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FINANCING EUROPEAN EXPENDITURES WITH THE ISSUANCE OF UNION BONDS

European Union's economic policy in a time of crisis

Since the onset of the financial crisis, which is widely traced back to the dramatic situation of American banks culminating in the bankruptcy of Lehman Brothers on September 15, 2008, significant changes have emerged in the management of economic policy at the European Union level. Initially, the European response to this crisis was weak and delayed, leading to a situation that seriously threatened the stability of the euro. This crisis was ultimately resolved—without fiscal interventions—by the firm stance taken by Mario Draghi, the President of the European Central Bank (ECB). On July 26, 2012, at the Global Investment Conference in London, Draghi declared that "within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough." his statement reassured the markets, as speculators understood that they could not effectively challenge the resources available to the ECB, thus averting the risk of a crisis in the European currency.

The European response to the COVID-19 pandemic was significantly different and quicker than prior measures. Faced with the threat of a severe recession and a substantial increase in unemployment, the European Council approved an extraordinary program on July 21, 2020, called NextGenerationEU (NGEU). This initiative is a €750 billion package aimed at revitalizing the European economy impacted by the pandemic. A key innovative feature of this program is that its funding—partly distributed through grants and partly through loans to Member States—is fully sourced from the issuance of European bonds on the market.

Council Decision 2020/2053, dated 14 December 2020, regarding the system of own resources[1], states that "for the sole purpose of addressing the consequences of the COVID-19 crisis (...) the Commission is empowered to borrow on the capital markets on behalf of the Union for a maximum amount of EUR 750 000 million at 2018 prices. Borrowing operations shall be carried out in euro" Article 5 of this Decision further clarifies that "the reimbursement of the principal and the payment of the related interest shall be borne by the Union budget. (...) All liabilities induced by the exceptional and temporary power of the Commission to borrow referred to in paragraph 1 of this Article shall be repaid in full at the latest by 31 December 2058".

Article 6 of Council Decision 2020/2053 outlines the limits on the amount of bonds that can be issued in the market and specifies how these funds should be allocated to certain programs, stating that:

"the [own resources] ceilings shall be temporarily increased by 0.6 percentage points for the sole purpose of covering all liabilities of the Union resulting from the borrowings referred to in Article 5 until such liabilities are terminated and at the latest by 31 December 2058". The increase in funding ceilings is essential because the current limits are insufficient to ensure that the Union can secure the necessary funds to cover expenses related to the exceptional and temporary borrowing for financing the NGEU. The repayment of these funds will be managed through a separate compartment, which will include the proceeds from the 0.6 percentage point increase in the own resources ceilings. These funds will be designated specifically for this purpose and cannot be used to cover other liabilities of the Union[2].

This decision addresses the serious consequences of the pandemic crisis by allowing the issuance of bonds backed by the European Union's budget. This choice arises from a critical situation that requires a significant step forward on a "limited, but crucial" matter, as outlined by Jean Monnet in the Memorandum of May 3, 1950, where he proposed the foundation of the European Coal and Steel Community to the French government[3]. Within the Union, the previous prohibition on issuing bonds for direct public spending is removed; this will enable financing that goes beyond merely providing repayable loans to member states. By allowing investments and reforms to be financed through market-raised funds, Europe can finally adopt the golden rule, which states that investments - typically long-term - can be financed through debt.

Financing European expenditures with emission of bonds and the rules of the Treaty

Considering the enormous investment required for the ecological and digital transitions, as well as the expenditures necessary for the Union's defence, it is crucial to evaluate how the decisions made with the launch of NextGenerationEU can be adapted to meet the Union's new spending needs through bond issuance. Considering the situation arising from the Russian invasion of Ukraine, which necessitates increased investments to ensure the security of Union member countries - alongside the expenditures for the ecological and digital transitions - it appears essential, especially given the limited size of the European budget, to finance these expenditures through bond issuance in the market.

However, it is imperative to verify the legitimacy of such substantial debt financing at the European level for these investments.

In this context, it is important to highlight that according to article 311, which states, “without prejudice to other revenue, the budget shall be financed wholly from own resources,” past instances included bond proceeds under ‘other revenue’. However, a critical issue to consider, based on the conclusions of an Opinion from the Council Legal Service[4], is whether Union debt can only be issued in limited amounts and for specific spending purposes, similar to what occurred with NGEU, or if it can also be used to fund the Union's general budget.

Should the approach taken with NGEU be pursued again, a revised version of the Own Resources Decision (ORD) would need to be approved to ensure the resources required for servicing the new debt are available.

The funds raised through the issuance of bonds in the market must be used to finance a specific expenditure program. According to the Opinion of the Legal Service of the Council, these resources should be regarded as external assigned revenues, designated for particular expenditure items. It should be noted that "the Union shall not use funds borrowed on capital markets to finance operational expenditure". Furthermore, the wording of Article 311 of the TFEU suggests that borrowed funds should not significantly exceed the amount of the Union's own resources. This point was emphasized in the ruling by the German Bundesverfassungsgericht[5] on the constitutional admissibility of the NGEU. However, the Court reaffirmed that the Treaty does not contain an outright prohibition on issuing bonds to finance the European budget.

With regard to compliance with the balanced budget rule provided for by art. 310(1) TFEU, it should be noted that when the Union borrows resources to directly finance expenditure programs, it sells bonds on the market and considers the proceeds from these issues as external assigned revenues, meaning they have a specific destination, and subsequently channels these revenues toward the selected expenditure programs. Later, when the bonds reach maturity, the Union repays the money using its own resources specifically allocated for this purpose.
However, the revenues obtained from the bond emissions are not included in the annual budget framework and thus represent an exception to the principle of universality of the budget, falling under "other resources" outlined in Article 311 of the Treaty on the Functioning of the European Union (TFEU).

According to Article 7, paragraph 2, letter e), of the Regulation on the Financial Rules applicable to the general budget, external assigned revenues constitute authorized expenditure ("appropriations"), but under Article 17(2) of the same Regulation, they are not part of the appropriations included in the budget. They are intended to have an additional nature with respect to the appropriations listed in the balance sheet. From a purely technical standpoint, external assigned revenues, by their very nature, cannot compromise the balance of the budget.

To comply with the balanced budget rule, the Council Legal Service emphasizes that "borrowing by the Union would be budgetarily neutral if the resulting debt is matched by a claim allowing the Union to cover the principal, interests and costs associated with that borrowing and where sufficient assets are dedicated for that purpose."

Given this limitation, it is clear that the current own resources are inadequate to fund the extensive expenditures necessary for achieving carbon neutrality and the digital transition, as well as promoting an effective defence and security policy. Furthermore, it appears challenging to allocate these revenues for specific spending programs, which is unavoidable by definition in the case of external assigned revenues.

European debt as an own resource

Considering the constraints that hinder a solution based on the mechanisms established for NGEU, Grund and Steinbach[6] conclude that "the EU could finance public goods through the proceeds of borrowing by adding a new category of own resources in Article 2 of the ORD [...]. However, the ORD, which requires ratification by all EU countries, must specify the permissible amount of borrowing and the EU must have adequate means to meet its debt service in any year, which must be secured by a sufficient amount of (non-borrowed) own resources". Clearly, in this scenario, the challenge of generating new resources to finance debt service persists, alongside the complications related to the mechanism outlined in Article 311 of the Treaty, which requires unanimous approval in the Council and ratification following the respective constitutional procedures in each member country. Moreover, unlike the NGEU approval process, in which the European Parliament is not involved in decisions regarding the use of external assigned revenues - even if these amounts are substantial - the inclusion of funds raised from Union bond issuance in the Union budget requires the European Parliament's involvement as a co-legislator, as stipulated under Article 314 of the TFEU. This ensures greater transparency in accordance with Article 310, which mandates that all revenues and expenditures be recorded in the budget.

Additionally, categorizing revenue from debt issuance as own resources would shift the dynamic between secondary revenues and own resources, aligning with Article 311 of the TFEU, which states that "without prejudice to other revenues, the budget shall be financed wholly from own resources." Regarding the budgetary balance mandated by Article 310(1), this principle must also be observed in the ORD, even when debt financing is classified as an own resource, as seen in the NGEU case, ensuring that the ceiling for own resources is appropriately set to maintain a balance between revenue and expenditure.

Debt financing of European defence and ecological and digital transition

Compared to financing European expenditure by issuing debt, considered an own resource, the issuance of EU bonds to provide loans to Member States is entirely different.

This is exemplified by the Council Decision of May 27, 2025, which adopted a Regulation establishing the Security Action for Europe (SAFE), a new EU financial instrument designed to support those member states wishing to invest in defence industrial production through common procurement and finance urgent, large-scale investments in the European defence technological and industrial base. The goal is to enhance production capacity, ensuring that defence equipment is available when needed, and to address existing capability gaps.

Through SAFE the EU will provide up to €150 billion that will be disbursed to interested member states upon demand, and based on national plans. The disbursements will take the form of long-maturity loans, to be repaid by the beneficiary member states. This is therefore a typical case of back-to-back lending where a basic act authorises the Commission to contract loans on behalf of the Union with a view to on-lending to Member States. The loans or the borrowing constitute a neutral, off-budget operation. In the case of back-to-back lending, the proceeds from the borrowing are not recorded as budgetary revenue and expenditure arising from on-lending is not recorded as expenditure, as the two fully counter-balance each other. The debt resulting from the borrowing is counterbalanced by an asset, which justifies its off-budget treatment, namely the claim against the recipient of financial assistance.

The annual budget only contains a line to accommodate defaults, but those are fully matched by budget revenue as the Union must honour its liabilities. The off-budget treatment of the abovementioned borrowing operations means that the budgetary balance is not affected.

The situation changes when the issuance of debt aims to finance the Union's expenditure. The challenge of debt financing for the Union's expenditure arises within a confusing framework as the global economy confronts extreme hardships stemming from a series of issues related to the geopolitical landscape, the ecological and digital transitions, and the disruptions caused by the new American administration.

Within this complex context, within the European Union, to meet the objectives laid out in the Draghi Report on competitiveness[7], a minimum annual additional investment of EUR 750 to 800 billion is needed, based on the latest Commission estimates, corresponding to 4.4-4.7% of EU GDP in 2023. Moreover, since the Russian invasion of Ukraine has made it urgent to strengthen the security policy for the protection of the Union, according to Bruegel's estimates "European defence spending will have to increase substantially from the current level of about 2 percent of GDP. An initial assessment suggests an increase by about €250 billion annually (to around 3.5 percent of GDP) is warranted in the short term"[8].

A realistic estimate of the annual cost for the production of European public goods is around 1,000 billion euros per year. Considering that the Draghi Report mentions a planned expenditure for security of 50 billion euros, if another 200 billion euros are added for defence to meet the amount suggested by Bruegel, this leads to the enormous sum of an additional 1,000 billion euros per year.
According to the Draghi Report, it can be estimated that, on average, about 20% of the total investments will need to be financed with public resources, a figure that is likely underestimated at least initially, as private investments will need to be incentivized with public funds. In any case, the additional resources required annually in the European budget are estimated to range between 200 and 250 billion euros.

This figure seems completely out of reach for the current finances of the Union. Therefore, it is important to identify new sources of revenue to support these investments. One approach, as previously argued, involves issuing European bonds, which could also help create a secure asset for countries seeking to reduce their dependence on the dollar, such as China and other nations in the Global South. However, even in this case, the necessary funds for debt servicing must be allocated in the budget. For servicing the issues carried out under NGEU, the Commission estimates that 30 billion euros are already needed annually.

European debt as a safe asset

If the financing of EU expenditures through the issuance of European debt is to create a safe asset for the entire world, it is essential to eliminate the fragmentation of the European capital market along national lines. At its core, this implies introducing a European bond with a dual purpose: financing the public component of investment and providing a sound and credible common benchmark for the entire financial system.

According to estimates by Panetta[9], the Governor of the Bank of Italy, an integrated capital market centered on a European safe asset would reduce financing costs for businesses, leading to an additional investment of €150 billion per year and an increase in GDP by 1.5 percent in the long run. The impact on GDP could be up to three times larger if the new investments target innovative high-tech projects.

This effect would be even greater if a single, well-structured, and liquid capital market could attract foreign resources. While the integration of the capital market is vital, the experience of NextGenerationEU demonstrates that it is feasible to finance an ambitious European investment plan through the issuance of common public debt without first needing to reform the Treaty rules.

The idea of introducing a safe asset within the European financial system has recently been relaunched through a proposal by Olivier Blanchard and Ángel Ubide[10]. This proposal revisits a previous suggestion made by Depla and von Weizsäcker[11] regarding the issuance of a European bond to address the sovereign debt crisis that followed the financial crisis of 2007-2008. The two authors propose that European states pool their public debt up to a maximum of 60% of GDP through the issuance of a European bond (Blue Bond), significantly reducing the cost associated with this portion of the debt. For the debt exceeding 60%, issuance would remain the responsibility of individual nations (Red Debt), carrying higher costs that would provide a strong incentive for greater fiscal discipline.

The analysis by Blanchard and Ubide follows a similar rationale. The core idea of their proposal is clear: to exchange a volume of national bonds for senior Eurobonds. Global investors seek alternatives to the US Treasury market, which, until recently, was perceived as deep, liquid, and safe. Currently, they lack obvious alternatives at scale. For Europe to present investors with a viable option, it must dramatically increase the size of the Eurobond market. This cannot be accomplished on the margins or solely through net flows; for instance, if all additional defence spending were financed entirely this way, it would only contribute about 1 percent of EU GDP to the stock each year.

The solution must be to replace a portion of the stock of national bonds with Eurobonds (Blue Bonds) for the time being. The main issue is then how much of the national debt of EU countries should be replaced with Blue Bonds. Blanchard and Udibe believe that exchanging national bonds for Blue Bonds up to 25 percent of GDP may suffice for liquidity purposes and still not raise concerns about safety.

Finally, and importantly, this proposal does not take a position on whether the proportion of Blue Bonds should be increased over time, how that proportion interacts with the size of the EU budget, what spending priorities the EU should have, and how much of EU spending will be financed by taxes or debt. These issues should be addressed later. To the extent that EU spending is partially financed by debt, the existence of a large Blue Bond market implies that financing should be cheaper than it is today.

Conclusions

There are no rules in the Treaty that exclude the possibility of debt financing for the European budget. The EU could finance public goods through the proceeds of borrowing by adding a new category of own resources in Article 2 of the Own Resources Decision, which must be adopted unanimously and requires ratification by all EU countries, following the special legislative procedure imposed by Article 311 TFEU, that makes the process extremely complex from a political standpoint. The ORD must specify the permissible amount of borrowing and the EU must have adequate means to meet its debt service in any year, which must be secured by a sufficient amount of (non-borrowed) own resources.

Regarding the European budget, the fundamental weakness is that the Union lacks the authority to autonomously decide its financing instruments, indicating that in this area a reform of the Treaty is necessary.

However, this challenge does not preclude the use of debt financing, pending such reform, as long as the conditions described in the Opinion of the Council Legal Service and the decision of the Bundesverfassungsgericht are respected, as it has happened with NGEU. This financing can help cover the substantial investments required for ecological and digital transition, along with the expenses necessary for guaranteeing the Union's defence and security. If debt is used to finance specific expenses, it is classified as external assigned revenue, and those expenses do not count as appropriations in the budget. Therefore, external assigned revenues, by their nature, cannot disrupt the budget's balance.

However, Union borrowing would be budgetarily neutral only if the resulting debt is paired with a claim that allows the Union to cover the principal, interest, and costs associated with that borrowing, and if sufficient assets are allocated for this purpose. Currently, a massive amount of investments must be allocated to the Union budget to ensure competitiveness, protect and secure Europeans, and promote ecological and digital transitions. A realistic estimate of the annual cost for producing these European public goods is around 1 trillion euros per year, with approximately 20% of total investments needing to be financed by public resources. This figure seems entirely out of reach for the current Union budget. Therefore, it is imperative to identify new forms of resources to support these investments.

The most realistic way to generate this significant revenue is through the issuance of European debt, adding a new category of own resources in Article 2 of the ORD. The previous experience with NextGenerationEU demonstrates that it is feasible to finance an ambitious European investment plan through European public debt issuance, adhering to Treaty rules, which should ultimately be revised to ensure that the Union has the authority to autonomously decide on the resources necessary for a sufficiently sized budget. Furthermore, financing EU expenditures through the issuance of European debt could also help create a safe asset for countries attempting to reduce their dependence on the dollar.

Recent estimates suggest that an integrated capital market centered on a European safe asset could stimulate additional investment, boosting GDP by 1.5 percent in the long run. This effect would be amplified if a single, well-structured, and liquid capital market could attract resources from abroad.

Note

[1]Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom
eur-lex.europa.eu/legal-content/IT/TXT/PDF/?uri=CELEX:32020D2053

[2]Article 6 of the Council Decision 2020/2053

[3]D'une pareille situation, il n'est qu'un moyen de sortir: une action concrète et résolue, portant sur un point limité, mais décisif, qui entraine sur ce point un changement fondamental et, de proche en proche, modifie les termes même de l'ensemble des problèmes

[4]Council Legal Service, Opinion of the Council Legal Service on Proposals on Next Generation EU, 9062/20, Brussels, 24 June 2020,
https://data.consilium.europa.eu/doc/document/ST-9062-2020-INIT/en/pdf

[5]Bundesverfassungsgericht, Urteil vom 6. Dezember 2022 Article 4
https://www.bundesverfassungsgericht.de/SharedDocs/Entscheidungen/EN/2022/12/rs20221206_2bvr054721en.html

[6]S.Grund, A. Steinbach, *European Union Debt Financing: Leeway and Barriers from a Legal Perspective*, Bruegel, Brussels, Working Paper, 15/2023, 12 September 2023

[7]*The Future of European Competitiveness*, September 2024

[8]G.B. Wolff, *Defending Europe without the US: first estimates of what is needed*, Bruegel, Brussels, 21 February 2025

[9]Banca d'Italia, *The Governor's Concluding Remarks Annual Report*, Rome, 30 May 2025

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[10]O. Blanchard, A. Ubide, *Now is the time for Eurobonds: A specific proposal*, Peterson Institute for International Economics, May 30, 2025 https://www.piie.com/blogs/realtime-economics/2025/now-time-eurobonds-specific-proposal

[11]J. Delpla, J. von Weizsäcker, *The blue bond proposal*, Brueghel Policy Brief, No.3, Brussels, 2010

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