

# Financing European air defence through European Union debt

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## Executive summary

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**EUROPE IS VULNERABLE** to air attacks by both state and non-state actors. Russia has substantially increased its production of hypersonic missiles, missiles and drones, while European air defence capacities remain patchy with little improvement in coverage in recent years.

**AIR DEFENCE IS** a classic European public good. No individual nation alone can provide it comprehensively, while air defence provided individual European Union countries can offer significant benefits to Europe as a whole. Joint EU funding for the build-up of greater air defence capabilities would be thus justified and help ensure rapid and sufficient provisioning. Debt funding would be economically justified as air defence systems, such as Patriot and IRIS-T, involve large upfront costs – debt would allow the cost of the investment to be smoothed over longer periods.

**ISSUING EU DEBT**, similarly to what was done with the NextGenerationEU post-pandemic recovery instrument, would be justified given the level of the air-attack threat. EU debt funding of air defence system is legally possible. Debt funding for air defence would respect the EU's limited competence in defence and such a scheme would maintain the exceptional character of debt funding, with EU countries responding to a security threat in an act of solidarity.

**JOINT DEBT ISSUANCE** would not imply changing the command structure of air defence as foreseen under NATO and the European Sky Shield Initiative, but it would impact procurement processes. Procurement could be organised in the framework of the EU's existing Permanent Structured Cooperation (PESCO) system. Additional EU debt would benefit the development of European industrial capacities in air defence, even if in the short term some funds were used to buy systems from the United States. Significant funds for research and the development of the domestic industrial base should be part of the initiative.

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# 1 Introduction

Ukraine is not the only part of Europe vulnerable to missile and air attacks<sup>1</sup>. However, Europe's current defensive capabilities, in particular NATO's integrated air and missile defence systems<sup>2</sup>, do not provide full coverage of European critical infrastructure, let alone the full territory.

Experience in Ukraine and Israel shows that effective missile defence is feasible<sup>3</sup>. It is also expensive. The high cost of air-defence systems such as the US-made Patriot or the German IRIS-T is one reason why European governments have invested insufficiently. A single Patriot missile battery costs around \$1 billion and the build-up of a European air defence shield could easily amount to an investment in the hundreds of billions.

European Commission President Ursula von der Leyen has said she intends to build a "European defence fund" and to propose "defence projects of common European interest starting with a European airshield"<sup>4</sup>. However, it is unclear, how such an airshield would be funded. Major upfront investments are difficult to fund from regular national budgets. Moreover, national and European budget rules, plus limited fiscal space, make it difficult for some European countries to borrow to fund expensive air defence equipment. Finally, if countries do it alone, they might invest insufficiently, neglecting the public good they are providing.

The fiscal rules that govern European Union countries could be sidestepped by issuing on an exceptional basis EU debt that would provide resources for this costly air-defence roll-out. This act of mutual assistance would free national budgetary resources and provide long-term funding stability, while also boosting the domestic defence industry<sup>5</sup>. But such EU debt would have to be justified in EU law and implemented. In this Policy Brief, we propose the creation of an EU funding mechanism to internalise the positive externalities provided by national air-defence systems, whether in the context of the "drone wall"<sup>6</sup>, protection against air raids and cruise missiles or threats from ballistic missiles. Command-and-control structures meanwhile would remain in the NATO framework and ultimate national sovereignty would be preserved.

After a short discussion about how sovereignty concerns have so far impeded EU defence integration, we argue that air defence is a European public good. Because of the substantial costs and economies of scale, provisioning by any country would be insufficient – air defence would benefit from European funding. Adequate funding governance for air defence can be put in place to account for continuing differences between countries in preferences and for distributional effects. Moreover, since air defence is a major investment, there is a case to fund it via deficits. We provide detailed arguments for that. We then discuss the legal base for a European debt instrument that permits debt funding while respecting limitations in scope, quantity and time.

- 1 Peter Dausend, Hauke Friederichs, Max Hägler, Matthias Krupa, Jörg Lau and Heinrich Wefing, 'Das fatale Loch im Himmel', *Zeit Online*, 27 April 2024, <https://www.zeit.de/2024/18/landesverteidigung-bundeswehr-flugabwehr-drohne>.
- 2 See NATO, 'NATO Integrated Air and Missile Defence', 8 August 2024, [https://www.nato.int/cps/en/natohq/topics\\_8206.htm](https://www.nato.int/cps/en/natohq/topics_8206.htm).
- 3 We do not delve further into the debate about whether air defence is too expensive relative to deterrence via attack capabilities, but simply note that both Ukraine and Israel show how important air defence is for critical infrastructure and for the protection of military targets and civilians.
- 4 *Reuters*, 'Von der Leyen pledges air shield in new EU defence push', 18 July 2024, <https://www.reuters.com/world/europe/von-der-leyen-pledges-air-shield-new-eu-defence-push-2024-07-18/>.
- 5 Since EU debt would be additional, increased spending in the short term would not come at the expense of defence industrial policy objectives. Germany, for example, bought Patriot systems in 2023 and 2024 for several billion euros. These purchases absorbed a significant part of a special €100 billion German defence fund (*Sondervermögen*). If EU funding were made available, freed-up fiscal resources could be focused on domestic and European military purchases – for example drones – including from European high-tech defence companies.
- 6 Rebecca Rommen, '6 NATO countries are planning to build a 'drone wall' to defend themselves against Russia, reports say', *Business Insider*, 27 May 2024, <https://www.businessinsider.com/nato-countries-plan-drone-wall-defend-themselves-russia-2024>.

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## 2 Sovereignty concerns

Defence and military capabilities are considered core sovereignty issues and reflect the ability of countries to effectively exercise state power (Dobbs, 2014). Some national constitutional courts have identified defence as a core function for the sovereignty of the nation state, and core defence capabilities would therefore have to remain under national control, making any significant transfer of competence possibly unconstitutional (GFCC, 2009). The sensitivity of defence as issue of national concern is further reflected in the very limited integration in the area of defence throughout the EU integration process after the French rejection in 1954 of the formation of a European Defence Community. Accordingly, the EU Treaties flag defence and military issues as areas of national competence, with EU-based defence activities limited in scope and constrained by unanimity voting.

**European defence integration enjoys consistently high levels of public support**

European defence integration does however enjoy consistently high levels of public support (Mérand and Angers, 2014). Genschel and Jachtenfuchs (2015) identified the increasing integration – without federalisation – of core state powers, including defence, in the EU. Strategic threat perceptions can influence public opinion on European defence cooperation and integration – in particular the perception that Russia's military activities in Ukraine threaten security – and increase support for the creation of a common European army (Graf, 2020).

Crises can counter the “*constraining dissensus*” in relation to defence integration (Burgoon *et al*, 2023), and there is both cross-border support for European defence and converging preferences on the actual design of such a policy. Unsurprisingly perhaps, a somewhat ad-hoc German proposal on air defence, the European Sky Shield Initiative (ESSI)<sup>7</sup>, proposed in August 2022 by Chancellor Scholz as an initiative to strengthen the European pillar of NATO and build up capabilities in air defence, has attracted the participation and interest of more than 20 states. ESSI involves procurement, maintenance and use under NATO command of air-defence capabilities<sup>8</sup>.

However, France is not part of ESSI and has criticised the initiative, in part because of its focus on US and Israeli defence companies. France's criticisms also relate to differences in deterrence doctrines, and political, economic and industrial policy questions (Arnold and Arnold, 2023). Since the establishment of ESSI, some convergence has been achieved on these issues and French president Emmanuel Macron has recognised explicitly the importance of ESSI for countries without nuclear deterrence<sup>9</sup>. To make EU-level debt funding for air defence acceptable, it will be important to strengthen interoperability of systems and include at least to some degree the French-Italian SAMP-T system alongside IRIS-T and other European systems.

In this context, EU funding for air defence could initially focus on R&D to advance interoperability. R&D funding could even focus on developing new EU systems able to intercept ballistic missiles. In a second step, EU funding would be used for the roll-out of such systems. While this approach may be politically more acceptable, such a staggered process risks taking too long. As Europe is currently vulnerable to air attacks, it is important to increase air-defence capabilities rapidly. In practice, it may therefore be necessary to advance along parallel R&D and procurement tracks. Purchases of the equipment necessary to protect critical infrastructure could start immediately, even if from foreign producers, while additional EU funding could be used to advance the development of EU systems.

7 Bundesministerium der Verteidigung, ‘European Sky Shield – die Initiative im Überblick’, undated, <https://www.bmvg.de/de/aktuelles/european-sky-shield-die-initiative-im-ueberblick-5511066>.

8 ESSI is quite missile-focused. Ukraine's air defence approach is broader and cheaper, involving cheap anti-aircraft guns such as German Gepards, and cheap drones, a feature that may need to be incorporated into ESSI.

9 See Bundesregierung, ‘Pressekonferenz von Bundeskanzler Scholz und Präsident Macron zum 24. Deutsch-Französischen Ministerrat am 28. Mai 2024’, <https://www.bundesregierung.de/breg-de/aktuelles/pressekonferenz-von-bundeskanzler-scholz-und-praesident-macron-zum-24-deutsch-franzoesischen-ministerrat-am-28-mai-2024-komplett--2288912>.

If new EU debt were created to pay for air defence, purchases from US companies, as being done under ESSI, would not crowd out European industrial development. Moreover, while EU debt financing would be strictly limited in volume and scope to European air defence (mainly for legal reasons; see section 4.2), the financial investments would also provide long-term funding that would give the necessary stability to industrial policy and fiscal forward guidance for the industry to enhance production capacities. Building-up the air-defence capacities of domestic defence companies will provide a diversity of systems, making European air defence more resilient to possible disruptions related to foreign suppliers. In short, EU debt would allow short-term needs to be met through procurement from abroad while also nurturing the build-up of an EU defence industry.

Since air defence is an issue for Europe as a whole, any EU funding initiative should be open to European allies, including the United Kingdom and Norway, which are part of the same airspace that needs to be defended (and which are already part of ESSI). While our proposed EU borrowing mechanism would focus on EU procurement, non-EU allies could participate in some form.

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## 3 Air defence as a European public good and its proper governance design

### 3.1 Why air defence is a European public good

A European public good (EPG) can be defined as a good not supplied at an adequate level without public intervention (Fuest and Pisani-Ferry, 2020), and which should be provided, at least partially, at EU level to internalise externalities and reap benefits of scale, notwithstanding potential differences in national or local preferences (Claeys and Steinbach, 2024). State-level defence has long been considered a public good but to what extent is defence a European public good? The EPG definition comes from the fiscal federalism literature (Tiebout, 1956; Oates, 1972; Alesina *et al*, 2005) and does not necessarily apply to the same extent to all aspects of defence.

In the EU and NATO, any national army provides to some extent a public good beyond its own security because it can be called up and contribute to collective defence via Article 5 of the NATO Treaty and Article 42(7) of the Treaty on the Functioning of European Union. This is a direct way of contributing to collective deterrence and thereby shows that national defence capacities are, at least to some extent, a European public good. Also, in case of threats from state and non-state actors that may use cheap drones and missiles to attack EU territory, border states play an important role in intercepting incoming threats to the benefit of the EU as a whole. As countries can, at least to some extent, count on assistance by others, there is an incentive to free ride on others' provisioning of military services.

Air defence is particularly subject to strong scale effects and externalities (Beetsma *et al*, 2024): When it comes to threat detection, the more that radar and other detection systems are interconnected and the more data is shared, the easier it is to detect threats early on, reducing investment needs for each country. For aircraft, cruise missiles and drones flying at low to medium altitude, countries of first entry should typically act to neutralise the threat, thereby providing a public good to more distant countries that might have been targeted. Even for high-altitude ballistic missiles, detection and neutralisation can be done from countries other than those being targeted.

For example, a ballistic missile fired at the Netherlands will unlikely be intercepted only over the Netherlands. European air defence is therefore a particularly robust public good that few European countries could provide alone. Scale economies and shared benefits thus

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offer a strong rationale for providing the public good at European rather than national level. With the significant fixed costs for building up air defence, unifying national efforts can untap substantial savings.

The counterargument against air defence as an EPG is that the current threat is primarily Russia and therefore countries in Europe's South and West may be less affected. It is perhaps no surprise that Spain and Italy have not reached the 2 percent of GDP NATO target for defence spending. However, Western Europe is not necessarily immune from the Russian threat<sup>10</sup>. Moreover, threats are evolving. Future threats could come from other EU neighbours. For example, should North Africa succumb to Islamic State-style Islamists, drones could become a direct threat to Mediterranean countries.

Nevertheless, concerns about European defence integration persist. At the strategic level, there is a worry that an air-defence build-up would upset the balance of power and deterrence between Russia and Europe. This concern relates in particular to high-altitude deterrence, as provided through the Israel/US Arrow 3 system. It is also feared that air defence could attract investment at the expense of deep-strike capacity. In terms of scale and availability, ESSI has been criticised as relying too strongly on US-based systems, in particular the Patriot system, creating a strategic dependency on the US and limiting availability to the production capacities of the US company Raytheon (which produces the Patriot system). Finally, there is an industrial policy worry that European taxpayer money would boost US defence companies instead of advancing European systems from France and Italy, in particular SAMP-T.

EU countries are gradually converging on these issues. French president Emmanuel Macron has explicitly recognised the importance of ESSI for countries without nuclear deterrence. When it comes to the balance between deterrence and strike capabilities, there is a growing recognition that air defence cannot come at the expense of strike capabilities. When it comes to strategic dependence, missile manufacturer MDBA Germany is building a factory to produce Patriot missiles, though capacities might still be insufficient and dependencies could persist. And importantly, ESSI includes German systems such as IRIS-T.

Furthermore, drawbacks must be balanced against the advantages of the availability of US systems and their high performance. Moreover, increasing investment in domestic production combined with investments in interoperability should increase the resilience of European air defence against geopolitical risks. To make debt funding acceptable and to ensure Europe's air defence industry thrives and that a diversity of systems is available, reducing strategic dependence on any individual supplier, it will be important to strengthen interoperability of systems and include SAMP-T systems, IRIS-T and other European systems in the European funding efforts. It would also be worth allocating a part of the EU funding to developing a European system that can rival current systems from abroad.

### **3.2 An adequate governance design for European air defence**

Characterising air defence as an EPG does not necessarily imply that all its elements should be centralised at EU level (Claeys and Steinbach, 2024). Rather, the EU legal and institutional framework offers a menu of design options that allow the governance of the public good to be customised, guided by efficiency and the trade-offs described above.

One design option that would account for highly diverse policy preferences is 'club good provision', through which deeper defense cooperation would be pursued by some rather than all EU members contributing to defence as an EPG. The EU Treaties generally allow for club good provision through 'enhanced cooperation' (Demertzis *et al*, 2018; Fuest and Pisani-Ferry, 2019). One design option offering flexibility in governance would be the existing Permanent Structured Cooperation (PESCO) in defence cooperation in relation to research,

<sup>10</sup> Max Seddon and Chris Cook, 'Russian navy trained to target sites inside Europe with nuclear-capable missiles,' *Financial Times*, 13 August 2024, <https://www.ft.com/content/237e1e55-401d-4eeb-875b-03fe68f81575>.

**Providing air defence as public good can be customised depending on whether it is supplied in centralised or decentralised fashion**

procurement and armaments cooperation<sup>11</sup>. Projects involving non-EU countries have also been pursued under the PESCO umbrella. PESCO could thus become the framework for some air defence equipment purchases and for enhancing R&D in air defence in collaboration, where applicable, with the European Defence Agency and the European Defence Fund.

Current frameworks overlap and do not intersect exactly. ESSI includes mainly EU members but also other allies Norway, the UK, Switzerland and Turkey. The PESCO cooperation framework covers 26 EU countries (Malta being the exception). The PESCO framework provides sufficient flexibility for at least the EU ESSI members to cooperate in PESCO projects. ESSI could become a new PESCO project, and its EU country members (out of the 26 PESCO members) could agree on a 'club good' based ESSI initiative<sup>12</sup>.

The participating member states would agree among themselves on the arrangements for, and the scope of, their cooperation, and the management of that project. Integrating non-European countries into ESSI is possible under the PESCO architecture, having already been done previously with the integration of the US and Canada into PESCO Military Mobility projects<sup>13</sup>.

The advantage of pursuing ESSI within PESCO is that suitable institutional governance exists that could provide the basis for joint debt financing and could also be used for greater cooperation in procurement and R&D. In particular, integrating ESSI into PESCO would allow resources from the European Defence Agency to be used, for example to enhance the interoperability of different systems and to invest in R&D, including for the French/Italian air defence system.

Providing air defence as public good can be customised depending on whether it is supplied in centralised or decentralised fashion. Our understanding is that, in the outline plan advanced by Commission President von der Leyen, the EU would play no operational role in air defence, which would remain solely the competence of member states within the NATO framework. Clearly, in a true 'federal' EU vision, military decision making, among other things, would one day be centralised, but that vision is not the framework of thinking in this Policy Brief, in which we consider concrete options for decision makers. Some elements of air defence however could be delivered at EU level, including procurement of air-defence systems (eg joint large-scale purchases of military equipment). For that option to advance, member states would have to agree on what systems are particularly suited for joint purchases and which are better procured with existing, though often slow, domestic procurement approaches. In case of a less-ambitious approach, procurement could remain national but under a joint framework contract. Joint debt issuance would not require the European Commission to decide on spending, as this would remain the responsibility of member states, or if centrally decided, subject to unanimity in the Council of the EU.

Finally, even if there is a strong efficiency case to supply air defence as an EPG, centralisation may have distributional effects. Joint procurement may create losers as well as winners and incumbent industrial players might seek compensation as they lose their (national) market shares<sup>14</sup>. The political implications of this must be taken into account, while understanding that additional EU debt would grow the market for defence products substantially. In a growing market, it would be a mistake for incumbent industrial players and governments to merely seek to retain national market shares. Rather, they should accept the importance of cost effectiveness and competition in overall conditions conducive to more revenues.

It is thus true both that joint, as opposed to national, procurement of air defence systems can revitalise competition, break up national markets and threaten national 'champions'

<sup>11</sup> Article 42 (6), 46 TEU and Protocol No 10 to the TEU.

<sup>12</sup> Article 5 of Council Decision (CFSP) 2017/2315 of 11 December 2017 establishing permanent structured cooperation (PESCO) and determining the list of participating Member States.

<sup>13</sup> See Permanent Structured Cooperation (PESCO), 'Development, delivery and determination: PESCO forging ahead', undated, <https://www.pesco.europa.eu/pressmedia/development-delivery-and-determination-pesco-forging-ahead>.

<sup>14</sup> See also Nicoli and Beetsma (2024).



(Burgoon *et al*, 2023), while simultaneously these national companies could grow substantially, as shown by the extraordinarily positive stock market performance of European defence companies since 2022. Nevertheless, some compensation mechanisms may still be politically advisable to strengthen domestic defence industrial bases that would not benefit directly from EU-funded ESSI procurement. We thus recommend including TWISTER (the Timely Warning and Interception with Space-based Theatre surveillance project, led by MDBA) and the Franco-Italian SAMP/T in the purchases and the R&D phase. Joint debt issuance and joint procurement would thus also increase budgetary resources for such domestic defence systems. Another mechanism would be to adapt, where necessary, existing EU funds to cushion adverse effects felt by regions (eg Structural Funds or the Just Transition Fund).

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## 4 Debt-financing ESSI

### 4.1 The economic rationale for EU debt funding

PESCO projects are generally financed by the participating countries<sup>15</sup>. In terms of air defence, joint debt issuance could increase the resources to fund procurement. While procurement and funding would ideally be centralised to achieve efficiency gains, it is likely and possible that funds raised from issuance of EU debt would be first disbursed to EU countries, which would then spend them on ESSI projects in the context of PESCO.

The economic rationale for debt funding air defence is straightforward: building air-defence systems represents a huge upfront investment. Once the system is in place, operational costs are relatively small. Large upfront investments should be funded by deficits for tax-smoothing reasons, and to spread costs over the periods during which systems will be operational.

### 4.2 Legal implications of EU debt financing for air defence

The legal implementation of exceptional debt financing for ESSI is challenging but feasible. There are two major legal issues, the first related to the financing of defence from the EU budget, and the second related to debt-financing for EU defence expenditure. For both issues, the mechanism must evidently comply with EU law, but national constitutional law also poses constraints. In particular the German Constitutional Court's concerns about EU debt should not be ignored in order to minimise legal challenges that could arise if decisions are brought before the German Constitutional Court.

There is a general restriction, stipulated in Article 41(2) of the Treaty on European Union, that prevents the EU budget from funding expenditure related to operations with military or defence implications. However, this provision has not stood in the way of the recent evolution towards an EU defence union. Despite its limited competence in defence, the EU has advanced joint procurement of defence equipment through the European defence industry reinforcement through common procurement act (EDIRPA, Regulation (EU) 2023/2418) and has stepped up production to sustain ammunition and missile deliveries from Europe to Ukraine through the Act in Support of Ammunition Production (ASAP, Regulation (EU) 2023/1525). These initiatives, built on the EU's internal market and industrial policy competence (Articles 113 TFEU and 173(3) TFEU), are a combination of building up EU military capability and industrial capacity. These initiatives do not conflict with Article 41(2) TEU because they entail development of military capabilities, not defence operations (Fabbrini, 2024). Unlike these initiatives, ESSI would go beyond propping up capabilities through joint development by purchasing military equipment, though not operational deployment of ESSI

<sup>15</sup> Article 8 (2) of Council decision (CFSP) 2017/2315, <http://data.europa.eu/eli/dec/2017/2315/oj>.

**The EU Treaties do not categorically preclude members from jointly debt-financing defence and military projects**

capabilities. Article 41(2) TEU thus requires such purchases to be made outside the regular budget. The EU has been dealing with this restriction through the framework of the European Peace Facility, an off-budget fund that allows EU countries to purchase lethal and non-lethal military support.

In addition to basing ESSI on internal market and industrial policy competences, a proper legal basis to permit debt-based funding can be found in Article 311 TFEU (for borrowing) and in Title V of the TEU on Common Foreign and Security Policy, in combination with Article 122 TFEU (for spending). Our solution would introduce EU borrowing ‘off-budget’ and outside the regular EU budget (similar to the EU post-pandemic economic recovery initiative, NextGenerationEU, NGEU). Proceeds from credits that are bound to go into grants to finance ESSI would be so-called “*externally assigned revenues*”, as they were treated under NGEU<sup>16</sup>. These revenues are not part of the annual EU budget, nor of the EU’s seven-year multiannual financial framework, because assigned revenues are not decided on under the annual budget procedure (CLS, 2020, para. 34)<sup>17</sup>.

Through such an ‘off-budget’ design, debt-financing of ESSI as defence expenditure would not violate the general ban on financing of defence from the EU budget. In any case, one must consider that the ban on using the EU budget for defence has two objectives. First, it seeks to protect neutral EU members from having to pay for military expenses. In our proposal, this protection is respected in any case through the Own Resources Decision (ORD, the decision of EU countries on resources for the EU budget), which would be the legal basis for debt funding. This decision requires unanimity, meaning approval by all EU members including neutral states. Second, the intention of keeping military expenses out of the EU budget is to preclude the European Parliament having co-decision rights (Achenbach, 2022). By keeping the parliament out of decision-making over defence and military issues, EU countries wanted to protect their prerogatives on these sensitive affairs. Again, our proposal foresees – just like under NGEU – no co-decision rights for the European Parliament, which is not able to vote on NGEU revenues and expenditure. In sum, the EU Treaties do not categorically preclude members from jointly debt-financing defence and military projects.

Since our proposal means designing EU debt financing similarly to how it was set up under NGEU, a distinction must be made between borrowing for ESSI purposes and spending on ESSI activities. The European Commission is enabled to borrow on the EU’s behalf by the ORD (Grund and Steinbach, 2023). The ORD requires a unanimous Council decision that designates the main sources of EU financing and requires ratification by each member state. The ORD authorises borrowing and specifies how the borrowing proceeds are to be used. This implies that borrowing for air defence requires a new ORD and hence requires ratification by EU countries in line with domestic constitutions (Article 311 TFEU). The German Constitutional Court has stipulated a number of limitations on EU debt financing that the overall borrowed funds may not exceed significantly the amount of own resources (GFCC, 2022; see footnote 18). Taking into account the existing stock of NGEU debt, there is thus a ceiling on permissible debt.

Spending of the funds raised needs to have a distinct legal anchor. For NGEU, this was the emergency clause in the EU Treaties (Article 122 TFEU), which permits the financing of targeted and temporary economic measures in exceptional situations. The emergency clause requires linking the use of borrowed funds to the addressing of the “*exceptional occurrence*” within the meaning of Article 122 TFEU. Despite obvious differences with NGEU, the creation of an ESSI-based air defence system can be likened to an emergency under Article 122 TFEU, in which EU countries permit mutual assistance to tackle an immediate security threat. Since individual EU countries are economically unable to finance ESSI, joint spending responds to the emergency situation. In conjunction with Article 122 TFEU, the EU can base ESSI expend-

<sup>16</sup> Article 21(5) EU Financial Regulation.

<sup>17</sup> According to Article 52(1d) of the Financial Regulation, the revenues are recorded in an annex to the budgetary plan.



**There is broad consensus that Russian territorial imperialism is a direct threat to EU security**

iture on its CFSP competences under Title V of TEU (and the PESCO framework, in particular), which gives member states sufficient leeway to adopt an instrument like ESSI that aims at promoting defence and security.

Russia's full-scale attack on Ukraine was a shock that has put at risk the security of the EU and its members. There is broad consensus that Russian territorial imperialism is a direct threat to EU security, which over time has intensified and increasingly threatens individual EU countries (see, for example, Cavoli, 2024).

The German Constitutional Court further ruled that debt financing must be limited in duration and substance (GFCC, 2022). A military assault on an EU immediate neighbourhood country can be considered an "*historically exceptional case*" in line with the court's findings (GFCC, 2022). Even today, the direct threat of a Russian attack on EU territory is visible. Increased hybrid attacks and stray missiles reportedly reaching EU territory are among the indicators of the immediacy of the threat, as is the strong build-up of Russian military production capacities (Wolff *et al*, 2024). Each EU countries individually would not be able to protect its skies sufficiently<sup>18</sup>. To account for the balanced-budget principle, the ORD must provide for sufficient future genuine own resources to ensure repayment of the debt. This is necessary to counterbalance the debt resulting from the borrowing by an asset, which justifies its off-budget treatment (CLS, 2020).

NGEU has been implemented through national Recovery and Resilience Plans, based on Article 175 TFEU, which follow a certain bottom-up logic with EU countries proposing projects which are then approved by Commission and Council. This approach ensured member-state ownership and a fair distribution of means. For air defence, there is no need to rely on Article 175 TFEU as a distributional device. Rather, the PESCO framework under Article 46 TEU offers the appropriate framework for the Commission and EU countries to decide which systems should be procured through joint purchases, or which should continue to be procured by member states – a decision that should be guided by cost-efficiency considerations.

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## 5 Conclusions

The increased threat perception has shifted sentiment in Europe and the building up of defence capabilities has increased in importance in many countries. Surveys also indicate that citizens want the EU to play a greater role in defence. It is therefore no surprise that the German initiative to build up a European air defence system – ESSI – has been welcomed and endorsed by more than 20 European countries. Yet, France and Italy in particular have expressed some reservations about the initiative, even though some strategic convergence became visible during 2023.

Joint EU debt funding would be appropriate to boost European air defence. Joint funding can be justified by the fact that air defence is an EPG with significant externalities and spillovers. Debt funding is appropriate since air defence system build-up requires high upfront costs. Such debt funding could follow a model close to NGEU. Such a legal construction would be tenable.

Policymakers should act rapidly to set up such a major EU debt programme to boost European security in a spirit of solidarity between European countries. This would free-up

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<sup>18</sup> Further requirements for EU debt financing of ESSI are that the expenditure is: i) strictly limited to the building up of ESSI (and must not be used for other defence or industrial-policy purposes); ii) that the required amount of EU debt is specified up front and identified in the ORD; and iii) that the debt financing is limited in time and that a redemption plan is fixed ex ante. Regarding the permissible amount, the necessary means must take into account that the maximum permissible EU debt (NGEU plus new ESSI-related debt) "*may not considerably exceed the amount of own resources*" (GFCC, 2022). The redemption of NGEU starting in 2028 will free up space for EU debt for ESSI.

national fiscal resources for other urgently needed defence systems. ESSI should be adjusted to take into account justified industrial policy concerns and to support R&D into the interoperability of systems and the enhancement of European technology in air defence. Finally, policymakers must find ways to include non-EU ESSI members in the effort. On the whole, EU debt would allow European defence efforts to be advanced greatly in a highly threatening security environment. Joint EU debt funding would internalise the major security externalities of air defence, be treaty compatible and politically highly welcome, all without detracting from EU industrial policy objectives.

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