BRIEFING

European Parliament

Future of EU long-term financing

Post-2027 needs and how to finance them

SUMMARY

The adoption of the next multiannual financial framework (MFF) for the period from 2028 will be one of the second von der Leyen Commission's defining projects. Striking a delicate balance between the EU's growing financial needs and many Member States' reluctance to shoulder higher payments to the EU has always been a challenging task. However, never before have the EU's many financial needs been greater – and, at the same time, Member States' budgets are under heavy constraints.

On the expenditure side, several costly projects are on the horizon. The EU's next long-term budget will have to finance the principal repayment of Next Generation EU (NGEU) grants from 2028 onwards, as well as borrowing costs that are higher than originally planned owing to a rise in interest rates. Other major expenditure items will include further financial support for Ukraine in its defence against Russia's war of aggression and the subsequent contribution to recovery and reconstruction, the need to enhance the EU's defence, security and preparedness, and the cost of EU enlargement. In addition, the EU must continue to invest in high-growth projects and its green and digital transformation in order to remain competitive, as recently underlined by the former president of the European Central Bank, Mario Draghi, in his high-level report on competitiveness.

To finance the repayment of the NGEU debt, the European Parliament, the Council and the European Commission have agreed to introduce new own resources. However, although the Commission presented a proposal, approved by Parliament, no significant progress has so far been made on new own resources in the Council. Some Member States consider increased gross national income-based own resources as a simpler and fairer solution, which they want to combine with savings in existing areas as a way to balance the budget. Parliament has started shaping its position for the forthcoming debate on the next MFF with a draft initiative report, 'A revamped long-term budget for the Union in a changing world', presented by co-rapporteurs Siegfried Mureșan (EPP, Romania) and Carla Tavares (S&D, Portugal).

IN THIS BRIEFING

EPRS | European Parliamentary Research Service

Author: Karoline Kowald and Marianna Pari; Graphics: Stéphanie Pradier

Members' Research Service

PE 767.242 – February 2025

EN

Introduction

The European Commission in expected to present a proposal for the next multiannual financial framework (MFF), starting in 2028, before 1 July 2025, although many observers expect a delay towards autumn. As regards the procedure for negotiating the MFF, the European Parliament's resolution of 27 February 2024 calls for cooperation to start at an earlier stage in the future in order to facilitate the adoption of a new regulation on the MFF, in accordance with Article 312(5) of the Treaty on the Functioning of the EU (TFEU) and point 15 of the Interinstitutional Agreement (IIA) on budgetary matters. This seems of particular importance, since – according to the special legislative procedure for adopting the MFF under Article 312(2) TFEU – the Council acts unanimously after obtaining Parliament's consent. This means Parliament cannot formally table any amendments but only consent or reject the Council's proposal.

Expenditure challenges for the post-2027 EU long-term budget

Financing EU security, defence and preparedness

Russia's full-scale invasion of Ukraine, which started in February 2022, made the EU and its Member States realise that, to increase their ability to defend the EU against military, hybrid or other types of attacks, they would have to invest more in their security. The United States (US), as the largest member of NATO and a guarantor for Europe's security, has long demanded more spending on security and defence from the European NATO members. After the re-election of President Donald Trump, the need for more spending on security and defence in Europe has become even more acute.

On 10 and 11 March 2022, a mere 2 weeks after Russia's full-scale invasion of Ukraine, EU leaders adopted the Versailles Declaration, in which they committed to bolstering the EU's defence capabilities. Further details were spelled out in a Strategic Compass for security and defence, which they adopted on 24 March 2022. During the European Council meeting on 21 and 22 March 2024, EU Heads of State or Government confirmed that the EU needed to be ready to defend its sovereignty, and thus to increase its defence capacity.

The Niinistö Report recommended that 'at least 20 % of the overall EU budget contributes to the EU's security and crisis preparedness'. The report suggested setting up two EU funds – a Defending Europe facility and a Securing Europe facility – in order to 'facilitate the pooling of resources'.

Article 41 of the Treaty on European Union (TEU) governs the financing of the EU's common foreign and security policy (CFSP), which includes the EU defence policy. Expenditure for the CFSP is, in principle, charged to the EU budget. However, in accordance with Article 41(2) TEU, expenditure 'arising from operations having military or defence implications' is expressly excluded from financing from the EU budget. After the start of Russia's war against Ukraine, an EU-wide debate developed on financing military assistance for Ukraine from inside and outside the EU budget. The wording of Article 41(2) TEU was generally understood to mean that the financing ban includes arms purchases for Member States or arms deliveries to third countries. However, there has never been an authoritative court decision on that prohibition's specific delineation. Some believe that only the funding of joint operations out of the EU budget is prohibited but not all military financing in general terms, such as arms purchases.

Independently of the question of the legality of financing defence purchases through the EU budget, the Treaties allow EU activities in that field if they are financed by the Member States. In March 2021, the Member States set up an off-budget instrument, the European Peace Facility, to finance joint military and defence activities. The Facility replaced and expanded the former financial instruments in that area, namely the Athena Mechanism and the African Peace Facility. The European Peace Facility had an initial financial ceiling of €5.69 billion (current prices) for the period from 2021 to

2027. Since the start of Russia's war on Ukraine, the Council has successively increased the Facility's financial ceiling to over €17 billion.

Furthermore, the EU has started to use various instruments inside its budget to support defence research, the defence industry, and military mobility in the EU through existing legal bases and budget lines. In the 2021-2027 MFF, a specific budget heading on 'security and defence' was established. The EU uses a European Defence Fund to finance research activities in the area of defence. It adopted a regulation to reinforce the EU defence industry through common procurement (EDIRPA), and a regulation to support ammunition production in the EU. In addition, the EU uses the Connecting Europe Facility to finance military mobility. These developments show a fundamental policy reversal in the field of EU defence financing and the EU budget (although its current share of spending in the EU budget, with around €1.5 billion per year, is still minimal).

In March 2024, the Commission, together with the High Representative of the Union for Foreign Affairs and Security Policy, presented a joint communication providing an overview of what is needed to strengthen the EU's defence industry. It opens a reflection on different financing options to ensure the EU defence industry's readiness, and suggests that the post-2027 MFF should envisage ambitious funding for defence. According to Commission President Ursula von der Leyen, the EU requires €500 billion in defence investment over the next decade. President von der Leyen has tasked Commissioner Andrius Kubilius with presenting a white paper on the future of European defence within the first 100 days of the new mandate; this might include new estimates.

Additionally, the EU will have to be prepared for future extreme weather events, health threats, cyberattacks and other unforeseen crises – all of which might have a considerable impact on the EU budget.

Increasing Europe's competitiveness

As analysed in the Draghi Report published on 9 September 2024, the EU faces several serious economic challenges relating to sustainable competitiveness, economic security, open strategic autonomy and fair competition. The report concludes that the current low level of productive investment, together with an ageing population, low growth in Europe, the need for Europe's environmental and digital transformation and for increased spending on research, innovation and defence, require at least €750 billion to €800 billion of annual additional investment over the period from 2025 to 2030. These additional investment needs would be oriented towards covering:

- the energy transition, including the deployment of clean technologies (€300 billion);
- transport, including charging infrastructure (€150 billion);
- digital technologies (€150 billion);
- strengthening defence and security capabilities (€50 billion);
- boosting productivity through breakthrough innovation (€100-150 billion).

According to the Draghi Report, investment in Europe has historically been financed about 80 % privately and about 20 % with public funds. Based on this split between private and public investment, additional public investment of between €150 billion and €160 billion a year would be needed for the 2025-2030 period. The report refers to simulations as to whether that split could be maintained for an investment push as large as this. It concludes that, to finance that volume of investment, progress on the capital markets union is fundamental, so that private savings can be channelled into investment across the whole EU. However, even with the mobilisation of private finance, 'public support will still be required'.

Green transition, including the Social Climate Fund

The EU has committed to 'achieving an overall target of at least 30 % of the total amount of the Union budget and the European Union Recovery Instrument expenditures supporting climate objectives'. These priorities are reflected in Ursula von der Leyen's political guidelines for the 2024-2029 Commission, which she presented to the European Parliament's plenary on 18 July 2024. To achieve the goals set by the European Green Deal, the Commission pledged, as early as 2021, to mobilise at least €1 trillion in sustainable investment over the current decade, 2021 to 2030.

The Social Climate Fund finances measures to support vulnerable households and transport users particularly affected by the inclusion of greenhouse gas emissions from buildings and road transport into the EU's emissions trading system (EU ETS). The Fund's aim is to ensure the green transition's social fairness.

The Fund will be financed by external assigned revenue pooled from the auctioning of allowances from the ETS2, as well as €50 million worth of allowances from the existing EU ETS. Together with a mandatory 25 % contribution by the Member States to their social climate plans, the Fund should mobilise at least €86.7 billion over the 2026-2032 period. For buildings, for instance, the Fund would help provide funds to renovate the worst-performing residential buildings, which are mainly occupied by low-income households. The specifics of both the implementation and the implications for the EU budget still have to be defined, as the Fund will not make funds available before 2026. A first Commission proposal on the financing of the Fund by revising the current MFF was withdrawn in 2024. The entire financing system for the Fund could change with the start of the next MFF.

Support for Ukraine

Since the beginning of Russia's full-scale war of aggression in February 2022, the EU and its Member States have supported Ukraine with unparalleled political, military, humanitarian and financial resources. EU support for Ukraine thus far totals almost €134 billion, including €1.5 billion from the proceeds of immobilised Russian assets.

While the €50 billion Ukraine Facility is financing Ukraine from 2024 to 2027, the EU has adopted a new macro-financial assistance loan. That loan is part of a G7 initiative: all G7 partners have jointly agreed to lend US$50 billion (€45 billion) to Ukraine on top of existing initiatives; the EU's share of the US$50 billion loans will be €18.1 billion. The repayment of these new G7 loans and the interest on them will be financed by extraordinary revenues generated by immobilised Russian sovereign assets in the G7 countries. The extraordinary revenues will flow into the Ukraine Loan Cooperation Mechanism, adopted by the co-legislators in October 2024, which will put the amounts at Ukraine's disposal for repaying the loans.

The longer the war lasts, the more costly the support for Ukraine will be. Once the war ends, the country will need significant financial support for its recovery and reconstruction. A joint Rapid Damage and Needs Assessment (RDNA3), released in February 2024 – almost 2 years into Russia's full-scale invasion – by the Ukrainian government, the World Bank Group, the European Commission and the United Nations, estimated that, as of 31 December 2023, the total cost of reconstruction and recovery in Ukraine was US$486 billion over the next decade. Although the largest part of the reconstruction and recovery should be financed by the private sector, a significant share of the publicly financed international support will have to come from the EU.

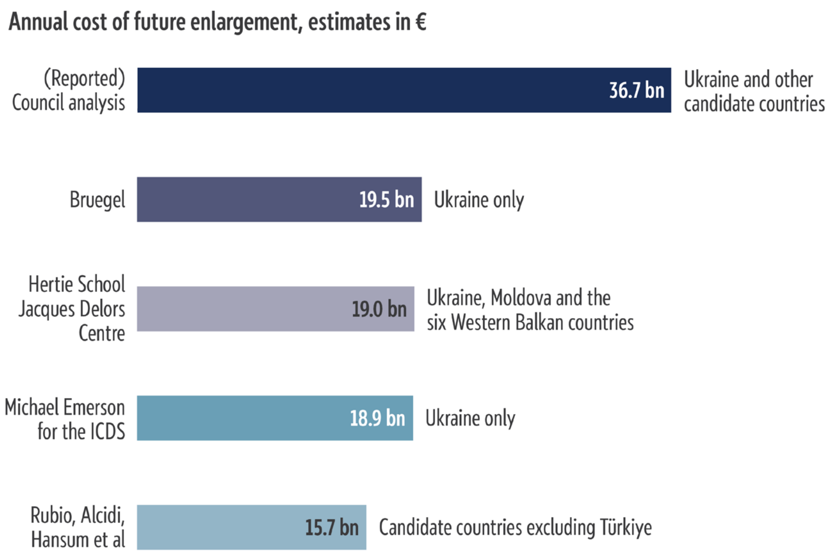
EU enlargement

The forthcoming enlargement, in particular the accession of Ukraine, will have a significant impact on the EU's long-term budget from 2028. Nine states are currently recognised as candidates for EU membership: Albania, Bosnia and Herzegovina, Georgia, Moldova, Montenegro, North Macedonia, Serbia, Türkiye and Ukraine. The European Council's December 2023 decision to open accession negotiations with Ukraine and Moldova, as well as with Bosnia and Herzegovina under certain conditions, gave new momentum to the enlargement process. Several studies estimate the likely costs of EU enlargement for the EU budget. In the event of EU enlargement, additional funds as well as transitional measures will be required, particularly for agriculture and regional policy, if the same budget structure is kept. The specific costs will vary, depending on the timeline of these countries' phasing-in to the EU, and on the possible reforms to the EU budget architecture and policies.

The General Secretariat of the Council distributed an internal document in July 2023 with an analysis of the consequences for the EU budget under the basic assumption that Ukraine and the other candidate countries would become full Member States without reforming the EU budget or policies – i.e. a 'status quo' estimate. That document reportedly estimates the total cost at €256.8 billion over 7 years (i.e. the current duration of an MFF). With nine new Member States, the current EU budget for 2021-2027 would increase by 21 % to €1.47 trillion, with the bulk of the funds going to Ukraine, particularly under the common agricultural policy (CAP) and the cohesion funds. This scale of change would tip the financial balance, and many existing Member States that are currently net beneficiaries would become net contributors.

A study on the cost of accession, conducted by Michael Emerson for the International Centre for Defence Studies (ICDS), calculates the costs of Ukraine's potential membership, estimating them to amount to €18.9 billion a year – as opposed to the €36.7 billion annually that is reportedly mentioned in the Council analysis. In total, the cost would be €132.3 billion over 7 years. Furthermore, a study by the Hertie School Jacques Delors Centre estimated that the accession of Ukraine, Moldova and the six Western Balkan countries would lead to total additional spending for the EU budget of approximately €19 billion per year, i.e. some €133 billion over a 7-year period. Finally, a study by the Brussels-based Bruegel think-tank estimates that, in their baseline scenario, the net cost of Ukraine's EU membership for the EU-27 would amount to €137 billion in the 2021-2027 period – about €19.5 billion per year. The estimates vary owing to differences in scope and methodological approaches: some even exclude additional CAP expenditure, and conclude that incorporating all current candidate and potential candidate countries, except Türkiye, would be possible at an annual cost of €15.7 billion (see Figure 1).

Figure 1 – Annual cost of future enlargement, estimates in € billion



Source: Compiled by the authors, 2025.

The lower costs estimated in the reports from the ICDS, the Hertie School Jacques Delors Centre and Bruegel, as opposed to the reportedly higher estimates in the Council document, are primarily the result of assuming the introduction of transitional arrangements and maximum caps on national allocations similar to those introduced during the 2004 enlargement. At the time, new Member States such as Poland received only 40 % of the level of direct payments under the CAP allocated to the existing Member States. In the case of Ukraine's membership, this type of transition mechanism could be applied again, including in other areas. In the above-mentioned studies, the authors propose to introduce spending caps on national allocations. According to Bruegel's baseline scenario, most net payers would need to contribute an additional 0.1 % of their gross domestic product (GDP) to the EU budget.

The dynamics and timing of enlargements are difficult to predict. Even if the next round of enlargement were only to take place after the end of the next MFF, the candidate countries would already receive sizeable amounts of pre-accession aid now, which would have to be integrated into the next MFF.

Increased flexibility for unforeseen expenditure

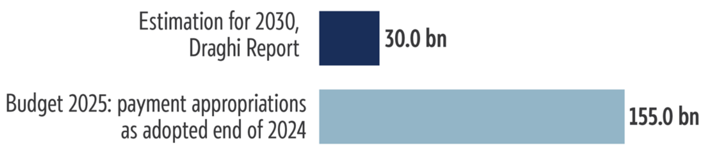
In the European Parliament's view, increasing and redesigning budgetary flexibility will be key for the next MFF. The flexibility instrument and non-allocated margins amounted to only 1.05 % of the commitment ceiling of the MFF adopted in 2020. The 2021-2027 MFF has therefore even resorted to reorienting cohesion policy; although not a crisis response tool, cohesion policy has been repeatedly called on to compensate for the lack of budgetary flexibility or crisis response mechanisms in the MFF, to the detriment of its long-term policy objectives. Although the MFF revision in 2024 has led to an improvement, the EU budget remains under pressure, with limited margins and flexibility. Parliament calls for the post-2027 MFF to have the necessary flexibility and budgetary space to be able to respond to crises and adapt to emerging and growing needs.

Repayment of NGEU

The EU is legally obliged to repay the debt created for financing the NGEU recovery instrument. The repayment of the NGEU-related debt will last well beyond the current MFF, to 2058. Currently, the EU only pays interest on that debt; from 2028, it has to start repaying the principal. The question of adequate funding to finance the repayment will therefore be central to the post-2027 MFF. The overall financing cost of the NGEU debt depends on the evolution of interest rates and is, therefore, uncertain for now; however, it will become more predictable going into the next MFF, as it can be assumed that bonds will have been issued. Remaining volatility will come from the choice of repayment profile for capital, but will be limited.

A recent estimate projects the total interest costs at €222 billion to 2058, and the annual principal repayments at around €13.9 billion from 2028 to 2058. Total annual financial needs for NGEU repayment could thus reach up to €30 billion in 2030, which represents more than 20 % of the total payment appropriations (€155 billion) that had been approved for the 2025 EU budget (see Figure 2). For the repayment of the principal, which must occur in a 'steady and predictable' manner, various scenarios with different borrowing costs are possible: for instance, equal annual amounts in euro from 2028 to 2058, or an equal share of gross national income (GNI) from 2028 to 2058. In the first scenario, the annual principal repayments are estimated to amount to around €13.9 billion per year from 2028 to 2058, while interest payments would be reduced from €10.4 billion in 2028 to €0.5 billion in 2058. However, if the annual principal repayments were to be a fixed percentage of GNI, such as 0.044 % of projected GNI each year from 2028 to 2058, they would rise from €8.7 billion in 2028 to €20.9 billion in 2058. In that scenario, interest payments would be higher, peaking at around €10.7 billion in 2032 and 2033, before falling to approximately €0.98 billion in 2058.

Figure 2 – Comparison of annual NGEU debt repayment cost and annual EU budget (in € billion)



Data source: European Council and Council of the European Union, EU budget for 2025, website.

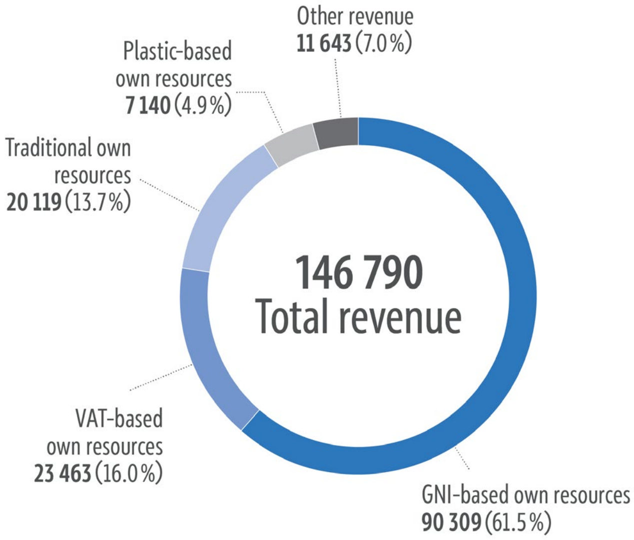
Revenue options for the post-2027 EU long-term budget

Current EU own resources

The current own resources will continue to play a major role in financing EU spending after 2027. Article 311 TFEU establishes that the EU budget is financed from EU own resources. The exact mix of own resources has changed over the years. The EU's current financing system is based on Council Decision (EU, Euratom) 2020/2053 (the Own Resources Decision), adopted on 14 December 2020. It provides for the setting up of a new category of own resources based on non-recycled plastic packaging waste. Furthermore, the decision increased the own-resources ceiling by 0.6 percentage points to 2 % of the EU's GNI, to ensure the EU will be able to cover its increased liabilities linked to the debts created by the NGEU grants.

The current system is built on four main categories of own resources: (i) GNI-based contributions; (ii) traditional own resources, mainly custom duties on imports into the EU; (iii) value added tax (VAT)-based contributions; (iv) since 2021, a new statistical own resource on non-recycled plastic waste. GNI-based contributions are established as a balancing revenue, in line with Article 310 TFEU, which requires that revenue and expenditure are in balance. With 61.5 %, the GNI-based own resource represents the largest share of the current own resources (see Figure 3). Some 'other revenue', collected directly by the EU institutions, results from the direct application of EU law, such as assigned revenue, taxes on EU officials, contributions from the United Kingdom, and fines. Together with the surplus of the previous year, they constitute a source of revenue, representing 7.0 % in 2024.

Figure 3 – Breakdown of current own resources, 2024 (in € million)



Data source: European Commission, Draft Amending Budget No 4/2024, COM(2024) 931.

Two options for financing additional expenditure exist: the establishment of new genuine own resources as agreed by the EU institutions; and increased national contributions based on GNI-based own resources, since they are a balancing revenue. A third option would be to expand EU borrowing, possibly taking the NGEU recovery instrument as a model (see also 'More EU debt' below).

Additional GNI-based contributions would put an even stronger focus on the debate on the *juste retour* and net contributions, i.e. the relationship between the Member States' contributions to the budget and the monetary returns from individual policy areas, such as the CAP, structural and cohesion policy, and research and innovation.

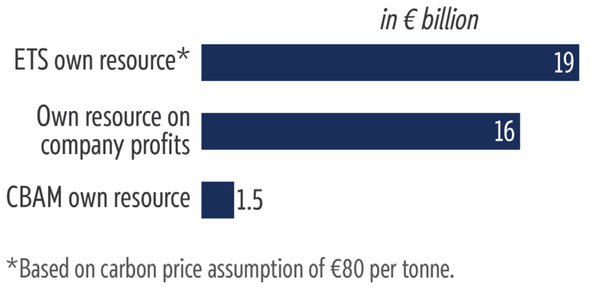
However, the strong link between the EU budget and national budgets established by the GNI-based resources is deemed by some Member States and academics to be a key advantage, as it sets strong incentives for the Council to control spending at EU level. At the same time, the GNI-based own resources are seen as a fair distribution system based on each Member State's prosperity and economic performance. However, several 'net contributing' Member States – those contributing more to the EU budget than receiving funds from the EU – benefit from a reduction in their overall contribution (a 'rebate').

The calculation of the 'net benefits' provides only an accounting result, and does not take into account the political, economic and other non-budgetary benefits of EU membership. The European Parliament, in a resolution on own resources of 10 May 2023, recognised the merits of the GNI-based own resource in view of its reliable balancing function. However, Parliament regretted the high level of GNI-based contributions, which made budgetary decisions too dependent on the Member States. Furthermore, the Member States tend to consider GNI-based resources to be national contributions to the EU budget. Parliament considers that too much reliance on GNI-based own resources impedes the EU from acting effectively. Parliament therefore supports the modernisation of the EU's own resources system and the introduction of new own resources.

New own resources for the EU

To support repaying the NGEU, the introduction of new own resources for the EU was agreed together with the 2021-2027 MFF and the NGEU package. The IIA on budgetary matters sets out the roadmap (see Figure 5 below) for introducing new own resources with a view to covering the expected expenditure relating to the repayment of NGEU, as demanded by the European Parliament. These should raise enough revenue to repay the grant component of NGEU and its borrowing costs, be aligned with EU policies and objectives, and contribute to fair taxation and the fight against tax fraud and tax evasion. The IIA notes that repayment of the NGEU should not lead to an undue reduction in other programmes or funds under the MFF. The gradual introduction of new own resources was planned in three steps, to be accomplished by the beginning of January 2026. In December 2021, with a 6-month delay, the Commission presented the first proposals for new sources of revenue from an extended ETS, a carbon border adjustment mechanism (CBAM), and a share of the reallocated profits of very large multinational companies based on Pillar 1 of the agreement between the Organisation for Economic Co-operation and Development (OECD) and the G20. The generated revenues were supposed to cover the repayment of the NGEU and the financing of the Social Climate Fund.

Figure 4 – Expected revenues from the proposed new own resources

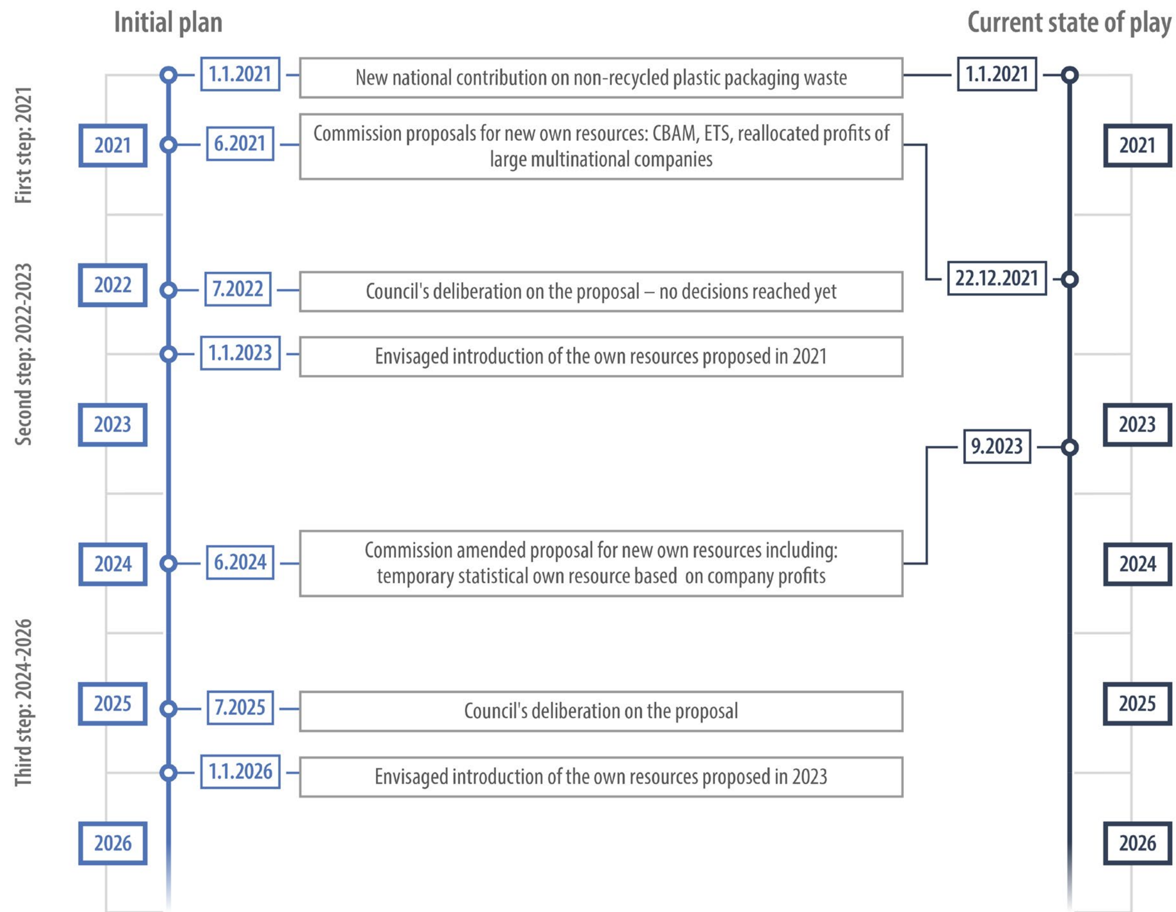


Data source: European Commission, An adjusted package for the next generation of own resources, press release, 2023.

The Commission updated the proposals for new own resources on 20 June 2023, proposing a new, temporary statistical own resource based on company profits. This could generate an estimated €16 billion annually as from 2024. It would, in future, be replaced by a possible contribution from the Business in Europe: Framework for Income Taxation (BEFIT) proposal, which is still under discussion. Furthermore, the Commission amended the previous proposals. For the ETS own resource, it proposed increasing the call rate from 25 % to 30 % from all revenues generated by EU emissions trading. This would bring the expected revenue for the EU budget to around €7 billion a year from 2024, and to around €19 billion from 2028. For the CBAM, the Commission proposed aligning its original proposal for an own resource with the adopted text. The CBAM would generate an estimated €1.5 billion annually on average from 2028. The proposed new revenues would thus provide €36.5 billion in total – 25 % on top of the current own resources (see Figure 4).

The European Parliament supports new – preferably genuine – own resources. Such additional resources would allow for the financing of the EU's priorities to be decoupled from considerations of *juste retour*. In its May 2023 resolution, mentioned above, Parliament requested to replace a share of the GNI-based resources with statistical own resources based on the gender pay gap, on recycling of biowaste and on food waste. In November 2023, Parliament endorsed the Commission proposals on new own resources under the consultation procedure. New genuine own resources would alleviate the pressure on national budgets. Because of Member States' reluctance, discussions in the Council are still ongoing at a technical level. It is now expected that the European Council will look into this issue in March 2025. According to the agreed roadmap, the Council should have started in July 2022 with political deliberations on the first package of proposals. It should deliberate until 1 July 2025 at the latest, so that the new own resources can be introduced by January 2026. Modifications to the Own Resources Decision are complex and lengthy: they require unanimous adoption in the Council, after consultation of Parliament, and ratification by all EU Member States in line with their constitutional requirements.

Figure 5 – Roadmap for the introduction of new own resources



Data source: IIA on budgetary matters, 16 December 2020.

More EU debt

The EU is under pressure to acquire more financial resources; in this context, the idea of additional borrowing by the EU has been aired repeatedly. The main model for new additional EU debt is currently the Next Generation EU (NGEU) recovery instrument. The debt created to finance NGEU grants has to be repaid fully by the end of 2058. The creation of NGEU, motivated by the objective of supporting Europe's economic recovery from the COVID-19 pandemic, marked a historic change to the EU's finances. Its main instrument, the Recovery and Resilience Facility (RRF), provided grants and loans totalling €806.9 billion (in current prices) to the EU Member States through borrowing operations. That amount corresponded to 5 % of EU GDP. Although the EU had borrowed in the past, the scale of the debt financing for NGEU has been unprecedented. Moreover, in the past the EU used borrowing to finance loans, whereas now the largest share of NGEU borrowing is used to finance grants, which have to be repaid by the EU budget.

According to Article 310(1) TFEU, 'revenue and expenditure shown in the budget shall be in balance'. In the Member States' budgets, deficits can be balanced with new additional debt. The balance principle in EU law has so far been interpreted as a general prohibition of debt at EU level. As the EU, unlike its Member States, cannot secure its financing through own direct taxation but is dependent on 'own resources', there are strong arguments for such a general prohibition.

However, the Commission explained that, for NGEU financing, Article 122 TFEU justified 'derogating from standard Treaty rules'. The Commission argued that, under the exceptional circumstances at the time of the COVID-19 pandemic, borrowing was a justified means to attain the EU's objectives. The German Federal Constitutional Court followed that argumentation, and rejected complaints against NGEU in a judgment of 6 December 2022 (see text box).

Is joint borrowing aligned with EU rules?

Germany's Federal Constitutional Court, in its judgment on the constitutionality of the Act Ratifying the EU Own Resources Decision – Next Generation EU (2 BvR 547/21, 2 BvR 798/21), concluded:

> *It is true that the Treaties do not contain a specific competence that would authorise the European Union to borrow on the capital markets. However, under exceptional circumstances, it does not appear completely implausible that the measure could be based on Art. 311(2) TFEU, with the borrowed funds constituting a new form of 'other revenue', provided that the decision on own resources satisfies at least the following requirements: it contains an authorisation to borrow on behalf of the European Union; it ensures that the funds obtained are used exclusively for tasks for which the European Union has competence in accordance with the principle of conferral; it subjects the borrowing to limits in terms of both the duration and the amount of the commitments assumed; and it provides that the amount of the 'other revenue' does not exceed the total amount of own resources. By contrast, it would be manifestly impermissible for the European Union to borrow on capital markets to provide general financing for its budget.*

Source: Federal Constitutional Court, Constitutional complaints challenging the Act Ratifying the EU Own Resources Decision ('EU Recovery Package') unsuccessful', press release, 6 December 2022.

Article 323 TFEU requires that the EU must have sufficient financial means to cover its legal obligations and therefore its debt. When NGEU was established, it was thus necessary to (i) underwrite the borrowing, and (ii) support repaying the grant part of the borrowing, the loans part being reimbursed by the Member States. For the first of these, in the Own Resources Decision the maximum level of own resources that can be called on per year was increased, from 1.4 % of the EU's GNI to 2 %. This increase of the EU budget's headroom assures investors that NGEU-related borrowing can always be repaid. However, it only concerns the reimbursement of the European Union Recovery Instrument (NGEU), and is therefore applicable until the end of 2058, the latest date for repaying all NGEU-related liabilities. By 2023, €260 billion had been funded under the NGEU through borrowing operations.

After the establishment of NGEU, a debate on the option of debt financing opened. A permanent facility that pays into the EU budget would make EU bonds more attractive, and it would have a stabilising effect on the EU as an economic and fiscal area. At the same time, the creation of a permanent debt-financed facility would raise important political and legal questions.

Another option would be to reschedule the repayment of the existing NGEU debt, or to prolong it beyond 2058. This would create space in the EU budget in the coming years, which could be used for other purposes than debt repayment. However, rescheduling the repayment of existing NGEU debt beyond 2058 would require a unanimous decision by Member States, something that seems difficult to attain.

European defence bonds

One area in which there is currently much discussion on how to find the necessary financing, including possible debt financing, is EU security, defence and preparedness. The new Commission has underlined the need for substantial investment to reinforce EU defence capabilities. Commissioner Andrius Kubilius, during his confirmation hearing before the European Parliament, noted that the needs were estimated at €500 billion for the next decade, and underlined the importance of finding such financing. He said the Commission would look at all options on the table, including defence bonds guaranteed by the EU budget.

A policy brief for the Centre for European Reform argues that increased EU spending on defence could be financed by EU defence bonds. Defence bonds through the EU budget could finance research and development in defence, joint defence procurement, or EU infrastructure aimed at increasing military mobility. The bonds could be based on existing EU funding mechanisms, on a new defence fund similar to NGEU, or on a new off-budget instrument. Additional debt would require additional national guarantees or, alternatively, the use of the European stability mechanism (ESM) to issue low-interest defence loans to Member States. If the support were provided through grants, revenue income for their repayment would be required; if it were provided in the form of repayable loans, sufficient guarantees – additional to the current level – would be needed.

EU defence bonds could help Member States with already high levels of debt to increase investment in defence. Moreover, they could allow funds to be directed more effectively towards agreed EU priorities, and provide longer-term predictable funding compared with national budgets. Furthermore, they could provide financial support to strengthen defence capabilities. However, some major obstacles exist: EU Treaty limitations regarding military spending (see Article 41(2) TEU), political resistance by some Member States to issuing more joint debt, and concerns about sovereignty and neutrality. The Draghi Report refers to Commission estimates from June 2024, according to which additional defence investments of around €500 billion are needed in the EU over the next decade.

Immobilised Russian sovereign assets

On 21 May 2024, the Council adopted several legal acts enabling extraordinary revenues generated from immobilised Russian sovereign assets in the EU to be used by the EU. In accordance with the decision in force, 90 % of those revenues go to the European Peace Facility, an off-budget instrument, to provide military support for Ukraine; the remaining 10 % go through the EU budget to finance Pillar 3 of the Ukraine Facility. A first transfer of €1.5 billion was made available on 26 July 2024. In the meantime, the Council decided to use 95 % of the revenues through the EU budget to finance the Ukraine Loan Cooperation Mechanism from the second half of 2025. The mechanism will finance the repayment and interest cost for Ukraine from the most recent G7 loans to Ukraine totalling €45 billion. In future, only 5 % of the revenues would go to the European Peace Facility.

A debate has started on whether the EU should use the immobilised Russian sovereign assets as such – as opposed to using only the extraordinary revenues generated by those assets – to finance both further military and budgetary support for Ukraine and the country's recovery and reconstruction once the war is over.

Structure of the post-2027 EU long-term budget: From programme-based to policy-based?

President Ursula von der Leyen, in her mission letter to Piotr Serafin, Commissioner for Budget, Anti-Fraud and Public Administration, demanded a 'simpler, more focused and responsive' long-term budget that links reforms with investments, establishes a European competitiveness fund and introduces new own resources. According to reports from *Politico* and *Agence Europe*, the Commission wants to restructure the EU budget, shifting from a programme-based to a policy-based budget. Numerous programmes could be merged into one national plan for each Member State. Access to funds would be subject to reforms and the fulfilment of policy objectives, similar to the model of the payments made under the RRF. The new approach has reportedly already been commented on negatively by Members, and drawn criticism from the European Committee of the Regions, which argued that such a model would weaken cohesion policy and exclude EU regions.

Another budget pillar would consist of a 'European competitiveness fund' designed to scale up the EU's defence and industry. Another pillar would serve to finance enlargement and EU external action.

The Commission is due to present its proposal for the post-2027 budget before 1 July 2025. Until then, numerous debates and considerations, as well as national elections and further geopolitical developments, are bound to influence decision-makers and shape EU citizens' expectations. Parliament will outline its vision and recommendations for the future EU long-term budget in early 2025, with an own-initiative report on a revamped long-term budget for the EU in a changing world. Debates have already started in the Committee on Budgets. The first draft report emphasises the budgetary needs in these different policy areas in order to respond to evolving spending needs and address the different crises. The co-rapporteurs, Siegfried Mureșan (EPP, Romania) and Carla Tavares (S&D, Portugal), call for a more flexible budget while fully respecting Parliament's budgetary and scrutiny prerogatives. The draft report underlines that a simpler, more flexible MFF requires more robust parliamentary accountability.

Key questions that need to be addressed in the EU's decision on its next long-term budget include the following: What will be the overall size of the future EU long-term budget? What structure will it have? Which priorities will be financed? Which options will be used to finance additional expenditure? How can the annual budgetary procedure be made more relevant? How should the EU set up an efficient and effective control framework for a performance-based budget? How can parliamentary scrutiny be ensured for a policy-based budget? Will the EU succeed in adopting a stronger budget that can support the EU in meeting its ambitious objectives?

eprs@ep.europa.eu (contact)

https://eprs.in.ep.europa.eu (intranet)

www.europarl.europa.eu/thinktank (internet)

http://epthinktank.eu (blog)