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EU is Bracing for a Heated Debate on Its New Budget

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Introduction

With fresh memories of the COVID-19 pandemic and with the ongoing war in the East of Europe, the European Union (EU) is bracing for a heated debate on its future budget after 2027. The ongoing budgetary framework for 2021-2027, or the multiannual financial framework (MFF), as the multiannual budget of the EU is officially called, has already been marked by the introduction of the Next Generation EU (NGEU) instrument. The NGEU is an ongoing instrument launched after the outbreak of the pandemic in 2020, financed by joint borrowing to mitigate the consequences of the COVID-19 crisis and strengthen economic resilience. The new impetus for the redesign of the EU's future budgetary spending was the beginning of the full-scale Russian invasion of Ukraine in 2022, paired with the election of Donald Trump in the US Presidential Elections in November 2024, followed by his subsequent threats of pulling out American support for Ukraine. This led to the introduction of the ReArm Europe Plan/Readiness 2030 initiative in March 2025, with its main instrument called the Security Action for Europe (SAFE). With the introduction of the SAFE financial instrument, the EU budget will back loans of up to 150 billion euros for Member States interested in increasing their defense capabilities through common public procurement.

Looking into the future, some of the budgetary challenges the EU will face include the need to secure funds to start repaying the NGEU debt, growing demands in the areas of defense and military spending, and the need to reform the EU's own resources system to increase the EU's budgetary autonomy. The introduction of new revenue sources, such as the Carbon Border Adjustment Mechanism (CBAM) and the EU budget's share of the revenues from the sale of emission allowances, is essential for the sustainability of the EU budget.

What is MFF?

The MFF is adopted for a period of seven years, which is directly linked to long-term planning and stability in the implementation of EU priorities. The MFF contains broadly defined budget categories that serve as a framework for establishing the detailed annual EU budgets. The MFF finances the implementation of common EU policies, such as the Cohesion Policy and the Common Agricultural Policy (CAP).

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Although relatively small compared to national budgets, the adoption of the MFF is one of the most complex issues on which Member States have to reach an agreement. The positions of Member States and the EU Parliament regarding the size and structure of the EU budget are often quite different, which is why negotiations between the stakeholders involved take a very long time.

The relative smallness of the EU budget compared to national budgets is viewed in the fact that in the previous 2014-2020 MFF, the average annual EU budget amounted to around 2% of the value of the budgets of all Member States. Regarding the budget's share in gross domestic product (GDP), the EU budget represents only 0.9% of the EU's GDP. The difference in the relative size of the national and EU budget partly reflects differences in the expenditure structure. While the EU budget is primarily focused on financing investments, national budgets are mainly focused on financing public services and social security funds.

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According to Council Regulation, the planned MFF for 2021-2027 amounted to 2.018 billion euros, of which 1.211 billion euros is the "standard" MFF financed through regular budget revenues, while 807 billion euros are set aside for the NGEU instrument, which is funded through borrowing. After the revision in February 2024, the MFF was increased by an additional 64.6 billion euros, to provide additional funding for the following: aid to Ukraine, investments in the European Defense

Fund, increased costs of the Next Generation EU instrument, and EU migration policy.

The MFF for the financial period 2021-2027 is divided into seven large budget units, or budget headings, which are sometimes divided into subheadings. The largest amount of funds available is for the heading "Cohesion, resilience and values", which mainly refers to investments related to the Cohesion Policy. The next heading in terms of importance is "Natural resources and environment", which relates primarily to the Common Agricultural Policy (CAP) and the Common Fisheries Policy (CFP). Compared to the previous MFF, the most significant changes relate to the decline in the share of the Common Agricultural Policy, which has been reduced from almost 60% to around 30% of the total budget. As for the Cohesion Policy, its share has been relatively stable and around a third of the total budget since the 1990s. All in all, these two headings still account for almost 70% of the budget, not counting funds from the NGEU, that is, over 80% of the budget when the NGEU is added.

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Concerning the EU budget revenue, it largely depends on payments from Member States based on GNI, which accounted for an average of 63.8% of the total revenue from 2014 to 2023. Revenues from customs duties, VAT, and other revenues have similar average shares, amounting to 12.6%, 11.3%, and 11.2%. The evident high dependence of the EU budget on Member States' payments results in Member States primarily acting by looking at the net positions of their budgets in relation to the EU budget during MFF negotiations, which slows down the process and makes it more difficult to reach an agreement.

Future of the EU budget

The new MFF is expected to bring some changes. The current budget period was marked by the fact that, for the first time since its inception, the EU opted for an extensive borrowing spree to boost investment, especially in Member States facing a lower level of development and the most significant economic downturn during the COVID-19 crisis. Finding a budgetary solution for the new budget period will be particularly challenging: it is necessary to increase investment in priority areas, secure funds for the repayment of the debt incurred by the NGEU which is planned to begin in 2028, and at the same time ensure that the new budgetary expenditure does not burden overly the national contribution of the Member States, which would undoubtedly cause great resistance from net contributing countries.

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In addition to these challenges, the EU has decided to increase its defense spending as a response to the Russian invasion of Ukraine and other security concerns. In March 2024, the president of the European Commission, Ursula von der Leyen, introduced a new initiative under the name ReArm Europe plan, officially known as Readiness 2030. This multi-billion-euro initiative aims to increase defense spending, strengthen the European defense industrial base, and create a more integrated EU-wide market for defense spending. In order to achieve this, the EU is planning to mobilize over 800 billion euros.

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The money is expected to come from different sources. While some funding will be provided from the national budgets of Member States and through the loans given by the European Investment Bank, particularly interesting for the future of the EU budget will be the funds coming from the Security Action for Europe (SAFE) instrument and the possibility of redirecting part of the cohesion funds towards the defense projects.

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Shift to defense – what does it mean for the next EU budget?

The SAFE instrument is one of the building pillars of the ReArm Europe plan, aiming to secure loans to Member States in amounts of up to 150 billion euros, which would be provided from the EU budget. In order to receive the funds, the Member States will have to submit a European Defence Industry Investment Plan to the European Commission in which they will describe the activities, expenditure, and products to be produced with the help of the loans, as well as the extent to which these activities will include Ukraine. The financing of the SAFE instrument is expected to come from EU Bonds, in the same way the financing for the NGEU instrument was provided. In other words, the European Commission will once again resort to borrowing from the international capital markets in order to provide support to the Member States.

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As mentioned above, another possibility of ensuring a larger allocation of funds to the defense sector is redirecting part of the cohesion funds. This will have the largest impact on the less developed countries and countries that joined the EU after 2004, as they are the ones benefiting the most from the Cohesion Policy. Adding to that the fact that these countries often do not have the necessary capacity to expand their defense industry and thus would not profit from this redirection of funds in any way, is something that ought to be taken into account if the dissatisfaction of these Member States is to be avoided. Some of these countries also have quite strong opinions on certain EU policies, values, and initiatives, so the EU might want to be cautious not to cause another crisis by trying to resolve the existing one.

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Repayment of the NGEU debt

The NGEU instrument and the SAFE instrument share some similarities. While NGEU was introduced in order to support the Member States in recovering from the crisis caused by the COVID-19 pandemic, the SAFE instrument also aims to support the Member States in contributing to resolving another crisis caused by the Russian invasion of Ukraine. Both instruments are funded through borrowing from the international markets, and thus, both instruments will have to be repaid. The difference between the two is in the fact that the NGEU funds combined grants and loans, while the SAFE instrument envisages loans to Member States only. The loans are to be repaid by Member States in both cases, while the grants provided through the NGEU instrument will be repaid through the EU budget. This means that the next MFF will have to take this into account, considering that the repayment of the NGEU debt is expected to begin in 2028. Thus, the borrowing made by the EU to finance the SAFE instrument might not be regarded as problematic for the EU budget itself, as the repayment of the debt will be directly repaid by the Member States themselves. The repayment of the NGEU debt, on the other hand, poses the question of where the additional financing for the repayment will come from.

In order to finance the repayment of the NGEU debt, the European Commission proposed introducing additional own resources as the sources of revenue for the EU budget. Of the proposed new revenues, Regulation 2023/956 introduced the CBAM from 1 October 2023, which should fully enter into force in January 2026. This mechanism should provide additional revenue to the EU budget by collecting a fee through the purchase of so-called CBAM certificates for products imported from third countries that are recognized as carbon-intensive, with 75% of the revenue collected being directed towards the EU budget. This new revenue is expected to provide around 1.5 billion euros per year for the EU budget, which covers only a small part of the new needs.

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A much greater budgetary impact would be left with the adoption of the EC proposal to share the revenues generated by the greenhouse gas emissions trading (ETS) in such a way that the Member State keeps 70% and the EU budget 30% of the revenues, in contrast to the current situation where all the revenues go to the Member State. This could provide up to 19 billion euros annually. However, apart from the CBAM, no official agreement has been made on the new revenues for the EU budget based on the ETS.

Although the European Commission announced that the aim of introducing new own resources is to reduce the weight of GNI based own resources in the revenues of EU budget, lack of agreement on the new additional sources leaves to wonder whether the Member States will finally have to start contributing even more in order for the NGEU debt to be repaid and for the SAFE instrument to be implemented. This might be particularly worrying to the so-called net contributor countries, i.e., Member States that allocate more money to the EU budget than they receive from it. This group of countries includes the most developed Member States such as Germany, Sweden, the Netherlands and Denmark, which, due to their high GNI, also have relatively high amounts of payments. At the same time, due to their high level of development, they benefit less from European policies such as the Cohesion Policy, which is aimed at less developed Member States, most of which belong to the other group of countries called net recipient countries. Although some of the net contributing countries have historically insisted on budgetary discipline, such as Germany and the Scandinavian countries, it is interesting to notice how the climate has recently changed in Germany in particular. Germany, the biggest EU economy and greatest net contributor to the EU budget, was traditionally the role model of austerity and budgetary discipline. However, this was dramatically altered in March this year, with the German Bundestag's approval of massive infrastructure and defense budgetary spending, which will enable the new Chancellor Friedrich Metz to abandon the traditional German frugality, so typical of Angela Merkel's tenures, and to delve ambitiously into public spending.

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However, it remains to be seen whether this will be the case for the increased defense spending only, or the stance of Germany towards the contribution to the EU budget has changed in general terms. All in all, the conclusion can be made that if a solution to expand the sources of budget revenue is not provided soon, the EU will be forced to increase the national contributions of the Member States based on GNI.

Conclusion

The EU is currently in the process of negotiating a new EU budget. Succeeding in satisfying all 27 Member States in the process is always a difficult task, but the ongoing negotiations for the 2028-2034 MFF seem to be particularly challenging.

The future EU budget is expected to be redesigned to address the current crisis in Europe as well as to provide sufficient funds to repay the NGEU debt. The EU's new increased defense spending plan, in the form of the ReArm Europe plan/Readiness 2030, will set the EU on a new borrowing path. The SAFE instrument, one of the most important pillars of the initiative, is expected to ensure support for the Member States wanting to invest in their defense industry by providing loans of up to 150 billion euros on demand. The repayment of these loans will later be fulfilled by the Member States themselves, while other ways of increasing defense spending might include reducing funding for other EU programs.

On the other hand, the repayment of NGEU debt is a challenge whose resolution is not completely figured out. The introduction of new own resources is viewed as a viable solution, however, not much has been done in that regard. Therefore, the possibility of increasing contributions of the Member States based on their GNI still exists and will inevitably cause dissatisfaction among particular Member States.

Furthermore, the current trade conflict between the EU and the United States could also affect the future shaping of the EU budget. On the one hand, increasing tariffs could increase the EU budget's revenues. However, if economic activity decreases, the EU budget's revenues will inevitably decrease due to lower national contributions and VAT revenue. Also, the spread of the adverse effects of the introduction of tariffs on the competitiveness of European industries could create additional pressures and increase the need for compensation mechanisms within the EU, especially in Member States that are more exposed to foreign trade shocks.

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