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Towards a next generation of joint borrowing in Europe

by

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Abstract

Europe's experience with the issuance of supranational debt backed by national sovereigns has spanned over seven decades by now. Despite differing aims and designs, joint borrowing initiatives have respected clear boundaries: only temporary issuances to finance new expenditure in response to crises or ad-hoc needs, no debt mutualisation, no common Treasury with a permanent fiscal capacity, no transfer union.

This paper argues that groundbreaking geopolitical and macro-financial shifts call for reassessing at least some of these boundaries, today. In a world where the new normal is competition and confrontation with predatory superpowers along with frequent systemic shocks, joint borrowing could finance European Public Goods (EPGs) essential to Europe's autonomy and resilience – and do so, for the first time, on a *permanent, strategic* basis. We explain how a '*coalition of the willing*' open to future entrants could make headway through ad-hoc intergovernmental arrangements, going beyond Treaty-based boundaries and taking account of the broader context in which joint borrowing needs to take place.

We also explore whether, in this changed context, there may be scope – and under which conditions – for partial replacement of national debt with new European instruments with joint-and-several guarantees so as to foster financial market integration and the emergence of a genuine European safe asset. A proposal it outlined to this aim.

Ultimately, progress toward the next generation of joint borrowing in Europe will hinge not on legal design but on political will, fiscal discipline, and mutual trust – a pragmatic path toward deeper European sovereignty.

Keywords (JEL classification)

fiscal policy (E62), financial aspects of economic integration (F36), debt, debt management and sovereign debt (H63), intergovernmental relations, federalism (H77), Europe: economy and development (O52)

Non-technical summary

Europe's experience with the issuance of supranational debt backed by sovereign national guarantees dates back to the 1950s. It spans more than seven decades, from the European Coal and Steel Community to NGEU, SAFE, and the financing of Ukraine. Despite differing aims and designs, all initiatives have shared a consistent underlying logic – a 'Brussels consensus' – which has so far defined clear boundaries for collective issuance. Six interlinked features stand out:

1) Joint issuance has always been designed to address ad-hoc policy objectives or in response to shocks and crises; it has never served as a strategic, lasting goal, or as a routine fiscal instrument.
2) Each scheme was temporary, carefully avoiding steps toward a fiscal union.
3) Borrowing has financed new expenditure or lending (flow approach), but it has never replaced national sovereign debts (stock-and-flow approach).
4) Liabilities have never been fully mutualised; guarantees were pro-rata, not joint-and-several.
5) Issuance has been managed by institutions such as the European Commission or the ESM, not by a common Treasury with a permanent central fiscal capacity (CFC).
6) Initiatives have excluded any "transfer union".

Why has the EU never evolved toward a permanent and mutualised fiscal capacity? The prevailing objection has been that such a step would require transforming the Union from a confederation into a federation of states. As long as autonomous taxing rights and the related accountability remain national, moving beyond the Brussels consensus is seen as undermining democratic legitimacy. A majority view crossing both the anti-federalist and federalist camps has been that only a political union with a CFC could sustain permanent common debt. The cart of joint borrowing, it is argued, must follow, rather than precede, the horse of political union. This has been reflected in Articles 310 and 312 of the Treaty on the Functioning of the European Union (TFEU), which prevent the EU from engaging in permanent borrowing as a general fiscal function, but do not preclude exceptional borrowing backed by earmarked revenues.

Consequently, all attempts to 'cross the Rubicon' of the Brussels consensus have failed, including proposals for (i) a permanent CFC for macroeconomic stabilisation or (ii) the creation of a European safe asset designed to replace part of national sovereign debts along a stock-and-flow approach.

Yet this reasoning deserves a reassessment, today. With the start of a new historical phase where all major economies are competing to channel global savings into productive domestic investments, and where an increasingly 'Darwinian' geopolitical environment demands strategic autonomy, the rationale for joint borrowing has changed. The focus has shifted to long-term financing of *European Public Goods (EPGs)* that safeguard Europe's resilience and sovereignty. This is typically the case with transnational investments in defence, security, clean energy, digital transformation, and other high-tech industry.

In this changed context – and given that Member States' governments are not willing to establish a European federal state, nowadays – a different approach has been gaining traction: promoting a *coalition of the willing* that would initiate *permanent and strategic* common borrowing, thus changing the first two pillars of the Brussels consensus. This would be open to any Member State that wishes to join on a subsequent stage, and would represent an intermediate step between the status quo and a future federal state, as envisaged in the Schuman Declaration of 1950. Following Mario Draghi's notion of *pragmatic federalism*, willing Member States could finance the joint procurement of large-scale, innovative investment projects that no single country could efficiently undertake alone. Their fiscal multipliers would be the higher the more spending targets European goods, includes a strong R&D component, is debt-financed, and is front-loaded.

Common sovereign issuance by willing European countries can take either of two forms. (A) *enhanced cooperation* under the EU Treaties among at least nine Member States, as recently done by 24 EU countries on the occasion of a loan to Ukraine; or (B) *ad-hoc intergovernmental arrangements* outside the EU legal framework, akin to the European Stability Mechanism (ESM). We examine the main features of, and trade-offs between, these two approaches, and conclude that only Option (B) can produce a genuine shift towards a next generation of joint borrowing in Europe. We also argue that common debt issuance should not be seen in isolation, but as just one out of many public funding avenues available to complement and support the private sector in the financing of strategic investment. Common issuance, moreover, should be integrated in a broader strategy also involving joint R&D and procurement, as well as well-thought industrial policies.

While, at least in an initial phase, participating countries would continue to only finance new expenditure on a pro-rata basis and without joint-and-several guarantees, the shift to permanent and strategic financing would mark a significant step forward, anchoring cohesion in strategic necessity.

However, funding EPGs on a flow basis alone would not suffice to integrate European financial markets and create a safe asset of global scale. The article therefore explores whether and how a coalition of the willing may also, over time, replace part of their sovereign bonds with a new common asset – thus adopting a stock-and-flow, joint-and-several approach.

A development supporting this evolution may be the recent convergence of sovereign yields across major euro area issuers. According to one view, this may reflect the emergence of a *de facto* European benchmark – not a legally joint liability, but a collectively priced confidence premium that mitigates idiosyncratic shocks. Even without full fiscal integration, investors may perceive a partial European "risk floor" that would reflect, among other factors, expectations of implicit mutual support and ECB readiness to prevent disorderly market fragmentation.

While the jury is out whether such observed yield convergence truly reflects a structural shift or, rather, is destined to break once confronted with larger economic or geopolitical shocks, the article outlines the conditions and modalities under which a coalition of the willing could pursue such an ambitious path. It shows that moving beyond some of the features (3)-(6) of the Brussels consensus would require mutual, binding commitments to fiscal sustainability, enforced through mechanisms stronger than today's EU fiscal framework. A proposal is sketched, which focuses on a stock-and-flow approach and joint-and-several guarantees.

It is clear that such an initiative would bring major benefits. The euro area still lacks a genuine safe asset comparable to U.S. Treasuries. This hinders capital market integration, limits the international role of the euro, and constrains Europe's strategic autonomy.

Ultimately, the proposals advanced in this article build on Mario Draghi's fertile idea of pragmatic federalism. Their internal logic highlights the enduring tension at the heart of European fiscal integration: balancing fiscal discipline, solidarity, and political feasibility.

These tensions are not contradictions but structural features of the European project. The success of any initiative will depend less on its legal form than on the participating states' willingness to enforce fiscal discipline and uphold mutual trust over time. Only then could a credible common European benchmark – and, with it, a genuine safe asset – gradually emerge.

1. Introduction

Europe has a long history of issuance of supranational debt, relying on the explicit or implicit backing by the participating Member States via fiscal contributions or guarantees[I]. Such joint borrowing started in the 1950s and by now spans more than seventy years of post-war integration.

At the time of the European Coal and Steel Community (ECSC), common debt issuance backed by the ECSC's own resources was used to finance investments in coal and steel industries[II]. In the years of the European Economic Community (EEC), programmes for limited amounts included the Euratom loans to finance nuclear energy projects (from 1977), the New Community Instrument to support regional development and industrial investment (1978-1981), and the Balance-of-Payment (BoP) loans to support Member States experiencing external financing stress (1975 onwards).

After the European Union (EU) entered into force in November 1993, a series of common issuances have followed one another at an increasingly frequent pace. Until Russia's war of aggression in Ukraine, the main goals of the initiatives were:

- providing non-euro area EU countries with BoP assistance during crises[III];
- since the 2010s, financial assistance to euro area members in crisis, initially via the European Financial Stability Facility (EFSF) and the European Financial Stability Mechanism (EFSM) (2010-14), and then through the European Stability Mechanism (ESM, from 2013);
- in 2020-2026, funding the programmes in response to the COVID-19 pandemic, namely Support to mitigate Unemployment Risks in an Emergency (SURE, 2020-2023) and NextGenerationEU (NGEU; 2021-2026). The latter has been by far the most important initiative to date, in terms of both size and ambition. The EU's issuance volume increased massively after the launch of the programme in 2021. By early 2024, it had reached levels comparable to Spain, while remaining considerably lower than that of the three largest euro area economies (Bańkowski et al., 2024).

The war in Ukraine has in turn sparked, directly or indirectly, new European borrowing programmes:

- since 2022, the EU Macro-Financial Assistance (MFA) to Ukraine (loan component);
- the Ukraine Facility, which entered into force in March 2024 and provides stable financing for Ukraine's recovery, reconstruction, and EU accession. It amounts to €50bn, spread over four years (2024-2027);
- the SAFE (Security Action for Europe) initiative, adopted by the Council of the European Union (henceforth: Council) in May 2025. The European Commission (henceforth: Commission) committed to issue additional bills and bonds from 2025 until 2030, backed by the EU budget. The purpose is to raise up to €150 billion in capital markets, to be lent to the requesting Member States with the aim of funding common procurement of defence capabilities;
- a new package of financial support to Ukraine, amounting to EUR 90bn over 2026-2027, which the Council agreed upon in December 2025[IV]. As in previous initiatives, this support will be financed on financial markets via EU borrowing and is guaranteed by the EU budget's headroom. Most importantly, joint borrowing will for the first time be implemented under a regime of *enhanced cooperation*[V], involving in this specific case 24 out of 27 Member States. This sets an important precedent (Castaldi, 2025; Fabbrini, 2025; Fabbrini, 2026; Union of European Federalists, 2025), but does not fundamentally change the key features of EU borrowing discussed below.

Finally, the Commission has also proposed, on 16 July 2025, additional joint issuance programmes under the next EU budgetary cycle (2028-2034)[VI], but the related debate in the European Council and Parliament is ongoing and their approval cannot be taken for granted at this stage.

While these episodes of joint debt issuance have differed in their specific objectives, scope, and design, they share a common institutional and legal logic, which has set clear boundaries for collective borrowing in Europe.

Six recurring features of what we may call a 'Brussels consensus' stand out.

First, joint issuance has always been designed to *address ad-hoc policy objectives, or in response to shocks and crises*; it has never served as a strategic, lasting goal, or as a routine fiscal instrument.

Second, all schemes have been explicitly *temporary* in nature, avoiding any step toward a fiscal union.

Third, joint borrowing has financed new spending or targeted lending, but it has never mutualised or refinanced existing national debts. In technical terms, borrowing has followed a *flow approach*, not a stock-and-flow approach (Bini Smaghi, 2025; Messori, 2025).

Fourth, there has been *no full mutualisation* of national liabilities. While Member States have contributed to issuance initiatives according to pre-defined criteria (direct or indirect guarantees or, in the ESM case, paid-in capital), their guarantees have been pro rata (i.e., each country is only liable for its part), not 'joint-and-several'[VII].

Fifth, issuance has been managed by institutions such as the *Commission* or the *ESM,* not by a common Treasury with a permanent central fiscal capacity (CFC).

Sixth, while inter-country transfers have been possible and could, at times, be very significant as in the case of NGEU, *permanent fiscal transfers across countries were consistently avoided* under the principle of "no transfer union."

Against this backdrop, three questions are addressed in this article:

- In the *past*, why did the EU never 'cross the Rubicon' toward a more permanent and mutualised CFC, involving common issuance with more advanced characteristics? Section 2 focuses on this issue, also reviewing the main proposals which did not go through.
- In the *present debate*, are any new factors emerging which would push to cross the Rubicon by upgrading at least some of the six features above? This is discussed in Section 3.
- In a *possible future*, what kind of novel borrowing initiatives would look not only meaningful, but also feasible in the current political and legal environment? And how may more advanced joint borrowing be structured? A tentative reply is suggested in Section 4, where we initially postulate a discontinuation of the first two features of the Brussels consensus, and then sketch a (partial) relaxation of other features.

2. The past

2.1. Why the Rubicon has never been crossed

From an *institutional perspective*, the prevailing objection to permanent and mutualised EU debt has been that it would imply empowering the Union with autonomous taxing rights, a European Treasury[VIII], and a Parliament with full fiscal sovereignty – transforming the EU into a de facto federation. As long as citizens elect national governments responsible for taxation and debt, it is argued, going beyond the Brussels consensus would require transferring the link between democracy, taxation, and accountability also at the European level[IX].

From a *legal perspective*, this institutional setting has been reflected in Articles 310 and 312 of the Treaty on the Functioning of the European Union (TFEU), which configure EU spending not as a general function of the EU government, but only to the extent that a future stream of revenues − the EU's own resources, be them genuine EU revenues or national contributions − has been earmarked. As a result, the issuance of new EU debt has been subject to the need to pre-constitute an asset matching the liabilities incurred, in the form of additional own resources allowing for debt repayment over a specified time horizon. This principle of 'budgetary equilibrium in the medium term' implies that borrowing can only be envisaged for spending and transfers related to specific projects and pre-set time horizons: in other words, the Brussels consensus on EU borrowing is not only historically determined, but to a significant extent also grounded in the EU Treaty.

The latest decision on funding of the €90bn loan to Ukraine has been no exception to this discipline[X]. Even in a context of extreme geopolitical urgency, and with overwhelming political support (24/27), the EU had still to resort to exceptional, carefully ring-fenced borrowing, rather than acknowledging a more general debt issuance power. Yet that decision sets an important precedent insofar as it implements joint borrowing via enhanced cooperation for the first time; its possible future implications are discussed in Section 4.1.

Lacking a will by Member States to approve higher EU own resources, the current EU budget has so far been limited to slightly above 1% of EU gross national income (GNI), a share that remains virtually unchanged even in the most recent Commission's proposal for the next Multiannual Financial Framework (MFF; 2028-34). Member States accept centralised transfers only insofar as these do not interfere with national budgetary control. Moreover, the bulk of EU revenues (around 80-85%) stem from national contributions, not genuine EU own resources. The latter are limited to specific tools and collected by national authorities on behalf of the EU (e.g., custom duties on imports from outside the EU, levy on non-recycled plastic packaging waste, etc.).

A historic opportunity to change this framework was offered when the monetary union process was initiated in the early 1990s, with the signing of the Maastricht Treaty. However, a fiscal union implying a permanent CFC was deliberately ruled out in that Treaty. In particular, Article 125 explicitly forbids the Union, or individual Member States, from assuming the debts of other Member States ('no bailout clause', as discussed e.g. in Padoa-Schioppa (2004) and Cochrane, Garicano and Masuch (2025)). In this legal context, any genuine shift at EU level to joint-and-several borrowing would require Treaty change and, in most countries, a constitutional amendment or referendum.

From an *economic* perspective, these institutional and legal reasons have been compounded, especially in 'frugal' Member States and conservative political circles, by a fiscal doctrine prioritising budgetary discipline at the *national* level ('put your house in order') along with prevention of moral hazard in the Economic and Monetary Union (EMU). As joint-and-several liability would mean that all states share the same borrowing cost regardless of national policy choices, creditor countries have feared that mutualised debt would have encouraged irresponsibility and weakened market discipline. Converting national debt into Eurobonds, moreover, would effectively socialise legacy liabilities, which fiscally conservative electorates deem unacceptable.

This contrasts with the federal fiscal model, according to which the states that are part of a federation should pursue balanced budgets, but this can *only* be credible in the presence of centralised fiscal transfers to such states along with federal spending that funds common projects on shared goals or addresses unforeseen shocks (Draghi, 2023). A federalist EMU would, therefore, entail *more*, not less fiscal discipline across EU Member States than the 'put your house in order' principle implies.

At any rate, the majority view – which has crossed both the anti-federalist and the federalist camps – has been that only a political union with permanent CFC could sustain permanent common debt. The cart of joint borrowing, it is argued, should follow rather than precede the horse of political union.

In the *political* debate, this view has been confronted with the contrarian view that permanent common debt could be created even without a fully-fledged political union. The supporters of this view have observed that, in many respects, the EU presents elements of a political union since 1979 (i.e., the direct election of the European Parliament), and even more so after the Lisbon Treaty, which entered into force in December 2009. Furthermore, especially in the federalist camp, many have considered it strategic to anticipate political outcomes, especially when they are required as a response to existential threats for the EU and its Member States – following Jean Monnet's famous statement, 'Europe will be forged in crises, and will be the sum of the solutions adopted for those crises' (Monnet, 1976). According to this view, the emergence of 'institutional contradictions' as a result of crisis-driven decisions would later require Member States to address them by adjusting the EU institutional framework[XI].

The interaction between these two views and the aforementioned legal boundaries have resulted in the Brussels consensus, implying that all attempts to cross the Rubicon have failed so far. The two most prominent, and yet unsuccessful proposals are recalled in the next sub-section as this will help better appreciate the present debate.

2.2. Failed attempts to cross the Rubicon

According to one strand of literature, common debt issuance should have funded – along with reprioritisation of the EU budget and tapping of new EU own resources – a *permanent CFC for macroeconomic stabilisation* purposes (Kenen, 1969 and subsequent literature[XII]). Cross-border fiscal transfers would have helped counteract adverse business cycle shocks on top of national fiscal policies, thereby completing EMU architecture. By fostering business cycle convergence in the euro area, this would have enhanced risk sharing and empowered the single monetary policy.

While this proposal has periodically resurfaced in EU policy debates – most notably in the Five Presidents' Report (2015) – it has been losing momentum over the past decade. As Draghi (2023) noted, three developments may have, at least to some extent, reduced the need for CFC to primarily focus on macroeconomic stabilisation:

i. *Major changes in both the reaction function of the central bank and EMU architecture*. Drawing lessons from the sovereign debt crisis of 2010-12, the European Central Bank (ECB) now sees unwarranted increases in sovereign spreads as a fundamental impediment to the smooth transmission of its monetary policy. The announcement of the potential use of ECB instruments such as the Outright Monetary Transactions (OMT; 2012) and the Transmission Protection Instrument (TPI; 2022) has enhanced the ability of national fiscal policies to stabilise the cycle beyond the use of automatic stabilisers, thus improving monetary-fiscal interactions in the presence of shocks. Moreover, crisis-related measures such as the Pandemic Emergency Purchase Programme (PEPP; 2020-22) have usefully complemented Commission's initiatives like NGEU when the Union has been affected by major shocks like the pandemic. Finally, a large set of new initiatives, rules and institutions have been introduced since the 2010s and point to a significant upgrade of the EU economic governance, with main focus on the prevention and resolution of macroeconomic and financial crises.

ii. *Some progress made by the euro area in complying with the optimum currency area criteria* (Mundell, 1961 and subsequent literature[7]). A number of economic developments have somewhat mitigated the need for fiscal transfers within the EU for macroeconomic stabilisation purposes. Notably, business cycles tend now to be more synchronised across countries than in the past (Martinez-Martin, Saiz and Stoevsky, 2018), while supply chains have become more integrated in the Single Market (European Commission, 2023).

iii. *The changed nature of shocks in more recent years – from mostly idiosyncratic and asymmetric to increasingly common and symmetric*, as in the case of the pandemic and the war of aggression in Ukraine (Boni et al., 2025). This has shifted the emphasis from supporting struggling Member States towards addressing shared challenges, thus leading to a better alignment of political preferences.

In the light of these developments, in the past fifteen years the policy emphasis of joint issuance was not on the goal of stabilising the business cycle through a permanent CFC, but on the need to address major shocks via *temporary* tools like NGEU and SURE. According to the latest Commission's proposal on the next MFF (2028-2034), an Extraordinary Crisis Mechanism would be activated in case of severe crises, but this would, once again, require joint issuance only on an extraordinary basis.

A second, important strand of literature that has, so far, not moved forward in the policy arena, has revolved around the proposal on a *European "safe asset"*, to be jointly issued with the purpose of replacing part of national sovereign debts along a stock-and-flow approach (see e.g. Brunnermeier et al., 2017; Leandro and Zettelmeyer, 2019; Amato et al., 2022; Blanchard and Ubide, 2025; Messori, 2025; Bini Smaghi, 2025; Sachverständigenrat, 2025). In this case, the motivation has been more financial than macroeconomic in nature: the euro area lacks a truly safe and liquid asset comparable to U.S. Treasuries[XIII]. This hinders the integration and liquidity of European capital markets, keeping them fragmented along national lines. It also limits the international role of the euro and Europe's strategic autonomy (Lagarde, 2025a and 2025b).

To address these hindrances and reduce risk across the whole spectrum of European sovereign bonds, the EU/euro area would issue common debt instruments. According to most proposals, this would happen via a supranational institution like the Commission, the ESM, or a possible new European Debt Agency. The ensuing proceeds would be used to buy or swap part of national sovereign bonds, thus transforming a portion of national debt into a single euro-area-backed safe asset.

Many different, alternative modalities have been outlined to put this scheme into effect (for a review of the main contributions and discussion of their limitations, see Messori, 2025). We focus here on two of the most influential recent proposals.

Blanchard and Ubide (2025) have suggested that the Commission issue new 'blue bonds' with senior status for the euro area. The proceeds would be used to purchase national sovereign bonds available in the market, for up to 25% of the GDP of each participating country. To make the scheme credible, each country would ring-fence a dedicated revenue stream to service the debt issued under the scheme. In this way, blue bonds would be guaranteed via ad-hoc revenues rather than joint liability, implying no full mutualisation of debt. As the Commission would be protected thanks to its status as a preferred creditor, this would not involve fiscal transfers between countries, even in the event of a default by one of them. The cost of a possible default would be borne by the other creditors. However, as the authors acknowledge, to make the blue bonds sufficiently large and safe, national governments would have to relinquish sizeable fiscal resources (e.g., a portion of the VAT revenues) to service this common issuance. This may encounter fiscal limits at country level. Moreover, while the proposal avoids full debt mutualisation, there could be political resistance as countries may indirectly fear bearing others' risks. Having said that, even as the authors envision a large-scale issuance, ideally by all euro area countries, they do not rule out that *a smaller group of willing countries could pilot it first.*

Messori (2025) has in turn identified the ESM as the body best placed to issue Eurobonds gradually replacing national debts. As the author does not foresee a flexible opt-in model, his proposal seems to apply to the whole euro area. The ESM capital that could be called in (over €600bn) and the ensuing lending power make of this institution a logical vehicle, though its 'triple A' rating and credibility would depend on strong guarantees. At the same time, Messori acknowledges that the current capital base of the ESM remains too small to support large-scale issuance, while increasing it looks politically and financially unfeasible. The only viable safeguard – introducing joint-and-several guarantees among euro area states – would entail an indirect transfer of national sovereignty, raising legal and political obstacles under the EU's framework. Consequently, while this scheme outlines a coherent path toward deeper fiscal integration, it remains legally uncertain and politically unrealistic in the current context.

Not surprisingly, several governments have opposed this kind of proposals. Low-debt countries believe that a joint debt instrument, even if mutualising sovereign risk only partially, would reduce the incentives for fiscal discipline in high-debt countries and create transfer risks from fiscally prudent to heavily indebted members. Even if framed as an asset swap with limited issuance, opponents fear a slippery slope toward full Eurobonds and quote the no-bailout clause. Many EU Member States also disagree on the significant transfer of national sovereignty to European institutions that any replacement of national debt with common debt would imply. The Commission currently cannot permanently use the EU budget as general debt collateral. Temporary exceptions, such as the Recovery and Resilience Facility (RRF) of NGEU, confirm this rule as key Member States oppose the rollover of the related debt, thus implying a reduction in the stock of EU debt. The ESM Treaty in turn allows loans with conditionality, but not large-scale asset swaps or purchases of sovereign debt.

As long as the EU treaties will not be changed, this kind of proposals would be viable *only if adopted by 'coalitions of the willing' through an intergovernmental treaty outside the EU legal order, and as long as the instrument remains institutionally and financially separate from the EU budget*. This is discussed in the remaining part of this article.

3. The present debate

3.1. What is changing today: (a) the main goal of joint borrowing and the group of potential sovereign debt issuers

From the historical excursus, legal stocktaking and review of the literature conducted in Sections 1 and 2, one may infer that joint borrowing will remain 'ad-hoc and temporary' – the first two features of the Brussels consensus – unless, in a hypothetical future of European integration, it would become the byproduct of a European federal state.

This conclusion, however, deserves re-examination today, in the light of major recent developments that have shifted the consensus on both (i) the *main goal of joint borrowing* and (ii) *the range of potential sovereign debt issuers*. This could justify a move to '***permanent and strategic' common issuance by coalitions of the willing***[XIV] as an intermediate step between the status quo and a future, but currently unrealistic federal state.

The global environment and Europe's strategic needs have been hastily changing. In a world where all major economies are competing to channel global savings into productive domestic investments, where the cooperative order that supported decades of economic integration shows signs of fragmentation (Chari et al., 2025), and where the emergence of a 'Darwinian' geopolitical context has been demanding global actors to rise to the challenge or risk extinction, the financing of European Public Goods (EPGs) has turned into priority. Recent developments related to the funding and resolution of the war of aggression in Ukraine, the future of defence in Europe, the US National Security Strategy 2025 and subsequent events (e.g., the military operation in Venezuela and the Greenland crisis in January 2026), have further added to this sense of urgency.

EPGs can be defined, following the well-known definition of Musgrave (1973), as goods which every European benefits from ('non-rivalrous') and where the benefits for one individual do not reduce the benefits for others ('non-excludable')[XV]. Today, this is typically the case with strategic transnational investments in defence, security, clean energy, digital transformation including artificial intelligence (AI), and other high-tech industry. A critical mass of such investments would enhance not only Europe's strategic autonomy but also its economic growth, given fiscal multipliers that on the whole are estimated to be larger (see Section 4.1 for further detail).

In both the policy and the academic debate, the main focus of potential joint borrowing has therefore shifted from special objectives and crisis management to contributing to the *long-term financing of EPGs* (see Panetta, 2022 and 2025; Buti and Messori, 2022; Draghi, 2024; Dorrucci et al., 2024 and 2025; Aven Janse et al., 2025).

This approach requires setting clear and ambitious objectives for mobilising resources and aligning efforts across sectors. Achieving these objectives entails a change in perspective: a *holistic, mission-oriented approach* (Mazzucato, 2021) that starts from the investment objectives and asks how the *entire* arsenal of financial instruments – at the national or EU level, existing or to be created, and whether private, public, or public-private partnerships (PPPs) – could be mobilised to achieve those objectives without undermining the sustainability of public and/or corporate debt.

Within this broader framework, joint borrowing in Europe should not be seen in isolation, but as just one of the many instruments available to boost productivity and complement the private sector in the financing of strategic investment. Accordingly, out of 172 proposals in the Draghi report on "The future of European competitiveness" (Draghi, 2024), the issuance of common debt is framed as one possible financing avenue among others, not as the backbone of the report as some have claimed. At the same time, joint borrowing offers significant comparative advantages over sole reliance on own resources in the EU budget and constitutes a necessary complement to the other instruments. Debt financing enables large-scale, rapid mobilisation of capital for EPGs – a feature that is particularly suitable for the initial ramp-up phase of EPG investments, which require high upfront costs while returns occur over the longer term. Borrowing also allows to spread financial costs over time, preventing cuts to health, cohesion, social, or other existing programmes, without requiring immediate increases in Member States' contributions.

In the same vein, Dorrucci et al. (2024 and 2025) have estimated, on the basis of official EU and NATO documents, the needs for additional strategic investments (private and public) that are required to implement the defence, green, and digital transitions. Focusing on the public funding component, they show that, even assuming that it would be possible to use all fiscal space and funding toolkit currently available at the national and Union level, a significant *funding gap* would remain for such investments. This gap cannot realistically be closed by only resorting to national solutions, such as lowering non-strategic public expenditure and introducing ad-hoc taxation at country level. As a result, a more cohesive Europe should pragmatically be seen as a *condicio sine qua non* for strategic investment. This encompasses not only joint borrowing, but crucially also implementation of (i) the Savings and Investments Union and (ii) the Competitiveness Compass (Commission, 2025), (iii) joint procurement initiatives, and (iv) a reform of the EU budget towards a scaled-up size, reallocation of expenditure to strategic investment, and higher EU own resources.

Against this backdrop, numerous and diversified sources make the case or indirectly justify the introduction of permanent and strategic joint issuance in today's Europe (see e.g. Draghi, 2024; European Commission, 2025; Aven Janse et al., 2025; Darvas et al., 2025a; Mejino-Lopez and Wolff, 2025; Burilkov and Wolff, 2025; Dorrucci et al., 2024 and 2025; Lagarde 2025a and 2025b; NATO 2025). From a legal and institutional perspective, an ad-hoc intergovernmental arrangement would make such issuance feasible, as discussed in Section 4.

The resistance to exploring such an avenue is, therefore, mostly *political* in nature. The current German government, most notably, has reiterated the country's opposition to permanent joint debt issuance for strategic investment, even just under a flow approach – a posture that the Council's decision on Ukraine of December 2025 has not fundamentally changed. Germany prefers to rely on its own fiscal resources (Habermas, 2025), taking advantage of its relatively low public debt. With the reform of the debt brake approved in March 2025, however, the Merz government has recognised that productive investments and other strategic public spending cannot be sacrificed to the dogma of a fully balanced budget[XVI] – a conclusion that other countries would share. Germany itself is expected to experience an increase in its debt-to-GDP ratio in the coming years as a by-product of its strategic spending plans (Zettelmeyer, Darvas and Welslau, 2025)[XVII].

In this context, the idea of a *coalition of willing states* that issues joint debt on a flow basis to finance investment in EPGs has been making headway in recent times, especially, but not exclusively, in the area of defence. On top of traditionally favourable countries like France, Italy or Spain, even countries like Finland, Denmark and, more recently, the Netherlands have been embracing a more flexible position, arguing that Russia's war of aggression may validate a new way of thinking.

Several policymakers, thinktanks and academics have endorsed this idea. To quote a few, Draghi (2025a) has observed that '(…) the next logical step will be to consider common debt for common projects, at the EU level or among a coalition of Member States.' Lane (2025) has in turn stated that '(…) in addition to initiatives at the European Union level, there could also be scope for joint issuance by subgroups of Member States in the context of investment projects that can be shared by coalitions of the willing.' Wolff, Steinbach and Zettelmeyer (2025) have proposed the creation of a European Defence Mechanism (EDM) built around the idea of market borrowing via joint bonds supported by members' capital to finance large, cross-border investment in defence-related 'strategic enablers'[XVIII]. The debt proceeds would either purchase and retain such goods on the EDM's balance sheet or be lent to members under coordinated terms. Hildebrand, Rey and Schularick (2025) in turn call for the joint issuance of 'European Future of Defence Bonds' (EFDB) by a 'Team Europe' in order to finance the next generation of defence-related strategic enablers.

The idea of coalitions of the willing to pilot further European integration has been gaining ground not only with regard to joint borrowing, but also, in more general terms, as a response to Treaty-based veto power. Lagarde (2025c) has underscored that '(…) we can intensify collaboration between groups of countries willing to progress faster, not as exclusive clubs, but as pioneers whose progress ultimately contributes to the strengthening of all'. Draghi (2025b) has further elaborated on this form of collaboration, introducing the fertile idea of ***pragmatic federalism***:

> ' (…) however desirable a true federation would be, it would require political conditions that do not exist today. And the challenges we face are too urgent to wait for them to emerge. A new, pragmatic federalism is therefore the only viable path forward. This is a federalism that is issue-based, flexible and able to act outside the slowest mechanisms of EU decision-making. It would be built by coalitions of the willing around shared strategic interests – recognising that Europe's diverse strengths do not require every country to move at the same pace. (…) Because opting in would require national governments to secure democratic support for specific shared goals, it would become a bottom-up construction of common purpose – not a top-down imposition. All those who want to join could do so – while those who seek to block progress would no longer be able to hold others back'[XIX].

3.2. What is changing today: (b) convergence of issuance costs among major European government borrowers

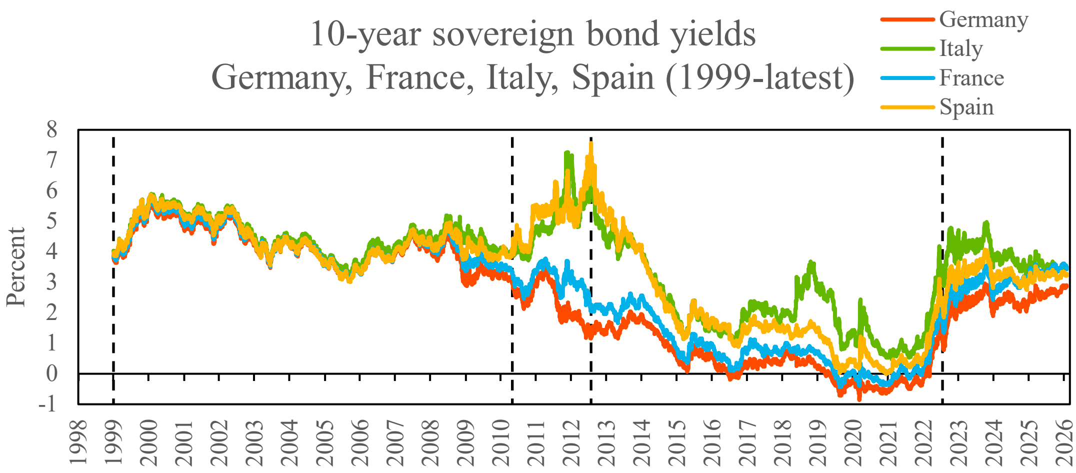
Another recent development that might set incentives for (forward-looking) leaders to promote the next generation of joint borrowing in Europe is *renewed convergence of sovereign yields across euro area issuers*. This, however, deserves further scrutiny as it is still unclear to what extent we are witnessing a structural shift or a short-lived phase.

Reflecting both global bond market trends and country-specific factors, yield curves reshaped in 2025 as euro area core rates and long-term yield benchmarks rose, but intra-area yield spreads narrowed. By mid-January 2026, German ten-year yields had increased moderately relative to end-2024, while Italian and Spanish spreads over the Bund had narrowed significantly. French government bonds in turn displayed resilience despite continued domestic political uncertainty (Charts 1 and 2).

According to one interpretation, market participants would be increasingly pricing a de facto European benchmark – not a legally joint liability, but a confidence premium that mitigates idiosyncratic shocks. Even without full fiscal integration, investors may be internalising some form of "European risk floor", reflecting not only the ECB's resolve to prevent disorderly market fragmentation, but also other factors. For instance, Lane (2025) observes that 'other national bonds also directionally contribute to the stock of safe assets as Bunds alone are too small to meet global demand'.

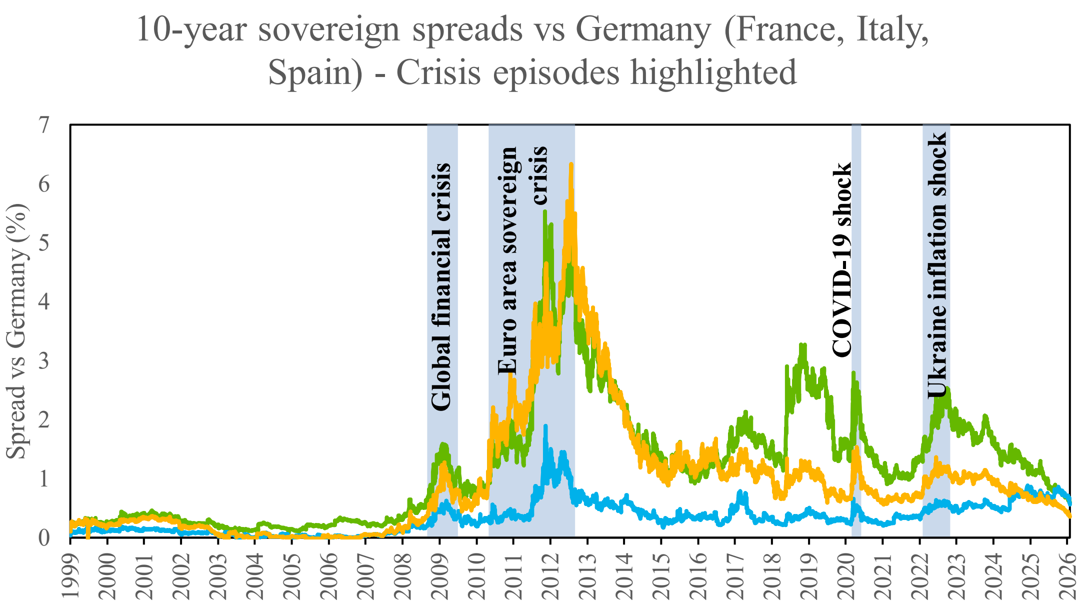
This configuration could, in principle, create more favourable conditions for coalitions of the willing to implement joint debt initiatives similar to the above-described proposal by Blanchard and Ubide (2025). This conclusion, however, warrants further analysis and supportive evidence. It remains unclear whether the observed yield convergence reflects a durable structural shift or a temporary phenomenon that could reverse in the face of larger economic or geopolitical stress.

Chart 1



Source: Bloomberg, daily data. Period: 1.1.1999 - 26.1.2026.
Notes: Vertical lines mark: a) start of the euro and the single monetary policy (1/1/1999); b) onset of euro area crisis (May 2010); c) ECB announcement of Outright Monetary Transactions (OMT, 26/7/2012); d) ECB announcement of Transmission Protection Instrument (TPI, 21/7/2022).

Chart 2



Source: Bloomberg, daily data. Period: 1.1.1999 - 26.1.2026.
Notes: Ten-year sovereign yield spreads of France, Italy and Spain vis-à-vis German Bunds. Shaded areas denote major episodes of financial stress in Europe.

Which *structural factors* may drive, today, the higher correlation, compared to the past decade, of returns among euro area sovereigns, and the substantial convergence of their yields (currently all within a range of 100 basis points for the 10-year segment)? Large institutional investors, including pension funds, insurers and exchange-traded funds (ETFs), frequently treat euro-denominated sovereign debt as a single asset class. Nenova (2025) finds that international bond portfolios handle euro area sovereigns not just individually but *substitutionally*, supporting the notion of a regional safe asset premium. Moreover, the euro area's institutional architecture has evolved significantly since the early 2010s: crisis-era debt restructurings have ended; macroeconomic adjustment programmes have largely achieved their objectives (Filip, Masuch, Setzer and Valenta, 2024); and important reforms – including the creation of the banking union, strengthened crisis-resolution mechanisms and updated fiscal governance – have all reinforced the policy framework. Recent shifts in U.S. policy may have also somewhat increased the relative attractiveness of European sovereign debt as a safe-asset alternative (Deutsche Bank, 2025; Lagarde, 2025a and 2025b; Merler, 2025; Rey, 2025).

On the other hand, *meaningful yield differentials vis-à-vis German Bunds persist* (Chart 2). International investors continue to regard German securities as the primary euro-denominated risk-free benchmark. France's public debt trajectory and political outlook remain sources of potential stress, as rating-agency assessments confirm. More broadly, Europe's fiscal and financial architecture still falls short of full integration[xx], leaving doubts about the system's capacity to deliver uniform responses under severe conditions. This underscores the continued importance of credible national policies and a fiscal and financial governance that is both coherent and enforceable.

For these reasons, it remains uncertain whether current conditions would enable the issuance of a genuinely safe common asset on a stock-and-flow basis. Nor is a parallel with the early years of the euro appropriate: back then, spreads nearly vanished because sovereign risks were mispriced, not because underlying fundamentals had converged. Today's spread compression rests on more solid foundations, but remains largely contingent on the ECB's anti-fragmentation stance and the political commitment to maintain fiscal discipline across Member States.

In sub-section 4.2 we will come back on this discussion in more operational terms.

4. Possible future developments

4.1. How could a coalition of the willing borrow to fund strategic investment in EPGs on a permanent basis?

Looking ahead, how could a coalition of the willing finance EPGs through the ***permanent and strategic*** issuance of new common debt? This sub-section follows a flow approach (Options A and B), while Section 4.2 will explore how this approach may, over time, evolve into a stock-and-flow scheme (Option C). In this perspective, the three options envisaged in this paper could also be seen as progressive steps of a process eventually aiming at the creation of a European safe asset (objective that only Option C would credibly pursue). This is summed up in Table1.

The main ***objective*** of novel issuances would be to finance the joint procurement of large-scale, innovative projects that no single European country could efficiently undertake alone. These projects would be both strategic and transformative in nature. Arguably, a critical mass of countries agreeing on joint borrowing for the financing of EPGs may be easier to achieve if the basket of projects were broad enough to capture different national perspectives.

In the area of *defence*, a pool of European sovereign borrowers could aim at 'rapidly developing joint defence assets that allow interoperability and operational efficacity of European forces without U.S. strategic enablers' (Quinet et al., 2025). Examples include an autonomous constellation of military and communication satellites, which would ensure secure connectivity independent of non-European providers; integrated anti-missile and anti-drone defence systems ('European sky shield'); hypersonic weapons and drones; strategic airlift (heavy transport aircraft and aerial refuelling systems); enhanced cybersecurity and shared intelligence capacities; and joint facilities for training and rapid deployment of armed forces (Hildebrand, Rey and Schularick, 2025; Quinet et al., 2025). Ideally, such investments would not only facilitate interoperability across national armies but also supply a multinational military force as part of a 'European Defence System' (Gallo et al., 2024; Camporini and Moro, 2025).

Beyond defence, joint sovereign borrowing could be instrumental to the public sector's efforts to support and complement the private sector in the financing of the *green and digital* *transitions* – and, more generally, *investment at the technological frontier*. Typically, this would comprise the funding of cross-border clean energy (Nerlich et al., 2025) and digital infrastructure. Examples are transnational electricity grids, hydrogen transport and storage networks, critical-mineral processing technologies, advanced software, artificial intelligence (AI) factories and other infrastructure, quantum computing, cyber capabilities, robotics, and sovereign European cloud services capable of hosting sensitive data under EU jurisdiction (see e.g. Draghi, 2024).

Because strategic innovation is a continuous and dynamic process, the examples above are far from exhaustive. As the initial projects would over time evolve into new projects, the liabilities stemming from joint issuance for the financing of EPGs would preferably become permanent in nature, with the corresponding assets being allocated to the balance sheet of the common entity responsible for their use. Collectively, such initiatives would strengthen Europe's strategic autonomy, support the defence, green and digital transitions, and increase the continent's resilience to external shocks.

If properly implemented, these projects would also carry relatively high *fiscal multipliers*, thereby boosting economic growth[XXI]. Public investment in strategic innovation and infrastructure typically stimulates private investment, enhances productivity, and creates high-quality employment. In particular, spending on innovative defence and digital infrastructure can generate positive spillovers into civilian technologies, logistics, and industrial ecosystems. The cross-border scope of these projects would amplify their macroeconomic impact through positive cross-country spillovers, reinforcing economic cohesion among Member States, although incentive compatibility must be addressed to ensure incentives are well aligned to secure wider participation.[XXII]

These outcomes, however, are not automatic. The challenge is substantial and requires well-designed, comprehensive strategies (Clover et al., 2025). Military buildups, in particular, entail reallocating capital and labour from other sectors, which can be both costly and time-consuming. Under supply constraints, the relative price of military equipment may rise, meaning governments could acquire less capability for a given expenditure (Antonova, Luetticke and Müller, 2025). As Ilzetzki (2025), Checherita-Westphal et al. (2025), and Bokan et al. (2025) show, the fiscal multipliers of defence spending vary widely depending on its implementation. They tend to be higher when spending targets European-made goods, has a strong R&D component, is debt-financed, and is front-loaded rather than delayed.

Joint borrowing would be well placed to meet these conditions. It should also be coupled with *joint R&D and procurement* among participating countries. This would reduce financing costs and improve efficiency by centralising demand, allowing for better contracts and interoperability, and stimulating innovation through larger and more predictable orders that incentivise private R&D and industrial scaling. Experience from the RRF and the European Defence Fund (EDF) suggests that joint financial and procurement frameworks can leverage national and private resources while aligning incentives around shared goals. Pooling creditworthiness through common issuance would lower risk premia, allowing participants to finance strategic autonomy at lower costs than individual Member States could achieve alone.

Turning to the ***institutional and operational framework***, joint borrowing by a coalition of the willing on a flow basis could in principle be implemented through either *enhanced cooperation*, in compliance with relevant EU law (Option A), or *ad-hoc intergovernmental arrangements* outside the EU legal framework (Option B). These options, however, are not equivalent. In the following, we argue that, while more could be done under Option A than is currently the case, only Option B would allow for strategic issuance on a permanent basis.

<u>Option A - Enhanced Cooperation</u>

Although EU law did not preclude it, until the Council's decision on Ukraine of 19 December 2025 there was no precedent of using enhanced cooperation for joint sovereign borrowing. Even more now, with a precedent being there, the question arises to what extent could this instrument be also used to create a dedicated budgetary facility empowering a coalition of willing Member States to finance EPGs. Could the Council authorise, following a Commission's proposal, a group of willing Member States to jointly issue *European Enhanced Cooperation Bonds* (EECBs), thus enabling such countries while keeping the initiative open to future entrants? And within what limits could this happen?

Enhanced cooperation (Article 20 TEU and Articles 326 to 334 TFEU - see footnote 6) allows a sub-group of Member States – nine at least – to move forward jointly, using EU institutions under an EU legal umbrella, thereby smoothing institutional legitimacy and administrative efficiency.

However, an important implication of Option A is that *all its acts must comply with EU law in full*. This would include, among others, the above discussed Articles 310 and 312 TFEU. As a result, joint borrowing via enhanced cooperation should continue to remain *exceptional,* *project-specific, and have pre-identified repayment resources* – all conditions which the funding of the loan to Ukraine fulfils. Other relevant EU provisions would be, for instance, the non-discrimination principle, the rules governing the internal market, and competence boundaries.

In the case of borrowing for defence-related EPGs, in particular, this would likely complicate the combination of joint issuances with joint procurement. In this case, the participating Member States would have to take measures to protect their essential security interests, given the sensitive nature of defence procurement. While Article 346 TFEU allows the participating Member States to derogate from EU procurement law under such circumstances, the European Court of Justice has always interpreted this possible exemption from EU procurement rules in a *narrow* way: Member States can only deviate from EU law (e.g., on competition in the internal market, including the Directive on defence and sensitive security procurement[XXIII]) on a case-by-case basis and when they are able to prove that it is necessary and proportionate for their essential security interests (Sundstrand, 2023).[XXIV] As a result, *each* Member State participating in a coalition of the willing would have to justify the use of Art. 346 for *every* specific defence-related procurement. This would strongly condition not joint borrowing per se, but the joint procurement accompanying it. The participating countries would have to either stay within EU procurement law (including, if applicable, the Directive on defence and sensitive security procurement) or each Member State would need to individually invoke Article 346 to exempt the defence procurement.

These legal considerations bring to the conclusion that *the creation of joint instruments, such as EECBs, for the funding of EPGs would well be possible, but only provided that they do not become a permanent borrowing programme financing strategic objectives on a lasting basis*. In line with Articles 310 and 312 TFEU, EECBs' issuances would have to remain exceptional, purpose-bound, revenue-backed operations. The rollover of debt over time would not be allowed. For this reason, and as discussed below under Option B, an intergovernmental arrangement would be the only way forward to mitigate these boundaries. Moreover, Option B, while remaining subject to Art. 346, would be preferable also because it could introduce ad-hoc provisions improving the overall conditions necessary for effective joint procurement in the defence sphere (Hildebrand, Rey and Schularick, 2025). This would be consistent with the principle of handling joint borrowing not in isolation, but as part of a broader package involving joint R&D, procurement and industrial policy.

Under Option A, the participating countries would continue to guarantee common debt proportionally, without crossing into joint-and-several liability. Servicing costs could be covered by dedicated own resources or national contributions linked to the mechanism, backed only by the budgets of participating states (no transfer union).

The Commission, acting on behalf of the participants and under Parliament and Council oversight, would serve as the issuing agent for EECBs. It could use the same infrastructure as existing EU borrowing programmes, such as the EU Primary Dealer Network. This would maximise investor familiarity.

Finally, while EECBs could not formally be labelled 'EU debt' (as this would require unanimity), they would likely be perceived as quasi-EU assets, earning relatively high credit ratings, though below those of Bunds.

Option B - Ad-hoc intergovernmental arrangement

If the participating Member States were prepared to move to a *new generation of joint borrowing in Europe*, involving debt issuance on a permanent basis for strategic purposes, they could complement EU law with additional, ad-hoc provisions. A coalition of the willing could thus initiate an intergovernmental arrangement outside EU law. This would allow for greater freedom of choice, flexibility and speed, though at the expense of more complex integration into the EU legal order.

Mirroring the ESM Treaty, the participating countries could establish a special-purpose financing vehicle (SPV) separate from the EU budget[XXV]. This SPV would issue *Strategic Investment Bonds* (SIBs) in its own name, guaranteed by the participating states on a several (but not joint) liability basis.

At least initially, SIBs would likely trade at higher yields than EECBs because of their legal novelty. Their market credibility would depend on the guarantee's structure and membership composition: the broader and 'fiscally healthy' the coalition, the more attractive the instrument to global investors.

Regarding the potential ***size*** of issuances, amounts would likely exceed those currently managed by the Commission, reflecting Europe's long-term investment needs. For instance, Hildebrand, Rey, and Schularick (2025) postulate a coalition of sixteen willing EU Member States and estimate that they could finance €1.8 trillion cumulatively between 2026 and 2035 through 'European Future of Defence Bonds'.

Depending on political consensus, issuance could begin with a relatively small coalition and expand gradually once the mechanism proves effective. ***Non-EU partners*** such as the United Kingdom, Norway, or Switzerland, could also be invited to co-finance specific projects, particularly in defence and security, thus reinforcing Europe's collective capacity without requiring full institutional membership.

Turning to the joint procurement aspects, Option B would be preferable. While still relying on Art. 346 for possible exemptions from internal market rules, an intergovernmental treaty could: (i) create a *dedicated joint procurement agency* that would accommodate confidentiality and other defence-specific processes; (ii) introduce *flexible procedures* tailored to e.g. military secrecy and interoperability; (iii) allow the participating countries invoking Article 346 to do so not only on an individual basis, but also *simultaneously and with a common legal justification*, thus reducing the risk of possible litigations; (iv) design procurement, its joint financing and the related industrial policies along *coherent, multi-year programmes*. This would allow for security discretion, a more flexible governance, and a better integration of different policies.

In conclusion, the choice between Option A and Option B would depend on the willingness to move towards a next generation of joint borrowing in Europe – which could only be done under Option B – as well as a careful assessment of the other described trade-offs. In particular, the design of a more comprehensive strategy, of which joint borrowing would only be one element, could be better accommodated under Option B.

If properly designed, both options may deliver to several participating countries lower borrowing costs than national issuance, while strengthening European financial markets. A deeper and more liquid market for European bonds would also enhance the international role of the euro, improve monetary transmission, and mark an intermediate step toward a genuine European safe asset – attracting global investors and reinforcing confidence in European economic governance.

4. 2 Is there any scope for a coalition of the willing to move further ahead, and how?

A key strength of the flow approach outlined in the previous section is that, *if* a coalition of the willing decided to proceed, the initiative would probably have good chances to succeed. Its main weakness, as Bini Smaghi (2025) and Messori (2025) note, is that funding EPGs on a *flow basis alone* would be insufficient to integrate European financial markets in the short to medium term, and therefore inadequate to create a ***safe asset of sufficient international scale***.

According to Bini Smaghi (2025), the critical mass required to achieve this goal would amount to at least *€5 trillion*, or roughly one-third of euro area GDP. This figure broadly corresponds to the combined entire value of French OATs (€1.5 trillion), Italian BTPs (€2 trillion), and Spanish Obligaciones del Estado (€1.5 trillion) currently in circulation – an amount roughly twice the outstanding stock of German Bunds, and much higher than the aforementioned flow-based scenarios.

By the end of this decade and under current policy assumptions, the gross EU debt issued by the European Commission (i.e., excluding the EIB, EFSF and ESM) could amount to roughly 1.1 trillion, including SURE (€98bn), NGEU-related (€730bn) and Ukraine-related (€140bn) debt, as well as SAFE (€150bn). Such debt is temporary in nature and, in any case, insufficient to attain the required dimension (Darvas, Welslau and Zettelmeyer, 2025).

As discussed in Section 2.2, the most effective way to reach a critical mass would be replacing part of the sovereign bonds currently held by euro area Member States with a new common asset – an option that, for the foreseeable future, remains politically and institutionally unfeasible at the level of the whole euro area.

At the same time, *if* a sufficient number of euro area countries were willing to do so – in the spirit of Draghi's pragmatic federalism and taking advantage of the favourable market conditions discussed in Section 3.2 – they could launch a joint issuance plan through an SPV established *outside the EU legal framework*.

While, at first glance, this initiative might resemble Option B described earlier, in reality it would be much more complex, challenging and ambitious, as Option C below illustrates. This would involve not only permanent strategic issuance, but also relaxing or discontinuing some of the other features of the Brussels consensus, notably moving in the direction of a ***stock-and-flow approach and joint-and-several guarantees***. Such a more advanced solution would be "first best" for the purpose of creating a European safe asset and bolstering the international status of the euro.

This could be done in different ways. For example, Sachverständigenrat (2025) has recently proposed the introduction of 'European Safe Bonds' (ESBies) through which member states' government bonds would be 'pooled according to a fixed formula and divided into safe and risky tranches'. Given the high debt burden of some EU member states, this would have to be accompanied by 'a new mechanism in case of potential defaults'.

We sketch below how, in our view, a coalition of the willing may move ahead along this avenue along a distinct Option C.

<u>Option C – Progressive mutualisation of national liabilities</u>

Under this proposal, the securities issued by a European coalition of the willing would be jointly and severally guaranteed by all participating countries. They would need to adopt a comprehensive common framework governing not only the instrument's architecture – its governance, issuance techniques, characteristics, emission quotas, etc. – but also, crucially, mutual and binding commitments to ensure the sustainability of national public finances.

Of course, there would be significant trade-offs depending on the group of participating countries. On one end of the spectrum of country configurations, a pool limited to the euro area members with AAA-rated bonds – Germany, the Netherlands and Luxembourg, which accounted for €2.6 trillion at the end of 2024 – would produce the safest and cheapest supranational debt, but also be relatively small, exclusive, and politically unlikely. On the other end, a pool comprising France, Italy and Spain would make sense in terms of size, market depth and policy relevance, but would necessitate a very robust framework to ensure credit enhancement and sound governance.

Without claiming to be exhaustive on such a complex and technical topic, some key features of a credible pooling scheme could be:

- an SPV established under a *new intergovernmental treaty*, enshrining fiscal discipline of the participating countries and, as a core pillar, stronger enforcement mechanisms than the recently reformed Stability and Growth Pact;
- governing bodies including:
    - a Board composed of the *Finance Ministers* of participating countries, with well-thought voting rules,
    - an independent *Fiscal Council* mandated to verify, certify and, when needed, enact compliance;
- *automatic budgetary adjustment mechanisms* in the event of significant fiscal deviations by Member States (e.g., temporary automatic increases in contributions), to be enforced by the Fiscal Council;

- issuance of bonds with irrevocable, unconditional, *joint-and-several* guarantees, with proportional country contributions (e.g. according to GDP and population weights);
- partial *backing through common revenues* (such as a defined share of national VAT) to enhance creditworthiness, with pari passu payment obligations governed by Luxembourg law;
- a *tranching plan* including:
  - a senior tranche with a pre-funded reserve that would serve as collective backstop to protect senior bond holders in case of extreme stress, and
  - a junior tranche that is sufficiently large and well capitalised[XXVI];
- incorporation of adequate *collective action clauses* (CACs);
- a predictable *public issuance* schedule;
- the creation of a *primary dealer network* and any other measures to enhance liquidity and stimulate market demand for common issuances;
- more broadly, ensuring that the bonds' governance and characteristics are sufficient for *ECB collateral eligibility* and *investment-grade status* from inception.

Regarding the *process* to set up such pooling scheme, an initial 'flow phase' could be designed to promote and establish the new common bonds on European and international markets, as discussed under Option B. A 'stock phase' would subsequently aim to replace part of existing national debt with common instruments through voluntary swaps – along lines similar to the Blanchard and Ubide (2025) proposal – or refinancing at maturity.

Participation in the SPV should remain open, allowing the market for common bonds to expand gradually as more countries join. Ideally, in a final phase these common bonds could be replaced by fully-fledged common issuances at euro area level (see Table 1). Indeed, Option C retains certain risks (such as political fragmentation in the EU bond market) and potential costs (liquidity premia for national debt due to the smaller size of national borrowing pools) that cannot be overcome until a European-level joint borrowing is established within a political union, thus making Option C a sub-optimal solution for the purpose of creating a European safe asset when compared with the creation of a federal State – but still much better than Option A and Option B.

We leave it to the readers to form their own judgement on the political feasibility of such an ambitious proposal, and under which time horizon.

Whatever the conclusion about viability, the potential benefits of Option C would be clear. If implemented, this initiative would:

- provide investors with a highly liquid, internationally credible safe asset, potentially serving as a new global benchmark[XXVII];
- mobilise savings to finance EPGs;
- help mitigate the sovereign-bank doom loop, as banks in participating countries would hold more diversified sovereign portfolios;
- strengthen the negotiating position vis-à-vis non-participating Member States on the path toward a genuine European safe asset;
- reduce issuance costs;
- lower the volatility and vulnerability of national public debts.

If one of the participating countries were to face a period of political instability, the solidarity of the other issuers, combined with the enhanced fiscal discipline embedded in the mechanism, could help stabilise confidence, thus preventing a loss of trust comparable to that experienced during the euro area sovereign debt crisis.

Quasi-federal common issuance could also act as a financial lifeline, enabling participating countries to withstand future endogenous or exogenous shocks in a context of growing international uncertainty. Being the destinies of European countries deeply intertwined, such an initiative – by strengthening market confidence and stabilising national debts – could prevent a new systemic crisis that may otherwise overwhelm the euro area as a whole.

At the same time, the degree of ambition of this proposal is evident. Its success would require strong political will, underpinned by a firm commitment to fiscal discipline from participating countries and, in the longer term, by a credible path toward political union.

5. Conclusions

The proposals and options outlined in this article can be summarised in the stylised format shown in Table 1. They point to the conclusion that, between the status quo and a possible European federation sometime in the future, *intermediate approaches* to joint borrowing would be well possible, and, in the current geopolitical context, desirable.

Options A, B and C leverage on the fertile idea of pragmatic federalism that Mario Draghi has recently advanced. Their logical coherence should not obscure the deeper tension at the core of European fiscal integration: the balance between solidarity, fiscal discipline, and political feasibility.

The *flow* approach presented in Sections 3.1 and 4.1 and in the second and third column of Table 1 offers a pragmatic path forward by enabling a coalition of willing Member States to finance EPGs within the limits of what one may consider today's political reality. Yet, the very pragmatism of Options A and B constrains its systemic impact: without a sufficiently large and liquid market for common bonds, the flow approach cannot deliver a genuine European safe asset. Nonetheless, we believe that moving from special and temporary to permanent and strategic common issuance (Option B) would *per se* mark a major step forward in the process of European integration.

Turning to the *stock-and-flow* approach sketched in Sections 3.2 and 4.2 and the last two columns of Table 1, Option C (let alone the final goal of a federal state) would overcome the limitations of the flow approach, but only subject to the creation of a scheme that requires the very degree of trust, policy alignment and long-term commitment it is designed to foster.

These tensions should not be seen as contradictions, but as structural features of the European project itself. They reflect a process in which institutional and political convergence advance in parallel rather than sequentially. Ultimately, the success of any such initiative will depend less on its legal design than on the willingness of participating states to sustain fiscal discipline and mutual confidence over time. Only then could a credible, common European benchmark – and with it, a genuine safe asset –gradually emerge.

Table 1 - Joint borrowing in Europe: options and stages

	Today's Brussels consensus	**→ Option A**	**→ Option B**	**→ Option C**	**→ Future European Federation**
	EU-level debt (existing instruments)	*European Enhanced Cooperation Bond* (existing instrument)	*Strategic Investment Bond* (new instrument)	*European Safe Bond* (new instrument)	*European Treasury bond* (new instrument)
Can respond to shocks	∨	∨	∨	∨	∨
Investment in European Public Goods	∨	∨	∨	∨	∨
Strategic and permanent debt instrument	⊗	⊗	∨	∨	∨
Stock-and-flow approach	⊗	⊗	⊗	∨	∨
Joint and several liability	⊗	⊗	⊗	∨	∨
Enhanced enforcement of fiscal rules	⊗	⊗	⊗	∨	∨
Requiring some form of fiscal union	⊗	⊗	⊗	∨	∨
Creating a euro-denominated safe asset	⊗	⊗	⊗	∨	∨
Issued by a body with permanent CFC	⊗	⊗	⊗	⊗	∨
Estimated debt stock (illustrative orders of magnitude)	€1,100 bn *	+ €1,800 bn **	+ €1,800 bn plus **	+ €5,000 billion ***	€10,000 billion ****

* estimate of gross EU debt issued by the European Commission by 2030 under current policy assumptions, including SURE (€98bn), NGEU-related (€730bn), Ukraine-related (€140bn), and SAFE (€150bn). This figure represents a plausible upper-range estimate, not a legally-fixed ceiling, and excludes the debt issued by the EIB, EFSF and ESM. Principal reimbursement and interest payments not considered.
** estimate under the assumption of a coalition of sixteen willing EU Member States, cumulatively between 2026 and 2035 and limited to 'European Future of Defence Bonds' (source: Hildebrand, Rey and Schularick, 2025); in addition to existing EU-level debt. Under Option A, the programme would be ad-hoc and end in 2035. Under Option B, the programme could continue also thereafter and be coupled with other standing programmes ('permanent and strategic approach'); the related debt would be rolled over.
*** estimate based on the illustrative hypothesis of conversion into common debt of the combined entire value of French OATs (€1.5 trillion), Italian BTPs (€2 trillion), and Spanish Obligaciones del Estado (€1.5 trillion) currently in circulation; in addition to existing EU-level debt.
**** estimate based on the illustrative hypothesis of conversion of the general government gross debt of euro area countries up to 60% of the current euro area GDP, stocked by acquiring part of national debts (today euro area public debt is around 88% of euro area GDP) through the issuance of new United States of Europe (USE) bonds. For reference, the current US gross federal debt amounts to 123% of GDP

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[I] A special case is the European Investment Bank (EIB), which was founded in 1958 under the Treaty of Rome. The EIB is an *autonomous, non-fiscal agency outside the EU budget*, and its debt is of a banking rather than budgetary nature. While its capital is subscribed by sovereigns, their guarantees are callable capital, not budgetary commitments. Different is the case of the European Stability Mechanism (ESM), which is an intergovernmental body whose decisions require national ratification and political oversight. ESM debt is fiscally backed and jointly guaranteed by the euro area Member States.

[II] The ECSC first borrowed on capital markets in 1954, when it issued a CHF 35 million bond.

[III] From 1999, euro area members shared the single currency and thus no longer had national BoP crises in the classical sense.

[IV] Pursuant to the Proposal for a Regulation of the European Parliament and of the Council implementing enhanced cooperation on the establishment of the Ukraine Support Loan for 2026 and 2027, presented by the Commission on 14 January 2026, it is a limited recourse loan: Ukraine will only have the obligation to repay if and when it receives reparations from Russia. Until then, the EU will roll over the underlying bonds in the markets. The interest costs and possible calls on the guarantee will be subsidised by the EU through the EU budget, with an adjustment mechanism to exclude contributions from the non-participating Member States, pursuant to Article 11 of the Making Available Regulation (Regulation EU, Euratom No 609/2014), in respect of any operational expenditure borne by the Union budget, comprising in particular debt service costs, as well as calls on the guarantee.

[V] The possibility to resort to enhanced cooperation is envisaged by Article 20 of the Treaty on European Union (TEU) and Articles 326-334 of the Treaty on the Functioning of the European Union (TFEU). According to these provisions, when, on a matter that requires unanimity, EU Member States do not manage to reach such unanimity, a group of at least 9 Member States can ask to establish enhanced cooperation to advance with the measures foreseen, despite the lack of unanimity. If the Council agrees to enhanced cooperation, the Member State(s) that opt out do not bear the financial costs and cannot take part in the decision-making related to it.

[VI] They include: (i) Catalyst Europe, consisting of up to €150bn in EU-backed loans for strategic investment; and (ii) the Extraordinary Crisis Mechanism, which would be activated in case of severe crises and consist of loans to Member States for up to €400bn.

[VII] *Joint and several'* liability means that (i) if one guarantor cannot reimburse the debt, the others remain fully liable for the entire amount, and (ii) each guarantor is individually responsible for the full debt vis-à-vis creditors. This is currently not the case in the EU. For example, under NGEU, all EU Member States are collectively responsible for ensuring repayment of the principal and interest through future contributions to the EU budget between 2028 and 2058. However, *creditors have no legal claim against individual Member States*. The debt is issued in the name of the EU and is secured by the EU budget, not by national treasuries or the own resources of specific countries. Therefore, NGEU engenders a *pro rata, EU-budget-backed liability*, not a joint-and-several liability. A full mutualisation of national debts would only be compatible with the Treaty on the Functioning of the European Union (TFEU) under Article 122, which allows financial assistance in *exceptional circumstances beyond Member States' control*. Such arrangements must remain temporary and cannot establish a permanent transfer or debt mutualisation mechanism.

[VIII] While the absence of genuine tax powers implies the absence of an EU Treasury empowered to borrow, the move to unified EU funding since 2023 has marked one significant step in that direction.

[IX] Some have criticised this argumentation. It has been pointed out that the political and institutional evolution of the EU has at the very least cast doubt on the validity of the objections to permanent and mutualised EU debt. The emergence and consolidation of European parties, the strengthening of the political dimension of the Commission, the growing relationship of trust between the European Parliament and the Commission, the politicisation of the European Parliament, and the now inextricable interconnection between the European political-institutional system and national ones have led to talk of a Euro-national "composite Constitution" (Lupo, 2019).

[X] Also in this case, borrowing is linked to a specific objective, the amount is capped, the repayment is pre-identified, and the time horizon is finite.

[XI] The best-known example has been the prioritisation of the monetary union before the creation of an economic, fiscal and financial union – which some did not see as a strategic mistake, but as a deliberate step towards further integration deepening, required to deliver monetary stability in Europe after a series of shocks (collapse of Bretton Woods international monetary order in 1971-1973, crisis of the European Monetary System (EMS) in 1992-1993).

[XII] More recent contributions include: Beetsma, Cimadomo, and van Spronsen, J. (2022); Beetsma, Cima and Cimadomo. (2018); and Arnold, Barkbu, Ture, Wang, and Yao (2018).

[XIII] Despite their high rating, EU bonds do not behave like genuine safe assets. Being considered as supranational and not truly sovereign in nature, they are excluded from the main sovereign indices that serve as benchmarks for large institutional investors. In a market where many investors must stay close to their benchmarks, this exclusion sharply reduces the set of potential buyers (Bonfanti, 2025) and increases borrowing costs due to factors such as lower liquidity and uncertainty about the EU's consistency as an issuer (and despite strong credit ratings and established infrastructure). Moreover, debt issued by the Commission is not backed by capital as in the cases of the EIB and the ESM, and therefore usually presents relatively higher yields.

[XIV] The expression 'coalitions of the willing' has longstanding roots in defence-related literature, but its broader application to any form of European strategic autonomy was first developed in Blanchard and Pisani-Ferry (2025).

[XV] For a conceptual framework on EPGs, see Buti and Messori (2024). For a discussion of European vs. national public goods, see Claeys and Steinbach (2024).

[XVI] This reform allows for debt financing above 0.35% of GDP for defence spending that exceeds 1% of GDP. It also creates an extrabudgetary fund of €500bn to finance infrastructure projects over 12 years.

[XVII] The authors also show that the German investment plans would inevitably lead to a breach of the current EU fiscal framework.

[XVIII] In the context of European military expenditure, 'strategic enablers' refers to critical capabilities and resources that support the effective planning and execution of military operations, thereby enhancing operational readiness among the participating countries. Key examples include logistics, transport and mobility, intelligence, and cybersecurity.

[XIX] It should be emphasised that the idea of pragmatic federalism differs from that of "Europa à la carte". In the latter case, the emphasis is on the possibility to opt out from the process of integration, not on the objective of deeper integration, and on preserving the intergovernmental approach and national sovereignty, not on sharing sovereignty across countries as in Draghi's approach.

[XX] Bouabdallah et al. (2025) provide a first assessment of the fiscal and economic implications of the reformed Stability and Growth Pact over the short and medium term, in the light of the Medium-Term Fiscal Structural Plans of the EU Member States. For a broader review of the reformed EU fiscal framework in a historical perspective, see Haroutunian et al. (2024). Arampatzi et al. (2025) present an assessment of the progress made over the past decade in advancing the Capital Markets Union, the challenges encountered, and the concrete steps required to move forward.

[XXI] For a recent assessment of the macroeconomic impact of the ongoing shift in defence spending in the EU, see Croitorov et al. (2025).

[XXII] Depending on the types of EPG investment that joint borrowing by a coalition of willing states may choose to finance, this might affect the incentives of others to join later. For instance, if EPG investment focuses on energy interconnections, the resulting lower energy prices may benefit the countries outside the coalition who import energy from the coalition's members. Since such outside countries would benefit even without participating, their incentives to join the coalition might be limited. Conversely, if EPG investments are in the area of critical minerals refinement, there might be fewer positive externalities and therefore stronger incentives to join the coalition.

[XXIII] Directive 2009/81/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of procedures for the award of certain works contracts, supply contracts and service contracts by contracting authorities or entities in the fields of defence and security, and amending Directives 2004/17/EC and 2004/18/EC.

[XXIV] The European Court of Justice has repeatedly held that this derogation must be interpreted strictly. It may be invoked only when the application of EU rules would obstruct the protection of essential security interests, and it is up to the Member States invoking Article 346 to bear the burden of proof in showing necessity and proportionality (see Case 222/84 Johnston and later cases C-414/97, C-337/05, C-157/06, C-615/10). This is already how joint procurement works today via the European Defence Agency (EDA).

[XXV] In principle, the SPV could be housed within the ESM, which is already established via intergovernmental treaty, is experienced in bond issuance and well capitalised. Moreover, being ESM debt off member-state balance sheets, this would be "a key advantage given fiscal constraints and NATO commitments" (Hildebrand, Rey and Schularick, 2025). However, the ESM was only designed as a crisis mechanism for the euro area, not as a general financing vehicle. This implies that the related intergovernmental Treaty would need to be significantly changed. For that reason, the creation of an ad-hoc SPV may be more feasible.

[XXVI] One drawback of such an approach is that, by increasing the riskiness of the junior tranche, such tranching also increases the risk of self-fulling runs on such tranches, especially during "risk-off" periods.

[XXVII] A key question is whether market participants would perceive coalition-issued debt as a safe asset or just a close substitute for EU supranational debt backed by all Member States. As previously discussed (see footnote 14), evidence suggests that investors differentiate among EU supranational bonds (e.g., the Commission vs., ESM/EFSF and EIB), with Commission bonds often priced less favourably than other supranational or some sovereign bonds, due to factors such as lower liquidity and uncertainty about the EU's consistency as an issuer. From this perspective, the success of this initiative would require the participation of large euro area issuers such as France, Italy and Spain, on a joint-and-several liability bases. This feature could improve the financial appeal of coalition debt, compared to the bonds currently issued by the Commission.

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