BRIEFING

Requested by the BUDG Committee

European Public Goods and the 2028-2034 Multiannual Financial Framework

Financing the EU in a decade of reform

KEY FINDINGS

In the next MFF, European Public Goods (EPGs) should start to gradually dominate EU activities and expenditure. In the long-term, this will require a doubling of the EU budget.

A small part of this expansion can be financed by the gradual decentralisation of agricultural policy and the streamlining of cohesion policy with a view to its function as a fiscal equalisation. For the larger part, additional sources of EU revenue will be needed.

This will require additional own resources (OR). However, the search for new, genuine OR should not be limited to revenue niches not exploited by the Member States. This will not suffice.

Ideally, three of the four revenue pillars of the future EU budget are: (1) traditional OR with strong, possibly even increased GNI-based OR, (2) genuine OR in the form of surtaxes or tax shares linked to income and consumption, and (3) a bundle of smaller, new OR that qualify under the applicable criteria.

Genuine EU debt could form the fourth revenue pillar for this future budget. Blended finance may also play some role in financing EPGs, but only a minor one, as it is usually more expensive.

The gradual build-up of the EPGs and their more political nature require a stronger focus on annual budgeting and a less restrictive long-term MFF.

The next Multiannual Financial Framework (MFF) 2028-2034 can become the budgetary instrument of a reform decade. The need for a comprehensive modernisation of the European Union is undisputed by most stakeholders. Europe needs to become more competitive, more sustainable and more sovereign. To achieve this, the EU must become more capable of acting on its own and needs to tackle its inefficiencies. Discussions on how to achieve these major goals focus on the EU's existing and possible future tasks. Over the past decade, the concept of European Public Goods (EPGs) has become a powerful paradigm in the reform debate, linking the 'natural' EU tasks with the revenues needed to perform them: Transferring existing tasks to the EU requires a corresponding transfer of existing revenues or taxing powers. Genuine additional public tasks for the EU, on the other hand, require additional competencies and revenues.

The EU Strategic Agenda 2024-2029 and European Public Goods

The EU Strategic Agenda 2024-2029 outlines three main priorities to guide the work of EU institutions: a free and democratic Europe, a strong and secure Europe, and a prosperous and competitive Europe. The agenda focuses on enhancing security and defence, managing migration effectively, and ensuring the EU's competitiveness through green and digital transitions. The recent Draghi report of September 2024 aligns closely with the strategic agenda by stressing the importance of closing innovation gaps to ensure competiveness

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and economic resilience. The need to build up additional security infrastructure and defence is highlighed by the EU's [Strategic Compass for a Stronger EU Security and Defence] of 2022.

These priorities are also reflected well in the economic discussion of European public goods (EPGs). The economic theory of fiscal federalism identifies a number of criteria for defining EPGs (Thöne and Kreuter, 2020). This theory identifiy the public goods that should be provided by *lower* levels of government. The modernisation of the EU budget with a view to EPGs entails the centralisation of various governmental tasks, while also facilitating the decentralisation of others. The first table provides an overview of key EPGs.

European public goods

Security, military procurement and defence	Digital and technological sovereignty	Asylum and refugee policy, immigration	Development cooperation	Foreign policy
Climate action and environmental sustainability	Research and development (major projects)	Health and pandemic preparedness	Infrastructure and connectivity / Trans-European networks	European fiscal equalisation

Sources: Fuest/Pisany-Ferry (2019), Thöne/Kreuter (2020), Felbermayr/Pekanov (2024), Claeys/Steinbach (2024), Thöne (2024).

The list highlights the proximity of the EU Strategic Agenda to the EPG concept. However, the table also highlights the significant distance to the traditional priorities of the EU budget. The regular EU budget of 2024 (without NGEU) allocates 69,7% of its expenditure to "Cohesion, Resilience and Values" and "Natural Resources and Environment". These funds primarily go to regional, social and agricultural policies with great importance at the national and regional level, but with comparatively little European added value. On the other hand, EPGS such as foreign policy, development cooperation, security, defence, migration and border management, together receive 11,8% of the common budget. These figures reflect the long path *away* from budgets dominated by the CAP alone as well as they illustrate the big steps to be taken towards more EPGs.

The modernisation of the EU budget in the light of the EU strategic agenda calls for more budgetary centralisation in the case of the EPGs and for decentralisation in the case of the two traditional major blocks of EU expenditure (Heinemann, 2016). But here, caution is advised. The resistance to be expected against a rapid nationalisation of agricultural and cohesion policy could also thwart the EPGs agenda. Furthermore, cohesion policy is also a redistribution mechanism. More clearly than in its function as a regional and social structural policy, the fiscal framework underlying cohesion policy is an EPG in its function as prototypical EU financial equalisation (Thöne, 2024). Streamlining cohesion policy to fulfil this function could free up around € 30 billion per year. Regarding agricultural policy, the strategy of a (possibly nominal) cap appears to be a politically viable way of gradually reducing this component of the EU budget. Thus, reallocations in the budget can at best provide only a small part of the necessary funding for the EPGs.

The level of funding for EPGs to be provided via the EU budget cannot be easily quantified. Budgeting does not start with the money. It starts with the specific definition of the tasks to be performed, which in turn provides a basis for calculating the necessary funding. The only estimates available do not follow this procedure. But they give a good, albeit rough, orientation. An ECB research team (Bouabdallah et al. 2024) calculates that central EPGs need € 1,3 trillion of public money for the seven years 2025 to 2031. Of this, € 900 billion – i.e. € 130 billion per year – would have to come from new sources. In today's terms, this would require an increase in the EU budget from 1,1% of EU GNI to 1,8%. With a view to all EPGs, Felbermayr and Pekanov (2024) estimate that the EU budget would even have to grow to 4% of EU GNI.

However, these figures do not reflect the fact that many EPGs have to be implemented in cooperation with the Member States. EPGs are mainly defined in terms of (central) decision-making and financing powers. Yet, the administrative competence – i.e. implementation – follows different criteria. This turns EPG governance into an 'administrative federalism' (Thöne and Kreuter, 2021). For most EPGs, the EU doesn't have – and won't get – its own administration (e.g. its own army). Yet, with delegated or shared implementation of EPGs, Member States should also remain involved in financing them to a certain (smaller) extent from their own budgets. As a consequence, we estimate that the EU budget will not have to grow to 4%, but probably to 2% – 2,5% of EU GNI. Even so, the gradual, needs-based doubling of the budget will require substantial new resources.

Additional Own Resources – genuine or shared

Typically, the long-running debate on strengthening the EU budget with new own resources (OR) intensifies every seven years in the run-up to a new Multiannual Financial Framework (see Büttner and Thöne, 2016). Prior to the current MFF 2021-2027, the Interinstitutional Agreement (IIA) of 2020 addressed six potential new OR. Of these, three proposals are awaiting further decisions to be taken by the Council by 1 July 2025 at the latest: (1) OR based on the Emissions Trading System, (2) OR from an EU Carbon Border Adjustment Mechanism and (3) temporary statistical OR on corporate profits. Other issues mentioned in the IIA, such as a financial transaction tax or a new common corporate tax base, have not been developed into proposals.

Prior to the IIA, the EU Plastics Own Resource was introduced in 2021. This OR provides an illustrative picture of the opportunities and limitations of the own resources debate. The opportunities are exemplified by the 'green' purpose of the levy which promotes a sustainable EPG already on the revenue side, while generating funds to be spent on other EPGs via the budget. The limitations are twofold: On the one hand, the plastics OR is a comparatively small tax that squeezes into a niche not covered by Member States' taxation. On the other hand, the plastics OR is caught between becoming a 'real' EU tax – recognised by taxpayers as a levy they pay to the EU – or remaining an indirect statistical levy financed from Member States' budgets.

Genuine EU own resources – Ideas beyond the IIA agenda

Corporate and trade	Financal sector and digital economy	Climate and Environment	Statistics-based MS contributions	Wealth and Others
Apportionment of CIT based on the BEFIT rules	Excise duty on share buybacks	Agro-ecological taxes	Gender pay gap-based own resource	Wealth of (ultra) high networth individuals
EU 'fair border mechanism' against 'social dumping'	Taxes on crypto-asset activities	Taxation of aviation	Waste beyond plastics packaging	PIT exit taxes for EU residents moving abroad
Broad border tax on undertaxed profits	Digital levy / tax on data traffic	Electricity tax	Biowaste-based OR; Hazardous waste OR; Food waste-based OR	Exit taxes on wealth and/or inheritances
	VAT on financial services	EU road transport fuel tax (surtax)	Other OR in social / environmental areas	Gambling and/or tobacco (surtax)

Sources: EP (2023), Fontana/Gasbarrro (2021). Konrad (2016), Naess-Schmidt et al. (2024), Saint-Adams (2024), Schratzenstaller et al. (2022), Thöne (2016), Zucman (2024),

Many of the other proposals for new and genuine own resources that have been put forward in addition to or independently of the IAA share these characteristics. The longest compilation of ideas for new OR comes from the European Parliament's resolution of 10 May 2023 on own resources, that depicts the six decades of work on this issue. The resolution urges "to continue the efforts to identify fresh and new, preferably genuine, own resources (…)". The table above gives an overview of ideas for or adaptable to new OR.

This is list includes ideas which, on closer inspection, will prove to be less interesting or simply unfeasible. This is not to say that some of these proposals do not deserve a rigorous individual assessment. The IIA itself, the High Level Group on Own Resources (HLGOR, 2017) and the academic discourse (see e.g. Popovic, 2024) propose comprehensive sets of criteria against which new ORs needs to be assessed. As a result, a well-filled basket of feasible ORs could theoretically provide partial funding for the additional EPGs.

However, if the EU budget needs to be gradually doubled to finance the central share of essential EPGs the question arises: Is a another round of searching for fresh and 'untapped' sources of revenue still the appropriate course of action? Tax history shows that untapped sources are usually also *minor* sources. Casting a spotlight into every little niche won't generate enough revenue for the EPG reform. A strong EU budget with an increasing share of essential EPGs must be based, at least in part, on a broad and reliable tax base that grows with economic development. To finance public goods, the Member States rely on the taxation of the two main macroeconomic streams: income and consumption. This rationale also holds for European public goods. Today, these tax bases accrue to the Member States, in a number of cases already shared with regional or local government. Better even, if all governmental levels have a share of these best revenues sources. A new and strong genuine OR could be an EU surcharge on income tax liabilities. Even more feasible would be an EU VAT percentage point replacing one of the Member States. The VAT revenue in the EU amounts to € 1200 billion per year. So an EU VAT of 1% could generate up to € 60 billion per year.

The political and legal hurdles to modernising the EU to deliver a strong set of European public goods are undoubtedly high. So are the hurdles to securing a sufficiently strong set of own resources to finance them. Ideally, three of the four revenue pillars of the future EU budget are: (1) traditional OR with strong, possibly even increased GNI-based OR, (2) genuine OR in the form of surtaxes or tax shares linked to income and consumption, and (3) a bundle of smaller, new OR that qualify under the applicable criteria.

Genuine own debt and blended finance

Genuine EU debt could form the fourth revenue pillar for this future budget. The current EU debt enjoys its impeccable AAA rating mainly because of the highly rated key member states and their underlying "irreplaceable mandate" (Scope Ratings, 2024). Taxing power and fiscal discipline are prerequisites for creditworthiness. With the three pillars outlined, the EU would develop real taxing power. With a debt regime that ensures fiscal sustainability, accountability and adherence to sound economic principles, the EU could move towards a genuine sovereign debt independent of the Member States.

At a time when global public debt is rising sharply (IMF 2024) and the cost of financing the EU's debt is also rising unexpectedly (Heinemann, 2024, *forthcoming*), extra caution would seem to be called for when considering additional debt. Indeed, more debt financing of public goods can only be justified if it generates macroeconomic returns – i.e. if it obeys the famous 'golden rule'. This notion is not straightforward for different EPG purposes. The 'return on investment' rule cannot be restricted to projects that are individually profitable, as public goods regularly fail to meet this requirement. From a long-term macroeconomic perspective, the golden rule includes investments in public infrastructure, climate protection and the green transition, as well as investments in digital and technological sovereignty.

Finally, should additional public debt for EPGs be complemented by private finance? The major transformations towards a climate-neutral and competitive Europe require mainly private investment (Bouabdallah et al. 2024). This private investment can be subsidised through programmes such as InvestEU. But that is another matter. Public goods – by definition – cannot be financed by purely private for-profit investment. Blended finance, on the other hand, can de-risk investment for private companies and encourage EPG investment. However, the 'merit order of financing costs' (Schuster et al., 2024) clearly shows that in countries with well-functioning financial markets, any private involvement will mainly increase the cost of financing public investment. Thus, with genuine public debt in the EU, the need to mobilise 'blended' private, more expensive funds is reduced.

Making the MFF structurally more fit for providing EPGs

Modernising the EU budget and the multiannual financial framework to provide more EPGs will require significantly more spending and more revenue from existing and new sources. It could also necessitate – and enable – structural reforms to the MFF. The current seven-year model provides a robust framework for long-term planning, stable policy priorities and hence budgetary discipline. However, this intended inflexibility creates problems when unplanned developments need to be addressed via the EU budget, as illustrated by the Russian war of aggression against Ukraine and the subsequent need to amend the MFF with a mid-term revision. But the aim of structurally cementing EU spending over a seven-year period is not only problematic in exceptional crises such as wars or pandemics. These problems increase the more political a budget becomes, because policy-making means acting and reacting, innovating and changing course. A more sovereign EU with a stronger focus on the EPGs needs an MFF that is conducive to making and improving policies not just every seven years but continuously, i.e. through the annual budget.

The gradual build-up of the EPGs – an immediate fully-fledged implementation would be impossible – requires a stronger focus on annual budgeting and a less restrictive long-term framework. In particular, the budget must be able to grow substantially and flexibly over the seven years of a MFF. With new ORs, which the EU can control independently and for which it is directly accountable to taxpayers, the need to contain spending seven years in advance becomes less important. As in the Member States, tax-based financing of public goods creates strong democratic incentives for fiscal discipline, especially when combined with a transparent regime that permits public debt only in accordance with clear and sustainable rules.

Furthermore, because of the more political nature of many EPGs, the EU budget will need to be more flexible in how it is spent. This would include the ease with which certain Member State government functions – in particular EPGs, which would still be administered by Member States – could be co-financed from the EU budget in a way that is responsive to changing needs. More generally, this would also imply a budgetary approach with a stronger role for *political* results and outcomes and a reduced role for a large number of specialised programmes focused on *technical* outcomes.

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