence spending from 2.0 per cent in 2025 to 3.5 per cent of gross domestic product (GDP) by 2035 will require additional defence spending averaging approximately \$33.5 billion per year in cash expenditures over the next 10 years.

PBO estimates that the additional core defence spending required to meet the NATO 5 per cent commitment will increase the budgetary deficit by \$63.0 billion (1.4 percentage points of GDP) in 2035-36 and the federal debt-to-GDP ratio by 6.3 percentage points of GDP in 2035-36.

Summary

This report examines the fiscal implications of Canada's commitment to reach the North Atlantic Treaty Organization's (NATO) military spending target of 5 per cent of GDP by 2035. The NATO 5 per cent commitment includes a 3.5 per cent of GDP target for core defence spending and up to 1.5 per cent of GDP for ancillary defence and security-related spending by 2035.

Despite indicating in Budget 2025 that accelerating investments will "put Canada on a pathway" to meet the NATO 5 per cent commitment by 2035, the Government has not published supporting projection details.

Given the lack of detailed defence spending projections, we provide a scenario analysis to estimate the fiscal implications of meeting the NATO 5 per cent commitment. To meet this commitment, we assume that core defence spending will gradually increase from 2.0 per cent in 2025 to its 3.5 per cent of GDP target in 2035, while ancillary defence and security-related spending is maintained at 1.5 per cent of GDP.

Fiscal impacts of meeting the 5 per cent NATO commitment are estimated relative to a reference scenario in which core and ancillary defence spending remain at 2.0 per cent and 1.5 per cent of GDP, respectively, through 2035.

Key results

- We estimate that meeting the NATO 5 per cent commitment by gradually increasing core defence spending from 2.0 per cent in 2025 to 3.5 per cent of GDP by 2035 would require additional defence spending averaging \$33.5 billion per year in cash expenditures over the next 10 years.
- We estimate that the additional core defence spending required to meet the NATO 5 per cent commitment by 2035 will increase the budgetary deficit by \$63.0 billion (1.4 percentage points of GDP) in 2035-36 and the federal debt-to-GDP ratio by 6.3 percentage points of GDP in 2035-36.

Background

On June 25, 2025, the Government announced its commitment to the new NATO defence spending target of 5 per cent of gross domestic product (GDP) by 2035.^{1,2} This includes a 3.5 per cent target for core defence spending and up to 1.5 per cent of GDP for ancillary defence and security-related spending (for example, critical infrastructure and networks, civil preparedness and resilience, innovation, and the defence industrial base).

Under PBO Information Request IR0836³ in July 2025, the Department of National Defence (DND) was asked to provide a projected spending profile to reach NATO's 5 per cent of GDP commitment by 2035. DND did not provide a year-by-year spending path and noted that NATO's measure of planned defence spending as a share of GDP is based on NATO-provided GDP forecasts. DND instead referenced estimates suggesting that defence spending equivalent to 3.5 per cent and 1.5 per cent of GDP in 2035 could be approximately \$150 billion and \$60 billion, respectively, subject to change.

Moreover, despite indicating in Budget 2025 that accelerating investments will "put Canada on a pathway" to meet the NATO 5 per cent commitment by 2035, the Government has not published supporting projection details. Budget 2025 stated that Canada will meet the NATO 2 per cent of GDP (core) defence spending this year and that the 1.5 per cent of GDP ancillary component is expected to be met under current planned spending by various levels of government.

Given the lack of detailed defence spending projections, we provide a scenario analysis to estimate the fiscal implications of meeting the NATO 5 per cent commitment. To meet this commitment, we assume that core defence spending will gradually increase from 2.0 per cent in 2025 to its 3.5 per cent of GDP target in 2035, while ancillary defence and security-related spending is maintained at 1.5 per cent of GDP.

Fiscal impacts of meeting the NATO 5 per cent commitment are estimated relative to a reference scenario in which core and ancillary defence spending remain at 2.0 per cent and 1.5 per cent of GDP, respectively, through 2035.

Increasing core defence spending to meet NATO 5 per cent

Defence spending for NATO reporting purposes is measured on a cash basis.⁴

For the purposes of this analysis, we construct a scenario in which defence spending (relative to GDP) increases in equal annual increments between 2026-27 and 2035-36, starting from 2.0 per cent of GDP in 2025-26 and reaching 3.5 per cent in 2035-36.⁵ The realized ratio in 2025-26 will depend on final spending outcomes and nominal GDP. On this basis, the increase required over the projection period is 1.5 percentage points, or 0.15 percentage points of GDP per year.

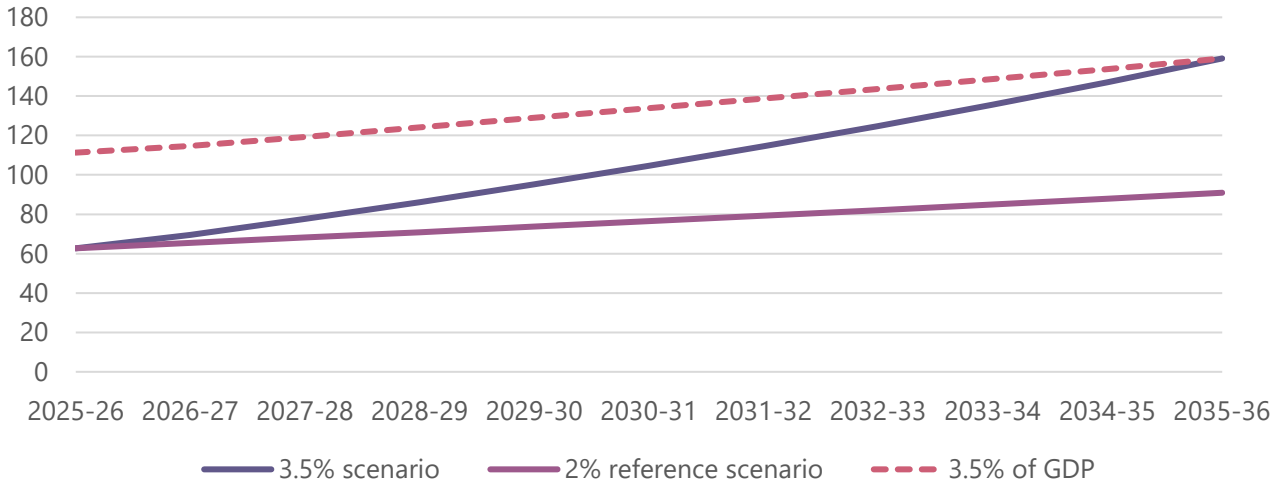
Under our reference scenario, defence spending is assumed to remain at 2 per cent of GDP from 2026-27 through 2035-36. Ancillary defence and security-related spending is assumed to be maintained at 1.5 per cent of GDP through 2035-36.

We estimate that meeting the NATO 5 per cent commitment by increasing core defence spending from 2.0 per cent in 2025 to 3.5 per cent of GDP by 2035 would require additional defence spending over a rising profile, averaging approximately \$33.5 billion per year over the next 10 years.

On a cash basis, increasing core defence to 3.5 per cent of GDP in 2035-36 to meet the NATO 5 per cent commitment would require core defence spending of \$159.1 billion in 2035-36, \$68.2 billion more than the 2 per cent of GDP reference scenario.⁶ Figure 1 presents the resulting spending profiles over the projection period. It also presents the level of spending equivalent to 3.5 per cent of GDP in each year.

Figure 1

Additional core defence spending required to meet NATO 5 per cent by 2035, billions of dollars



Source:
Office of the Parliamentary Budget Officer.

Fiscal implications

The analysis examines the impact of additional core defence spending on the budgetary deficit and on the federal debt-to-GDP ratio, a widely used indicator of fiscal sustainability.

To assess the fiscal impact of higher defence spending, cash-basis defence expenditures are converted to an accrual basis. NATO's spending target is assessed on a cash basis, while Canada's fiscal indicators are generally reported on an accrual basis. This distinction matters primarily for capital spending, which is recorded up front under cash accounting but amortized over the service life of assets under accrual accounting. As a result, a rapid increase in capital outlays can raise cash-based spending quickly, while the associated accrual expense is reflected more gradually. Operating spending is assumed to be recorded in the same years under both accounting treatments.

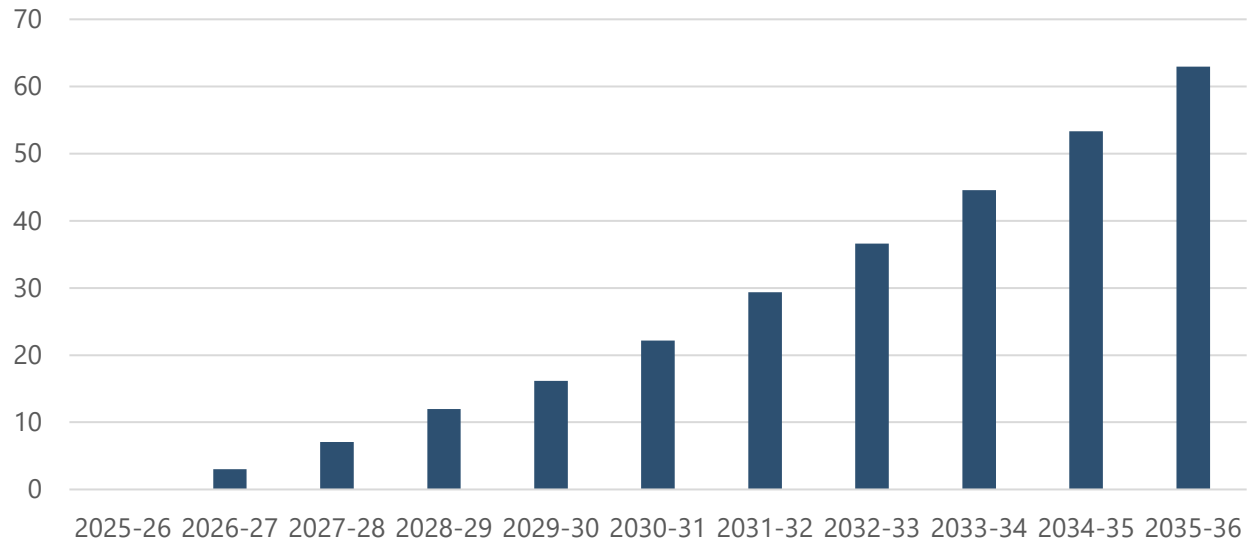
For the purposes of this analysis, the distribution of spending between operating and capital is based on an assumed percentage calculated from existing spending plans in DND's Capital Investment Fund relative to projected total defence spending. Additional spending required to achieve the NATO 5 per cent commitment is assumed to be financed by issuing market debt at a fixed rate of 3.00 per cent annually. The budgetary impact incorporates public debt charges related to financing additional core defence spending.

Impact on the budgetary deficit

Under our scenario where the NATO 5 per cent commitment is met by increasing core defence spending to 3.5 per cent of GDP, the impact on the budgetary deficit is projected to increase from \$3.0 billion in 2026-27 (0.1 percentage points of GDP) to \$63.0 billion (1.4 percentage points of GDP) in 2035-36 (Figure 2).

Figure 2

Impact on the budgetary deficit of meeting the NATO 5 per cent commitment, billions of dollars



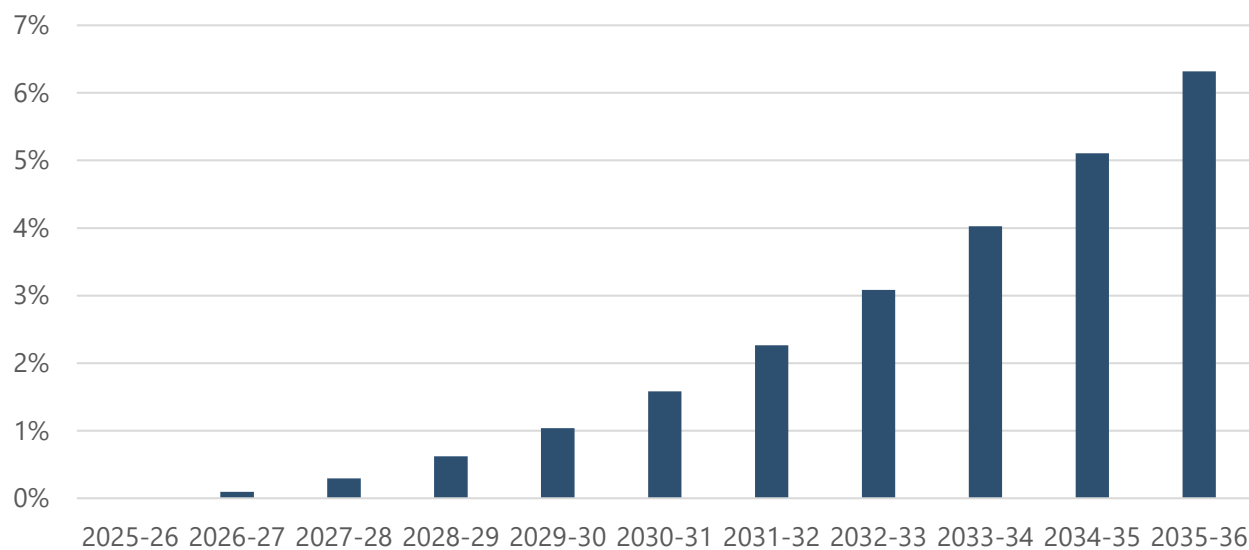
Source:
Office of the Parliamentary Budget Officer.

Impact on the federal debt-to-GDP ratio

Under our scenario where the NATO 5 per cent commitment is met by increasing core defence spending to 3.5 per cent of GDP, the impact on the federal debt-to-GDP ratio is projected to increase from 0.1 percentage points of GDP in 2026-27 to 6.3 percentage points of GDP in 2035-36 (Figure 3).

Figure 3

Impact on the federal debt-to-GDP ratio of meeting the NATO 5 per cent commitment, percentage points



Source:
Office of the Parliamentary Budget Officer.

Notes

¹ [Canada joins new NATO Defence Investment Pledge](#). Office of the Prime Minister, June 25, 2025. Accessed 1/18/2026.

² [Defence expenditures and NATO's 5% commitment](#). North Atlantic Treaty Organization, 2025. Accessed 1/18/2026.

³ PBO [Information Request IR0836](#). Office of the Parliamentary Budget Officer, 2 July 2025. Accessed 1/18/2026.

⁴ NATO periodically releases an [assessment of defence spending](#) by member nations. The figures reported reflect actual in-year expenditures under an agreed definition of defence spending. Accessed 1/18/2026.

⁵ The nominal GDP projection over 2025 to 2035 is taken from Budget 2025. For simplicity, nominal GDP is assumed to be unchanged across the scenarios considered.

⁶ NATO spending percentages are calculations based on defence spending in a given fiscal year divided by GDP in the corresponding calendar year.

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