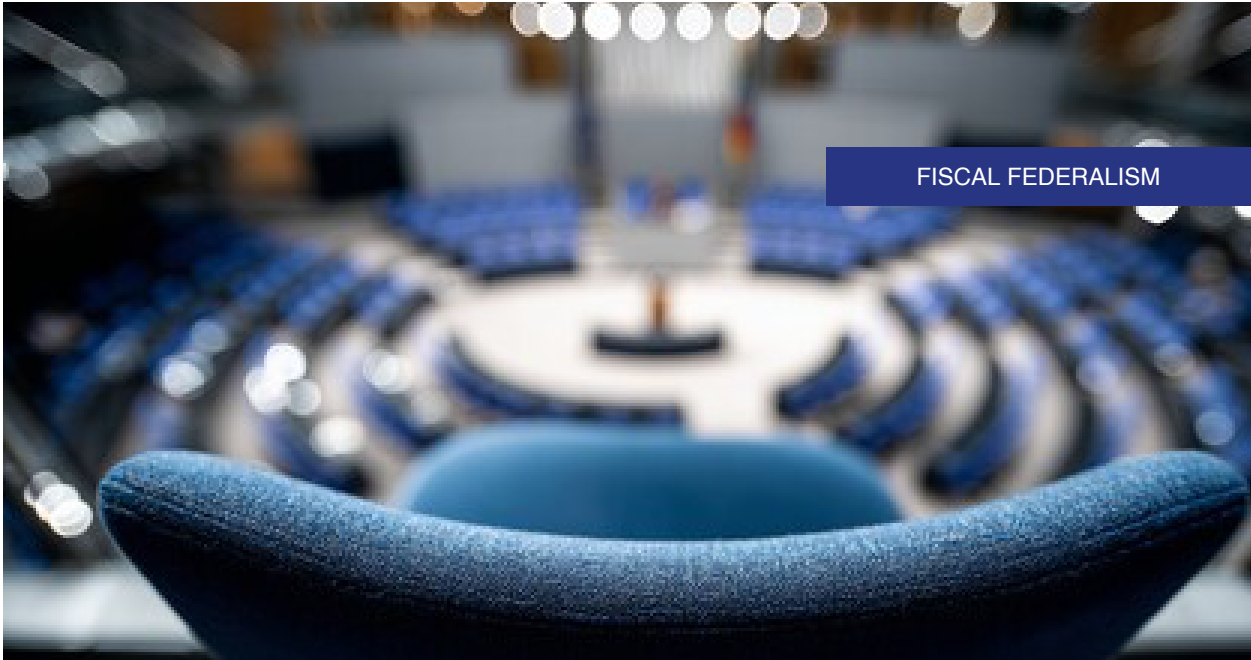




Financing a federal Europe: A roadmap for a European treasury

Recent crises have expanded the EU's fiscal capacity through temporary instruments, while growing demands for defence, cross-border infrastructure and the green and digital transitions are increasing pressure for greater fiscal coordination. A more federal fiscal architecture would require stronger own resources and disciplined borrowing capacity, while overcoming significant legal, institutional and political obstacles.

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Abstract: The COVID-19 pandemic and the war in Ukraine have accelerated a familiar pattern of crisis-driven European integration. When the costs of inaction become apparent, the European Union (EU) has resorted to extraordinary instruments that temporarily and imperfectly expand its capacity to act. Moving from this reactive approach towards a genuinely federal fiscal architecture would require recognising that some public goods and strategic investments

can be provided more efficiently at the European level, supported by visible and politically legitimate own resources. A European treasury could provide a framework for financing shared priorities, including defence and security, external action, major cross-border infrastructure, collective insurance against extreme risks and asymmetric shocks, and investment in the green and digital transitions. Such a framework would need to strike an

appropriate balance between taxation and borrowing while addressing significant legal, institutional and political-economy obstacles. Progress would therefore depend on what can realistically be achieved in the short term and on the further steps that could command sufficient support over the medium term.

Foreword [1]

The COVID-19 pandemic and war in Ukraine extended a pattern of European integration in which crises spark forward movement (Costas and Lago-Peñas, 2015). The response to the financial crisis, the pandemic and, more recently, the war in Ukraine, illustrates this dynamic: the EU has created instruments such as SURE to sustain job protection schemes, issued debt to finance the Next Generation EU programme and shored up its role in providing Ukraine with financial and military support. Although these initiatives have in practice broadened the EU's fiscal space, they remain exceptional and of limited duration.

The leap to a genuinely federal treasury will require the structural reallocation of powers from the member states to the European level in areas where economies of scale, cross-border externalities, and coordination requirements are both more pronounced and tangible. The goal of this paper is twofold: to delineate which functions should be assumed at the European level and provide guidance in terms of size, composition and governance, emphasising realistic short-term measures alongside more far-reaching medium- and long-term steps.

What exactly do we mean by a federal European treasury?

A robust federal treasury needs to be built around three fundamental pillars. Firstly,

the strategic transfer to the European level of the governance of pure public goods (Fuest and Pisani-Ferry, 2019); the reinforcement of the European macroeconomic stabilisation policies, which could include emergency unemployment insurance schemes (Beblavý and Maselli, 2014; Dolls et al., 2018); and a stronger commitment to coordinated responses to shared challenges of different kinds. The public goods referred to include defence and security, external action and cross-border infrastructure. The shared challenges include preparing for and responding to extreme events and some of the strategic investments set down in the Draghi Report and Competitiveness Compass.

Secondly, a system of own tax revenue streams, with sufficient collection power, visible to citizens and articulated around the principle of vertical neutrality, *i.e.*, any increase in European revenues must be accompanied by an equivalent reduction in national taxes or contributions.

Lastly, the federal European treasury needs the ability to take on a disciplined amount of leverage to finance investments with intergenerational returns and dampen shocks, underpinned by a credible fiscal base and subject to explicit rules around leverage and debt service ratios relative to ordinary revenue.

Experience with fiscal federalism suggests that the transfer of spending powers without commensurate tax-raising powers generates opaque transfers, fiscal discipline and fiscal illusion issues and conflicts over distribution. A multi-level treasury structure must steer clear of these risks by establishing a clear link with taxation and political representation.

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Budget size and financing

The current European Union budget is just over 1% of the EU's gross domestic product (GDP) and is financed mainly through national contributions calculated over gross national income, funds based on VAT and customs duties and new sources, such as the contribution levied on unrecycled plastics. This architecture hails from a past focused on the construction of the single market and the financing of cohesion and agricultural policies, rather than on the provision of pure public goods.

The spending needs associated with defence, economic security, cross-border infrastructure and the green and digital transition would imply far higher requirements if these functions were increasingly assumed at the European level. The commitments recently assumed within NATO, which include most of the EU member states, set a target for total defence and security spending that could go as high as 5% of GDP by 2035, compared to the current level of just over 2%. Although not all that effort needs to be channelled at the European level, the current gap illustrates the scale of the budget challenge.

Adding together the required increase in investment in defence and security, reinforcement of cross-border infrastructure and provision of systematic support for the green and digital transitions, the order of magnitude of a European budget capable of assuming those functions would be somewhere between 3% and 5% of GDP, depending on the extent to which the latter are centralised (in some cases, expense coordination could be a good substitute for centralised execution). It is risky to

attempt to put an exact figure on the budget size because the political viability of transferring responsibilities from member states to the EU is limited in the short term. Nevertheless, a European budget assuming these additional functions would need to be substantially larger than the EU budget today (Bouabdallah et al., 2025).

Against that backdrop, the weight of European debt has been rising. As of the end of April 2026, the EU's outstanding debt amounted to around 761 billion euros, mainly associated with the NGEU and SURE programmes and aid for Ukraine, which is equivalent to roughly 3.9% of EU GDP. However, when expressed as a share of ordinary income, the EU's debt ratio is already higher than that of the most indebted member states (Greece and Italy), underscoring the need to shore up the tax base and prevent debt from becoming a permanent substitute for European taxes. Added to this is the challenge of the delicate context surrounding the sovereign debt accumulated by member states. Although debt ratios have fallen from the peaks reached during the pandemic, the average stood at 83% in 2025, with significant fiscal risks in the short term and, in many countries, a deteriorating outlook over the medium and long term, alongside an upward-sloping interest rate curve (European Commission, 2026).

Short-term outlook: What can be done quickly?

In the short term, the space for advancement involves making the most of the existing instruments and carrying out reforms that do not require in-depth modification of the Treaties. First of all, in the last

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two years a political window has opened for centralising a growing share of the defence and security effort at the European level, particularly in the "security" area, which includes critical infrastructure, cyber defence, innovation and adjacent technological capabilities. Without having to immediately assume the 5%-of-GDP target established as the long-term benchmark within NATO, the EU can already coordinate and finance joint programmes to increase efficiency and reduce overlaps across the 27 national armies and governments.

Secondly, over the past decade, the Commission has presented several proposals to diversify the EU's own resources, associated with emblematic policies such as the Emissions Trading Scheme (ETS), the Carbon Border Adjustment Mechanism, and the OECD Pillar One corporate tax reform. The most recent proposal, presented in July 2025 in the context of the Multiannual Financial Framework (MFF) 2028-2034, contemplates assigning some of the revenue from the ETS and CBAM to the European budget and introducing new sources based on uncollected electronic waste, excise duties on tobacco and the creation of a Corporate Resource for Europe (CORE), an annual financial contribution levied on large businesses, scaled

according to their net turnover brackets. Gradual progress in implementing these proposals is realistic and would diversify the EU's sources of financing and reduce its dependence on national contributions based on gross national income. Moreover, there is room to increase VAT compliance and introduce levies on e-commerce imports from outside the EU. Taken together, these measures would broaden and diversify the EU's income stream without having to depend exclusively on national contributions.

Lastly, there is scope for cementing the use of proven collective insurance schemes like SURE, transforming extraordinary responses into more stable mechanisms capable of creating an economic security buffer in the event of severe shocks. This transition can be undertaken gradually, tapping spending ceilings and clear rules to avoid perverse incentives.

Medium- and longer-term outlook: Towards a European treasury

Over a longer-term horizon, the ambition should be to create an authentic European treasury responsible for multiannual fiscal planning, end-to-end debt management, relations with the national contributors

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and tax authorities and the preparation of sustainability reports.

From a legal standpoint, the main lever remains Article 311 of the Treaty on the Functioning of the European Union (TFEU) and decisions on own resources, which today require unanimity in the Council and ratification by national parliaments. In the medium term, two non-mutually exclusive avenues are worth exploring: gradual reform within the Treaties to broaden the shared tax bases and reinforce the role of the European Parliament; and a route of enhanced cooperation among willing groups of countries, emulating the blueprint used to forge ahead with the creation of the euro.

The remit should encompass collective defence programmes with a greater emphasis on European planning and funding, external action and industrial policies relating to critical technologies and cross-border transport, energy and digital communications networks, as well as safeguards against extreme events subject to ‘radical uncertainty’, which could overwhelm the fiscal capacities of heavily indebted countries. [2] Even though extending the field to include ordinary social protection programmes is more controversial, the experience built up around collective insurance for unemployment and stabilisation mechanisms in response to asymmetric shocks provides a foundation on which to build, while respecting the diversity of national welfare states. The synthesis of studies presented in Lago Peñas (2026) points to an annual cost that could reach half a percentage point of EU GDP.

On the income side, progress would need to be made towards stable and significant participation in the major taxes, especially VAT and corporate income tax. With respect to VAT, its broad and relatively stable base, coupled with the high degree of harmonisation already attained, lends itself to articulating a European tranche that would partially replace the current national contribution, to be offset by an equivalent reduction in the national tranches. In the area of corporate tax, the higher mobility of tax bases, the risk

of unhealthy tax competition and the need to preserve the uniformity of the internal market justify moving towards a common tax base, structured so that the European and national authorities could share regulatory powers and revenue streams. This shift should preserve aggregate tax neutrality, strengthen the visibility around the link between European taxation and policies and be accompanied by common administration and control mechanisms to limit fraud, avoidance and discrepancies in compliance.

On the political economy of European integration

Unquestionably, the creation of a federal European treasury faces considerable legal, institutional and political economy obstacles. The need for unanimity on the creation of own resources and subsequent national ratification renders each attempt at fiscal reform a complex process, vulnerable to cross-border vetoes and tensions between net contributors and net recipients.

Moreover, differences in priorities among countries, the surge in euroscepticism and the perception that fiscal federalisation implies higher taxes and greater public interventionism fuel resistance. Vertical fiscal neutrality, *i.e.*, the reduction of national taxes as European taxes increase, could be key to mitigating that resistance by explaining that the change does not necessarily affect the overall size of the public sector.

Elsewhere, the link between taxation and political representation needs to be reinforced to ensure the legitimacy of the new federal treasury. Expanding the role of the European Parliament in the creation and supervision of the EU’s own resources, together with formulas for involving the national parliaments in key decisions, could help to close the gap between Europe’s taxpayers and its tax decisions. Lastly, the fiscal illusion associated with the extensive use of debt and the moral hazard implicit in risk-sharing must be addressed through clear rules and transparency.

Conclusions

Recent experience shows that the EU is capable of moving forward on its fiscal integration when crises reveal the costs of inaction. However, relying solely on this reactive dynamic will not be enough to tackle structural challenges such as the twin green and digital transitions, economic security, and the provision of public goods.

A federal European treasury, as depicted in this paper, would provide a coherent framework for reallocating powers, reinforcing its fiscal capacity and making the provision of public goods and management of risks more efficient and equitable. In the near term, the priority should be to gradually expand the joint effort around defence and security, consolidate collective insurance schemes and link new sources of revenue to emblematic policies, while respecting vertical fiscal neutrality.

In the medium term, the agenda should be to build a European treasury with a clear mandate and broader remit. The political economy underpinning this process suggests that the windows of opportunity will remain open in times of crisis but also that consolidation of a federal treasury will require consistent agreements over time, transparency and stronger links between taxation and meaningful representation.

Notes

[1] This paper is based on a longer document whose title translates as “Building a federal European treasury: Goals and instruments”, which can be retrieved from https://www.funcas.es/documentos_trabajo/la-construccion-de-una-hacienda-federal-europea-objetivos-e-instrumentos/

[2] Between 1981 and 2023, natural disasters caused around €900 billion in direct economic losses in the European Union, at 2023 prices. Only around a quarter of the losses resulting from extreme weather and climate events were insured. This protection gap does not mean that all uninsured losses are borne by the public sector, but it can place considerable pressure on public finances when governments intervene to fund emergency relief, compensation or reconstruction (European Central Bank and European Insurance

and Occupational Pensions Authority, 2024). Moreover, all indications suggest that annual losses will increase substantially relative to their historical average.

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