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Armin Steinbach  
([armin.steinbach@bruegel.org](mailto:armin.steinbach@bruegel.org)) is a Non-resident  
Fellow at Bruegel

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Guntram Wol  
([guntram.wol@bruegel.org](mailto:guntram.wol@bruegel.org)) is a Senior Fellow at  
Bruegel

## Executive summary

**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





# 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



## 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



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 MBDA 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,

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

(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

**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.



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



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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