European Policy
Innovation Council

2025

Collateral for Victory

Transforming Frozen Russian Assets into a One Trillion Defence Fund

Abstract

This paper explores an innovative financial engineering to enable Europe to increase military spending without overburdening national budgets or violating legal constraints: leveraging frozen Russian assets as collateral to create a €1 trillion European Defence and Reconstruction Fund. Rather than outright confiscation—an approach fraught with legal and diplomatic risks—the proposed mechanism would use the €200 billion in Russian central bank reserves currently held in the EU to back large-scale debt issuance. By issuing European Defence and Reconstruction Bonds with a 5:1 leverage ratio, the EU could generate immediate liquidity of up to a trillion Euros, while keeping the assets technically frozen.

Publisher

Published by the European Policy Innovation Council (EPIC)

EEPIC and the authors of this report have not received any financial contributions or donations from the tobacco industry. The views expressed herein are solely those of the authors and do not necessarily reflect the official positions of EPIC.

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Page layout: Penu Kirazov
Editor: Dr. Antonios Nestoras

Introduction

A Turning Point for European Security

The war in Ukraine has forced Europe to confront a stark reality: the continent can no longer rely on unconditional U.S. security guarantees. The shifting stance of the United States—marked by conditional aid and diplomatic pressure on Ukraine—has exposed the fragility of transatlantic security arrangements and raised urgent questions about Europe's ability to defend itself. As Washington recalibrates its strategic priorities, European leaders face a critical inflection point: either they step up to fill the growing gap in military support, or they risk a security vacuum that could embolden Russian aggression and destabilize the region.

In response, the European Union has unveiled ReArm Europe, an ambitious €800 billion defence plan aimed at transforming its military capabilities and reducing dependence on external allies. Yet, the initiative faces significant financial, legal, and political obstacles, from strained national budgets and restrictive EU fiscal rules to the lack of a unified defence strategy across member states. With no common borrowing mechanism for military spending and limited EU budgetary resources, Europe must find a way to finance its security without overburdening already stretched economies. This challenge has led to a groundbreaking proposal: leveraging frozen Russian assets as collateral to fund European defence and Ukraine's reconstruction.

By applying financial engineering techniques like those used in post-war recovery efforts, the EU could create a European Défense and Reconstruction Bond Fund, using the €200 billion in frozen Russian reserves to back large-scale debt issuance. This approach would unlock immediate liquidity without violating international law, ensuring that Russia ultimately bears the financial cost of its aggression. As the EU grapples with this new security landscape, the success of such a financial strategy could set a precedent for Europe's long-term economic and geopolitical resilience, extending beyond defence to securing critical raw materials and strategic infrastructure.

Conditional Support: How Washington's Shifting is Forcing Europe to Step Up

On February 28, 2025, a heated meeting took place in the Oval Office, where President Trump and Vice President JD Vance clashed with President Zelensky over Ukraine's stance on peace negotiations with Russia. The confrontation escalated, resulting in an abrupt end to discussions and the failure to sign a planned U.S.-Ukraine mineral rights agreement.

In the aftermath, the Trump administration suspended all military aid to Ukraine, citing concerns over Zelensky's commitment to peace talks with Moscow. However, in the weeks that followed, the U.S. agreed to restart support—albeit conditionally—tying further assistance to a ceasefire agreement. This shift underscores the transactional nature of Washington's backing and the uncertainty surrounding its long-term commitment.

With the U.S. signalling that its support is contingent on diplomatic concessions, Ukraine faces heightened vulnerability, exposed to renewed Russian aggression at a time when it can least afford uncertainty. Europe may have no choice but to expand its economic and military support. The alternative—allowing Ukraine to falter—risks not just a military collapse but a broader geopolitical crisis that could spill over into the EU itself.

European leaders, long accustomed to Washington's security coordination, now face the challenge of compensating for the U.S.'s shifting stance. This means reinforcing military aid, training, and logistical support—at a cost. Already stretched by commitments to strengthen their own defences, European governments must now weigh higher defence spending, accelerated military coordination, and the difficult question of how far they are willing—and able—to go without reliable U.S. leadership.

ReArm Europe: The EU’s €800 Billion Gamble on Defending Ukraine

On March 4, 2025, European Commission President Ursula von der Leyen unveiled the "ReArm Europe" plan, a strategy aimed at significantly enhancing the European Union's defence capabilities. The initiative seeks to mobilize up to €800 billion over the next four years to bolster Europe's defence infrastructure. The plan comprises several key components:

- Fiscal Flexibility: Suspending EU budgetary constraints to permit member states to increase defence spending without triggering excessive deficit procedures, potentially unlocking approximately €650 billion.
- Défense Loans: Establishing a €150 billion loan program to support joint defence projects, including the development of air and missile defence systems, artillery, drones, and cybersecurity enhancements.
- Budget Reallocation: Allowing member states to redirect existing EU funds, such as cohesion funds, toward defence investments to address immediate security needs.
- European Investment Bank (EIB) Involvement: Proposing adjustments to the EIB's lending policies to facilitate financing for defence-related projects, thereby strengthening the European defence industrial base.
- Mobilizing Private Capital: Implementing measures to attract private investments into the defence sector, aiming to enhance innovation and competitiveness within Europe's defence industry.

The ReArm Europe plan signals an EU commitment to assume greater responsibility for its security and reducing reliance on external allies, particularly considering recent geopolitical developments. However, the plan is fraught with political, legal, and financial challenges.

The Political and Legal Challenges of Rearming

The ReArm Europe plan faces considerable political and legal hurdles that could delay or even derail its implementation. Défense policy remains a deeply national competence, and European Union member states hold diverging strategic priorities. While frontline states like Poland and the Baltics strongly support increased defence spending, others such as Spain and Italy remain focused on economic recovery. Achieving consensus among all 27 EU members will require complex negotiations, particularly as some governments remain reluctant to cede further sovereignty over defence policy to Brussels. Additionally, legal restrictions complicate matters, as current EU treaties prohibit the use of common budgetary resources for military spending, meaning any significant changes may require lengthy treaty revisions or legal loopholes. The European Parliament, already sceptical of diverting EU funds from economic development, could further complicate approval, and opposition from fiscally conservative governments threatens to prolong negotiations over how the plan should be structured and funded.

Beyond political obstacles, Europe's defence industry remains highly fragmented, making joint procurement and industrial cooperation difficult. Unlike the United States, which benefits from a centralized and coordinated defence procurement system, Europe has a patchwork of national defence industries competing for contracts. Even past EU initiatives aimed at fostering collaboration have often failed due to national preferences for domestic suppliers, slowing progress toward an integrated defence market. The lack of standardization across weapons systems and logistical chains further hinders interoperability, reducing the effectiveness of collective military efforts. While ReArm Europe aims to strengthen Europe's defence manufacturing base, the challenges of aligning national production priorities, regulatory frameworks, and industrial strategies remain a major obstacle. Without a fundamental shift in how Europe approaches defence industrial policy, the plan risks becoming another symbolic initiative with limited impact on Europe's actual defence capabilities.

The Financial Dilemma: Who Pays for Defence?

The biggest challenge, however, remains financial. Supporting Ukraine—and ensuring Europe's broader security—requires massive financial resources, yet the EU's current defence funding mechanisms are woefully inadequate. The European Union operates under a multi-annual financial framework (MFF) that sets spending limits for seven-year periods, but its current allocation for defence is just €5.7 billion—a sum that pales in comparison to the scale of military investments needed. This funding is minuscule compared to the defence expenditures of individual NATO allies or even the emergency financial packages the EU mobilized in response to the COVID-19 pandemic. Unlike health crises or economic downturns, where rapid EU-wide funding mechanisms were established, defence spending remains largely a national responsibility, and the EU budget offers no viable path to bridge the widening gap between Europe's security needs and available resources.

At the national level, European governments face severe fiscal constraints, limiting their ability to scale up defence spending. Even if member states agree to loosen budgetary constraints, not all have the fiscal space to significantly increase defence spending. Many EU member states are already burdened with high debt levels, particularly in the wake of the pandemic and energy crises, leaving little room for additional military investments. While some wealthier nations, such as Germany, have committed to ramping up defence expenditures, others—especially in Southern and Eastern Europe—lack the fiscal space to match those commitments. Furthermore, the EU's strict fiscal rules, designed to limit budget deficits and public debt, restrict governments from taking on the necessary debt to finance large-scale military build-ups. Efforts to temporarily relax these rules for defence purposes face political resistance from fiscally conservative member states, particularly those that prioritize economic stability over increased military spending.

Compounding these challenges is the absence of a common EU borrowing mechanism for defence—a stark contrast to the pandemic recovery programs, where the EU issued joint debt to finance the €800 billion NextGenerationEU fund. This precedent shows that collective borrowing is possible when political will exists, yet there is no equivalent defence fund to mobilize large-scale investments in security. Instead, Europe relies on fragmented national efforts and ad hoc initiatives, making defence funding slow, inefficient, and highly dependent on political shifts. Calls to establish a European Défense Bond or a joint defence financing facility remain contentious, as some member states fear that collective borrowing for military purposes would set a precedent that undermines national control over defence policy. Without a structural financial solution, Europe's ambitions for greater strategic autonomy will remain financially unsustainable, leaving the continent vulnerable to geopolitical shocks and dependent on unreliable external partners.

The Case Against Using Frozen Russian Funds for European Defence

With traditional EU defence financing mechanisms proving inadequate, a potential solution lies in the frozen Russian assets held by European and Western financial institutions. Since the start of Russia's full-scale invasion of Ukraine, the EU, the US, and their allies have seized over €300 billion in Russian central bank reserves, with roughly €200 billion held within the EU, primarily in Belgian financial institutions. Redirecting these frozen funds toward Ukraine's defence and reconstruction could provide a significant financial lifeline without requiring additional national contributions or EU borrowing. Given the growing urgency of military support and long-term European security needs, repurposing these assets presents an attractive alternative to politically fraught fiscal debates.

However, confiscating and reallocating Russian state assets is legally and diplomatically complex. Under existing international law, sovereign assets enjoy significant protections and permanently seizing them without a clear legal framework risk setting a precedent that could backfire—potentially undermining the security of other countries' foreign reserves held in Europe. Some governments worry that such a move could erode trust in the global financial system, making the euro and other Western currencies less attractive as reserve assets in the long run. Additionally, within the EU, not all member states agree on outright confiscation, fearing both legal challenges and possible Russian retaliation against European investments in Russia.

To navigate these challenges, the EU is exploring workarounds that stop short of full confiscation but still allow the use of these assets for Ukraine's benefit. One emerging proposal is to redirect the interest generated by these frozen assets, which amounts to several billion euros per year, toward Ukraine's military and reconstruction needs. This approach would avoid outright expropriation, reducing legal risks while still leveraging Russian financial resources to counter Russian aggression. While not a comprehensive solution, it could serve as a bridge financing mechanism, alleviating some of the immediate funding shortfalls Europe faces in bolstering Ukraine's defences and strengthening its own security posture.

The Solution: Leveraging Frozen Russian Assets as Collateral

Rather than confiscating the principal outright—an approach fraught with legal and diplomatic risks—the most viable solution is to use the frozen Russian assets as collateral to create a large-scale financial instrument. This would allow the EU to establish a dedicated European Security and Reconstruction Fund, which could borrow against the frozen Russian reserves to finance military support for Ukraine, defence investment in Europe, and reconstruction efforts. By leveraging these €200 billion in Russian assets held within the EU, the fund could raise substantial sums without requiring additional national contributions or violating international legal norms.

Calculating the Total Fund Value
Using Frozen Russian Assets as Collateral
The EU currently holds €200 billion in frozen Russian central bank reserves. Instead of outright confiscation, these assets could be used as collateral to issue bonds, allowing the EU to raise immediate funds for defense and reconstruction.
Leveraging Financial Markets
Financial markets typically allow sovereign-backed collateral to be leveraged at a 5:1 ratio, meaning the fund could borrow five times the collateral value. This means the initial fund (bond issuance) would total €1 trillion:
200 billion×5=1 trillion (€)

This approach mirrors the successful NextGenerationEU model, where the EU issued joint debt backed by the collective fiscal strength of its member states. Instead of drawing on EU taxpayers or stretching national budgets, a security and defence fund backed by Russian reserves would enable Europe to mobilize tens or even hundreds of billions of euros in fresh capital—funding that could be disbursed rapidly to meet Ukraine's urgent needs and strengthen European military capabilities. Crucially, this method would keep the assets technically frozen, sidestepping immediate legal challenges while still ensuring that Russian wealth contributes to repairing the damage Russia has caused.

Politically, this solution could also unify EU member states, as it avoids the most contentious aspect of outright confiscation while still ensuring that Russia bears financial responsibility for its aggression. With interest earnings on these frozen funds already generating billions, this mechanism could even be self-sustaining in the long run, reducing the financial strain on EU economies. If structured correctly, such a fund could accelerate Europe's defence transformation, provide Ukraine with stable long-term financial support, and demonstrate Europe's strategic resolve without compromising its legal and financial principles.

Key Takeaways
Bond issuance significantly increases available capital, turning €200 billion in frozen reserves into over €1 trillion in usable funds.
Financial engineering ensures that Russia indirectly finances Ukraine's reconstruction and European security over the long term.
This method provides a legally viable and politically feasible alternative to outright confiscation, unlocking trillions in potential defense and reconstruction funding while maintaining the EU's financial stability.

The European Defence and Reconstruction Fund: Advantages and Historical Precedents

Instead of outright confiscation, frozen Russian assets could serve as collateral for a European Defence and Reconstruction Bond Fund, unlocking immediate liquidity without breaching legal norms. The assets, while remaining frozen, would be leveraged to back debt issuance, allowing the EU to raise substantial funds through bond markets. Investors would purchase these European Défense and Reconstruction Bonds, providing immediate capital for Ukraine's defence, European military expansion, and post-war reconstruction—without imposing additional fiscal burdens on EU taxpayers.

This approach carries a key legal advantage: since ownership of the Russian assets would technically remain with Moscow, it avoids direct expropriation claims that could weaken the EU's legal standing in international courts. Russia would still have a theoretical claim to its frozen reserves, but any attempt to recover them would be contingent on the settlement of reparations through the European Court of Justice (ECJ)—a process that could take years. Meanwhile, the EU could proactively initiate legal proceedings for reparations, reinforcing the legitimacy of this approach. The European Investment Bank (EIB) would likely be unable to issue these bonds itself but could act as a guarantor, ensuring credibility and investor confidence.

And there is a historical precedent for such a financial engineering in the Dawes Plan of 1924, which provided a structured financial solution to Germany's post-World War I reparations. Instead of demanding immediate payments that Germany could not afford, the plan used a combination of foreign loans and controlled asset management to stabilize the German economy while ensuring reparations were gradually paid. This structured financial mechanism avoided economic collapse while still ensuring accountability. Applying similar financial engineering today, the EU could use frozen Russian assets as collateral for a European Défense and Reconstruction Bond Fund, allowing immediate liquidity for Ukraine's war effort and Europe's military build-up while ensuring that Russia remains financially liable for its aggression. Like the Dawes Plan, such a mechanism would create a long-term structured solution rather than a one-time expropriation, reinforcing the legitimacy and sustainability of European defence financing.

Criteria	Confiscating Frozen Funds	Using as Collateral for Bonds
Legal Feasibility	Legally complex, requires new legislation or treaty changes	Legally sound, as ownership remains with Russia
Risk of Legal Challenges	High – Russia and other states may challenge in international courts	Lower – Funds remain frozen, but legal cases could still arise
Impact on Financial Markets	Could undermine confidence in EU financial stability and reserve currency status	Maintains stability, as it does not involve expropriation
Speed of Implementation	Slow – Requires legal processes, international agreements, and political consensus	Faster – Can begin bond issuance while legal proceedings for reparations continue
Political Feasibility	Difficult – Some EU states and financial institutions oppose outright confiscation	More viable – Less resistance from EU member states and financial markets
Sustainability	One-time solution – Once funds are used, no further capital can be generated	Sustainable – Can generate ongoing capital through bond markets
Potential Amount Mobilized	Limited to the existing frozen assets (~€200 billion)	Potentially exceeds €200 billion through leveraged borrowing
Effect on Russia	Direct punishment, but may provoke strong retaliation and countermeasures	Keeps Russia financially liable while ensuring EU has access to liquidity
Precedents	Libya, Iraq, but with mixed success and prolonged legal battles	Dawes Plan (but also pandemic recovery bonds - NextGenerationEU)

Looking Ahead: A Blueprint for Europe's Strategic Future

The financial engineering behind a European Défense and Reconstruction Bond Fund could mark a turning point in how Europe funds its security and strategic autonomy. By leveraging frozen Russian assets as collateral rather than engaging in outright confiscation, the EU can unlock immediate liquidity for Ukraine and European defence while maintaining a firm legal and diplomatic footing. This approach would not only ensure that Russia bears financial responsibility for its aggression but also establish a long-term funding model for Europe’s security needs—one that does not depend on unstable political cycles or unreliable external alliances. If implemented correctly, such a financial instrument could transform Europe’s ability to act as a geopolitical power, reducing its dependence on U.S. security guarantees and strengthening its position in global defence markets.

Looking beyond immediate war financing, this model could extend to Ukraine’s vast mineral and rare earth resources, which will be essential for Europe’s green and digital transitions. The recent collapse of the U.S.-Ukraine mineral rights deal underscores the strategic value of these resources and the challenges in securing long-term investment. Instead of relying on unstable bilateral agreements, the EU could apply a similar financial mechanism to Ukraine’s critical raw materials sector, creating a European-led investment framework that finances extraction, processing, and supply chain development. By structuring investments through collateral-backed bonds, Europe could secure access to Ukraine’s resources in a way that benefits both sides—providing Ukraine with funding for reconstruction and modernization, while ensuring the EU’s strategic industries have a reliable supply of critical materials for the future.

The lessons from frozen Russian assets, past financial recovery programs, and historical precedents like the Dawes Plan suggest that Europe must embrace bold financial innovations to meet 21st-century challenges. The war in Ukraine has already forced a shift in European defence thinking—now, the challenge is to ensure that this shift is backed by the right financial instruments. Whether in defence, reconstruction, or securing strategic resources, the EU could create lasting, self-sustaining economic mechanisms that reinforce both its security and its industrial competitiveness. The question is no longer whether Europe can afford to act—but whether it can afford not to.

Contact

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Contact Information

European Policy Innovation Council (EPIC) asbl
Rue du Chatelain, 8, Box 4
1000 Brussels, Belgium
www.thinkepic.eu

European Policy
Innovation Council