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Making the EU's Multiannual Financial Framework Fit for Purpose

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ABSTRACT: The European Union's budget—known as the Multiannual Financial Framework (MFF)—has over time been a key tool for enhancing economic efficiency, achieving redistribution, and helping the Union tackle pressing challenges. As the Union navigates an increasingly complex global environment and faces looming structural and demographic changes, it is increasingly evident that decisive EU-level actions will be needed to boost productivity and resilience. The MFF is a critical policy lever that can enable the needed EU-level actions. This paper argues for three key changes to the next MFF (2028-34) to help the budget play this role. First, bottom-up estimates of investment needs suggest that spending on European Public Goods to boost productivity and resilience needs to be increased to at least twice the current level. While this would require an at least 50 percent increase in the budget's size or about 0.6 percent of EU GNI annually (if spending on programs such as the Cohesion Policy and Common Agricultural Policy is kept unchanged), focusing on activities that maximize positive externalities and reduce costly duplication can generate net positive values for member states. Second, reforms are needed to make the budget more streamlined, responsive to evolving needs, and more effective by incentivizing good performance. Lastly, the financing framework should be strengthened by integrating borrowing as a regular tool, alongside greater own resources to bolster debt service capacity. Increasing own resources by about 0.2 percent of GNI annually to cover peak debt servicing costs along with additional reserves for unexpected challenges would likely provide financial security to support the proposed increase in the budget. A clearer focus on strategic investments and measurable outcomes will reinforce the budget's positive sum value, helping build support for a more ambitious EU budget.

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WORKING PAPERS

Making the EU's Multiannual Financial Framework Fit for Purpose

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Executive Summary

The EU budget, known as the Multiannual Financial Framework (MFF), has been instrumental for helping the EU navigate common challenges—supporting European economic convergence through its cohesion policy and bolstering resilience during recent crises through the NextGenerationEU (NGEU). Since the first MFF was deployed in 1988, it has evolved into a key tool for addressing important goals of boosting economic efficiency, facilitating redistribution, and dealing with pressing challenges.

Europe now faces an increasingly complex global environment and profound structural and demographic shifts. These challenges call for decisive actions at the EU level—with the EU budget serving as a key policy lever to drive effective responses, alongside actions to strengthen the EU single market and structural reforms at the national level. To address both existing and emerging challenges, the next MFF for 2028-34 will need to be revamped along three lines.

First, the MFF will need to emphasize key common priority areas that are optimally addressed at the central, EU level to better internalize positive cross-border externalities, leverage economies of scale, and avoid costly duplication at the national level—delivering European public goods, or EPGs. Specifically, the MFF should target critical EPG investments for which the need for joint action is clear. This includes investments to enhance resilience (for instance, investing in energy security, clean energy transition, and defense) and boost productivity (e.g., spending on research and innovation). Joint provision at the EU level would help achieve common goals more cost effectively, yielding savings for member states' national budgets and supporting fiscal sustainability. Such an expanded envelope for EPG investment would support and reinforce needed structural reforms at the EU and national levels to deepen the integration of the single market, facilitate allocative efficiency gains, and boost resilience.[1] Based on estimated public investment needs in these areas, the EU budget allocation for EPGs would need to increase to at least twice the current level. Achieving this would require increasing the overall budget by at least 50 percent (about 0.6 percent of GNI annually), if funding for other programs including the Common Agricultural Policy and the Cohesion Policy were to be kept unchanged.

Second, to maximize the MFF's impact, its design should be revamped to make it *more flexible* in responding to macroeconomic shocks and changing priorities; *more efficient* by reducing administrative burdens and streamlining processes; and *more effective* by incentivizing good performance and crowding in additional resources from national and regional governments, as well as the private sector.

Third, to meet the growing demand for EPG investments, the financing of the MFF must be strengthened with greater own resources and borrowing capacity. The current framework, based mostly on GNI-based national contributions and with no borrowing capacity outside of crises, constrains the potential of EU-level financing. Integrating borrowing as a regular financing tool, with own resources to secure repayments, can allow for greater strategic investments without delay while distributing the fiscal burden more effectively over time. Calculations based on available estimates of EU debt servicing costs suggest that increasing own resources by about 0.2 percent of GNI annually to cover peak debt servicing costs along with additional buffers for

[1] Fully unlocking the benefits of these EPG investments will require complementary EU-level reforms that deepen the single market, removing barriers to firms' scale up and innovation, and national-level reforms tailored to country-specific structural gaps that hold back growth potential. Budina and others (2025) and IMF 2024c delve into the needed EU- and national-level complementary reforms.

unexpected challenges would likely provide financial security to support the proposed budget increase, though significant uncertainties remain. As a beneficial side effect, a bond-financed EU budget can lead to a stronger presence of EU bonds in financial markets which can be a step for Europe to further reap the benefit of European safe assets and advance the capital markets union.

Introduction

Over the past year, several analyses of Europe's economic challenges (including Letta 2024; Draghi 2024; IMF 2024a and Adilbish and others 2025; European Commission 2025; Lagarde and von der Leyen, 2025) have converged on one overarching conclusion. Decisive EU-level actions are needed on multiple fronts to boost productivity and enhance resilience—both considered essential for the EU to navigate an increasingly challenging global environment while preparing for large structural and demographic changes ahead.

The EU budget—known as the Multiannual Financial Framework (MFF)—is a critical policy lever that can enable the needed EU-level actions. Through this budget, the EU conducts its fiscal policy at the central level. The budget aims to effectively transform high-level strategies for boosting efficiency and facilitating redistribution into concrete actions through financial allocations. It directs resources toward fostering collaboration and cross-border initiatives, while providing incentives to accelerate national reforms and investments that support EU priorities and growth potential. The EU budget also plays an important role in addressing economic and social disparities across regions to promote cohesion.[2] Together with reforms undertaken by member states, cohesion and other EU-level polices in the past contributed to significant economic gains among both old and new member states following the 2004 EU enlargement (IMF 2024b). Furthermore, the EU budget facilitates economic stabilization by mobilizing resources through initiatives like the NextGenerationEU (NGEU), which has provided member states with critical financial support for recovery and resilience, as well as assistance during natural disasters and other emergencies. Finally, it provides public goods by focusing on investments in projects that are strategically important for the Union's future.

Looking ahead, the EU budget is called upon again to play a central role in facilitating EU-level actions for boosting productivity and enhancing resilience. With ambitious reforms, a well-designed, adequately resourced MFF can significantly enhance the EU's capacity to achieve these goals directly (through its spending) and indirectly (through coordinating member states' actions). For the next MFF spanning 2028-34 to realize this ambition, this paper argues that three key departures from the current EU budget will be needed on spending priorities, design features, and financing.

The first departure relates to spending priorities. The MFF has gradually evolved with changing priorities but has not kept pace with the growing list of EU challenges that require centralized responses. The common agricultural policy (CAP) and the cohesion policy (CP) still account for almost two-thirds of the current MFF, leaving limited allocation for new investment needs.[3] Meeting the EU's increased investment needs in areas of shared interest and common benefits across member states (i.e. European public goods or EPGs—such as

[2] Lang and others (2022) find evidence in a sample of (231 in maximum) European regions during 1987-2017 that place-based policies such as the EU's cohesion policy are effective in reducing income inequality across regions (although within regions they tend to increase incomes of the relatively more well-off).

[3] Under CAP, about half of beneficiaries of direct payments are very small farms (with less than 5 hectares) and 80 percent of payments are concentrated in 20 percent of CAP beneficiaries.

research and innovation, energy transition and security, and EU security and defense—where central provision is more efficient),[4] would require an increase in the size of the MFF by about 50 percent, from the current 1.1 percent of GNI to 1.7 percent of GNI in the 2028-34 MFF, if funds for other programs including the CAP and CP were not to be reduced. The expanded envelope would allow for a doubling of EPG investments to meet the investment needs, necessitated by fast-crystallizing spending requirements that are making fiscal tradeoffs ever more acute in the EU.

EU-level spending on EPGs could generate sizable net positive savings compared to a fragmented national approach, through internalizing externalities, leveraging economies of scale, and avoiding costly duplicative national efforts. A given increase in EU-level EPG investment would allow a larger reduction in national spending among member states at the aggregate, thereby supporting fiscal sustainability. Various past studies point to sizable savings from greater EU-level policies and initiatives. In the area of clean energy transition, an IMF study estimates that better coordination and planning can reduce investment costs by 7 percent (IMF 2024c). In the area of security and defense, McKinsey (2016) points to significant economies of scale in joint procurement with savings potential of up to 30 percent (see also Munich Security Report 2017 and European Commission 2017).[5]

The second departure is on design features of the MFF, which can be improved to maximize efficiency and effectiveness of its spending. There is considerable scope for streamlining. Consolidating programs and organizing them into clusters around key EU policy priorities can help remove overlapping objectives across programs, reducing inefficiency and potential inconsistencies. Moreover, the structure of the EU budget is ill-suited for challenges in an increasingly shock-prone world and can benefit from reinforcing existing flexibility tools. Refining and integrating the performance-based budgeting into broader areas—where financial incentives are particularly impactful and those where member states can be incentivized to implement national-level reforms that complement EU-level investment—can help achieve shared goals while leveraging on local, regional, and national expertise. Finally, enhancing the deployment of various financial instruments with robust safeguards, such as through providing strategic guarantees to absorb a portion of risks, can enable partnering financial intermediaries to take on ambitious projects and catalyze more private sector investment.

The third departure concerns financing and resources. An expanded budget envelope will be better supported by more permanent bond financing paired with own resources for debt services. Calculations based on available estimates of EU debt servicing costs suggest that additional own resources of about 0.2 percent of GNI annually to cover peak debt servicing costs along with additional buffers for unexpected challenges would likely provide financial security to support the proposed budget increase, though significant uncertainties remain. A more durable presence of EU borrowing in the market would enhance liquidity, bolster investor confidence, and strengthen the role of EU securities as stable benchmark safe assets. Expanding EU borrowing to support spending in normal times in addition to crisis response could enhance the budget's ability to finance EPGs and to provide macroeconomic stabilization through better risk sharing. Going beyond financing EPG investments, developing a genuine European safe asset (in March 2024, outstanding EU

[4] See, for example, Fuest and Pisani-Ferry (2019); Buti, Coloccia, and Messori (2023); Claeys and Steinbach (2024); Wyplosz (2024), for discussions on European public goods. The Wyplosz (2024) provides a useful overview on a framework to identify an appropriate level of government to provide public goods depending on their characteristics based on the theory of fiscal federalism.

[5] EPG investment will benefit from complementary EU-level reforms to deepen the integration of the single market that remove barriers to firms' scale up as well as other national-level reforms tailored to country specifics in addressing domestic structural gaps that hold back growth potential (Budina and others, 2025; IMF 2024c).

supranational bonds surpassed €1.0 trillion) will support deeper integration of European capital markets and mitigate financial fragmentation risks, thereby contributing to macrofinancial stability (Allard and others 2013). Meanwhile, rolling over NGEU obligations would open up space for EPG investments.[6]

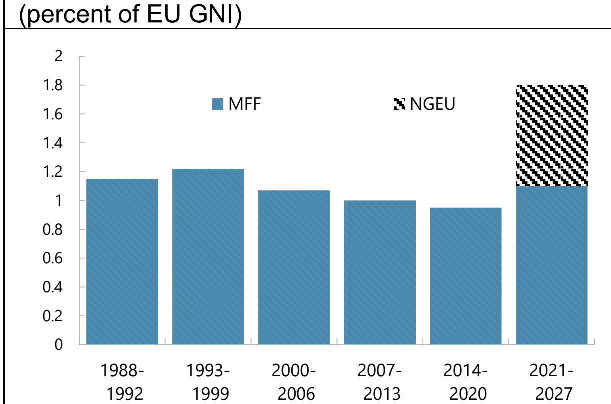
The paper proceeds as follows. First, it proposes areas where the EU can invest through the MFF in EPGs to address shared challenges and estimates the budget augmentation needed to deliver these EPG investments if funding in other programs (e.g., CP, CAP) were to be kept unchanged. Second, it proposes changes to the MFF's design to improve its efficiency and effectiveness, through streamlining programs, making it more adaptable, enhancing performance-based budgeting, and strengthening the deployment of financial instruments. And third, it discusses how to enhance the financial capacity of the EU budget and proposes a more permanent presence of EU common borrowing in the MFF paired with own resources for debt service.

The Next MFF: Priority Spending Areas and Size

Background: Evolution and Current State of MFF

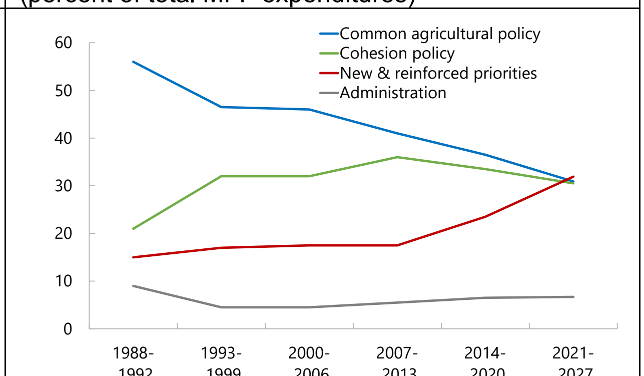
The MFF has remained modest in size, despite increasing spending needs for addressing shared EU priorities. The current MFF amounts to €1.2 trillion (2020 prices) for 2021-2027—a little over 1 percent of EU GNI annually, in line with its historical size since 1988 (Figure 1). The CAP and the CP—accounting for almost two-thirds of the current MFF (excluding NGEU)—have played an important role in supporting European economic convergence (Figure 2).[7] At the same time, the need for the EU budget to address other shared EU priorities is becoming more pressing in an increasingly challenging global environment (e.g. EPG investments for boosting productivity and strengthening resilience).

Figure 1. Annual MFF Expenditures
(percent of EU GNI)



Sources: European Commission; Kengyel (2016); IMF staff calculations

Figure 2. MFF Composition
(percent of total MFF expenditures)



Sources: European Commission

[6] Recent estimates indicate that annual debt servicing costs related to NGEU borrowing will peak in 2028 at approximately €20-38 billion, gradually declining until maturity in 2058; over the next MFF period, 2028-2034, these costs are projected to total between €140 billion and €185 billion (Darvas and McCaffrey 2024; Cluse and others 2025). Directing the resources freed up by rolling over NGEU borrowing toward EPG investments would require member states' agreement.

[7] See Darvas and others (2019) for an overview of the impact of CP and CAP and Christou and others (2024) on an analysis of EU's 2014-27 CP.

The NGEU has provided a significant temporary boost to the budget. The NGEU has a total program envelope of €826 billion, most of which is financed through EU bonds (with the Commission's maximum borrowing capacity of €807 billion). Majority of this program envelope (€743 billion) is allocated for the Recovery and Resilience Facility (RRF), which provides grants and loans to member states to support their reforms and investments (€359 billion and €384 billion, respectively).[8] However, the NGEU, as well as the associated new bond issuance, will expire in 2026. As its debt repayment sets to begin in 2028, rolling over the NGEU borrowing can alleviate immediate pressures on the budget to preserve space for EPG investments.

European Public Goods

The EU budget should prioritize EPGs essential for boosting productivity and resilience and for which EU-level policies can deliver efficiency gains compared to national provision. There is broad consensus in the literature on the definition of European public goods (EPGs)—goods and services involving favorable cross-border spillovers and positive externalities that are not fully captured at the national level, and therefore should be at least partially provided at the EU level.[9] EU-level efforts can internalize externalities (bringing provision closer to the EU optimum), leverage economies of scale, and avoid costly coordination failures. Further to qualify as EPGs and justify EU-level provision, the benefits of central provision must outweigh the advantages of national provision related to, for instance, local expertise and national preferences—in line with the principle of subsidiarity. Some EPGs could be better delivered at the national level, but support under the EU budget may be essential to ensure adequate delivery.

More efficient and effective EPG investments can yield net positive savings for the EU and its member states in aggregate or free up space to deliver other essential public goods. EU-level investments targeting EPGs with clearly identified investment needs will not merely transfer costs from national to EU levels. Instead, by enhancing coordination, leveraging economies of scale, and avoiding duplicative national efforts, these investments can generate net savings, as the overall reduction in spending on these public goods among member states would exceed the increase in spending at the EU level. This could potentially create fiscal space, which inter alias could be used to further strengthen public good delivery at the national and local levels. Various past studies point to sizable savings from EU-level spending. In the area of clean energy transition, a joint EU-level mechanism to facilitate effective allocation of investments and reallocation of emission cuts, through the IMF's proposed EU Climate and Energy Security Facility, can reduce total investment costs by 7 percent (IMF 2024c). On security and defense, McKinsey (2016) estimates suggest significant economies of scale in joint procurement with savings of up to 30 percent (roughly split equally into savings from labor and material and equipment; see also Munich Security Report 2017 and European Commission 2017).

Key EPGs aimed at fostering faster productivity growth and enhancing resilience are aligned with the EU strategic agenda for 2024-2029, which includes fostering research and innovation (R&I) alongside the digital transition; enhancing the EU's productivity and competitiveness; strengthening EU security and defense; and advancing the clean energy transition and energy security.

[8] The rest of the NGEU (€83 billion) is allocated to reinforcing existing EU programs (e.g., Horizon Europe and InvestEU). The grant portion of the RRF has been fully subscribed based on member states' requests, while only €291 billion of the loan portion has been requested by the 2023 deadline, leaving about €93 billion of the borrowing capacity under the NGEU untapped.

[9] See, for example, Fuest and Pisani-Ferry (2019); Buti, Coloccia, and Messori (2023); Claeys and Steinbach (2024); Wyplosz (2024).

- *Digital, research & innovation*. Despite the great potential for positive externalities, EU-level public spending on R&I and support for the digital transition currently lacks scale and focus. As outlined by the Draghi and Letta reports, the EU can boost productivity through regulatory simplification[10] that can help lower transaction costs for productive firms looking to scale up within and across borders, deepening the single market, improving policy coordination (e.g. through a European approach to industrial policies to minimize distortions), and, crucially, providing finance for high-risk, high-reward projects in common priority areas.

- *EU security and defense.* While preferences regarding defense policy, including spending levels, vary across member states, stronger EU involvement and coordination can significantly enhance efficiency (Beetsma, Buti, and Nicoli, 2024). As member states aim to increase defense spending simultaneously, EU-level coordination becomes crucial to achieving the EU's objective in the most cost-effective manner, by achieving economies of scale and minimizing redundancies.[11] The budget can contribute to advancing defense objectives by i) funding the coordination and governance of joint procurement, and ii) financing R&D and targeted investments to enhance cross-border infrastructures and improve productivity.

- *Clean energy transition and energy security.* The EU aims to ensure a secure, sustainable energy supply and achieve net-zero greenhouse gas emissions by 2050. This would require a major shift to renewable energy sources, improved energy efficiency, and widespread electrification.[12] The EU can play a central role in this regard by i) regulating frameworks such as the Emission Trading System (ETS) and the Climate Border Adjustment Mechanism (CBAM), with potential revenues for the EU budget; ii) investing in R&D and cross-border infrastructures including the electricity grid and grid connectors (where national governments or private actors may not have sufficient incentives to invest the optimal amount); and iii) supporting communities vulnerable to adverse impacts of the transition.

- *Possible co-financing of Important Projects of Common European Interest (IPCEIs).* IPCEIs are currently not part of the EU budget. They facilitate large-scale, cross-border projects through collaboration among participating countries, with financing support from national budgets via state aid. Many IPCEIs have mobilized private investments and supported innovation. Going forward, additional financial incentives (co-financing) from the EU budget could be explored on a project-by-project basis, depending on the extent of positive spillovers from the project—whether they benefit a limited group of EU countries or the majority—and whether current collaborations sufficiently address market failures.

[10] Draghi (2024) recommends reducing the "stock" of regulation by simplification and adopting "a single, clear methodology to quantify the cost of the new regulatory "flow"".

[11] The EU budget cannot finance expenditures for military or defense operations (Article 41(2) TEU), but it can finance defense projects related to the EU's competence—research, scientific and technological development, industrial policy, trans-European network, and space program ("Financing European defense industry," Clapp and others, 2024). Member states have identified a list of priority investment areas in defense including air and missile defense, artillery systems and precision strike capabilities, missiles and ammunition, drones and anti-drone systems; strategic enablers related to space and critical infrastructure protection; military mobility; cyber capabilities; artificial intelligence; and electronic warfare.

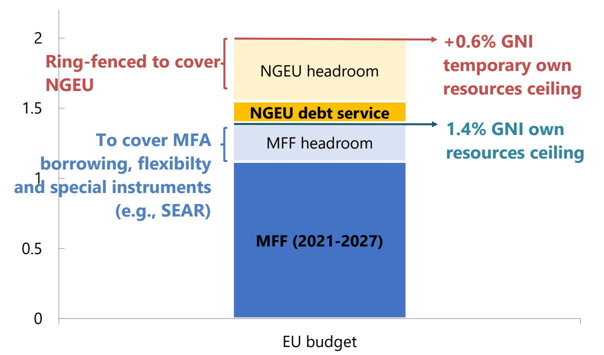
[12] See political guidelines for the next European Commission 2024-2029.

Emergencies and Natural Disaster Relief

The modalities for emergency financing should continue to balance tapping standing reserves and deploying special instruments on top of the MFF. These financing mechanisms operate outside the regular MFF expenditure ceilings, by either utilizing the budget's regular headroom (i.e., the difference between the maximum amount that the budget can request from the member states and the MFF expenditure ceiling) or relying on a temporary increase in member states' guarantees beyond the MFF (Figure 3). The EU budget provides financial aid to address unforeseen asymmetric shocks, such as natural disasters and other emergencies, primarily through the Solidarity and Emergency Aid Reserve (SEAR), capped at €1.2 billion annually (2018 prices), as well as the refugee crisis through the reinforcement of emergency assistance provided under the Asylum, Migration and Integration Fund (AMIF), the Internal Security Fund (ISF), and other relevant funds.[13] This standing reserve is provided by the budget's headroom (a similar mechanism applies to the Security Action for Europe (SAFE) [that came into force in end-May]).

With the rising frequency and cost of emergencies, reassessing the reserve's size may be necessary, along with measures to enhance operational efficiency by streamlining application procedures and reducing administrative delays (Garcia-Herrero and Mjino-Lopez, 2024). For extraordinary emergencies (like the Covid-19 pandemic and the energy crisis related to the war in Ukraine), deploying, on top of the MFF, instruments financed by EU borrowing (e.g., Support to mitigate Unemployment Risks in an Emergency (SURE) and NGEU), can continue to be a solution, provided that efficient frameworks are established to enable rapid implementation. NGEU financing was supported by a temporary increase in the own resources ceiling and headroom, maintained until the NGEU borrowing is repaid by 2058. This headroom is ring-fenced exclusively for post-pandemic recovery efforts.

Figure 3. The EU Budget Own Resources Ceiling
(percent of EU GNI)



Sources: European Commission

Operating the emergency financing framework outside the regular MFF seems appropriate considering the nature of these instruments and competing priorities. Provided that a mechanism ensuring timely deployment is established, this approach balances the budget's preparedness for emergencies with direct financial burden on member states. In the discussion on the size of the budget below, we focus on EPG investment needs that require regular budget allocation within the MFF.

[13] EU funds for migration integration amounted to €9.9 billion over 2021-27, up from €3.137 billion over the 2014-2020 period. In response to the refugee crisis, the European Parliament adopted in October 2015 provisions to increase the financial assistance through augmenting the AMIF and ISF, as well as redeploying the Emergency Aid Reserve (EAR) to Humanitarian Aid.

Box 1. European Public Goods Investment: Current MFF Allocation and Future Needs

Research and innovation

- The EU budget allocates €2 billion for digital infrastructure, and €100 billion (€89 billion excluding the NGEU) for financial support for R&I—amounting to 11 percent of the overall budget envelope or 7.5 percent excluding the NGEU. Horizon Europe is the flagship R&I program that provides grants, with the budget allocation of €71.4 billion under the MFF and additional €5 billion under the NGEU. For InvestEU, a risk-sharing investment instrument, €10 billion is allocated for provisioning the guarantees of €26.2 billion, in partnership with the European Investment Bank (EIB) and other financial intermediaries.
- Estimating investment needs for R&I and its share from the public sector is virtually impossible, and estimates vary widely: on a lower side, in 2020, the Commission estimated that total additional investments needed for digital transformation amount to €125 billion per year (in 2020 prices); a more recent study for the European Parliament, Saulnier and others (2025), estimated a range of €108 to €278 billion annually in public investment.[1] Specifically for the EU budget, recent policy reports (Draghi 2024) suggest doubling the current €100 billion budget to about €200 billion in the next MFF.

Security and defense

- The current MFF allocates about €11 billion (0.9 percent of the MFF total resources), primarily directed toward R&D and industry support. This allocation is supplemented by an off-budget instrument to cope with unexpected needs (e.g., €17 billion in the European Peace Facility).
- However, to meet the EU's defense goals, the Commission estimates additional investment of €500 billion over the next 10 years—likely a conservative estimate, as other analyses suggest, for instance, an increase of €250 billion (annually compared to the baseline) over the next five years for effective defense against Russia (Burilkov and Wolff 2025).[2] For the next MFF 2028-2034, the EU Defense and Space Commissioner has indicated an ambition to increase the defense allocation to about €100 billion.

Clean energy transition

- While dedicated instruments are modest (about €20 billion, or 1.7 percent of the budget, in Just Transit Fund, LIFE program, and Connecting Europe Facility – Energy),[3] most EU investments in the green and energy transition are embedded in "climate mainstreaming." This approach mandates that programs across all policy areas allocate 30 percent of their budgets to climate objectives and track expenditures through green budget tagging. For the 2021–2027 period, the Commission estimates climate-related spending will total €658 billion, including those financed through NGEU (€276 billion) which expires in 2026—amounting to 34.3 percent of the overall budget envelope. However, challenges in tagging may lead to an overestimate of these figures (Darvas and Sekut, 2025; Begg and others, 2025; European Court of Auditor, 2024).
- Achieving the EU's 2030 climate targets requires substantial investment. The Commission estimates that an annual additional investment of around €480 billion will be needed in 2021-2030 for energy supply (including power grid), energy demand, and transport (which could have been reduced by around €200 billion through the IMF's proposed Climate and Energy Security Facility cumulatively over the period 2024-2030 if implemented in 2024; IMF 2024c). This is expected to

grow to €600-700 billion annually over 2031-2040—amounting to about 2 percent of GDP. While subject to large uncertainty, this broadly aligns with other estimates (see Pisani-Ferry and Tagliapietra 2024 and Nerlich and others 2024 for further discussions).

- While private investments will cover the majority of needs, the public share remains substantial—estimated at 25–50 percent.[14] The ECB (Nerlich and others 2024) approximates the EU public funding share at around 17 percent, based on the sectoral public investment share, weighted by the sector's total investment needs estimated by the Commission. This amounts to over €760 billion for the 2028-2034 period.

[1] Saulnier and others (2025) estimates that for the EU to retain its position as a global contender, its investment needs are €652-927 billion per year, including €108-278 billion per year in public investment up to 2035, based on reviews of recent literature. They estimated that strong collaboration among member states, coordinated through the EU, can yield efficiency gains for public and private sectors between 0.9 percent and 2.6 percent of GDP in 2035, which they dubbed as "the cost of non-Europe."

[2] The Commission indicated that this estimate is based on the Strategic Compass to the European Defense Industrial Strategy, as well as some member states' call for European air defense shield, reinforcement of the Union's eastern land border.

[3] The size of dedicated instruments is small: Just Transit Fund (€8.4 billion) and Program for Environment and Climate Action (LIFE, €4.3 billion), as well as Connecting Europe Facilities for energy and transport for infrastructure investments (€5.8 and 2.1 billion respectively).

Augmenting the Size of the MFF

The MFF falls short of meeting the EU's estimated EPG investment needs. Budget allocations for key priority areas (i.e., R&I and the digital transformation, the clean energy transition and energy security, EU security and defense) are currently modest (Box 1). Funding for R&I, digital transformation, and defense represents only a small fraction of the overall budget. Despite significant efforts to integrate clean energy transition efforts across all policy areas—such as those under the CAP and CP, current MFF investments in clean energy transition (about €658 billion for 2021-27 including the amount from NGEU and less than €400 billion excluding the amount from NGEU) also fall short of estimated investment needs (over €760 billion for 2028-34, see Box 1). In total, allocations for these priority areas add up to less than 40 percent of the budget, or about 0.4 percent of EU GNI. This is less than half of the envisaged EU public investment needs (flows) in those areas (as discussed in Box 1).

The current size of the MFF, especially after the expiration of the NGEU in 2026, will leave the EU budget underprepared for EPG investment. The NGEU (with an envelope of 0.7 percent of GNI) has provided a significant, though temporary, boost to the budget, nearly doubling the resources allocated for advancing the clean energy transition and energy security. While this has helped narrow the EU investment gap,[15] the expiration of NGEU in 2026 (with about 50 percent of funds not disbursed as of May 2025) risks leaving the EU underprepared to fully deliver on these areas. Figure 4 illustrates how the size and composition of the current MFF, temporarily bolstered by the NGEU (through 2026), measure up to the investment needs expected of the EU budget.

[14] Overall, Pisani-Ferry and Tagliapietra (2024) estimate that the public sector annual investment needs amount to 0.5-1 percent of GDP, providing overview on the public share of green investments in the literature. EIB (2021) and Darvas and Wolff (2022) estimate around 25 percent of public share; Pisani-Ferry and Mahfouz (2023) estimate around 50 percent (for France) in line with bottom-up estate by Baccianti (2022).

[15] A similar finding in Nerlich and others 2024.

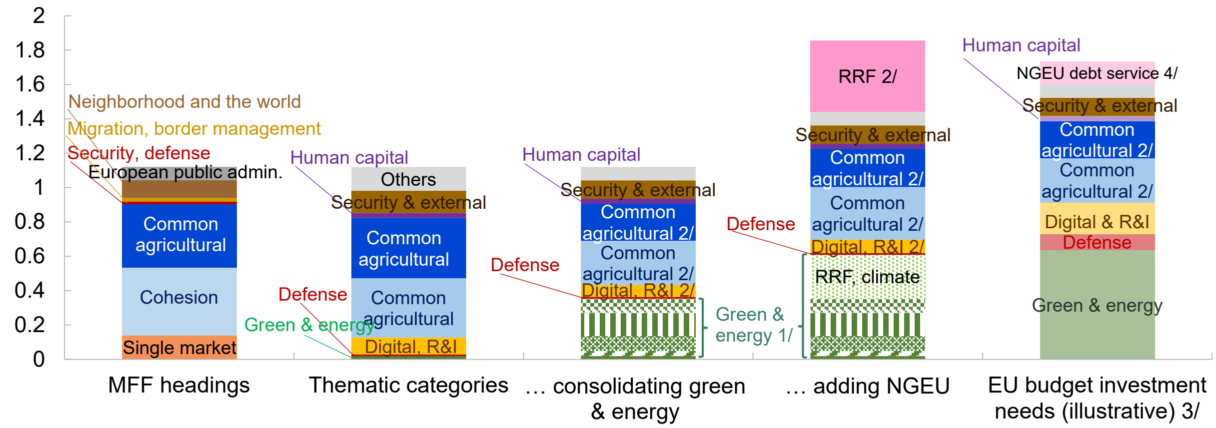
To prevent a critical shortfall, the EU budget will need to more than double its current MFF allocation for EPG priorities. Achieving this would require expanding the overall MFF size by at least 50 percent, summing across the following categories, if funding for other programs including the CP and the CAP were to be kept unchanged (for details, see Box 1):

- Digital, R&I investment needs are based on the proposal by Draghi (2024) and the Competitiveness Compass by the Commission to double the allocation to €200 billion in the next MFF.

- Defense investment needs are based on the ambition announced by the Defense Commissioner to allocate €100 billion, equivalent to less than 30 percent of the total investment needs estimated by the Commission.

- The EU budget investment needs for the clean energy transition and energy security are calculated based on the Commission's estimates on investment needs to achieve the EU climate goals and the share of EU public sector investments (weighted by the sectoral investment needs) estimated by the ECB, which amounts to over €750 billion for the next MFF period.

Figure 4. The Multiannual Financial Framework 2021-2027 and the EU Budget Investment Needs
(percent of EU GNI)



Sources: The European Commission, Darvas and McCaffrey (2024), Draghi (2024), Letta (2024), Nerlich and others (2024), IMF staff calculations.

Note: R&I = research and innovation; the "defense" category includes programs that support defense R&D, defense industry competitiveness, and cross-border cooperation such as the European Defence Fund, not overlapping with programs under the subheading security, external action, and pre-accession assistance; 1/ Incorporating the Commission's estimate on the EU budget spending based on the Climate Mainstreaming, consolidating climate-related expenditures in various programs. While fully recognized in the charts, many have argued that these estimates are likely overstated (Darvas and Sekut, 2025; Begg and others, 2025; European Court of Auditor, 2024); 2/ Excluding the portion counted for the Climate Mainstreaming; the EU budget pursues digital objectives as another horizontal priority, but comprehensive estimates are not available for the whole budget period and incorporating it simultaneously with "climate mainstreaming" likely results in double counting (i.e., unable to clearly distinguish spendings on two horizontal objectives, for some programs, separating the estimated spending for the two horizontal objectives results in negative figures); 3/ The EU budget investment needs for the clean energy transition and energy security is calculated based on the Commission's estimates on total investment needs to achieve the EU climate goals and the share of EU public sector investments (weighted by the sectoral investment needs) estimated by the ECB (Nerlich and others 2024); Defense investment needs are based on the ambition announced by the Defense Commissioner, equivalent to about 30 percent of the total investment needs estimated by the Commission; Digital, R&I investment needs are based on the proposal by Draghi (2024). It assumes spending needs for other areas remain constant. 4/ €140-168 billion in total during the 2028-34 MFF, based on Darvas and McCaffrey (2024).

The Next MFF: Streamlined, Adaptable, Effective

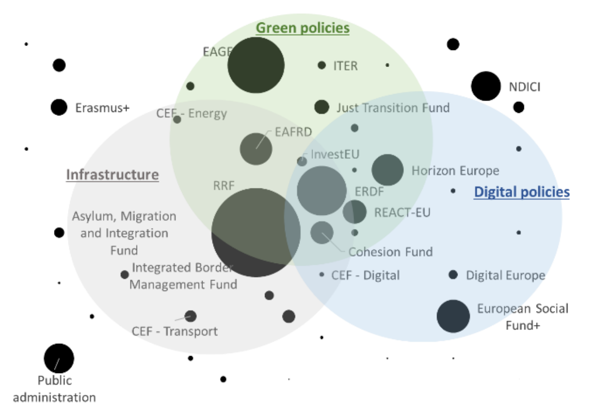
Background: Current Design Features of the MFF

The EU budget is complex, rigid and not suited for an increasingly volatile global economic environment. The MFF has grown increasingly complex with overlapping objectives across programs. Yet it sets expenditure ceilings for the seven-year period with limited margins for reallocation across programs. Revision processes are arduous, often requiring unanimous member state agreement. This rigidity makes the EU budget ill-suited for challenges in an increasingly shock-prone world. Moreover, there is room to improve the effectiveness of the budget by linking financing more to performance indicators and to amplify the impact of EU funding by catalyzing private investment, which in turn could lower the need for public investment.

Streamlining the EU Budget

The structure of the EU budget can be streamlined to better align with EU priorities, leverage synergies and reduce complexity. Over time, the budget has become more fragmented, with the addition of headings, sub-headings[16] and programs—reaching a record high of over 50 programs. While some additions address emerging funding needs, others stem from a pragmatic choice to create new programs as a simpler alternative to reforming existing ones. This has led to overlapping objectives across programs, inefficiencies, and potential inconsistencies (Figure 5). There is a considerable scope to consolidate programs and organize them into clusters around key EU policy priorities, ensuring greater alignment with the ambitions of the next MFF.

Figure 5: EU Programs Under Current MFF by Broad Policy Areas (Green, Digital and Infrastructure)



Source: European Commission.
Note: Size of bubbles corresponds to available funds under the current MFF, including NGEU. A few minor programs and funding of decentralized agencies are omitted. Positioning is crude to ensure readability.

The multiplicity of programs hampers transparency, complicates access to funds and increases administrative burdens. Variations in eligibility criteria, application processes, reporting requirements, and co-financing rates across programs have created significant administrative burdens, particularly for entities active in multiple programs—a growing issue as thematic overlap across programs has increased over time. For example, funding for the digital transition is available through Horizon Europe, the Digital Europe Programme, the Connecting Europe Facility Digital portion, and digitalization efforts under the European Structural and Investment Funds (ESI Funds), with similar overlaps in other domains.[17] Streamlining programs while harmonizing eligibility criteria and requirements would alleviate administrative burdens, particularly for small and medium-sized enterprises with limited resources, thereby creating new opportunity for growth. Additionally,

[16] Sub-heading 2a "Economic, social and territorial cohesion" and sub-heading "Resilience and Values", which both entail an expenditure ceiling as regular headings.

[17] See European Commission (2024a).

it would help authorities during the planning and programming stage of pre-allocated funds, addressing persistent administrative bottlenecks that delay the approval process and disbursement of funds.[18]

The EU budget's effectiveness can be further enhanced through a more centralized approach to identifying investments of EU-wide strategic importance. A large share of the EU budget functions as an "enabler" for projects that are nationally and regionally identified and executed, particularly in areas like cohesion policy, agriculture, and regional developments.[19] However, given potential misalignments between national and EU priorities, this approach may risk missing opportunities to directly target key EU-wide strategic priorities (e.g., large, cross-border infrastructure projects and research initiatives), or to achieve them with optimal efficiency. To address these challenges, the EU budget should balance its enabling role with its strategic capacity, actively identifying opportunities and steering collective initiatives through financial incentives. The Commission's proposed Competitiveness Coordination Tool (CCT) aims to coordinate strategic interests at EU and national levels. Enhancing budget allocations for centralized investments, such as through Horizon Europe, Connecting Europe Facility, InvestEU, and the Defense Fund, could further reinforce the Coordination Tool's role, by promoting greater national alignment with overarching EU-wide goals through targeted financial incentives.[20]

Making the Budget More Adaptable

The current EU budget is rigid by design. The MFF sets annual expenditure ceilings for each budget heading and sub-heading at the start of the seven-year cycle, and revision processes are arduous often requiring unanimous member state agreement. Moreover, a significant portion of the budget (e.g., the CP, the CAP, and Just Transition Fund) is pre-allocated to member states, leaving reallocation decisions to national governments. As a long-term investment budget, the EU budget must balance stability and predictability with adaptability to ensure optimal outcomes. On the one hand, strict annual expenditure ceilings for seven years with little margin hinder the ability to adjust the budget when priorities shift. On the other hand, transitioning toward a more annual budget model, while increasing flexibility, risks undermining predictability and exposing the budget to prolonged, and complex negotiations too frequently. A pragmatic solution lies in enhancing existing flexibility tools, allowing for greater adaptability within the current framework.[21]

The budget includes tools to address unforeseen spending needs, but their scale and scope remain limited. First, within the MFF, each budget heading has unallocated annual "margins" (the difference between

[18] For example, by the end 2024 less than seven percent of available Cohesion Policy funds have been paid out, despite being over halfway through the seven-year MFF period.

[19] The EU budget has taken steps to align these investments with broad EU objectives. Enhanced coordination, budget mainstreaming and setting spending targets have been instrumental in this regard, and recently, the EU also invited member states to reprogram their cohesion programs toward strategic priorities by providing financial incentives.

[20] Horizon Europe, Connecting Europe, InvestEU, Defense Fund are competitive and project-based funding mechanism, where the EU budget plays a key role in identifying, funding and implementing them often in partnership with implementation partners (e.g., national authorities, financial intermediaries, including notably the European Investment Bank). Implementation depends on proposals submitted by member states, businesses, or research institutions, and projects are assessed competitively, and funds are awarded based on merits and strategic priorities.

[21] In some cases, there is flexibility to repurpose resources within a program to address emerging needs. For example, the Commission has proposed financial incentives for member states to redirect resources from the CP to tackle challenges such as enhancing competitiveness, supporting the defense industry, and facilitating the energy transition. Successful implementation will depend on the willingness of member states to participate.

the ceilings and the appropriation), which can be mobilized through an amended budget.[22] For the current MFF, these margins are small, totaling €5.5 billion or 0.5 percent of overall expenditure. Their flexibility is even more limited, as this amount is divided up and largely not transferable across the budget headings. Second, the EU budget relies on "special instruments" to exceed expenditure ceilings in case of specific, unforeseen events ("thematic" special instruments for natural disaster (SEAR), migration, refugee crises, or Brexit) or more generally emerging priorities ("non-thematic" special instruments)—set at €24 billion or 1.9 percent of the total expenditure. Altogether, flexibility tools built in the budget (aside from temporary instruments on top of the MFF like the NGEU and SURE) represent 2.4 percent of total expenditure (see European Commission 2024a)—a modest figure given the long seven-year horizon.

The next EU budget should reinforce existing flexibility tools. By 2023, most flexibility tools had been fully utilized to address the pandemic, the fallout from the war in Ukraine, natural disasters, creation of new programs and other challenges. The rapid depletion of flexibility tools in the current MFF underscores the urgent need to enhance them. To achieve greater flexibility, especially given the increasing frequency of crises and a rapidly evolving global economic environment, existing special instruments and margins should be expanded.[23] The optimal size of these tools would depend on the number of budget headings: consolidation of budget headings could help increase flexibility by reducing the compartmentalization of margins, albeit modestly; if the number of budget headings remains large, special instruments (operating independently of budget headings) should see significant increases. Flexible resources within the regular budget should be geared toward moderately sized shocks. Relatedly, it is important to maintain adequate safeguards to ensure that enhanced flexibility tools are utilized effectively and as intended (see more discussion in sub-section "Enhancing the deployment of financial instruments"). For extraordinary crises, temporary instruments on top of the MFF, like the NGEU, may be more appropriate.

An expenditure review assessing the optimality of budget allocation and the spending effectiveness and efficiency can help respond to changing realities. To ensure the budget remains responsive to an evolving environment, its spending is effective, and the deployment of the spending is efficient, an expenditure review—that allows for necessary adjustments in allocation to better align with policy priorities and optimize outcomes—should remain as part of the regular budget cycle. Such reviews could help guide resource allocation and budget amendment decisions, including in case a comprehensive revision is required to meet the pressing new challenges as was seen in the mid-term revision of the MFF in 2023-24.[24]

Strengthening Performance-based Budgeting

The EU budget incorporates performance-based budgeting in several programs, notably the RRF. It aims to improve the effectiveness and efficiency of public expenditures by linking financing to performance indicators—in contrast to the traditional cost-based approach which ties funding to cost reporting. The RRF

[22] A few programs also have built-in financial cushions that can be deployed in case of unforeseen spending needs (such as the Neighbourhood, Development and International Cooperation Instrument, the CAP, the Asylum, Migration and Integration Fund, the Border Management and Visa Instrument and the Internal Security Fund).

[23] Larger funding for flexibility tools would ideally be backed by a higher own resource ceiling, but it could also be financed via reallocations within the budget.

[24] In response to unexpected challenges and the rapid depletion of built-in flexibility tools, a mid-term revision of the MFF was undertaken in 2023-2024. For the first time, this revision resulted in a sizable net increase in the spending ceiling—adding €64.6 billion, primarily for the Ukraine Facility.

exemplifies a direct performance-based approach by linking disbursements to the achievement of predefined targets and milestones.[25] The targets and milestones are outlined based on national recovery and resilience plans (NRRPs) developed by the member states and agreed with the Commission[26]—fostering national ownership and ensuring alignment with country-specific recommendations (CSRs) from the European Semester. The RRF has supported these plans through a dedicated central governance framework with increased transparency (e.g., clear timelines, measurable outputs, and close monitoring). Some targets and milestones have been revised in response to implementation difficulties, which in some cases could result in reforms that are less impactful than originally planned. Nonetheless, the Commission's mid-term evaluation found that the RRF helped advance common EU priorities and facilitated implementation of country-specific recommendations—the share of CSRs where at least some progress was made increased from 52 percent in 2021 (before RRF implementation) to 69 percent in 2023 (European Commission 2024b and Corti and others 2023).[27] Further, its growth impact is expected to be significant, boosting the euro area GDP level by 0.4-0.9 percent by 2026, and the positive impact is sustained through productivity gains and increased economic capacity, driving GDP-level gains to 0.8-1.2 percent by 2031 (Bańkowski and others 2024).[28]

A direct performance-based approach would be suitable where financial incentives are particularly impactful. This includes areas where incentives are currently weak and where outcomes/results are closely linked to efforts. Most of (though not all) the CP funds and CAP fit this category: they are largely pre-allocated (hence there are relatively weak incentives for the member states to maximize outcomes to secure resources), and they support domestic projects, within the context of EU framework, that are selected, implemented, and monitored by member states (hence there is strong correlation between outcome/results and the level and quality of effort put forth by member states). In these areas, the EU budget primarily functions as an "enabler" for projects that are nationally and regionally identified and executed (leveraging also on regional expertise). With further refinements related to limiting the administrative burden and easing coordination across different levels of government as discussed below, a direct performance-based approach can help incentivize timely implementation of these national projects and enhance the efficiency of the pre-allocated resources. Priority and stronger incentives should be given to projects that can complement key EU-wide strategic priorities (e.g., last-mile initiatives such as local permitting to build distribution networks that tie into cross-border energy infrastructure projects).

A direct performance-based approach could also incentivize member states to implement accompanying reforms to facilitate outcomes, thereby enhancing the impact of EU financing. As identified in Budina and others (2025), there exist large domestic policy gaps relative to the most growth-friendly regulatory settings that prevent countries from achieving higher growth potential. National reform efforts to close part of these gaps—with technical assistance and capacity development support from the EU as needed—can be made prerequisites for accessing some funds under the CP and CAP, especially if these reforms can help improve absorption and maximize the impact of these funds. For instance, reforms of employment agencies can be made a prerequisite for receiving funding for active labor market policies under

[25] Member states are still required to provide cost estimates, which the Commission checks up front in terms of reasonability and plausibility.

[26] The Council then decides on the final adoption of the proposed NRRPs.

[27] EP 2024 suggest that special circumstances of the pandemic may have also contributed.

[28] Michels and others (2025), using the European Commission's FIDELIO sectoral modeling approach, estimated that if all measures are implemented real GDP in the EU would be 0.4 percent higher per year through 2030 than in a scenario without the RRF.

the European Social Fund+, and speeding up permitting procedures for windfarms can be made in exchange for funding for energy infrastructure under the European Regional Development Fund.

Certain programs, however, are best served by maintaining a cost-based budgeting approach. For programs that allocate funding through a competitive framework or public tenders (where incentives to demonstrate performance are already in place), or programs that support high risk projects (where efforts are not necessarily linked to outcomes or results), a cost-based approach would be more suitable (e.g., Horizon Europe or the Innovation Fund). For programs that are geared to cross-border projects such as the Connecting Europe Facility and Interreg Europe (European Territorial Cooperation under the Cohesion Policy promoting cross-border and interregional cooperation), tying funding to performance measures that depend on multiple countries could prove inefficient, discourage cooperation, and risk "collective punishment." In such cases, a cost-based approach can be more effective, facilitating cross-border projects without imposing unnecessary constraints. A cost-based approach would also remain appropriate for programs delivering critical funding where EU-level provision is indispensable, such as humanitarian aid, public health, and security and defense.

A performance-driven EU budget must strengthen coordination across all levels of government. NRRPs are often driven by central governments and lack sufficient opportunities for regional authorities to shape investment projects and contribute to reform proposals (Committee of the Regions 2022). By contrast, a stronger bottom-up approach, for instance in most of the CP funds, would allow regional authorities to leverage their detailed knowledge of local needs and obstacles to drive operational programs and oversee project implementations. A future performance-based approach in these domains should establish a multi-level governance system that ensures both national and regional ownership. This would enable regional authorities to propose reforms and investments within their explicit competencies, either integrated into national plans or pooled across relevant regions (e.g. permitting for renewable energy projects or digital public services that are often regional competency).[29] Conditionality approaches, such as those currently taken under CP funds, could serve as a fallback option. However, these mechanisms will need to become more results-oriented, and the fulfilment of conditionalities should play a key role in guiding resource reallocation decisions in the mid-term review of the CP.

For effective performance measurement, the selection of indicators should strike a balance between ambition and realism. To ensure comprehensive evaluation, indicators should encompass input, output, outcome and impact measures, tailored to the specific needs of each program.[30] Input- and output-based indicators are currently most prevalent (among RRF milestones and targets, Darvas and others (2023), as well as indicators used to assess eligibility to access the Performance Reserve in the CP in previous MFFs, ECA (2021)). However, outcome indicators should be adopted where feasible, as they incentivize authorities to prioritize cost-efficient and effective projects. Outcome indicators are generally more suitable where results are quantifiable and expected in the short term. Where this is not feasible, input/output indicators may be

[29] Country specificities should be considered, depending on the structure of government and their capacities.

[30] Performance can be categorized into four types of indicators: inputs, outputs, outcomes and impact. Input indicators (e.g., hired personnel, money spent) are the easiest to achieve and monitor but only provide limited insight into true performance. Output indicators measure tangible results (e.g. construction of a bridge or the completion of retraining courses). Outcome indicators assess the short- or medium-term effects of interventions (e.g. traffic flow over the new bridge or the improved skills gained by course participants). Finally, impact objectives evaluate the long-term achievement of the ultimate project, making them the most desirable. However, their realization often depends on external factors beyond the control of the implementing authority, and impact assessment typically requires a longer-term timeframe.

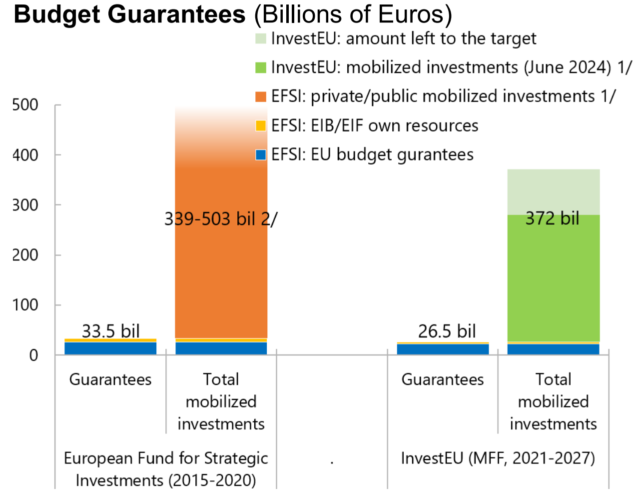
warranted—particularly when capturing outcomes or impacts is impractical and could cause delays (Begg and others 2024).

Minimizing the administrative burdens associated with performance-based budgeting is essential, including through strengthened support measures. Slow absorption poses a significant challenge, undermining program relevance and delaying the realization of their full potential (Schwab 2024; Ciffolilli and others, 2024; Bańkowski and others 2024). Addressing this issue requires eliminating duplicative reporting processes and harmonizing reporting requirements, coupled with clear guidance from the Commission (Begg and others 2024) to alleviate administrative burdens while maintaining transparent monitoring and accountability.[31] The absorption of the RRF has been slower than expected (also interrupted by large shocks and ensuing revisions of plans) partly due to heavy administrative burdens, given extensive programming, monitoring, verification, and auditing processes. The Commission has taken steps to reduce the burden and support member states in strengthening their capacities including through technical support instrument (European Commission, 2024b). Looking ahead, capacity building tools should be integrated into the future MFF, by expanding financial support for technical assistance and capacity development. Addressing capacity constraints at all levels of government, particularly regional and local bottlenecks, will be crucial for ensuring efficient implementation and realizing the full potential of EU programs (European Commission, 2024c).

Enhancing the Deployment of Financial Instruments

The EU budget has traditionally been grant-based, but the past decade has seen a significant increase in the use of financial instruments. The European Fund for Strategic Investment (EFSI), commonly referred to as the "Juncker Plan", marked a notable shift in the EU investment strategy during 2015-20. Rather than relying predominantly on grants, EFSI emphasized financial instruments such as loans, guarantees, and equity investments. These instruments, backed by EU budget guarantees, were designed to attract private investment and amplify the impact of EU public funds. The EFSI leveraged public money to unlock significantly larger private investments (Figure 6).[32] This approach was carried forward under InvestEU during the 2021-27 MFF, with €22.5 billion in guarantees provided from the EU budget (provisioned at 40 percent, with a €10.5 billion budget allocation in case

Figure 6. Financial Instruments through the EU Budget Guarantees (Billions of Euros)



Source: European Court of Auditors (2025); European commission, IMF staff calculations

Note: 1/ including financing provided by the EIB group; 2/ European Cour of Auditor (2025) found that the initial figure for mobilized resources €503 billion was overstated by €131 billion.

[31] ECA (2019) cautioned against too far-reaching simplification of the administrative processes that could undermine the performance-based approach. ECA (2025) also warned that an RRF-style approach lacks cost documentation and surveillance, which risks hampering public procurement and state aid controls.

[32] It was reported that the instrument mobilized 503 billion additional, but the European Court of Auditor (2025) found that this is overestimated by 131 billion.

guarantees are called). InvestEU expanded into broader policy areas including sustainable infrastructure, R&I, digitalization, small- and medium-sized enterprises, and social investment and skills.[33] It aims to mobilize €372 billion in partnership with national promotional banks, international financial institutions, and the EIB group.

Further increasing the use of financial instruments can help support EPG projects that demonstrate the potential for profitable financial returns. These instruments should support projects that have higher risk profiles than investments normally financed by partnering intermediaries, thus would not have been carried out by them or under other existing EU instruments—ensuring "additionality" of the funds.[34] Europe has ample savings and liquidity in the economy, yet market dynamism is constrained by insufficient risk-taking, thereby hindering the flow of capital into innovation and growth-enhancing ventures. By providing strategic guarantees to absorb a portion of risks, the EU budget can act as catalyst, enabling the partnering financial intermediaries, notably the EIB, to take on more ambitious projects and unlock more resources from the private sector.[35] The recent increase in the flexibility of the EIB to manage its investment capacity can support a bigger role of the EIB in financing EPGs. In addition, standardizing and consolidating the EIB's cooperation agreement (i.e., mandates) with the MFF could help unlock funds tied up in instruments, facilitate redeployment of resources, and reduce administrative burdens.[36]

Robust safeguards are essential to ensure responsible and effective use of financial instruments. Strengthening mechanisms to monitor and mitigate risks associated with guarantees is critical to ensuring fiscal stability. Regular evaluations are essential to align financial instruments with evolving market needs, ensuring their continued relevance and effectiveness. These measures must be complemented by streamlined governance structures and decision-making processes that enable swift and adaptive adjustments. Simplifying and harmonizing reporting frameworks across various instruments and programs is equally crucial to reduce administrative burdens on implementing partners. Finally, enhancing technical assistance for beneficiaries is vital to equip them with the necessary tools and knowledge to utilize financial instruments effectively and responsibly, thereby maximizing their potential impact.

Financing the Next MFF

Current Financing of the MFF and Options to Increase the Budget

The EU budget's spending envelope is constrained by its reliance on GNI-based national contributions. Excluding temporary NGEU borrowing until 2026, the current MFF depends largely on member state contributions: primarily GNI-based (around 0.7 percent of GNI averaged over 2021-23) supplemented by VAT-based own resources (at 0.3 percent of each country's VAT intake, amounting to 0.1 percent of GNI), and a

[33] The interim evaluation of the InvestEU Programme found that the program has a meaningful crowding-in effect of private and is on track to achieve its target to mobilize €372 (European Commission 2024c).

[34] European Court of Auditor (2025) argued that the additionality of investments mobilized by EFSI was not sufficiently demonstrated given the lack of an analysis establishing a causality between EFSI financing and additional investments.

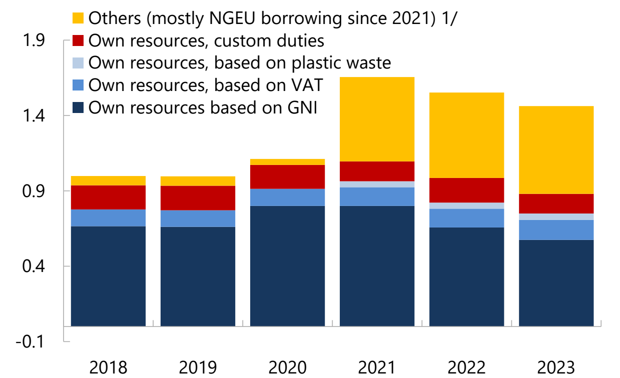
[35] For instance, Carvalho (2025) recommends that the future European Competitiveness Fund make use of the full range of funding modes, including grants, loans, equity, guarantee, and blended finance, matching to specific objectives. He argues that equity investment would be suited for venture and growth-stage innovative project with high risk and high potential return, while guarantees can be suitable for near-market innovation needing credit access from bank loans but risking not getting it due to lack of collateral.

[36] The EIB reports that its mandate with the MFF is currently fragmented with over 130 mandates including from previous budget period, with burdensome reporting requirements (over 400 reports annually).

small share from plastic waste contributions (Figure 7). Custom duties on imports from non-EU economies are the only major direct EU own resources (often called "genuine" own resources), representing just 0.1 percent of EU GNI (or about 15 percent of the total budget).

Broadly, three options exist for financing an expansion of the budget to support increased EPG investment: financing through GNI-based national contributions, new own resources, and debt-financing backed by an increased budget headroom. The first two options, both forms of own resources, mirror revenue financing in national fiscal policy. The first option—raising GNI-based contributions—would immediately and directly burden national budgets. For member states with limited capacity to finance this within their budgets, this could be funded through national government debt. However, this approach would forgo the benefits of EU-level borrowing, to be discussed in the following section, including scope to lower borrowing costs for many member states and greater risk and burden sharing. The second option—introducing new own resources—has the advantage of providing greater budgetary discretion for the EU in addressing joint investment needs. It, however, could face difficulties in securing member states' agreement as member states may be reluctant to cede potential revenue streams to the EU budget. The third option—bond financing—is likely the most viable path despite challenges (such as the necessary changes in the current frame that constrains EU borrowing to crisis contexts). Additional borrowing to support EPG investments, would generate net positive gains for member states as discussed earlier, while spreading financial costs over time. Given the high upfront costs and longer-term returns generated on EPG investments, debt financing is particularly suitable for the initial ramp-up phase of EPG investments. The Treaty, however, requires that borrowing be backed by increased claims to cover debt servicing costs (Council Legal Services, 2020; Grund and Steinbch 2023). The following subsection discusses the implications of bond-financing the proposed budget increase, followed by discussions on necessary increases in own resources to accommodate increased borrowing.

Figure 7. The EU Budget Financing Sources
(percent of GNI)



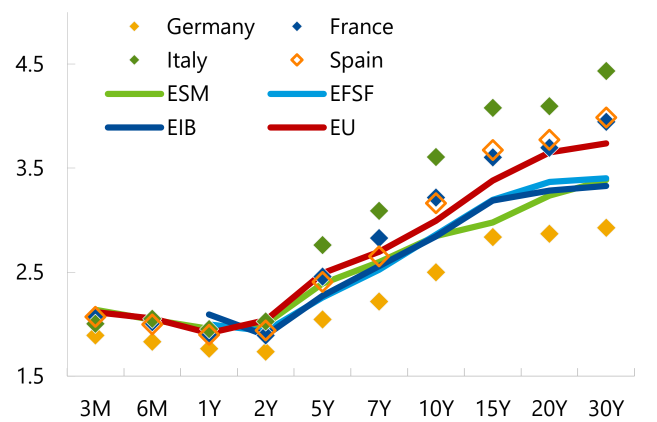
Sources: European Commission; IMF staff calculations
Note: 1/ Mostly consists of NGEU borrowing (not own resources) since 2021, but includes small parts of own resources (other revenues, sugar levies, adjustments)

EU Borrowing

In the current framework, EU borrowing is confined to crises contexts, despite innovations introduced through the NGEU. The NGEU borrowing marks a significant shift in EU financing policy—unprecedented in scale (with a planned issuance of €712 billion) and structured to enhance efficiency by issuing single branded EU bonds to centrally fund all EU policy programs. Unlike previous borrowing mechanisms, part of it is used to finance EU budget expenditures to provide grants to member states (rather than back-to-back loans for which the EU on-lends the amount, while the beneficiary country is responsible for servicing debt). However, as with past EU borrowing, NGEU remains bound by the framework that requires borrowing linked to *temporary* and *exceptional* difficulties.[37] A similar approach is reflected in the Security Action for Europe (SAFE), which aims to support member states' security and defense investments through centralized borrowing—though at a smaller scale (€150 billion) and structured as back-to-back loans.[38]

Borrowing as a last resort, ad-hoc instrument, however, comes with inherent limitations. First, defining borrowing as "*exceptional*" creates uncertainty, making each decision contingent on political agreement over its interpretation. This complicates the process—as seen with the SAFE proposal—and risks delaying urgent actions when swift responses are needed. Second, restricting borrowing to "*temporary*" use limits its full potential and weakens the market impact of EU bonds. The absence of sustained market presence has resulted in lower liquidity, likely contributing to EU bond interest rates higher than those on EFSF, ESM, EIB instruments and exclusion from sovereign benchmark indices despite top-tier credit ratings (Figure 8) (Arampatzi and others 2025).[39]

Figure 8. Yield Curves for European Supranational Issuers and Select EU Countries (percent; as of April 28, 2025)



Sources: Bloomberg Financial LP.; Janse 2023; and IMF staff calculations

The ad-hoc nature of existing EU bonds hinders their potential as genuine common European safe assets. Centralized debt issuance would help develop a new safe asset for investors. Europe currently offers several euro-denominated assets that are considered safe, including a few highly rated national sovereign bonds and those issued by supranational European institutions such as the EU, EIB, ESM/EFSF.[40] The outstanding stock of supranational "European" safe assets surpassed €1 trillion in 2024 (Janse and others 2024), temporarily expanded by NGEU borrowing since 2021 which is set to gradually wind down by 2058. Those assets, however, still represents a modest share of total euro-dominated safe assets, and the majority consists a few national sovereign assets, notably German Bunds with their outstanding stock over €1.2 trillion

[37] The Article 122 TFEU has been used as a legal foundation for temporary financial instrument, as it allows the EU to adopt measures to address severe economic challenges affecting member states and enables the EU to grant financial assistance to member states experiencing difficulties due to extraordinary events. In addition to being temporary, Article 131 TFEU requires that borrowing is considered as "other revenues" and remain smaller than "own resources."

[38] Abraham and others (2023) argue that a similar logic applies to financing of cross-country energy infrastructure to bolster energy security.

[39] There are other, related contributing factors: i) in the absence of specific hedging instruments (e.g., bond futures for Bund) EU supranational bonds are benchmarked against the euro-denominated interest rates swap curve; with rising inters rates in 2021-2023, heavy use of interest rate swaps by investors to hedge their bond positions lead to larger spread of interest rate swap against Bunds, thus pushing on yields on EU supranational bonds; ii) excluded from global sovereign bond indices, EU bonds have relatively low visibility and lower demand from index-tracking funds and many institutional investors that allocate capital based on index inclusion (Janes, 2023; Bletzinger and others, 2022; Claey and others, 2023).

[40] See Janse 2023 for more on history and comparison of European safe assets,

in 2024.[41] This fragmented landscape, coupled with flight to safety tendencies during periods of uncertainty, could increase the risk of abrupt portfolio reallocations between sovereign issuers and might possibly trigger the sovereign-bank vicious cycle, as observed during the sovereign debt crisis (Allard and others 2013; Brunnermeier and others 2017). Developing common European safe assets could help mitigate these risks by supporting banks in diversifying their sovereign debt portfolios, ultimately reducing market volatility and enhancing financial stability (Alogoskoufis and others 2020). Furthermore, fostering a larger, more liquid market for European safe assets would help strengthen the international role of the euro and increase the attractiveness of the euro as a reserve currency (Villeroy de Galhau 2019; Cœuré 2019).

Integrating borrowing into the EU budget presents a transformative opportunity for fiscal integration. The IMF (e.g., Arnold and others, 2018; IMF 2024c) has advocated for an EU central fiscal capacity with borrowing powers, backed by a revenue stream to service debt, while recognizing that the design of the financing mechanism ultimately remains a political decision. Expanding EU borrowing to cover spending in normal times in addition to crisis response could enhance the budget's ability to finance EPGs and potentially macroeconomic stabilization (through better risk sharing and by instituting a stronger backstop). Further, a bond-financed EU budget could signal a more durable presence of EU borrowing in the market, which would enhance liquidity, bolster investor confidence, and strengthen the role of EU assets as a stable benchmark security. This in turn would allow the EU to unlock untapped fiscal resources—the latent demand for common safe assets—and better harness the associated convenience yield (i.e., the premium investors are willing to forgo in exchange for holding safe, highly liquid assets) for financing EPG investments.[42] This could prove fiscally beneficial as illustrated by the quantification analysis on debt mutualization by Ando and others 2023.[43]

Along with increased EU borrowing, the EU's fiscal reporting must continue evolving to provide a more comprehensive and timely view of the Union's financial position. While the EU budget and borrowing are centrally managed, fiscal backing depends on Member States. Aside from the on-lent amounts, these commitments represent contingent liabilities (as a future obligation) rather than immediate debt burdens. Since EU borrowing to finance EU expenditures (e.g., grants to member states) is not explicitly reflected in national debt or the aggregate EU government debt figures, achieving a more holistic fiscal assessment requires a consolidated approach (IMF 2022). The EU has recently begun publishing consolidated accounts for its institutions and bodies, with data available for 2021-2023, as of June 2025.[44] The EU debt, after consolidating the on-lent assets against member states, remained relatively modest at €169 billion (compared to €740 billion pre-consolidation) until the last available datapoint in 2023—a fraction of the €14 trillion general government debt of EU member states—although it would have risen since then due to borrowing linked to the NGEU. Moving forward, continued efforts to enhance the timeliness and usability of this data will be essential for a

[41] There are divided views on debt financing of the general EU budget (Leino-Sandberg and Ruffert, 2022). Gosse and Mourjane (2021) noted that the Maastricht Treaty prohibits "*any mutualisation of existing debts and does not provide for any significant fiscal capacity or joint borrowing capacity at the European level*." As a result, current European safe assets are mainly the highest rated national sovereign debts, such as the German Bund and the French OAT. Grund and Steinbach (2023), however, noted that EU primary law does not have broad explicit restrictions preventing the EU from borrowing to finance its budget.

[42] Arcidiacono and others (2024) find evidence that a country's convenience yield is lowered by increases in another country's supply of sovereign bond, with the spillover largest for countries that have low risk of default similar to the issuer country.

[43] Ando and others (2023) estimated that European Debt Management Agency (EDMA), as proposed by the German Council of Economic Experts in 2011 and Draghi and Macron, in 2021, can safely issue common debt up to 15 percent of euro area GDP (19 percent of GDP capacity, minus the NGEU debt which amounted to 4 percent of euro area GDP at that time), capitalizing the convenience yield, to replace higher interest rate national government debt. While conducted in a specific context of a debt mutualization, the analysis highlighted potential from common fiscal resources, which could be used to fund EU-wide investments.

[44] See Annual statistical accounts of the EU institutions and bodies subsector - Statistics Explained - Eurostat

comprehensive evaluation of the Union's fiscal health. Additionally, as contingent liabilities linked to member states' guarantees grow, potentially with increased EU borrowing for spending, they should be monitored as a supplementary fiscal risk under the EU Economic Governance Framework (EGF). The EGF regulation requires the Medium-Term Fiscal Structural Framework to include information on contingent liabilities, reinforcing the need for improved fiscal oversight.

New Own Resources

Increased borrowing must be accompanied by expanded budgetary headroom. The Treaty requires that any increases in borrowing be paired with increased claims that would allow the budget to cover debt servicing costs, i.e., GNI-based member states' guarantees to raise the resource ceiling as seen in the NGEU framework (Council Legal Services, 2020; Grund and Steinbach 2023). This is designed to ensure solid debt repayment plans and fiscal sustainability. However, this also means that, once the grace period for principal repayments ends and debt servicing costs rise, the budget will confront political challenges: either cutting other expenditures or invoking guarantees to increase national contributions—unless other new own resources are increased to cover debt servicing costs. This creates uncertainty, which could potentially undermine the budget's stability.

Progress in adopting new own resources to cover debt service is critical to ensure budget stability. Precisely estimating debt servicing costs of the proposed bond-financed budget increase and the associated increase in new own resources required to safely cover the cost is difficult, given uncertainties around borrowing conditions (e.g., interest rates, maturity structure) and macroeconomic conditions. However, NGEU borrowing, particularly its grant portion (borrowing-for-spending), offers a useful benchmark. The proposed 50 percent budget increase is approximately 1.8 times the size of the NGEU's grant portion. For reference, the Commission's 2023 proposal for new own resources—aimed partly to cover NGEU debt servicing—is expected to generate about 0.2 percent of GNI annually (or €36.5 billion in 2018 prices, European Commission, 2023), more than sufficient to cover peak servicing costs of the NGEU grant estimated around 0.1-0.12 percent of GNI (incorporating interest rates that have risen significantly since 2020, Darvas and McCaffrey, 2024). Using the latter, latest estimates on debt servicing costs as a reference, phasing in new own resources around 0.2 percent of GNI annually (0.12 percent of GNI multiplied by 1.8), with additional buffers for adverse shocks, would likely cover the full bond-financing of the budget expansion—possibly resulting in a surplus buffer in later years as debt amortization progresses and interest expenses decline.[45] Identifying new own resources of this scale is an immense challenge, and any remaining shortfall may require invoking member state guarantees. Nonetheless, maximizing new own resources remains essential to minimize future uncertainties around the budget.

Opportunities for new own resources lie where EU-level policies and the delivery of EPG generate additional value. Revenue sources related to EU policies stem from both the EU-level regulatory framework and policy coordination that reduce distortions, including common rules for taxation. The Commission's 2023 proposal aligns with this vision by drawing from revenues generated by the ETS, the CBAM, and a possible contribution from Business Europe: Framework for Income Taxation (BEFIT) once agreed.[46] Further, some

[45] The figure refers to peak debt servicing costs in two scenarios: annual principal repayments i) constant in nominal amount and constant as a share of GNI. In both scenarios, interest payments are expected to peak in early years and gradually decline (Darvas and McCaffrey, 2024).

[46] In the absence of agreement on BEFIT, the proposal includes a temporary statistical based own resource on company profits.

have advocated for mutualizing revenues from EU-level policy coordination, such as expanding border tax mechanisms through common tax policies (Saint-Amans, 2024). Drawing resources from common tax rules offers dual advantages: improving efficiency while gradually building the budget's macroeconomic stabilization capacity.[47] Additionally, while direct revenue generation from EPG investments remains limited today, it holds long-term potential. For instance, while the current scope for redirecting revenue streams from EU-financed cross-border investments (including energy infrastructure) back into the budget remains limited, it could expand as the budget shifts toward more EPG investments.

EU borrowing backed by new own resources has potential for enhancing the fairness of the budget. First, borrowing, as discussed earlier, would better align financial costs with gradual returns generated on EPG investments over time rather than imposing a large upfront fiscal burden. Second, new own resources based on EU-level policies and EPG investments (such as capacity charges for usage of cross-border infrastructure) would require proportionately higher contributions from countries benefiting more from EU-level actions.

The political feasibility of EU borrowing backed by new own resources critically hinges on demonstrating its positive sum value to member states. Debates on the EU budget often revolve around the perception that member states' benefit from the EU budget is measured by its net contribution balance (Buti, Darvas, and Steinbach, 2024), framing the discussion as zero-sum and making discussions on budget size highly political. Effective EPG delivery, however, allows all member states to derive substantial benefits. Maximizing the impact of the EU budget can further increase public returns and shift the conversation toward a positive-sum perspective. With growing calls for expanded EU actions, pressure on the budget is intensifying—making the next MFF a critical window to advance the search for new, sustainable revenue streams that would enhance the EU's ability to tackle emerging challenges.

Conclusion

An overhaul of the he Multiannual Financial Framework would help facilitate decisive EU level actions for boosting Europe's productivity and enhancing its resilience. Achieving these goals is essential for ensuring Europe successfully navigates an increasingly complex global environment while preparing for challenges from looming demographic and structural changes. Both through its direct spending role and through its indirect coordination role of member states' policies, the MFF has a key role to play in helping Europe meet these shared goals—but will need to be overhauled to allow it to do so.

This paper has identified three key areas for making the MFF fit-for-purpose to help Europe address the large challenges it faces. Changes are needed in the spending priorities, design features, and financing of the MFF.

First, the MFF should emphasize European public goods critical for boosting productivity (spending on research and innovation) and enhancing resilience (investing in energy security, clean energy transition, and defense). To meet these objectives, the size of the MFF would need to be augmented to at least 1.7 percent of EU GNI from its current 1.1 percent envelope to help meet public goods investment needs if spending on other

[47] For instance, taxes that respond to cyclical conditions would help stabilization: in a given year, countries with stronger activity pay more and those with weaker activity pay less, and at the same time, EU-level spending stays as planned across the EU. Therefore, common taxes yield countercyclical benefits, contributing to stabilization.

programs (such as the common agricultural policy and cohesion policy) were to remain unchanged. Joint investment at the EU level to achieve common goals in a most cost-effective manner can generate net positive savings at the aggregate, benefiting national budgets.

Second, the MFF's design should be revamped to make it *more flexible* in responding to macroeconomic shocks and changing priorities (for instance through enhancing existing flexibility tools and increasing adaptability within the framework); *more efficient* by reducing administrative burdens and streamlining processes; and *more effective* by incentivizing good performance and crowding in additional resources from national/regional governments and the private sector.

Third, the financing of the MFF will need to be reconfigured to meet the higher needs for European public goods investment. A bond-financed EU budget with identified own resources for debt services can deliver several benefits for the EU. It can likely support a larger spending envelope beyond the amounts resting on direct national contributions at a time of national consolidation efforts, and potentially enhance macroeconomic stabilization through better risk sharing. Because of their high credit quality, regular issuances of EU safe assets across the maturity spectrum can deliver an EU safe asset benchmark yield curve to anchor the pricing of euro-denominated assets and help advance the EU CMU. Finally, building out the volume of EU safe assets can help banks meet regulatory requirements on liquid assets with a more diverse range of securities, thereby contributing to financial stability.

The next MFF presents opportunities for an ambitious overhaul of the EU budget, but the process will be challenging. Any changes must adhere to the limits set by the Treaty governing the EU budget (including ensuring appropriate amounts to key areas such as cohesion and agricultural policies). Additionally, the type of overhaul discussed here will require unanimous approval from all member states. Therefore, the legal and political difficulties in pushing ahead with proposed reforms are not to be underestimated. Nonetheless, such an overhaul may soon prove unavoidable if the EU is to decisively meet the large challenges that lie ahead and continue to deliver sustained improvements in social and economic outcomes for its citizens.

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