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## **HOW HIGH CAN EU DEFENCE SPENDING GO?**



## HOW HIGH CAN EU DEFENCE SPENDING GO?

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**Abstract:** In the aftermath of Russia's invasion of Ukraine, military budgets across Europe have seen substantial increases. Despite the Treaty on European Union's (TEU) prohibition on spending for operations with military or defense implications, there has been a noticeable surge in defense expenditures from the European Union (EU) budget, leading to the creation of new financial mechanisms. Meanwhile, the EU is actively leveraging joint extra-budgetary funds, thus allowing for flexibility beyond traditional budgetary constraints. Additionally, the European Investment Bank (EIB) can play a significant role in providing credits for defense-related projects. The current geopolitical landscape underscores the critical importance of European integration and the necessity to secure adequate funding to support EU's military expenditures. This is essential not only to deepen its sovereignty and strategic autonomy but also to enhance spending efficiency, reducing redundancies in military expenditure that have traditionally been overly focused on the needs of individual Member States. However, there still exist differences of opinion on the most effective collective approach to collectively finance military expenditures. Given the determination of EU leaders to continue providing military aid to Ukraine amidst the ongoing conflict, with no signs of a short or medium-term solution, the EU will persist in exploring the most suitable financial strategies to finance its military expenditures in accordance to the prevailing circumstances.

**Resumen:** Tras la invasión rusa de Ucrania, los presupuestos militares en Europa han aumentado considerablemente. A pesar de que el Tratado de la Unión Europea (TUE) prohíbe el gasto en operaciones con implicaciones militares o de defensa, los gastos en defensa con cargo al presupuesto de la Unión Europea (UE) también han aumentado y ésta ha creado nuevos instrumentos financieros. La UE está financiando también gastos militares con cargo a fondos extrapresupuestarios conjuntos, lo que permite mayor flexibilidad al margen de las limitaciones presupuestarias tradicionales. Adicionalmente, el Banco Europeo de Inversiones (BEI) también puede llegar a desempeñar un papel importante concediendo créditos para la financiación de proyectos relacionados con la defensa. El panorama geopolítico actual determina la importancia de la integración europea y la necesidad de conseguir una financiación adecuada para apoyar los gastos militares de la UE, lo que resulta esencial no solo para tratar de profundizar en su soberanía y autonomía estratégica, sino también para gastar de manera más eficaz, evitando las redundancias del gasto militar en Europa, demasiado centrado hasta ahora, principalmente, en las necesidades individuales de cada Estado miembro. Pero todavía hay diferencias de opinión sobre la mejor manera de proceder colectivamente en este

campo. Dada la determinación de los líderes de la UE de continuar con la ayuda militar a Ucrania y la situación de ese conflicto militar, sin visos de solución a corto o medio plazo, la UE seguirá buscando las fórmulas financieras más adecuadas para financiar sus gastos militares en función de las circunstancias.

**Keywords:** EU defense expenditures, EU Multiannual Financial Framework, EU budget, European Defense Fund (EDF), European Peace Facility (EPF), European Investment Bank (EIB).

**Palabras clave:** Gastos en defensa de la UE, Marco Financiero Plurianual, Presupuesto de la Unión Europea, Fondo Europeo de la Defensa (FED), Fondo Europeo de Apoyo a la Paz (FEP), Banco Europeo de Inversiones (BEI).

## 1. INTRODUCTION

The increase in defence spending in Europe following Russia's invasion of Ukraine has not only affected the budgets of European countries. The European Union (EU) has also increased its funds to cooperate in the form of military aid for Ukraine and to promote the defence industry in Europe. These funds, which are still modest, are rapidly increasing, given the continuing insecurity in Europe, as new financial and regulatory instruments are put in place to help make them more effective in the future. The next few years will be crucial to assess the functioning of these new mechanisms in order to decide on the best possible financial coverage of European defence from 2028 onwards. This is a technically complex issue, as it concerns novel financial mechanisms that affect European integration itself, but it is also a highly topical one where the aim is to provide a clear overview given the abundant information available in the press and online.

This article begins by describing this widespread increase in defence spending and the limitations existing in the EU and then goes on to describe the various instruments, by reference to the EU budget, almost all of which have been recently created, that enable military spending to be funded: either exclusively out of the EU budget or through the EU budget and the budgets of the Member States – these are referred to as "mixed" – and, finally, those that are funded exclusively by the contributions of the Member States (MS). The role that the EIB can play is also reviewed.

The conclusions provide a short and medium-term outlook on the possible evolution of this type of expenditure in the EU on the basis of recent regulatory and financial developments in the field of defence, the EU budget timetable and the expected development of events.

## 2. THE WIDESPREAD INCREASE IN DEFENCE BUDGETS IN EUROPE. LIMITATIONS IN THE EU

Russia's invasion of Ukraine has led to a geopolitical shift in Europe and increased military spending. Whereas in 2016 only five NATO countries reached 2% of GNP, there are now 11 according to the Secretary General of NATO; but 18 of the 31 NATO Member States will surpass this symbolic percentage this year (2024).<sup>1</sup> Germany may reach 2% this year<sup>2</sup>, France in 2027<sup>3</sup>, and Spain, which currently spends 1.3% of its GNP on defence, expects to reach it in 2029, although this target seems particularly complicated for that time horizon: "... the main question is what will be the trajectory to achieve that situation and approach a trend from 2024 onwards. The result shows that a very significant effort is needed from 2027 onwards according to current projections." (Fonfría and Calvo, 2023, p. 13).

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<sup>1</sup> Press conference by NATO Secretary General J. Stoltenberg, 14 February 2024

<sup>2</sup> The German Press Agency *Deutsche Presse-Agentur* (DPA) advanced the figure of €68.58 billion as this year's German defence budget expenditure, which is in fact 2.01% of Germany's GDP, later confirmed by a German Defence Ministry spokesperson. Chancellor Scholz announced in February 2024 the creation of a new fund of €100 million that would allow defence spending to exceed 2% of GNP.

<sup>3</sup> *Fondation pour la recherche sur les administrations et les politiques publiques* (IFRAP): "Budget militaire : la France doit se doter d'un fonds spécial de 57 milliards" 23 May 2023. <https://www.ifrap.org/etat-et-collectivites/budget-militaire-la-france-doit-se-doter-dun-fonds-special-de-57-milliards>

According to the European Defence Agency<sup>4</sup>, defence spending in the EU increased by 6% in 2021 compared to 2020, and in six EU Member States this increase exceeded 10%. In Sweden it increased by 30%. According to Maulny (2023), budget increases were particularly significant in Austria, the Baltic States, Slovakia, Slovenia and particularly in Poland, with a 46% increase from 2022 to 2023. However, according to EU High Representative J. Borrell, by the end of 2023 the defence spending of the EU-27 was still at an average of 1.5% of Gross National Product (GNP), and €75 billion per year would have to be added to reach the 2% target.<sup>5</sup>

By 31 October 2023, the United States had committed €43.9 billion in military aid to Ukraine, the EU Member States and institutions had committed €41.4 billion, and other non-EU NATO allies (Canada, Iceland, Norway, Turkey, the UK, etc.) had committed €12.4 billion which, according to the *Ukraine Support Tracker* of the Kiel Institute for the World Economy (IfW Kiel), amounts to a total of €97.7 billion. This amount may have increased substantially following the US Senate's recent approval of the \$60 billion-plus aid package for Ukraine. This has so far enabled Ukraine to cope with the Russian army's invasion.

Russia, for its part, is reported to have been increasing its defence spending from 3.6% to 4.3% last year which, according to High Representative Borrell himself, is a 70% increase in its defence budget in 2022 compared to 2023. As for Russia, 30% of its budget and 6% of its GNP are currently devoted to defence, and that is without counting additional resources considered as classified expenses.<sup>6</sup> He also added that: "The economic growth recorded in Russia in 2023 was the classic result of a policy of 'wartime Keynesianism' already seen in Germany in the 1930s" (Borrell, 2024).

According to the Stockholm International Peace Research Institute (SIPRI), Ukraine, excluding the military donations received from allies, increased its defence spending by more than 50% (\$64.8 billion), spending 37% of its GNP on defence, which accounts for 58% of all government spending.<sup>7</sup>

The 2% defence target has become a necessity in Europe following D. Trump's comments on what the US would do (or not do) if he were president in the event of a Russian invasion of an ally country that did not invest sufficiently in defence. If NATO were no longer a sufficient guarantee for collective defence in the event of external aggression (Art. 5 of the Washington Treaty), European partners would not only have no choice but to substantially increase their national defence spending in order to deal with this potential threat but also do everything in their power to strengthen their regional

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<sup>4</sup> EDA *Defence Data Report 2022 Key findings and analysis*. <https://eda.europa.eu/publications-and-data/brochures/eda-defence-data-2022>

<sup>5</sup> *Speech by High Representative Josep Borrell at the EDA Annual Conference 2023*. 30 November 2023. [https://www.ecas.europa.eu/ecas/defence-speech-high-representativevice-president-josep-borrell-eda-annual-conference-2023\\_en](https://www.ecas.europa.eu/ecas/defence-speech-high-representativevice-president-josep-borrell-eda-annual-conference-2023_en)

<sup>6</sup> *Blog by Josep Borrell, High Representative of the European Union for Foreign Affairs and Security Policy / Vice-President of the European Commission: "No, time is not on Russia's side"* 4 April 2024. [https://www.ecas.europa.eu/ecas/no-time-not-russia%E2%80%98s-side\\_en](https://www.ecas.europa.eu/ecas/no-time-not-russia%E2%80%98s-side_en)

<sup>7</sup> SIPRI. *Global military spending data*. Press release 22 April 2024. *Global military spending surges amid war, rising tensions and insecurity*. <https://www.sipri.org/media/press-release/2024/global-military-spending-surges-amid-war-rising-tensions-and-insecurity>

military cooperation, for example by seeking closer ties with EU Member States. And this is exactly what is already happening, slowly but inescapably.

European public opinion is in favour of increased cooperation on defence matters in the EU. According to the Standard Eurobarometer 100 (autumn 2023), 79% of Europeans believe that defence cooperation should be increased, and 69% believe that the EU should strengthen its capacity to produce armament, while 60% believe that the EU should fund the purchase and supply of weapons to Ukraine.<sup>8</sup>

In the political sphere, the informal meeting of the European Council held in Versailles on 11 March 2022, just days after Russia's invasion of Ukraine, committed to strengthening Europe's defence capabilities. Among other actions, the EU's heads of state and government agreed to increase defence spending and intensify cooperation through joint projects and the joint acquisition of defence capabilities.<sup>9</sup> The mandate was also included in the so-called "Strategic Compass for Security and Defence" endorsed at the same European Council meeting. It should be added that the European Council has subsequently reiterated this willingness to fulfil the shared commitment to substantially increase defence spending, most recently at the European Council meeting of March 2024.<sup>10</sup>

Defence is a national power *par excellence*, even if the Commission is playing an increasingly important role in such matters, to the point that there has been talk of the need to create a new portfolio for a Defence Commissioner at the next European Commission. Reflecting the fact that defence is intergovernmental, the largest share of defence spending in the EU by far comes directly from Member States' national budgets.

Heading 5 of the EU's Multiannual Financial Framework (MFF) 2021-2027 on Security and Defence amounts to €13.185 billion and covers internal security (e.g. terrorism, organised crime, cybercrime and external management of illegal migration), crisis response and nuclear decommissioning, but also defence. Despite this, and despite the fact that it is also a new heading, probably chosen to highlight the growing importance attributed to the Common Security and Defence Policy (CSDP), defence-specific spending in the EU is still modest. However, there are other funds in the EU budget that may also affect defence and are not listed as such under Heading 5. This category (Engberg, 2021, p.16) includes, for example, those funds – €13.202 billion – allocated under Heading 1 (Single Market, Innovation and Digital) to the EU Space Programme managed by the Directorate-General for Defence Industry and Space (DG DEFIS). But even so, and adding up all possible indirect military spending under this and other headings, these amounts are relatively modest in relative terms in the context of the EU budget.

But they are growing, which is all the more striking given the political legal impediment posed by Article 41(2) of the Treaty on European Union (TEU) which, after allowing CFSP/ESDP operational administrative spending from the budget, expressly excludes expenditure on operations with military or defence implications.

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<sup>8</sup> <https://europa.eu/eurobarometer/surveys/detail/3053>

<sup>9</sup> <https://www.consilium.europa.eu/media/54800/20220311-versailles-declaration-es.pdf>

<sup>10</sup> EUCO 7/24. Page 5. <https://www.consilium.europa.eu/media/70880/euco-conclusions-2122032024.pdf>

Thus, whenever it has been necessary to fund expenditure with military implications from the budget, the Commission has based its proposals on legal grounds other than Article 41(2), based on other articles of the Treaty, such as the promotion of R&D or the Internal Market. The conflict in Ukraine, which has generated a greater volume of investment and new legislative measures related to defence, as discussed throughout this article, has only made the use of these new legal grounds more widespread so as not to clash with this express prohibition of primary EU law. Likewise, in order to carry out this policy (Rodrigues, 2014), the EU has resorted to greatly increasing the number of possible initiatives within the EU budget, supporting the activity of other players, such as the European Defence Agency (EDA) or the use of other instruments, especially the European Peace Facility (EPF), which is (Teodoro, F. 2021) another example of the EU's desire to be more effective in an increasingly complex world.

There is also a second difficulty, in this case of an institutional nature, that makes it difficult – although not impossible<sup>11</sup> – to fund military expenditure in the EU: the unanimity rule. Although the UK's exit has allowed for greater flexibility in the funding of indirect military spending by the EU, its implementation always results in various types of reluctance by some Member States: either because of the pacifist nature of the foreign policies of some, such as Austria, Ireland, Malta and Cyprus, the close relations of others with Putin's Russia (Hungary), or different opinions between Member States when it comes to implementing joint military support measures – Germany and other so-called "frugal" states (Austria, the Netherlands, Sweden, etc.) generally prefer national contributions.

### 3. EU DEFENCE FUNDING INSTRUMENTS

What most of the following instruments have in common is that they have generally been created fairly recently, they are funded entirely from the EU budget and they are regularly reassessed to see how they are working, with the aim of examining, if necessary, whether they should be maintained, reformed or abolished beyond 2028, at the time of the next MFF.

#### 3.1 The European Defence Fund (EDF)

In 2017 the Commission proposed the Preparatory Action on Defence Research (PADR), with a budget of €90 million for the period 2017-2019, which was implemented in collaboration with the European Defence Agency (EDA) and has funded up to 18 research projects considered as high priority. Regulation 2018/1092 of 18 July 2018 approved the European Defence Industrial Development Programme (EDIDP) to support the competitiveness and innovation capacity of the EU defence industry, the first EU programme with the ability to subsidise capability development and co-fund the joint

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<sup>11</sup> Art. 31(1) TEU regulates the so-called "constructive abstention", which allows a Member State to abstain from voting in favour of a given action but without blocking it. Similarly, under Art. 5.2 of Council Decision 2021/509 of 22 March 2021 (governing the EPF), if a Member State abstains from approving a Council decision endorsing a military operation and issues the formal declaration required by Article 31(1) TEU, it will not be obliged to contribute financially to the operation, and this does not prevent the operation from going ahead. Art. 27 of the above-mentioned Council Decision states that, if the operation or support measure consists of the supply of military equipment, that Member State shall make its additional contribution with a different type of equipment but of the same value as would apply to it according to its GNP (non-military, non-lethal, etc.).



development of defence products and technologies, with a budget of €500 million during 2019-2020. These two programmes, entirely funded by the EU budget, were the precursors of the European Defence Fund (EDF) approved by Regulation 2021/697 on 29 April 2021 to co-fund European collaborative projects in the field of defence research and capability development.

This is the most important defence programme, in financial terms, of the MFF 21-27. The EDF has a budget of €13 billion for the period 2021-2027, divided into two core areas:

- €4.1 billion to be allocated to funding collaborative defence research to address emerging and future security threats, making the EU the third largest defence research investor in Europe in its own right.
- €8.9 billion to co-fund collaborative capability development projects to supplement national contributions.

Without replacing Member States' efforts, it promotes cooperation between companies and research players across the EU and Norway, supporting competitive and collaborative defence projects throughout the research and development cycle, focusing on projects that lead to advanced defence technologies and equipment. The working plan and priorities are defined on the basis of the priorities agreed by the Member States in the framework of the CSDP. In addition to being able to fund priority projects agreed by the Member States in the framework of the CSDP and other regional and international organisations, it can also fund collaborative projects involving at least three Member States, promote cross-border activities of small and medium-sized enterprises (SMEs), co-fund common prototypes and promote projects in the framework of Permanent Structured Cooperation (PESCO).

It is managed directly by the Commission through annual programmes split into 34 horizontal and thematic categories covering the entire military spectrum, within the Programme Committee, with the participation of representatives of the Member States, the European Defence Agency (EDA) and the European External Action Service (EEAS).

The EU Defence Innovation Scheme (EUDIS), endowed with €2 billion until 2027 (€1.46 billion from the EDF and the rest from European public and private investors), was also created as part of the EDF to facilitate the participation of smaller players and innovators in the European defence sector and to increase the EU's competitiveness in the field of critical technologies. Following the provisional agreement reached by the Council and the Parliament in February this year, the Strategic Technologies for Europe Platform (STEP) will be created, with an additional €1.5 billion in funding for the European Defence Fund to increase investment in critical technologies.

### 3.2 Military Mobility

Of the financial resources allocated to defence, those that facilitate military mobility, particularly at times of crisis, play an important role. The need to facilitate the transport of forces and armaments between Member States has been an essential element for both NATO and the EU in their efforts to improve defence on the continent. In fact, this is seen as a key element in NATO-EU cooperation. The US, Canada, Norway and the UK have joined a PESCO Military Mobility project led by the Netherlands.

The Strategic Compass pointed to the need to improve military mobility within and beyond the EU's borders, particularly in the wake of the invasion of Ukraine. A new Action Plan on Military Mobility 2.0 (2022-2026) that is evaluated every year proposes additional actions to improve the European mobility framework to reduce reaction times, creating more capable, safer, sustainable and resilient transport infrastructures and capabilities.

After a significant cut in funds, the ceiling of the programme under Heading 5 of the MFF is €1.69 billion. Its aim is to improve the EU's transport and other infrastructure to adapt it to the needs of military mobility. It covers both civilian and military structures with the aim of investing in infrastructure and removing administrative difficulties hindering their use.

These actions are similarly eligible for funding from the Connecting Europe fund (which can fund dual-use infrastructure projects) with an endowment of €1.5 billion and from the EDF (support for the development of interoperable digital and logistics systems).

The EU is supporting with €807 million a total of 38 military mobility projects, such as the renovation of railway facilities in ten EU Member States, which will help make key investments in infrastructure for dual civilian and defence use, which is crucial in light of the war in Ukraine. The projects also help strengthen the EU-Ukraine Solidarity Lanes.

### 3.3 The European Defence Industry Reinforcement Through Common Procurement Act (EDIRPA)

The European Defence Industry Reinforcement Through Common Procurement Act (EDIRPA) is contained in Regulation 2023/2418 adopted on 18 October 2023, with a legal basis in Art. 173.3 (R&D) of the Treaty on the Functioning of the European Union (TFEU), and builds on the work of the Defence Joint Procurement Task Force, which works with Member States to coordinate very short-term defence procurement needs for the replenishment of stocks, in particular in view of the support provided to Ukraine. This was an emergency solution to replenish the arms stocks that were being emptied as a result of donations to Ukraine and allow supplies to Ukraine to continue.

The Commission pledged to provide €300 million from the EU budget (€500 million was initially proposed) over two years (2023-2025). The Act provides incentives for common procurement by the Member States and facilitates their access to urgently needed defence products. It seeks to prevent Member States from competing for the same products and helps save costs. It will strengthen interoperability and enable the EU's Defence Technological and Industrial Base (EDTIB) to better adapt and increase its manufacturing capabilities to deliver the necessary products. The Act will support actions by consortia composed of at least three Member States. Eligible actions may include new defence procurement projects or the extension of those started since the outbreak of the war.

EDIRPA is an unprecedented mechanism: there is no other European law that encourages Member States to engage in collective procurement (Fiott 2022).

### 3.4 The Act in Support of Ammunition Production (ASAP)

Regulation (EU) 2023/1515 establishing the Act in Support of Ammunition Production (ASAP) has a budget of €500 million (2023-2025) to increase production of ammunition and missiles, with Article 114 TFEU (approximation of laws / Internal Market) as its legal basis. Its aim is to ensure that European companies have the capacity to urgently export to Ukraine, as well as to allow Member States to replenish their stocks.

A new mixed funding facility called the Ramp-up Fund could potentially be created, with a budget of €30 million to provide loans to mobilise, reduce risk and accelerate the investment needed to increase production capacity. Unlike the investment itself, which will be managed directly by the Commission, this new fund would be managed indirectly by other EU bodies, such as the European Investment Bank (EIB) or non-EU bodies.

## 4. MIXED (BUDGETARY AND EXTRABUDGETARY) FUNDING INSTRUMENTS

This section includes EU defence expenditure that, although coming mostly from the contributions of the Member States, also receives contributions, albeit still modest, from the EU budget.

### 4.1 The European Defence Agency (EDA)

The EDA was established 20 years ago now and assists the 27 Member States to improve their defence capabilities through cooperation. Its expertise and networks allow it to cover a broad spectrum of defence activities, including research and innovation for technology development, training and maintenance exercises in support of CSDP operations or the harmonisation of requirements for the achievement of operational capabilities. The EDA is currently the key institutional point of reference for EU defence-related cooperative issues.

In 2017, it was decided to reinforce its core mission as a cooperation forum and management support structure for participating Member States, notably in military technology and capability development activities, acting as a central operator for EU-funded defence activities.

It is based in Brussels and led by the High Representative (HR) himself through a Chief Executive. Like the EU's other decentralised agencies, it was created to assist the Commission in the management of specific areas, in this case defence matters.

The EDA is funded mainly with contributions from participating Member States based on their respective GDPs. However, since 2016 it can also receive deductions from the EU budget itself, on a case-by-case basis, and even contributions from third countries. Its annual budget in 2023 was €43.5 billion, and €1.487 billion was earmarked in the MFF 2021-2027 for that period for "EU agencies", of which the EDA takes the lion's share.

## 4.2 Permanent Structured Cooperation (PESCO)

The Treaty on European Union (TEU) makes PESCO possible – Arts. 42.6 and 46 – by allowing Member States with more advanced military capabilities to establish an institutional framework among themselves within the EU. Protocol No. 10 on PESCO specifies that it is open to any State with higher capabilities through the development of national contributions and their participation in multinational forces, in major European equipment programmes and in EDA activities in the field of defence capabilities, research, acquisition and armaments. The June 2017 European Council<sup>12</sup> agreed on the need to launch an inclusive and permanent PESCO to strengthen European security and defence and help achieve the level of EU ambition expressed in the 2016 Global Strategy.

In November 2017, ministers from 23 Member States signed a joint notification on PESCO.<sup>13</sup> Two more Member States joined in December 2017. On 23 May 2023, Council Decision (CFSP) 2023/1015 of 23 May 2023 formally confirmed the participation of Denmark in PESCO, setting the number of participating Member States at 26. In fact, all of them except Malta. Its Secretariat is composed of the EDA, the EEAS and the EU Military Staff.

Although PESCO is in principle funded by the participating Member States, including administrative costs, its projects may receive contributions from the general EU budget, in compliance with the Treaties and in accordance with the relevant EU instruments, amounting to approximately 10% of the total. The administrative expenditure of the EU's institutions and the EEAS incurred by PESCO is also covered by the EU budget. In its first phase of existence, PESCO has 68 projects in progress.

According to its 2023 Annual Report<sup>14</sup>, PESCO accounts for a very small share of Member States' contributions to capability development. However, many wish for greater coordination in their respective military planning, which at the moment is largely confined to the national level. HR Borrell himself considers that the level of ambition needs to be raised, because PESCO's current projects are rather on the periphery of European military capacity, when they should really be at the heart of those capabilities, and he gave as an example the new generation of warships.<sup>15</sup>

That said, PESCO does not operate in a vacuum but has been able to accumulate a wealth of experience in coordination with the EDA. There are therefore high hopes for improved coordination and a better type of joint project in the new project cycle from 2026 onwards. Areas of interest could include trying to reverse the declining research and technology spending trend<sup>16</sup>, encouraging prioritisation of European projects, enabling

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<sup>12</sup> EUCO 8/17 <https://www.consilium.europa.eu/media/23969/22-23-euco-final-conclusions-es.pdf>

<sup>13</sup> <https://www.consilium.europa.eu/media/31511/171113-pesco-notification.pdf>

<sup>14</sup> <https://data.consilium.europa.eu/doc/document/ST-12112-2023-INIT/en/pdf>

<sup>15</sup> [https://www.eeas.europa.eu/eeas/defence-speech-high-representativevice-president-josep-borrell-eda-annual-conference-2023\\_en](https://www.eeas.europa.eu/eeas/defence-speech-high-representativevice-president-josep-borrell-eda-annual-conference-2023_en)

<sup>16</sup> The decrease in this type of investment in Europe is very striking but, according to HR Borrell in his November 2023 speech at the EDA Annual Conference, (military) R&D expenditure decreased by almost 6% in 2022 compared to 2021. [https://www.eeas.europa.eu/eeas/defence-speech-high-representativevice-president-josep-borrell-eda-annual-conference-2023\\_en](https://www.eeas.europa.eu/eeas/defence-speech-high-representativevice-president-josep-borrell-eda-annual-conference-2023_en)

greater cross-border cooperation by European industry and encouraging a joint and shared use of capabilities.

### 4.3 The European Defence Industry Programme (EDIP)

The proposed Regulation (European Defence Investment Programme, EDIP) presented by the European Commission in 2023 represents a crucial step towards a stronger and more unified European defence industry. With a modest budget of €1.5 billion for the period 2025-2027, this programme combines financial and regulatory measures to boost innovation, collaboration and production capacity in the defence sector. The programme will also contribute to the EU's strategic autonomy by reducing dependence on external defence equipment suppliers.

In terms of funding, it is an extension of EDIRPA and ASAP and supplements both programmes by providing financial support for cooperation at the contracting stage and to expand production capacity respectively. The programme will support the industrialisation of EDF-funded products resulting from cooperative research and development. The EDIP budget will also be used to strengthen EU industrial cooperation with Ukraine in defence matters, supporting the development of its industrial and technological base in this field. EDIP will enable the implementation of European defence projects of common interest with possible financial support from the EU. It is expected to have a strong impact on the industry that can further increase its production capacity. As the HR stated before the Ukrainian Parliament in February 2024, "the production capacity of the European defence industry has already increased by 40% since the beginning of the war" (Borrell).<sup>17</sup>

The measures announced include, among others: a Fund to Accelerate defence Supply chains Transformation (FAST) to facilitate access to funding (debt or equity) for SMEs and mid-cap companies that industrialise defence technologies or manufacture defence products. At the regulatory level, a new legal framework, the Structure for European Armament Programme (SEAP), is created to facilitate and extend cooperation between Member States on defence equipment, including in the framework of PESCO. Member States that meet specific conditions will be able to access a higher percentage of funding and simplified and harmonised procurement processes. A European Military Sales Mechanism (EMSM) has also been proposed to promote the availability of EU equipment in terms of time and volume, and a Defence Industrial Readiness Board is established, comprising representatives of the Member States, the Commission and the High Representative, to oversee joint armament programming and procurement missions, as well as the implementation of the programme.

In conclusion, EDIP is a very recent but crucial instrument for strengthening Europe's defence industry and ensuring the security and defence of the continent that will boost innovation, collaboration and production capacity, consolidating the EU's position as a global player in defence matters. It is true that its limited financial endowment leaves much to be desired and spectacular results should not be expected in the short term (Clapp, 2024), but its implementation and development in the coming years should be

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<sup>17</sup> <https://legrandcontinent.eu/es/2024/02/12/borrell-en-kiev-europa-debe-apoyar-a-ucrania-cueste-lo-que-cueste/>

closely monitored. Its greater or lesser effectiveness will translate into greater financial ambition from 2027 onwards, but especially in the next MFF, from 2028 onwards.

## **5. EXTRABUDGETARY FUNDING INSTRUMENTS: THE EUROPEAN PEACE FACILITY (EPF)**

This section deals exclusively with the European Peace Facility (EPF), which has in fact become the most suitable financial vehicle for channelling military aid to Ukraine, given the legal limitation of being able to do so through the EU budget, even though it was not originally conceived for this purpose. As Schmidt (2021) says, there is probably no other project that better describes the EU's transition from peace project to military power than the EPF. As of November 2023, military support to Ukraine has taken up 83% of the total.

The EPF was created in 2021 (Council Decision (CFSP) 2021/509) as an EU extrabudgetary facility, merging the African Peace Facility (created in 2003 to support peacekeeping operations on that continent, around 25, which by the end of 2020 had taken up around €4 billion) and the Athena mechanism (an instrument created in 2004 to fund the common costs of EU military operations based on Member States' contributions). Some have seen in its creation and conception as an extrabudgetary financial mechanism the EEAS's desire to give institutional competence to the Commission (Dumoulin, 2023, p.9) because it is a CFSP mechanism whose implementation is the responsibility of the HR with the support of the EEAS, albeit with the assistance of two administrators: one from the Commission (European Commission's Service for Foreign Policy Instruments; FPI) for support measures and one from the General Secretariat of the Council (GSC) for the administration of the common expenditure of CSDP operations.

The HR proposed its use, and the Council made the decision, with the support of the Political and Security Committee (PSC), a preparatory body of the Foreign Affairs Council composed of ambassadors from the 27 Member States and always chaired by the EEAS, which gives strategic and political direction to EPF actions. It has its own legal personality, and each State's contribution is determined according to its GNP. It is managed by a Committee (Art. 11(7) of Council Decision CFSP 2021/509) chaired by the representative of the Member State holding the rotating presidency of the Council and composed of representatives of the Member States (whose meetings may be attended, without voting rights, by a representative of the Member State that has abstained on the operation or supporting measure), and to which representatives of the EEAS, the Commission, the EDA, contributing third countries and other interested parties are invited (also without voting rights). The administrators, commanders and auditors of the operations or support measures are also involved. Decisions are binding and taken unanimously.

It has two core areas: one for military operations and one for support measures. Its purpose is to provide funding for the common costs of all CSDP actions, to contribute to the funding of military peace support operations led by other international players and to participate in broader actions aimed at supporting a partner country's armed forces with military infrastructure, equipment or assistance, as well as in other operational actions in the framework of the EU's CFSP with military implications, when so defined by the Council.

A large percentage of the costs associated with military operations in the EU must be borne by the Member States themselves in accordance with the "*costs lie where they fall*" principle. However, the costs considered as common costs, as set out in Annexes II to V of the above-mentioned Council Decision, are funded by the EPF. This category includes, *inter alia*, HQ running and implementation costs, including travel, IT systems, administration, public information, local employment, deployment, shelter, force support, infrastructure, medical services, satellite support, payments to international agencies and specific troop deployment costs. Depending on the Council Decision, transport and accommodation of troops etc. are also included.

Since its creation in 2021, it is now possible to use this mechanism worldwide and not just in Africa, which has made it possible to support the strengthening of the stability and security of 22 countries and organisations in three main areas neighbouring the EU: Africa: close to €1 billion has been allocated to operations led by the African Union and regional organisations, as well as to the armed forces of eight African countries to improve their ability to fight terrorism, piracy and organised crime; the Western Balkans and Eastern Neighbourhood: the EPF has supported regional military cooperation, as well as Bosnia and Herzegovina and North Macedonia, seeking to strengthen security and stability in the region and to contribute to European integration and to Moldova and Georgia; Mediterranean neighbours: Jordan and Lebanon have received assistance from the EPF to enhance their security capabilities in the face of external threats and to promote peace and stability in their regions.

In addition, cooperation with NATO has been strengthened in areas such as space, cybernetics, climate and defence, and bilateral security and defence relations have been broadened and deepened with countries such as Norway, Canada, Georgia, Moldova, South Africa, Rwanda, Japan, South Korea, Australia, Chile and Colombia.

With an initial budget of €5 billion for the period 2021-2027, given the situation in Ukraine, the budget was increased by €2.29 billion in March 2023 and by €4.06 billion in June 2023, plus an additional €5 billion in March for the supply of arms to Ukraine under a new fund: the Ukraine Assistance Fund. Around €17 billion in total (from 2021 to 2027). Priority will be given to the supply of EU-made arms, but they can be obtained outside the EU if this is the only possibility.

Although it is a fund fed by national budgets, direct supplies to Ukraine by the Member States are considered in-kind contributions to be deducted from the cash contributions to the EPF. The intention is to ensure a coordinated approach and resolve any conflicts that may arise from its very short-term procurement needs to deal with the new security situation. Despite this, there have been many frustrating delays in reimbursements to Member States, as military support to Ukraine has sometimes required a very rapid implementation of actions, even before completing in-depth discussions on them.

In the light of the prohibition of Art. 41(2) TEU on funding military operations out of the EU budget, joint extrabudgetary funding, mainly through the EPF, by Member States with the participation of all or only some Member States, according to a distribution method based on GNP, has proved to be the most pragmatic, preferred and most commonly used funding formula and is likely to remain so for the foreseeable future.

Obviously, it would always be possible to make it feasible for the EU budget to fund operations with military or defence implications in the future, but this would require a reform of the Treaty – removing the reference in Art. 41(2) – which is impossible given the unanimity rule and in view of the position of some more neutral or Putin-friendly Member States. Perhaps a new treaty could be negotiated among the more willing Member States to allow for this. But in this second option, military funding would no longer be provided by the current EU but by a new international organisation with a different composition from the EU, made up of those States that joined it. Nor do I believe that any of these complicated options will be retained for the foreseeable future unless circumstances change dramatically.

Finally, in the framework of the EPF and support for Ukraine, mention should be made of the EU Military Assistance Mission in support of Ukraine (EUMAM Ukraine) created in November 2022, which allows for the training of Ukrainian military personnel at different levels and specialisations (such as chemical, biological, radiological and nuclear (CBRN) medical assistance, demining, logistics and communications, maintenance and repair, among others). To date, some 60,000 Ukrainian soldiers have been trained in this way on the territory of the 24 participating Member States, and the number will continue to rise given the recent decision to increase its capacity. It is also open to the participation of third countries, and military equipment (lethal and non-lethal) is provided by each participating Member State with financial support from the EPF.

Another important matter recently funded by the EPF has been the 2023 commitment to the urgent and joint supply of ammunition and missiles to Ukraine. The first stage, carried out in April 2023 and endowed with €1 billion, has enabled the Member States to be reimbursed for equipment donated to Ukraine from existing stocks. The second stage, carried out in May of the same year and endowed with a further €1 billion, supports the joint supply of ammunition and missiles from economic operators based in the EU and Norway. It is important to note that, in addition to these donations by the EU and its Member States, the European defence industry is also delivering additional artillery ammunition to Ukraine under standard commercial contracts.

## **6. THE POSSIBLE ROLE OF THE EUROPEAN INVESTMENT BANK (EIB)**

The basis for security and defence financing by the EIB stems from its "Strategic European Security Initiative" (SESI), which was approved by its Board of Directors in March 2022 to replace an earlier one. Its aim was to mobilise investment in support of dual-use security and defence systems by supporting Europe's technology industry and civil infrastructure.

In June 2023, the EIB increased its endowment from €6 billion to €8 billion by 2027 – of which only €2 billion has been used to date – for eligible projects to achieve EU security and defence goals in relation to research and development and advanced technologies ranging from artificial intelligence and quantum technologies to cybersecurity and biosecurity, civil security infrastructure and dual-use projects, which are used for both civil and military purposes.

The Defence Equity Facility (DEF) was announced last January with a capital of €175 million, €100 million from the EDF and the rest from the European Investment



Fund<sup>18</sup>, to invest in SMEs and start-ups between 2024 and 2027 to develop innovative defence technologies with dual-use potential, i.e. with both civilian and military applications.

That said, the possible financial reinforcement of EIB support to the defence sector has been one of the issues recently analysed by the EU with a view to improving funding possibilities for military industry through its joint procurement loans in addition to its ongoing dual-use support. The EIB could also play an important role with its lending policy in terms of increasing short-term defence industry production and contributing to long-term modernisation.

This is why the main EU institutions have been calling on the EIB to change its lending policy and allow the financing of military equipment. Thus, very recently, in the text of the 2024 European Defence Industrial Strategy, the Commission directly asked the governing bodies of the EIB Group to review their lending policies this year and adapt the current defence-related exclusions in line with the EU's political priorities and the applicable legislation.<sup>19</sup> This was also expressly requested by the European Parliament in its resolution of 28 February 2024 on the financial activities of the European Investment Bank (annual report).<sup>20</sup> The European Council meeting held in March in turn once again invited the EIB to "adapt its lending policies to the defence industry, as well as its current definition of dual-use products, while safeguarding its financial capacity".<sup>21</sup>

Technically, there is nothing to prevent the EIB from investing in purely military projects. The shareholders are the Member States, and a simple majority could change the bank's investment criteria. However, some Member States share the view of some investors that excessive credit risk in defence could lead the EIB to lose its AAA rating, the highest on the bond market, which currently allows it to borrow on the financial markets at particularly favourable rates.

It thus seemed that a change in the EIB's lending policy with respect to military investments was on the cards with the change in president, and the fact is that its new president, Nadia Calviño, seems to have listened to institutional appeals. She thus presented the EIB's new Security and Defence Industry Action Plan to the EU's Finance Ministers in February, which received strong support; and more recently, on 8 May, the EIB's Board of Directors finally agreed to update its definition of "dual-use projects". The EIB will henceforth waive the previous requirement for dual-use projects eligible for financing in the area of security and defence to derive more than 50% of their expected revenues from civilian use. Similarly, projects and infrastructure used by the armed forces

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<sup>18</sup> This fund is part of the EIB Group, whose majority shareholders are the EIB itself (65%) and the Commission (29% through the EDF), but which also includes a large group of public and private banks and other financial institutions.

<sup>19</sup> *A new European Defence Industrial Strategy: Achieving EU readiness through a responsive and resilient European Defence Industry*, of 5 March. Pages 26 and 28.

[https://defence-industry-space.ec.europa.eu/document/download/643c4a00-0da9-4768-83cd-a5628f5c3063\\_en?filename=EDIS%20Joint%20Communication.pdf](https://defence-industry-space.ec.europa.eu/document/download/643c4a00-0da9-4768-83cd-a5628f5c3063_en?filename=EDIS%20Joint%20Communication.pdf)

<sup>20</sup> 2023/2229 (INI) "calls on the EIB to reform its eligibility list so that ammunition and military equipment that go beyond dual-use application are no longer excluded from EIB financing" [https://www.europarl.europa.eu/doceo/document/TA-9-2024-0107\\_EN.html](https://www.europarl.europa.eu/doceo/document/TA-9-2024-0107_EN.html)

<sup>21</sup> EUCO 7/24. Page 5, paragraph 15 b). <https://www.consilium.europa.eu/media/70880/euco-conclusions-2122032024.pdf>

or the police that also serve civilian needs will now be eligible for EIB financing. There will no longer be a minimum threshold for expected revenues from civilian applications or the proportion of civilian users.<sup>22</sup> Time will tell whether these reforms are sufficient or whether further adaptations to the EIB's lending policy will be required.

## 7. CONCLUSIONS

In the light of the above, a number of conclusions can be drawn about possible future short- and medium-term scenarios in relation to the funding of military expenditure by the EU and its Member States:

1. All indications are that general aid to Ukraine and military aid in particular from the EU and its Member States will continue or even increase.

According to the European Commission, the total amount of EU and Member States' bilateral military aid to Ukraine to date<sup>23</sup>, has been €32 billion. According to HR Borrell, this amount could reach €21 billion in 2024 alone<sup>24</sup>.

The mid-term revision of the MFF a few months ago introduced some proposals for increased funding in this regard, such as a new €50 billion financial facility (Ukraine Facility) for the reconstruction of Ukraine that was finally approved by the European Council last January.

The conclusions of the March 2024 European Council<sup>25</sup> are clear on this point: ... "The European Union is determined to continue providing Ukraine and its people all the necessary political, financial, economic, humanitarian, military and diplomatic support for as long as it takes and as intensely as needed." "At this critical moment, the European Union and Member States will speed up and intensify the delivery of all the necessary military assistance." This provision entails using all available possibilities, whether they involve using the budget or specific contributions from all or some Member States. As discussed above, a boost to the EIB's lending activity in these areas is more than likely.

It is therefore a foregone conclusion that, given the security situation in Europe, defence budgets will continue to grow significantly in both Member States and the EU unless the geopolitical situation changes for the better, which is not expected to happen in the short to medium term. Moreover, had Congress persisted in blocking the US government from approving a new military package to Ukraine, which fortunately has

<sup>22</sup> Defensa.com of 13 May 2024 <https://www.defensa.com/otan-y-europa/banco-europeo-inversiones-facilitara-financiacion-industria>

<sup>23</sup> *EU military support to Ukraine* [https://eu-solidarity-ukraine.ec.europa.eu/eu-assistance-ukraine/eu-military-support-ukraine\\_en](https://eu-solidarity-ukraine.ec.europa.eu/eu-assistance-ukraine/eu-military-support-ukraine_en)

<sup>24</sup> *EU Defence ministers meeting: Member States ready to commit €21 billion for military assistance to Ukraine in 2024*. 1 February 2024 <https://eunighbourseast.eu/news/latest-news/eu-defence-ministers-meeting-member-states-ready-to-commit-e21-billion-for-military-assistance-to-ukraine-in-2024/>

<sup>25</sup> EUCO 7/24. <https://www.consilium.europa.eu/media/70880/euco-conclusions-2122032024.pdf>

not been the case, there would have been more political pressure on European governments to urgently try to fill the gap to the extent possible.

2. As the EU's collective defence spending increases, its effectiveness will also improve. As the single defence market is gradually refined, this improvement will be reflected in the European defence industry.

Given the huge funds that have been talked about to rebuild and boost Europe's defence industry, the amounts allocated so far for defence spending in the EU are, despite their increase, still limited. That said, with a budget expenditure of €1.283 billion in the 2023 budget, the EU appears for the first time as an independent entity in the records of the Stockholm International Peace Research Institute (SIPRI), with a similar amount of defence spending to the defence budgets of Bulgaria, for example.

Certainly, taking advantage of the overall increase in defence budgets, which is set to continue, many believe that this may be an ideal, perhaps decisive, moment to drive European integration forward. Seeking to concentrate defence spending as a priority on collective action at the EU level to the detriment of national investment as has been the norm so far would not only enhance the EU's sovereignty and strategic autonomy but can help reduce redundancies in national budgets.

Based on the conclusions of the last European Council held in March, European leaders seem to share this goal<sup>26</sup>: "Increasing defence readiness and enhancing the Union's sovereignty will require additional efforts, in accordance with Member States' competences, to: a) fulfil the shared commitment to substantially increase defence expenditure, and invest better and faster together", etc.

It seems that the defence industry itself will continue to adapt to the new situation, as many large companies have already created holding companies, have merged or are creating other cooperation structures. Zandee (2024) mentions some examples: Krauss Maffei Wegman (Germany) and Nexter (France) have created a joint venture, KNDS, for the Franco-German Main Ground Combat System (MGCS) programme. The French Naval Group and the Italian group Fincantieri and Navantia have formed Naviris, which manages the European Patrol Corvettes (EPC) programme. MBDA is a truly European defence company with an industrial specialisation presence in several European countries. Europe's seven largest shipbuilding companies, other industries, technology institutions and eight Member States established Sea Defence in May 2023 to work together on next-generation naval platforms. Airbus Defence, Dassault (France) and Leonardo (Italy) are developing the Eurodrone, a medium altitude long endurance remotely piloted aircraft system that will be acquired by Germany, France, Italy and Spain. Rheinmetall has acquired the Spanish munitions manufacturer EXPAL and plans to open production facilities in Ukraine.

3. Differences of opinion between EU Member States on how best to proceed together to obtain the necessary defence funding will not be resolved in the short term (unless there is a dramatic change in circumstances).

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<sup>26</sup> EUCO 7/24. <https://www.consilium.europa.eu/media/70880/euco-conclusions-2122032024.pdf>

Germany, the leader of the group of "frugal countries" (Austria, the Netherlands, Sweden, etc.) is opposed in principle to the use of the EU budget for this type of large-scale expenditure and advocates giving priority to the bilateral national efforts of Member States.

In contrast to the "frugal countries", France, Italy and others, such as Spain, have a more ambitious vision of the possibilities that the EU budget can offer. Based on the precedent of the NextGenerationEU funds, they advocate the possibility of issuing bonds out of the EU budget to directly or indirectly fund the European defence industry (the Italian Paolo Gentiloni, European Commissioner for Economy, has spoken of up to €100 billion per year<sup>27</sup>, as has the Frenchman Thierry Breton, European commissioner for the internal market<sup>28</sup>).

That said, the "frugal countries" fear that the lower debt rating of southern countries will end up contaminating the EU budget "ratio", which currently enjoys the highest ratings on the international bond markets, which means that everyone would lose out.

But it should be borne in mind that, if all the effort must be made by national budgets, many of them (all of those mentioned second) are already stressed enough with deficits and public debt at levels that are too high to increase defence budgets. Further taxation or cuts in social benefits to fund new military spending are also ruled out at this stage. It is therefore pertinent to refer to the EU's new fiscal rules, which are due to come into force soon, which would allow, depending on the circumstances, to exempt certain defence investments from deficit and debt accounting. But it remains to be seen how much flexibility will be allowed in the application of the new rules on this point. Therefore, even if some countries objectively have less room for manoeuvre at the national level to increase their military budgets, a flexible application of the new Stability Pact would make it more feasible to increase these investments.

Therefore, in my view, this discussion is unlikely to yield results in the short term unless circumstances change drastically.

4. There is still room for manoeuvre with the current instruments and the funding planned for the next four years, so it does not seem likely that novel financial solutions or overly ambitious policies will be proposed.

To date, €6.1 billion from the EPF has been used to encourage potential military aid to Ukraine from Member States. At the moment, its ceiling has been set at €17 billion, with the possibility of reaching €20 billion in four years. There thus seems to be a margin of around €10 billion until 2027 to cover the sending of military equipment or the training

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<sup>27</sup> M. Gomez. La UE busca vías para financiar el aumento del gasto en Defensa. EL PAIS 24 February 2024 <https://elpais.com/economia/2024-02-24/la-ue-busca-vias-para-financiar-el-aumento-del-gasto-en-defensa.html>

<sup>28</sup> A. Pugnet. *Breton pitches €100 billion fund for defence industry cooperation*. Euroactiv. 10 January 2024 <https://www.euractiv.com/section/defence-and-security/news/breton-pitches-e100-billion-fund-for-defence-industry-cooperation/>

of Ukrainian military personnel, while also considering setting aside EPF funds for defence spending or for spending in other military operations and in different regions.

Although the EPF will be the financial source that the EU will make most use of until the end of the current MFF, at least as regards military assistance to Ukraine, which is by far the largest absorber of funds, there are other recently created mechanisms, as discussed above (EDIRPA, ASAP) that have secured funding until 2027. Other mechanisms, such as PESCO, that are partly funded out of the EU budget, will also be re-evaluated in 2025. In addition, the mechanisms envisaged in EDIP (FAST, SEAP, the European Military Sales Mechanism, etc.) that could receive a financial boost from 2028 onwards have yet to be put in place.

Moreover, I believe that the solution of using the proceeds of Russian assets frozen by sanctions to pay for arms supplies to Ukraine may help buy some time. Out of a total of €260 billion of frozen Russian assets worldwide calculated by the G7<sup>29</sup> (US, UK, Canada, Australia, Japan, EU), according to Véron (2023) €206 billion is in the EU, mostly in Belgium – €190 billion in the securities depository Euroclear – which could generate after-tax interest of around €20 billion by the end of 2027, depending on the evolution of interest rates.

A proposal from the Commission and the EEAS<sup>30</sup> has apparently already been approved by COREPER for discussion by the Council which, if approved within the normal timeframe, could be operational this summer.<sup>31</sup> The idea would not be to confiscate the assets, as this would raise serious legal, moral or geopolitical problems (Véron, 2023), but to transfer the yield generated by the assets in Euroclear, some €3 billion per year, starting in February 2024 and every two years, to the EU budget (10%) for reconstruction and, for the most part (90%), to the EPF, to fund the supply of arms to Ukraine.

Another – more ambitious – solution, as advocated by the G7<sup>32</sup>, could be to use frozen Russian state assets or their interest as collateral to borrow money from a G7-backed fund to procure weapons for Ukraine. This solution would also maintain those assets that could potentially be returned in full at the end of the conflict and can therefore even be used as an incentive in any peace negotiations. In June this year, we will see what decisions are taken by the G7 and the EU respectively. For the moment, they seem to be leaning towards different solutions.<sup>33</sup>

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<sup>29</sup> G7 Finance Ministers and Central Bank Governors' Statement of 12 October 2023, paragraph 3. <https://www.consilium.europa.eu/en/press/press-releases/2023/10/12/g7-finance-ministers-and-central-bank-governors-statement/>

<sup>30</sup> P. Tamma and L. Dubois. EU agrees to arm Ukraine using profits from Russian state assets. Financial Times 8 May 2024. <https://www.ft.com/content/10d3f259-44fe-4361-b322-2a485a0efe45>

<sup>31</sup> L. Dubois, H. Foy and P Tamma Brussels aims to fast-track up to €3bn for Ukraine from frozen Russian assets. Financial Times 11 March 2024 <https://www.ft.com/content/036b8215-cfe8-4778-a839-3332d8183eae>

<sup>32</sup> I. Koshiw, G Chazan, P. Tamma and L. Dubois *US proposes debt to fund Ukraine using profits from frozen Russian assets*. Financial Times 12 April 2024. <https://www.ft.com/content/6cb21054-ccfc-4cb9-ab58-516d80be94de>

<sup>33</sup> However recently, despite the fact that the EU's decision has already been approved by COREPER, from the other side of the Atlantic they are insisting that the positions of the G7 and the EU are moving closer

5. Concrete discussions on the concrete increase of military spending in the EU will start from 2025, and changes will materialise in 2028, when the new MFF enters into force.

Apart from bilateral contributions to the EPF by Member States, the possible use of frozen Russian assets, the implementation of recently created instruments, including pending EDIP instruments, new PESCO projects etc., due to political reasons, no drastic changes in EU military funding to Ukraine are likely to take place this year 2024. The establishment of a new Commission and a new European Parliament after the June elections will require a certain amount of time to mature in order to present proposals of some significance in this area. Moreover, Hungary's presidency of the EU Council of Ministers in the second half of the year is not the most conducive to fostering such discussions, largely motivated by Russia's invasion of Ukraine, which may pave the way for common defence.

New developments are more likely from the first half of 2025, with a new Commission and Parliament and coinciding with the Polish presidency or, subsequently, with the Danish one, especially if Donald Trump wins the US presidential election at the end of the year. By then, the recent regulatory and financial mechanisms (EDIRPA, ASAP, EDIP etc.) will be fully operational, and it will be possible to make a more accurate assessment of their functioning and their possible use for the next MFF, whose first discussions, including on defence funding, should start around then.

In any case, the European Defence Industrial Strategy (EDIS), a joint Communication of the Commission and the HR outlining a vision of European defence industrial policy for the future, published on 5 March<sup>34</sup>, offers some clues as to how the financial effort of the EU and its Member States in the military sphere (in the Commission's opinion) might develop over the next decade, which will ultimately depend on the political will of the Member States that have built up the regulatory walls – which will now need to be dismantled – to protect their national industries from external competition and the rules of the Single Market (Arteaga, 2024).

The Strategy reiterates once again that, in order to increase Europe's defence industrial readiness, Member States must invest more, better, together and at European level. Similarly to the climate or digital transition, the Commission sets out a number of temporary goals in this area. Three of them (which will not be easy to achieve) are highlighted here:

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together: “U.S. and Europe Move Closer to Using Russian Assets to Help Ukraine” *New York Times* 19 May 2024. A. Rapeport <https://www.nytimes.com/2024/05/19/us/politics/russian-assets-help-ukraine.html>

<sup>34</sup>A new European Defence Industrial Strategy: Achieving EU readiness through a responsive and resilient European Defence Industry. JOIN (2024) 10 final of 5 March 2024.

[https://defence-industry-space.ec.europa.eu/document/download/643c4a00-0da9-4768-83cd-a5628f5c3063\\_en?filename=EDIS%20Joint%20Communication.pdf](https://defence-industry-space.ec.europa.eu/document/download/643c4a00-0da9-4768-83cd-a5628f5c3063_en?filename=EDIS%20Joint%20Communication.pdf)

- For Member States to procure at least 40% of defence equipment through European cooperation by 2030<sup>35</sup> (this is currently only 18%)<sup>36</sup>.
- To ensure that by 2030 the value of intra-EU defence trade accounts for at least 35% of the value of the EU defence market.<sup>37</sup>
- To make steady progress towards at least 50% of defence equipment being produced in the EU by 2030 and 60% by 2035.<sup>38</sup> (Since the start of the war in Ukraine, 78% of defence procurement by EU Member States has been from outside the EU, with the US alone accounting for 63%.<sup>39</sup> The Commission also states in the Strategy that US arms imports have doubled since 2022, and EU Member States still prefer to spend more than half of their military procurement budgets on national programmes).

Unfortunately, as Faure and Zurstrassen point out, the interventionist instruments proposed in the Strategy lack sufficient financial resources and political incentives to implement them. Despite the Commission's ambitions, the intergovernmental paradigm of defence – the will of each and every Member State – remains intact.

Nevertheless, it can be taken for granted that, if things continue as they are now, as is happening with the budgets of all European states, the EU defence budget under the new MFF from 2028 onwards will see a significant increase in funding, both in direct expenditure – Heading 5, in particular around the EDF – and in indirect expenditure – Heading 1 and others. Personally, I would not rule out a proposal to at least double defence spending from the EU budget for the next MFF compared to the current MFF, including the new allocations resulting from its mid-term revision. The allocations of the EPF, which has established itself as the ideal method to, bypassing the differences in opinion between the Member States and the limitations of the TEU, jointly fund military operations and the supply of equipment through extrabudgetary means, will depend above all on the progress of the war in Ukraine. But I believe that it will be the defence spending classified in this article as "mixed", i.e. that funded mostly by the Member States but also by the EU budget (EDA, PESCO and EDIP), that could grow the most in the medium and long terms.

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<sup>35</sup> Page 10 of the aforementioned Strategy

<sup>36</sup> European Defence Agency. 2022 Coordinated Annual Review on Defence Report. November 2022. Page 6. European Defence Agency

<sup>37</sup> Page 15 of the aforementioned Strategy

<sup>38</sup> Page 15 of the aforementioned Strategy

<sup>39</sup> Jean-Pierre Maulny, The impact of the war in Ukraine on the European defence market, IRIS, September 2023.

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