DISCUSSION PAPER

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Thinking outside the Multiannual Financial Framework: Financing Europe's security priorities

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EXECUTIVE SUMMARY

With Russia's full-scale invasion of Ukraine, war in the Middle East and uncertainties about the future of the Western alliance, the EU finds itself in a precarious security situation, calling for a significant ramp up in defence spending.

Much of the additional funding will need to take place in the private sector and particularly at the national level. But there is also a need to adopt a common approach and increase joint European funding into the EU's security which is a European Public Good. However, while further leveraging of existing funds should be aimed for, larger shifts in the Multiannual Financial Framework (MFF) towards more defence spending are difficult to achieve due to the unanimity requirement and a bias for the status quo.

Therefore, new solutions outside of the MFF should be explored. A supranational avantgarde of willing EU and non-EU states such as the UK and Norway could pool funds for a financially leveraged European Security Funding Facility (ESeFF). To kick things off, the ESM could provide initial financing using some of its unused borrowing capacity and act as the institutional nucleus for ESeFF.

To support Ukraine more effectively, willing EU and non-EU countries could provide guarantees for Ukraine Resilience Bonds (URBs) issued by the Ukrainian state as long-term public borrowing dedicated to defence and reconstruction.

Such instruments based on coalitions of the willing are suboptimal, but in the absence of viable alternatives the risks involved are worth taking in face of existential security threats.

THE NEXT MFF - CHALLENGES AHEAD

The EU is about to embark on negotiations for the next Multiannual Financial Framework (MFF), to run from 2028 to 2034. This exercise is always difficult given that it needs to be passed by unanimity, while member states often have different preferences. Net payers insist on limiting the overall amount of the budget to around 1% of EU GDP while looking for 'juste retour', i.e. EU spending to policy areas they benefit from. Meanwhile, net beneficiaries try to maximise the amount they receive at the same time as reducing the amount of control exercised at the EU level (this is especially the case for those who do not share overarching EU objectives, like Victor Orbán's Hungary). Vested interests inform member states efforts to preserve the spending allocated to them. This makes major shifts in funding difficult, although there is usually some degree of taking account of new priorities at the expense of traditional spending areas.

In the past, this lack of flexibility has led to compromise MFFs that contained a degree of reform and included some shifts in funding, but maintained a significant part of the status quo. At the same time, there has been increasing use of financial instruments, especially via the European Investment Bank (EIB), but more recently also through national promotional banks (NPBs) and international financial institutions (IFIs) to leverage additional funding. The most radical change seen in recent years has been the NextGenerationEU recovery instrument, launched in response to the COVID-induced economic crisis, which broke with some long-standing taboos, including large-scale EU borrowing.. However, the political consensus needed for this breakthrough was exceptional. Driven by the pandemic, it was seen as very much unique, affecting all member states and only temporary.

Despite the security emergency, the changes that can be achieved in the next MFF are rather limited.

INVESTMENT IN AN INSECURE WORLD

Many have argued that we are currently facing a similarly exceptional moment. The need for additional investment across many policy domains is clear. In particular, there will need to be more funding to underpin the triple transition of technology, sustainability and security. Pressure to increase spending on defence will be further cranked up by the Trump administration, which is looking to reduce the US military presence in Europe and will push strongly for EU countries to go above their NATO pledge of 2% of GDP (and perhaps as high as 5%, going by comments made in December 2024). At the same time, there is an ongoing need to support and strengthen Ukraine against current and future Russian aggression.

A significant part of the additional investment needed will have to come from the private sector. Some of that can be facilitated through the financial engineering mechanisms that have been developed at the EU level, including through the EIB and other implementing partners. In particular, there will need to be a focus on de-risking – in other words, compensating for (geo) political risks – to ensure that private companies commit long-term investments. At the same time, the availability of private credit for defence is contingent on the demand for defence capabilities, which will always remain driven by governments.

Much of the public spending will need to take place at the national level. These are absolutely necessary to ensure Europe's security in the foreseeable future. But there is also a need to increase common European funding, not least because it will be impossible to increase the effectiveness of overall European spending without a common approach.

NEW PRIORITIES, OLD CONSTRAINTS

Alas, member states are showing no indication of overcoming their EU-level financing taboos at this time, despite the security crisis the EU is facing. While there has been a shift in the attitude of some of the 'frugals' – i.e. those countries that have argued for EU spending restraints in the past – many net payers still argue that fiscal constraints at home prevent any decisive actions at EU level. In addition, they reject the implication that more common funding would benefit those who do not share the EU's overarching priorities and are not committed to the EU's security, or who are, for constitutional and/or political reasons, unable to contribute to a stronger role for the EU in defence.

This implies that, despite the security emergency, the changes that can be achieved in the next MFF are rather limited. Essentially, we are facing an ambition-unity dilemma, where the need for unanimity restricts the ability to achieve the level of ambition required.[1] Yes, the centrist parties in the European Parliament are likely to call for a more ambitious budget, but this alone will not be able to push the member states to where we need to be. The status quo bias will be reinforced by the rules that apply when no agreement is reached. In such a case, the current Multiannual Financial Framework (MFF) would automatically continue on an annual basis until a new deal is approved.[2]

REFORM AND RE-PRIORITISATION

So, what can be done? Certainly, some shifts in MFF funding are possible, as well as further increases in the use of financial instruments. For example, the large pool of funds available to national promotional banks - some of which have more flexible investment policies for defence than the EIB - could be better leveraged by blending them even more with EU instruments, such as InvestEU. An instrument like the Flexible and Scalable Tool (FAST), proposed under the European Defence Industry Programme (EDIP) as a top-up to InvestEU, could serve as a valuable opportunity to test this approach within the current MFF.

Frontloading resources from the European Peace Facility and the next MFF could help to tackle some immediate financial needs, such as those that could arise if President Trump imposes a ceasefire on Ukraine. This may require the deployment of European troops to Ukraine and more investment in Ukraine's defences to prepare for future Russian aggression. However, existing MFF flexibility mechanisms, such as the flexibility instrument and the contingency margin, would only allow limited repurposing, especially considering likely political hurdles.

New ways of spending to achieve greater impact are also possible – for example, dedicating cohesion policy funding to increase common security.[3] But, in the end, the status quo bias will limit what is possible. This will lead to another instance of the progress illusion – namely, while there are improvements, they are nowhere near the scale and scope of what is required to address the severity of the perma-polycrisis that we are facing. More radical, and more innovative, change is needed.[4]

AMBITION OR UNITY?

Not everybody will be on board, and a priori there might be many member states, including some of the most important net payers, that will resist any changes. But the pressure will inevitably increase, so it is vital to put in place mechanisms and processes that can be activated if and when the political wind changes. To prepare for this moment, those countries willing to take the first step within a smaller group, in the spirit of a supra-governmental avantgarde, must do so.[5]

Rather than trying to change the MFF itself – a difficult task, given limitations such as the unanimity provision – the member states that most clearly perceive a need to address the current geo-political watershed moment should establish a parallel financing mechanism that does not rely on an EU consensus.[6] The most obvious spending area for such an instrument is defence and security. Those are European Public Goods, and they are underprovided on the national level while all participants would profit from their provision on the EU level due to positive externalities. Investing in a more coordinated manner would also enhance the interoperability of military equipment and tackle the fragmentation of Europe's defence industrial base, which is still predominantly structured along national lines, limiting economies of scale.

FUNDING SECURITY OUTSIDE THE MFF

A European Security Funding Facility (ESeFF) would be in the interest of all participants and could broadly be based on previously created instruments outside the EU budget, such as the European Stability Mechanism (ESM). Such a fund would rely on national contributions of the participating countries, be financially leveraged, and be based on a common commitment to European defence and security. This should also include an exit mechanism, whereby following a unanimous vote by remaining members, a country that moves away from the common commitments could be excluded from the mechanism. While not an EU mechanism, the ESeFF should be

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integrated into EU processes and administration as far as possible and be open to other countries willing to make the commitment and put up the funding.

There are a number of options for financing such a fund. One way would be to create an intergovernmental special purpose vehicle (SPV) to issue jointly underwritten AAA-rated bonds to fund front-loaded investment – for example, in jointly procured defence equipment.[7] Another could be financial market financing using the ESM itself, which might considerably speed up the initial process and eliminate or significantly reduce the need for additional financing to kick things off (see box below).

Spending of the fund would be on the basis of complementary additionality, focusing on investments that would otherwise not be financed by national governments while complementing existing national public and private efforts. This would involve national match funding whereby recipients would be required to provide national funding as a condition for receiving a grant.[8] This would increase the impact of ESeFF spending, while providing member states with a significant degree of control. Wherever possible, funding carved out from the EU budget should be incorporated inside such a mechanism. The spending could be focused on defence and security research and development, dual technologies and measures to increase resilience, defence infrastructure, arms and ammunition production, and joint procurement.

ESeFF would have a number of advantages: in addition to leveraging more investment in defence and security, it would provide a mechanism for (self-interested) cross-European solidarity by channelling money to countries that would struggle to find sufficient spending on their own, but which are on the front line in dealing with the common security threat. In public accounting, contributions to the ESeFF could potentially be counted as defence expenditure, helping NATO countries to achieve their (higher) targets. It would also benefit participating countries' defence industries. Countries not committed to common goals could be excluded, and interested non-EU countries like the UK or Norway admitted.

LIVING IN A SECOND BEST WORLD

Yes, such a mechanism is far from the ideal solution, and it has distinct shortcomings and risks, including undermining common European action and sidelining

THE EUROPEAN STABILITY MECHANISM: A QUICK FIX FOR MORE DEFENCE FUNDING AND A NUCLEUS FOR A EUROPEAN SECURITY FUNDING FACILITY?

A key operational challenge for defence funding outside the MFF is the initial financing. This will require setting up, or finding, an appropriate organisation able to borrow at low cost on international capital markets. A highly attractive option for this may be to consider the use of the ESM Treaty for the financing of first common defence projects and, perhaps, subsequently using the ESM organisation itself as the nucleus for a new defence financing organisation.

A significant advantage of the ESM is that it already has some €422 billion of unused borrowing capacity under the ESM Treaty, fully based upon already existing member state paid-in capital and guarantees. The organisation moreover has an AAA credit rating and a strong reputation in capital markets, allowing it to achieve better borrowing rates than the EU Commission received for Next Generation EU. Use of this available borrowing capacity for defence investments would almost certainly require an amendment to the existing ESM Treaty. However, the provision of defence investments can in fact be seen as closely related and highly relevant to the ESM's existing Treaty mandate of safeguarding euro area financial stability, as demonstrated by the adverse reaction of Baltic country bond spreads to Russia's invasion of Ukraine. Nevertheless, allocating funds to defence investments would reduce the capacity for crisis funding from other financial risks, necessitating careful consideration on this trade-off.

An agreement amongst euro area members would be needed to make an amendment to the ESM Treaty. However, this could likely be achieved substantially faster than negotiating a new defence financing treaty from scratch. A key simplifier of course is that Hungary, which has attempted to block common EU foreign and security policy initiatives in the past, is not a euro area member. Such an amendment would likely include a widening of the Treaty's financial stability mandate to security issues and also provide for an explicit threshold for defence-related borrowing. However, agreeing a threshold of even €50 billion or €100 billion would allow for substantial initial financing of important defence investments. Discussions could perhaps be further speeded up through tying the amendment to a specific defence project with a clear European Public Good purpose, such as a focus on reinforcing the European air and missile defence system.

Financing under the ESM Treaty could be the first step towards setting up a more permanent European Security Funding Facility (ESeFF) under a new defence financing treaty. The new treaty would likely contain a wide membership, possibly including some non-EU member states. Meanwhile, the provision of a much larger budget would inevitably require further paid-in capital and guarantees by the new membership. Still, the use of the existing ESM organisation as an initial nucleus might greatly facilitate progress. The ESM already has a precedent for dealing with the funds of multiple funding facilities, given it took over the administration of the earlier separate European Financial Stability Facility (EFSF). Moreover, the organisation has shown its flexibility and readiness to deal with different types of financing such as for the stability of the banking sector.

the MFF. But given current limitations within the EU system, and within the MFF in particular, such a parallel instrument outside of EU budgetary mechanisms might be the only way to decisively increase defence and security spending. Moreover, a successful ESeFF could attract additional members going forward and thereby make up for some of its shortcomings. This has happened in the past with initiatives such as Schengen or the Prüm Convention on cross-border police cooperation. Both of these were spearheaded by a number of states outside the EU framework but were later integrated into the EU acquis.

Incentives for initially reluctant EU member states to join ESeFF should be put in place to avoid them freeriding on increased overall security financed by the supranational avantgarde. Adding to US pressure to increase NATO defence spending, targets could be increased to 3%, which would make ESeFF even more attractive. Moreover, ESeFF participants should benefit disproportionately from membership, for example by preferential funding for their arms industries.

FUNDING UKRAINE

The ESeFF would address one of the key current needs for Europe's defence – increasing common defence spending. But this is only one side of the coin. Europe will also have to ensure that it continues to enable Ukraine to finance its capabilities to defend itself from Russian aggression. As argued earlier, if President Trump imposes a ceasefire on Ukraine, the risk of future aggression will remain. Therefore investment in Ukraine's defences should increase, not decrease.[9] Additionally, there is a need to improve Ukrainian resilience as well as begin reconstruction.

While the need is clear, the willingness to find this money within existing budgets is virtually non-existent in many of the strongest economies. Economic woes at home and fiscal constraints make the political economy of providing support for Ukraine rather tricky. This is further undermined by the likely stance taken by the Trump administration, which seems reluctant to commit US finances. But at the same time, US pressure on Europe to shoulder more responsibility for Ukraine will be significant. In fact, European support for Ukraine is needed, not only for Ukraine's sake but as an investment in Europe's own security.

BORROWING TIME

How to square the circle? One way would be to have common European borrowing dedicated to this purpose. This is likely to come – eventually. But, for the moment, political resistance to some form of Eurobonds is persistent, especially in some of the stronger economies that are crucial for such a mechanism to be established. But Ukraine can't wait until these countries bow to the inevitable. Something is needed now, not least because of the Trump 2.0 presidency.

A quick way out would be to provide security guarantees for Ukrainian national borrowing dedicated to defence and reconstruction. Ukraine Resilience Bonds (URBs) could be issued by the Ukrainian state as long-term public borrowing, underpinned by willing EU countries that would guarantee cover for the financial and political security risks involved. Clearly, there would have to be conditions attached, including in relation to overall volumes, modalities of issuance, who benefits from spending facilitated by these bonds, and contingencies for the future when the bonds reach maturity. There would also need to be a clear anti-corruption framework, with external oversight, making guarantees contingent on good governance. In addition, there would need to be concrete incentives (for instance in taxation) for public and private financial institutions at home that such bonds can and should be part of financial portfolios of, for example, pension funds. The ECB could be mandated to invest a certain amount in URBs, further increasing their effect. Potentially, this could also provide a test case for Eurobonds in the future, once it is recognised politically that these are necessary and inevitable.

Only a common approach with novel instruments like ESeFF and URBs will help Europe to effectively address its most existential threat: Russian aggression.

URBs would offer a number of advantages. Actual spending is likely to be low, unless risks materialise. However, given the geopolitical nature of these risks, Europe is already exposed to them, and therefore will not be able to avoid their impact. Rather than passively accepting our exposure to this risk, URBs offer a way of countering and reducing it. URBs would not constitute European borrowing, and arguably are not even a borrowing instrument for those countries covering the risk. They would provide a vehicle for private money to reach Ukraine, including potentially from citizens who want to support the country. They could quickly and directly cover the shortfall of US support under Trump, and hand significant control to Ukraine to enable it to prioritise funding as needs dictate. Crucially, URBs would not rely on the support of all EU countries, and they would enable non-EU countries such as Norway and the UK to contribute.

Again, URBs are not a panacea. They involve, on the one hand, Ukraine increasing its long-term indebtedness, and on the other, the countries underpinning the mechanism to take on risks. They might be controversial in a number of countries and could be legally challenged. Grand coalitions of centrist parties in these countries may be required to carry them through. But the alternatives do not look more promising at this moment in time, and Ukraine needs continued support.

RISKS WORTH TAKING

Both ESeFF and URBs, or similar vehicles, would be born out of necessity. They would be untested, and inevitably flawed and risky. But if the alternative is failing to take the necessary steps for our security – namely to increase common European defence spending and to continue to support Ukraine – these are risks worth taking. In fact, committing to our common security together reduces rather than increases our overall risk exposure. Only a common approach with novel instruments like ESeFF and URBs will help Europe to effectively address its most existential threat: Russian aggression.

[1] Zuleeg, Fabian; Emmanouilidis, Janis A. (2022), "Overcoming the ambition-unity dilemma", Brussels: European Policy Centre, 31 October

[2] Article 312(4) **TFEU** states: "If no Council regulation determining a new multiannual financial framework has been adopted by the end of the previous multiannual financial framework, the ceilings and other provisions corresponding to the last year of that framework shall be extended until such time as that act is adopted."

[3] Hunter, Alison (2024), "An EU era of heightened security: what role for the future Cohesion Policy", Brussels: European Policy Centre, 14 May

[4] Zuleeg, Fabian (2023), "Overcoming the European Progress Illusion", Brussels: European Policy Centre, 26 April

[5] Zuleeg, Fabian; Emmanouilidis, Janis A.; Möller, Almut (2024), "Confronting the permacrisis: Time for a supra-governmental avantgarde", Brussels: European Policy Centre, 17 July

[6] Zuleeg, Fabian; Emmanouilidis, Janis (2025), "Europe's next watershed – how liberal Europe should react to Trump 2.0", Brussels: European Policy Centre, 9 January

[7] Chihaia, Mihai Sebastian et al. (2025), "Quick march! Ten steps for a European defence surge", Brussels: European Policy Centre, 22 January

[8] Zuleeg, Fabian (2018), "Squaring the MFF circle: How match funding can deliver the EU's new priorities", Brussels: European Policy Centre, 23 February

[9] Zuleeg, Fabian (2024), "Calm after the storm? A Trump-imposed ceasefire means doing much more to protect Ukraine and Europe", Brussels: European Policy Centre, 13 December

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