REBUILD

Working Paper

From the Pandemic to the War: The EU Fiscal Response to Russia's Aggression of Ukraine, the Legacy of NGEU and the Challenge to "Promote the General Welfare"

Federico Fabbrini

Co-funded by the European Union

From the Pandemic to the War:
The EU Fiscal Response to Russia's Aggression of Ukraine, the Legacy of NGEU and the Challenge to "Promote the General Welfare"

Federico Fabbrini[1*]

Abstract
The article maps the core fiscal and economic measures adopted by the European Union (EU) to respond to the Russian war of aggression and to fund Ukraine, discussing the legacy effect of the policy response to the Covid-19 pandemic. In particular the article examines the European Peace Facility, the Macro-Financial Assistance Instrument for Ukraine 2023 and the Ukraine Facility 2024-7. The article underlines how the measures adopted by the EU reproduced several of the mechanisms put in place during the Covid-19 pandemic – including the use of common debt experimented with Next Generation EU. At the same time, the article emphasizes the structural challenges in the EU constitution that limit the consolidation of a fiscal capacity in the EU.

Keywords
War in Ukraine, fiscal capacity, Next Generation EU, Ukraine Facility

1. Introduction

As the European Union (EU) was slowly re-emerging from the Covid-19 pandemic, which started in February 2020, it faced another unprecedented shock: Russia's large-scale military invasion of Ukraine, which started in February 2022. The war in Ukraine posed a major geopolitical challenge for the EU. In responding to that, however, the EU was able to build on the legal and policy measures that it had developed to address the Covid-19 pandemic. In particular, Next Generation EU (NGEU) and the use of common debt provided a template that the EU could use to mobilize financial resources to support Ukraine against Russia's aggression.

The purpose of this article is to examine the key tools the EU deployed in 2022-2024 to finance Ukraine, discussing how the EU responded to the challenge of the war in the field of economic and fiscal policy. In particular, the article overviews three instruments: first, the European Peace Facility (EPF),[2] a fund for the common purchase of weapons initially worth 5.6bn€, and subsequently increased to 17bn€; second, a temporary government support fund, the Macro-Financial Assistance Instrument for Ukraine (MFA+) for 2023, worth 18bn€;[3] and third, a long term support fund, called the Ukraine Facility (UF), amounting to 50bn€ from 2024 to 2027.[4]

As the article argues, the war in Ukraine quickly prompted the EU to replicate some of the novelties it used to respond to Covid-19. To address the devastating socio-economic consequences of the pandemic, the EU agreed in 2020 to establish ground-breaking instruments, such a 100bn€

[1*] Federico Fabbrini is Full Professor of EU Law, Founding Director of the Brexit Institute and PI of the Jean Monnet Centre of Excellence REBUILD, Dublin City University
A revised version of this article is forthcoming in a Symposium of the *American Journal of International Law* (2024)
[2] Council Decision (CFSP) 2021/509 of Mar. 22, 2021 Establishing a European Peace Facility and Repealing Decision (CFSP) 2015/528, 2021 O.J. (L 102) 14.
[3] Regulation 2022/2463 of the European Parliament and the Council of Dec. 14, 2022 Establishing an Instrument for Providing Support to Ukraine for 2023 (macro-financial assistance +), 2022 O.J. (L 322) 1 (EU).
[4] Regulation 2024/792 of the European Parliament and of the Council of Feb.29, 2024 Establishing the Ukraine Facility, 2024 O.J. (Series L) 1 (EU).

unemployment re-insurance system (SURE),[5] and the 750bn€ NGEU.[6] The latter, in particular, endowed the EU with a fiscal capacity by empowering the Commission to raise funds by issuing common debt on the financial markets, to transfer these amounts to the member states as grants and loans, and long term to levy new taxes to repay the debt.[7] Formally, these tools were designed to be temporary. Yet, they provided a legal technique and a policy template that the EU promptly re-used when facing the war in Ukraine.[8] In fact, the MFA+ and the UF entail once again common borrowing and spending, which highlights the legacy of the NGEU model and suggests a trend towards consolidating a centralized fiscal capacity at the EU level of government.

Nevertheless, structural weaknesses in the EU constitutional system challenge the EU's ability to consolidate a centralized fiscal capacity that can "promote the general welfare."[9] From a governance perspective, in the EU all decisions related to revenues and expenditures have to be taken unanimously by all 27 member states. This gives every member state government a right to veto crucial financial decisions – a power that can be abused to obtain concessions on other unrelated issues. This is exactly what happened in response to the war in Ukraine: the approval of the MFA+ in 2022, and of the UF in 2023, was delayed for several months by Hungary, which vetoed the measures as a leverage to obtain disbursement of EU funding withheld for breaches of the rule of law. These difficulties confirm that several constitutional and governance shortcomings still limit the EU's ability to mobilize resources and leverage power on the international stage. Hence, while the war in Ukraine proved correct the insight from historians, political scientists and sociologists that war is a powerful driver of state building and institutional change,[10] at the moment the effort to establish a permanent fiscal capacity in the EU remains a work-in-progress.

This article is structured as follows. Section 2 analyzes the core fiscal measures adopted by the EU to address the war in Ukraine: the EPF, the MFA+, and the UF. Section 3 highlights how the war pushed the EU to reproduce funding mechanisms based on common debt akin to those rolled out during the pandemic, and reflects on how threats to international security contributed to the slow consolidation of a fiscal capacity in the EU. Section 4, however, underlines how this trend is slowed by governance shortcomings and constitutional constraints. Finally, section 5 concludes.

2. The core measures

The weapons purchase fund is a novel funding mechanism that the EU created in 2021 as part of the financial package for 2021-2027, which is centered on the MFF and also includes NGEU. The EPF was specifically established as a special fund to finance the common costs of military operations by EU member states under the EU Common Security and Defense Policy (CSDP), as well as actions to improve the military and defense capabilities of third states and partners. From a financing viewpoint, the EPF is entirely resourced through member states' transfers determined on the basis of the Gross National Income (GNI). Moreover, as a further guarantee to member states' discretion,

[5] Council Regulation 2020/672 of May 19, 2020 on the Establishment of a European Instrument for Temporary Support to Mitigate Unemployment Risks in an Emergency (SURE) Following the Covid-19 Outbreak, 2020 O.J. (L 159) 1 (EU).

[6] Council Regulation 2020/2094, of Dec. 14, 2020 Establishing a European Union Recovery Instrument to Support the Recovery in the Aftermath of the COVID-19 Crisis, 2020 O.J.(LI 433) 23 (EU); Regulation 2021/241 of the European Parliament and of the Council of Feb. 12, 2021 Establishing the Recovery and Resilience Facility, 2021 O.J. (L 57) 17 (EU).

[7] *See* Federico Fabbrini, EU Fiscal Capacity: Legal Integration after Covid-19 and the War in Ukraine, (Oxford Univ. Press 2022)

[8] *See* Federico Fabbrini, *Funding the War in Ukraine: The European Peace Facility, the Macro-Financial Assistance Instrument and the Slow Rise of an EU Fiscal Capacity*, 11 Pols. & Governance 52 (2023).

[9] U.S. Const. pmbl.

[10] *See* Miguel A. Centeno & Elaine Enriquez, War and Society (Polity 2016), Margareth McMillan, War: How Conflict Shaped Us (Profile Books 2020), and famously The Formation of National States in Western Europe (Charles Tilly ed., Princeton Univ. Press 1975).

on the basis of Article 27 "[a] Member State which has indicated its intention to abstain from the adoption of an assistance measure [...] may identify other assistance measures to which it will make an additional contribution". This means that while the EPF is a common financial pot, each member state still maintains full control on which measures its share of the funding is directed to. Following Russia's aggression in Ukraine, the EU quickly decided to mobilize the EPF, initially worth 5.6bn€, to provide financial support to the Ukrainian military.[11] Spending under the EPF to support Ukraine was so rapid that the Council decided in December 2022 for a 2bn€ increase in the EPF for 2023,[12] in June 2023, it agreed to a further 3.5bn€ top-up of the EPF, bringing its size to 12bn€,[13] and ultimately in March 2024 it further increased the EPF envelope to a total of 17bn€.[14]

Yet, given the limited resources available under the EPF, and as the war in Ukraine worsened, in fall 2022 the European Commission proposed to establish the MFA+ in the form of a regulation of the EP and Council. This temporary fund, worth 18bn€, was designed to provide financial relief to Ukraine in 2023, thus supporting its rehabilitation and reconstruction and prospectively its preparation for EU membership.[15] From a financing viewpoint, moreover, the MFA+ is based on the issuance of common EU debt, rather than member states' transfers as the EPF. To achieve this end, the Commission proposed to amend the spending ceiling of the EU budget – the Multi-Annual Financial Framework – to enable the Commission to issue common debt. Yet, under Article 312 TFEU this change required unanimity among EU member states, and Hungary for many months vetoed the revision, to the point that the other 26 member states took steps to enable the Commission to issue debt through bilateral guarantees pro-quota. In the end, though, Hungary yielded, and the MFA+ was approved in December 2022. Pursuant to Article 16 of the regulation "in order to finance the support under the Instrument in the form of loans, the Commission shall be empowered, on behalf of the Union, to borrow the necessary funds on the capital markets or from financial institutions". The MFA+ empowers the Commission to transfer the money to Ukraine as loans, subject to favorable interest rates, and standard conditionality.

The MFA+ proved to be a successful instrument to support Ukraine, but its duration was limited to 2023. The Commission therefore put forward a new financing tool, modeled on the temporary fund, but designed for a longer period and with a bigger envelope: the UF, worth 50bn€ for 2024-7. In a European Council meeting in December 2023, 26 EU member states expressed their support for a revision of the EU budget spending ceiling and the establishment of a long-term fund.[16] However, in the same summit which blessed the opening of EU accession negotiations with Ukraine,[17] Hungary once again vetoed the approval of the UF.[18] As a result, a special European Council summit was convened on 1 February 2024, in which Hungary eventually yielded and the EU set up the UF.[19] From a funding viewpoint, this consists of 17bn€ of grants and 33bn€ of loans, which again are funded by empowering the Commission to issue common debt. Resources raised on the financial markets are then transferred to Ukraine, subject to conditionality, in accordance with a national plan approved in April 2024.[20]

[11] Elena Chacko & Katerina Linos, *Ukraine and the Emergency Powers of International Institutions* 116 AJIL 775 (2022).

[12] Council Decision (CFSP) 2023/577 of Mar.13, 2023 Amending Decision (CFSP) 2021/509 Establishing a European Peace Facility, 2023 O.J. (L 75) 23.

[13] Council of the EU press release, European Peace Facility: Council Agrees on Second Top-Up of the Overall Financial Ceiling by 3.5 Billion, June 26, 2023.

[14] Council Decision (CFSP) 2024/890 of Mar.18, 2024, Amending Decision (CFSP) 2021/509 Establishing a European Peace Facility, 2024 O.J. (L) 1

[15] European Council conclusions 23-24 June 2022, EUCO 24/22, para. 11 (granting candidate status to Ukraine).

[16] *See* European Council meeting (Dec.14 and 15, 2023) - Multiannual Financial Framework 2021-2027 Negotiating Box, Dec. 15, 2023, EUCO 23/23.

[17] European Council Conclusions, Dec. 14-15, 2023, para. 15, EUCO 20/23.

[18] *See id.* para. 24.

[19] European Council Conclusions, Feb. 1, 2024, para. 1-2, EUCO 2/24.

[20] European Commission news, 'Commission endorses Ukraine Plan, paving the way for regular payments under the Ukraine Facility', 15 April 2024.

3. Consequences

The EU financial response to the war in Ukraine reveals a trend towards the consolidation of a fiscal capacity in the EU, highlighting the dynamic nature of the EU integration process.[21] The unprecedented geopolitical threat posed by the Russian military aggression at Europe's Eastern borders forced the EU to resort to funding mechanisms analogous to those rolled out in response to the Covid-19 pandemic. As pointed out in the prior section, at the start of the war in Ukraine the EU deployed for the first time the EPF. Nevertheless, its limited size – and arguably its complicated governance arrangements – quickly led the European Commission to propose an alternative funding instrument, in the form of the MFA+. The MFA+ enabled the Commission to raise 18bn€ on the financial markets on behalf of the EU, and to transfer these to the Ukrainian government in 2023 as loans. The MFA+, in turn, served as the model for the UF, which had a longer duration and a larger size – with an envelope for the period 2024-2027 of 50bn€, to be partially disbursed also as grants.

While the EPF presents features which resemble the traditional EU budget, the MFA+ and the UF rather track the solution that the EU adopted to tackle the Covid-19 pandemic. The EU budget is mostly funded by member states' transfers, based on GNI.[22] On the contrary, to address the devastating socio-economic damages caused by the pandemic, the EU engineered a policy shift and set up SURE and NGEU.[23] Under SURE, the European Commission was empowered to raise 100bn€ on the financial markets by issuing common debt on behalf of the EU, subject to 25bn€ of member states' guarantees.[24] In the case of NGEU, instead, the Commission was empowered to raise 750bn€ by issuing common debt on behalf of the EU, with the general EU budget serving as a single guarantee through an increase of the spending ceiling.[25] From this point of view, the MFA+ and the UF follow in the footsteps of SURE and NGEU. In particular, like SURE, the MFA+ provides loans, while, like NGEU, the UF provides both loans and grants. Moreover, like SURE, the MFA+ envisioned a mechanism of states' guarantees to empower the issuance of EU debt, in case Hungary would veto raising the EU spending ceiling – although this was ultimately approved in December 2022.[26] Like NGEU, instead, the UF directly enables the issuance of common debt through an amendment of the EU budget ceiling, which occurred in February 2024.[27]

The adoption of the MFA+ and the UF, therefore, reveals the importance of path dependency in the functioning of the EU. As political science literature on historical institutionalism,[28] and legal scholarship research on emergency legislation[29] have both pointed out, once norms are adopted in time of emergency and become entrenched, they set a precedent for future action. Formally, all measures enacted by the EU to address the Covid-19 pandemic were designed to be temporary. Yet, SURE and NGEU offered the policy template and legal technique which the EU could resort to in order to address a new crisis arising even before the Covid-19 pandemic dissipated. At the same time, the Commission has now set up a unified funding strategy, whereby EU bonds to fund NGEU

[21] See Alberto de Gregorio Merino in this symposium

[22] FEATURES AND CHALLENGES OF THE EU BUDGET (Luca Zamparini & Ubaldo Villani-Lubelli, eds., Elgar 2019).

[23] Bruno de Witte, *The European Union's Covid-19 Recovery Plan: The Legal Engineering of an Economic Policy Shift* 58 COMMON MKT. L. REV. 635 (2021).

[24] SURE Regulation, *supra* note 6, art.11-12.

[25] Council Decision 2020/2053 of Dec. 14 2020 On the System of Own Resources of the European Union and Repealing Decision 2014/335/EU, Euratom, 2020 O.J. (L 424) 1, art. 5(1) (EU, Euratom).

[26] See Council Regulation (EU, Euratom) 2022/2496 of Dec. 15. 2022 amending Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027, 2022 O.J. (L 325) 11.

[27] See Council Regulation (EU, Euratom) 2024/765 of Feb. 29, 2024 amending Regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027, 2024 O.J. (L) 1.

[28] *See* Kurt Dopfer, *Toward a Theory of Economic Institutions: Synergy and Path Dependency*, 25 J. ECON. ISSUES 535 (1991).

[29] *See* OREN GROSS & FIONNUALA Ní Aoláin, LAW IN TIMES OF CRISIS: EMERGENCY POWERS IN THEORY AND PRACTICE (Cambridge Univ. Press 2006).

and the various Ukraine-related programs are now part of a bundled issuance, thus creating the bulk of a new EU treasury function in Brussels.

4. Challenges

Nevertheless, the road towards the consolidation of a fiscal capacity in the EU remains fraught with challenges. Indeed, as the difficult approval of both the temporary and long-term funds highlight, the EU is hampered by constitutional constraints and institutional shortcomings which limit its ability to provide for the general welfare, in the ways in which a central authority in a federal system of government does, and therefore to rise to the geopolitical threats it is facing.

To begin with, from a substantive viewpoint, there are a number of constitutional constraints on the ability of the EU to raise fiscal resources. On the one hand, Article 41(2) TEU explicitly prohibits charging to the EU budget "expenditure arising from operations having military or defense implications" – which means that CSDP expenses have to be covered by separate funds, like the EPF, set up outside the MFF. On the other hand, Title II of Part VI of the TFEU, which sets the "Financial Provisions" of the EU, lays out daunting rules. In particular, according to Article 310(1) TFEU, the revenues and expenditures of the EU budget "shall be in balance". Moreover, Article 312 TFEU states that the MFF, which is to be approved by the Council unanimously with the consent of the EP, must set "the amounts of the annual ceilings on commitments appropriations by category of expenditures and of the annual ceilings on payment appropriations". Finally, Article 311 TFEU requires the EU budget to "be financed wholly from own resources": but the Own Resource Decision (ORD) must be approved by the Council unanimously, and ratified by each member state in accordance with its constitutional requirements. The combined effect of the above mentioned provisions is therefore to require a cumbersome amendment to the MFF and ORD every time the EU wants to increase spending, and borrow money.[30]

Moreover, from an institutional viewpoint, there is a key structural obstacle towards the development of a permanent EU fiscal capacity: the complex EU governance system. As noted, EU member states must unanimously approve (or amend) EU expenditures and revenues – which must also be ratified by each member state in accordance with its constitutional requirements (usually parliamentary procedure). This means that a single member state can veto efforts by the others to enable further EU borrowing and spending – even for unrelated, idiosyncratic reason. This is exactly what happened in the case of both the MFA+ and the UF. In December 2022 Hungary vetoed an amendment to the MFF, which was needed to raise the EU budget ceiling required to issue 18bn€ of new common debt for the MFA+; and in December 2023 Hungary voted a broader revision of the MFF, thus preventing the approval of the UF. In both circumstances, the Hungarian veto was unrelated to the matter at stake: rather, Hungary leveraged its necessary vote in the European Council and the Council in order to obtain the disbursement of EU funding which had been frozen due to its rule of law backsliding problem.[31] Yet, the shrewd blackmail by the Hungarian government had consequences on the EU's ability to mobilize resources, forcing the other member states to envision back-up options, and ultimately delaying assistance to Ukraine.

The dependence on the consent of 27 member states for any EU financial operation is bound to continuously create challenges for the EU in the long term, fundamentally weakening its ability to respond to unforeseen events which require urgent fiscal responses. If one adds to this that the EP finds itself largely in an inferior position to the Council and European Council in deciding fiscal issues, it appears that the governance infrastructure for decision-making on funding is

---

[30] See Alicia Hinarejos in this symposium

[31] *See* Kim Lane Scheppele, *The Treaties Without a Guardian: The European Commission and the Rule of Law*, 29 COLUMBIA J. EUR. L. 93 (2023).

democratically inadequate.[32] In this context, as I argued elsewhere, a number of institutional reforms are clearly needed to increase the EU's capacity to act.[33]

5. Conclusion

As the EU was re-emerging from the Covid-19 pandemic, it faced another unprecedented challenge due to the war in Ukraine. In response to the illegal Russian aggression, the EU mobilized financial resources to support Ukraine, deploying for the first time the EPF, then establishing the MFA+, and eventually setting up the UF. As this article claimed, the EU efforts to support Ukraine built on the model employed to address the Covid-19 pandemic and relied on the issuance of common EU debt. As such, the war in Ukraine reveals a trend towards the consolidation of a fiscal capacity in the EU – confirming the historical insight that wars are powerful engines of fiscal centralization.

Nevertheless, the process of fiscal integration in the EU remains a work-in-progress. Constitutional constraints and governance problems hamper the ability of the EU to raise resources and rise to the geopolitical challenges it faces. While the EPF is a purely intergovernmental arrangement, Hungary's idiosyncratic veto delayed the approval of the MFA+ and the UF. Otherwise, the EU Treaties currently prevent the use of EU resources for CSDP purposes, and severely constrain the ability of the EU to borrow money, tax and spend. In this context, a number of constitutional reforms appear therefore inevitable if the EU wants to endow itself with the resources needed to rise to the geo-political challenges it faces – particularly as the war continues.

[32] See Franz Mayer in this symposium

[33] Fabbrini, *supra* note 8 at 141-44.