Advisory report

to the Subcommittee on European Union Issues of the German Parliament's Budget Committee

on the payment obligations and risks for the federal budget linked to debt servicing for the EU Recovery Fund

This report comprises the concluding audit findings issued by the Bundesrechnungshof in accordance with article 96 (4) Federal Budget Code. The report is available at www.bundesrechnungshof.de.

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EU Recovery Fund: Agree on swift and binding debt repayment

Real growth will create sufficient room for manoeuvre in the EU budget, which should be used to repay the EU Recovery Fund's debt. The Federal Government should take this position at EU level when negotiating a binding repayment schedule. It should avoid late repayment, as this leads to higher costs and risks.

What is it all about?

The EU member states may receive €421 billion in grants from the EU Recovery Fund (the Fund). The European Union raises required funds on the capital market by issuing bonds. Such bonds must be repaid by the end of 2058. The exact terms of repayment are still unclear. Depending on the repayment schedule, the total payments to be made for interest and repayment of the bonds (debt service) range between €574 and €752 billion. Such payments are to be made via the EU budget. This means that Germany will bear 24 per cent of the burden. Due to higher market interest rates, there is also the threat of additional burdens in the years 2025 to 2027.

What needs to be done?

The Federal Government should ensure that the additional interest expenditure in the years 2025 to 2027 is covered via "real" redeployments from other EU programmes. It should also make sure that the EU member states agree on a binding repayment schedule for the period starting in 2028 as quickly as possible. We recommend utilising the leeway in the EU budget for debt servicing that is created by real economic growth.

What is the objective?

The burdens from debt servicing for the Fund add to an already strained situation in the federal budget. The aim should therefore be to minimise such burdens. To this end, the Federal Government – with the support of the German Parliament – should work towards avoiding late repayment in the negotiations at EU level in order to reduce interest expenditure and risks. It should also ensure that the room for manoeuvre in the EU budget created by real economic growth is used for debt servicing.

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Abbreviations

B

BAR *Brexit Adjustment Reserve*

C

Council *Council of the European Union*

E

EGF *European Globalisation Adjustment Fund*
EURI *European Union Recovery Instrument*

G

GDP *gross domestic product*
GNI *gross national income*

M

member states *EU member states*
MFF *Multiannual Financial Framework*

R

RRF *Recovery and Resilience Facility*

0 Executive summary

In response to the Covid-19 pandemic, the EU member states (member states) established the EU Recovery Fund in late 2020. The Fund has a total volume of €812.1 billion (in current prices). The member states may receive non-repayable grants and loans from the Fund. The EU Commission raises funds for the Fund on the capital market by issuing bonds on behalf of the European Union. The EU is to repay such debts by year-end 2058 at the latest. It has not yet decided on a binding repayment schedule.

The member states may receive grants of up to €421.1 billion from the Fund. The EU budget is to assume the debt service – i.e. interest payments and debt repayment to service the bonds – relative to the funds provided as grants. The payment obligations thus burden all member states according to their respective share in the EU budget. Germany's share is currently just under 24 per cent.

We analysed how the payment obligations could affect the federal budget. We also examined as to whether and to what extent the EU budget could cover interest payments and debt repayments without increasing the real burden on national budgets. The report takes into account developments until late May 2024 as well as the Federal Government's comments on our draft report.

Our key findings are as follows:

0.1 The EU Commission has been issuing bonds for the Fund since 2021 and needs to pay interest on them. €11.4 billion has been earmarked in the EU budget for interest payments in the years 2025 to 2027. Such funds will not be sufficient due to the rise in market interest rates. In a baseline scenario, the Commission anticipates additional expenditure of €15.3 billion. In a stress scenario, additional expenditure is expected to amount to €20.6 billion. The member states agreed to cover such additional expenditure via a so-called cascade mechanism.

This cascade mechanism will only lead to no additional burdens on the federal budget if the additional expenditure is compensated by "real" redeployments at the expense of other EU programmes. The Federal Government should therefore – with the support of the German Parliament – ensure in the budget negotiations at EU level to cover as much of the additional expenditure as possible via "real" redeployments.

0.2 The European Union has the duty to repay all of the Fund's debts by 2058. The total amount of debt service payments depends, among other things, on how the EU distributes repayments over the entire period (repayment schedule). This determines the amount of the remaining debt per individual year and thus the amount of interest payments.

0.3 We analysed four repayment schedules:

- equal annual repayment (repayment schedule 1);
- repayment as late as possible (repayment schedule 2);
- the earliest possible repayment (repayment schedule 3); and
- annual repayment that remains stable in proportion to the projected gross domestic product (GDP) of the European Union (repayment schedule 4).

Depending on the repayment schedule, the EU budget will incur nominal debt servicing expenses totalling at least €574 billion (early repayment) and at most €752 billion (late repayment) in the period from 2028 to 2058. The federal budget would then – as a function of the repayment schedule – be responsible for at least €138 billion and up to €180 billion. We consider repayment schedules 1, 3 and 4 to be a good starting point for the negotiations at EU level. The main arguments against a late repayment (repayment schedule 2) are the significantly higher interest payments. It also bears considerable risks.

The Federal Government should therefore – with the support of the German Parliament – work at EU level to ensure that a binding repayment schedule is agreed in advance, if possible before 2028. Otherwise, this could lead to the start of repayment being postponed further and further over time, which would ultimately lead to late repayment.

0.4 The EU budget essentially consists of various own resources that the EU calls in from the member states. The own resources collected on the basis of the gross national income (GNI) serve as a residual figure: if the calls of the other own resources are not sufficient to cover the EU's financial needs, the GNI rates of call are increased. Due to the burdens from the debt service for the Fund, there is a risk of rising rates of call. The member states and the Commission therefore agreed in 2020 to work towards the introduction of new own resources. Among other things, this step is intended to mitigate the increase in GNI own resources.

In principle, own resources dip into the economic performance or the assets of the national economies. New own resources may change how national burdens are distributed. However, the EU must always be funded in essence and predominantly by the national economies. This means that even if new own resources mitigate the increase in GNI own resources, the total transfer payment amounts from the national economies to the EU remain unchanged. Hence, new own resources are not required for the Fund's debt service.

0.5 The debt service for the Fund will place a significant burden on the EU budget in the decades to come. Nevertheless, the EU budget legislator does not want this fact to lead to unreasonable cuts in programme spending or investment instruments in the EU budget. The EU and some member states could therefore argue in favour of shifting some or all of the burden of debt servicing to national budgets. However, at national level, there is only little room for manoeuvre due to high deficits in some cases and other challenges – such as demographic change or investments in climate protection, digital transformation and defence. Additionally, some member states' public debt levels are already very high.

The Fund is not only supposed to make a significant contribution to overcoming the Covid-19 pandemic, but also to fund investments and reforms aiming to enhance productivity. If the Fund is successful, it should lead the member states – and thus the EU as a whole – onto a higher growth path. It is also to help mitigate adverse impacts caused by future crises – such as economic downturns and welfare losses. What is more, the Fund's financial resources may also be seen as an advance use of future EU budgets.

Against this backdrop, it appears logical to give consideration to the positive effects of the Fund when deciding on the funding of debt servicing. Not only the positive economic dynamics and the targeted higher resilience, but also the relief for future EU budgets resulting from upfront investments should be appropriately taken into account.

If EU budget ceilings are kept stable as a percentage of GNI, the EU's potential room for expenditure will automatically increase in absolute terms as EU GNI rises. This results in additional leeway in the EU budget without the member states having to pay more in real terms. If the expenditure incurred for EU programmes is, at the same time, kept stable after adjustment for inflation, the real growth over the next few decades will, in total, always be sufficient to fully finance the debt service for the grants given by the Fund.

The EU could hence utilise the positive economic dynamics to service the debt from the EU budget without having to increase the member states' contributions in real terms. However, this is based on the premise that the member states take into account the anticipated leeway in the EU budget when designing the binding repayment schedule. In view of the limited financial room for manoeuvre in the federal budget, the Federal Government – with the support of the German Parliament – should advocate such a design of the repayment schedule in the negotiations at EU level.

1 Background

In response to the Covid-19 pandemic, the EU member states set up the Recovery Fund at the end of 2020.[1] The Fund originally had a total volume of €812.1 billion (in current prices). The member states may receive up to €421.1 billion from the Fund as non-repayable grants until the end of 2026. The member states may also request up to €391 billion as loans. Of such loans, €98 billion have not been applied for by the end of 2023. These funds have therefore been cancelled.[2] The EU Commission borrows the funds needed for the Fund on the capital markets by issuing bonds on behalf of the European Union. The member states have the duty to repay the debt by 2058.[3] The EU has not yet specified a binding repayment schedule.[4]

The debt service – i.e. the interest payments and debt repayments to service the bonds – for the funds granted as loans to the member states will be borne by the respective recipients. At the same time, the EU budget will cover the debt service for the bonds used to fund the grants. This means that the member states will be burdened in proportion to their respective contribution to the EU budget. Germany's share in funding the EU budget is currently just under 24 per cent. Consequently, this will also be the German budget share for the debt service. Since the European Commission has been issuing bonds since 2021, interest payments are already due under the Multiannual Financial Framework (MFF) 2021-2027.

The Council of the European Union (Council), the European Parliament and the European Commission agreed in an interinstitutional agreement to work towards the introduction of new own resources.[5] Such new own resources are intended to support the repayment of bonds and thus prevent debt service from leading to an "undue reduction" in programme expenditure or investment instruments under the MFF.[6]

The European Commission disburses the funds provided under the Recovery Fund through various EU programmes, primarily the Recovery and Resilience Facility (RRF). All funds

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1 Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis, OJ EU L 433 I/23 of 22 December 2020.

2 All figures in current prices. Cf. Bundestag publication 20/10875 of 21 March 2024, Sixth Report of the Federal Government on the "Next Generation EU" reconstruction instrument, page 2 et seq.

3 Council Decision (EU, Euratom) 2020/2053 of 14 December 2020 on the system of own resources of the European Union and repealing Decision 2014/335/EU, Euratom, OJ L 424/1 of 15 December 2020 (own resources decision), Article 5 (2).

4 The EU Commission has published a possible repayment scenario. The scenario involves repaying €15 billion annually until 2055 and the remaining balance of just under €1 billion in 2056.

5 Interinstitutional Agreement of 16 December 2020 between the European Parliament, the Council of the European Union and the European Commission on budgetary discipline, on cooperation in budgetary matters and on sound financial management, as well as on new own resources, including a roadmap towards the introduction of new own resources, OJ EU L 433 I/28 of 22 December 2020 (Interinstitutional Agreement).

6 Cf. ibidem, annex II, point E.

earmarked for loans and 80 per cent of the funds earmarked for grants are allocated to this instrument. The remaining grants will be used to provide additional resources to other EU-funded programmes.

To be eligible for RRF funding, member states must submit national recovery and resilience plans outlining the policy measures they wish to fund. Each measure needs to be linked to milestones and targets. Starting in 2021, the funds will be disbursed in several instalments. To receive the funds, member states submit payment requests to the EU Commission, in which they provide evidence for the achievement of milestones and targets. If the member states fail to reach milestones and targets set, the appropriated funds will be cancelled. This means that the volume of bonds actually issued in a given year depends on whether and to what extent the member states have achieved the milestones and targets set, and on the timing of their payment requests.

2 Financial leeway in the federal budget becomes smaller

Under Article 20, paragraphs 1 and 2, and Article 79, paragraph 3 of the German Constitution, the Parliament’s budgetary prerogative and its overall budgetary responsibility are protected as an inalienable part of the principle of democracy. The German Parliament decides on all significant revenues and expenditures included in the federal budget. The principle of democracy would be weakened if any payment obligation and liability commitment not only had the effect of restricting budgetary autonomy, but also essentially negated this autonomy, at least for an appreciable period of time.[7]

Although the budget legislator is responsible for establishing the annual budget, it has limited room for manoeuvre. This is because the federal budgets of the near future include precommitments and are – figuratively speaking – largely "petrified" due to legal provisions. Under the current legal situation, only about 10 per cent of a federal budget’s spending volume is non-earmarked.[8] This is in particular due to payment obligations based on laws governing social benefits.

It is already evident today that the amount of available and uncommitted funds will continue to decrease in the coming decades unless the legislator reduces social security entitlements provided under the relevant laws governing the provision of benefits. The reason for this is

[7] Federal Constitutional Court, judgement of 6 December 2022, reference number 2 BvR 547/21, point 136.
[8] Report pursuant to Art. 88 (2) Federal Budget Code addressed to the parliamentary Budget Committee on the basic conditions to ensure sustainable public finances of 23 August 2022, chapter 5.

that spending induced by demographic trends will increase. In addition, increased interest payments and debt repayment obligations will narrow the budgetary leeway.[9]

Furthermore, there are international obligations, in particular at the level of the European Union. In this context, the Council's legal service concludes that, with their own resources decision made on 14 December 2020, the member states have given an "irrevocable, definitive and enforceable guarantee"[10] to repay, by year-end 2058 at the latest, the debts incurred by the Recovery Fund via their future contributions to the EU budget. To this end, they have agreed to increase the own resources ceiling by 0.6 percentage points of the EU's gross national income (EU GNI).[11]

In addition to the debt service for the grants, further burdens could put pressure on the federal budget if recipients of loans from the Fund are no longer able or willing to meet their payment obligations.[12] There could also be contingent liabilities which the Federal Government has assumed at the European level and which might put further pressure on the federal budget.[13]

The burdens that will be placed on the federal budget must be transparent for the budget legislator. Only then can the budget legislator make an informed decision on whether and to what extent it will be possible to incur further financial obligations for the years to come without actually undermining the right of future parliaments to adopt the budget and control its execution.

3 Driver and objective of the report

In view of the future burdens that will be placed on the federal budget, the budget legislator should know the extent to which federal budget funds might be needed to service the debt incurred for the Recovery Fund. Two periods have to be distinguished in this context:

- Under the current MFF and until the end of 2027, the European Union must pay interest on the bonds already issued. Due to increased market interest rates, interest expenditure

9 Federal Performance Commissioner’s opinion addressed to the Federal Ministry of Finance on the preparation of the federal budget 2025 and the financial planning until 2028, Preventing risks and avoiding off-budget mechanisms – framework conditions for a substantial budget consolidation, 16 April 2024, chapters 5 and 6.

10 Council of the European Union, Opinion of the legal service of 24 June 2020, Proposals on Next Generation EU, 9062/20, No. 38 seq.

11 Own resources decision (see footnote 3), Article 6.

12 Report pursuant to Article 99 Federal Budget Code on the potential impact of joint borrowing of the member states of the European Union on the federal budget (Recovery Fund) of 11 March 2021.

13 Regarding risks from contingent liabilities see the Report pursuant to Article 88 (2) Federal Budget Code addressed to the parliamentary Budget Committee on basic conditions to ensure sustainable public finances of 23 August 2022, chapter 4.3.

in this period will probably be higher than expected. We therefore believe that the repayment of the bonds cannot start before 2028.[14]

- Under the subsequent MFF from 2028 onwards, the bonds will have to be repaid. This means that, in addition to interest payments, the EU budget will also have to repay the debt.

Against this background, the Subcommittee on European Union Issues of the parliamentary Budget Committee asked us to assess the payment obligations and the medium and long-term risks for the federal budget arising from the debt service related to the Recovery Fund.[15] For this purpose, we have, among other things, examined

- how the increased market interest rates could affect the federal budget by 2028 (chapter 4);
- which parameters have an impact on the total interest payments and debt repayments and their annual distribution starting in 2028 (chapter 5);
- the impact of different repayment schedules on the interest payments and debt repayments (chapter 6);
- to what extent new EU own resources could reduce the burden on the EU budget arising from interest payments and debt repayments (chapter 7.1); and
- how the EU budget could absorb the interest payments and debt repayments without increasing the real burden on national budgets (chapter 7.2).

4 Federal budget risks due to increased interest payments under current MFF

Background

The 2021-2027 MFF estimates the amount of interest expenditure under the budget line "Financing cost of the European Union Recovery Instrument (EURI)" at **€11.4 billion** in the years 2025 to 2027. Due to the increased market interest rates, these budget funds will not be sufficient to cover the actual interest expenditure. In November 2023, the Commission forecasted an **additional funding need** of **€15.3 billion** for the years 2025 to 2027 under a **baseline economic scenario**. Under a **stress scenario**, the Commission predicted an

[14] The own resources decision (cf. footnote 3) stipulates in Article 5 (2) that the repayment of the bonds is to begin in the current MFF. This is only possible if funds originally intended for interest payments on the bonds issued for the Fund have not been used for this purpose and are therefore still available. In view of the rising market interest rates, this is not to be expected. On the contrary, the funds earmarked for this purpose are likely to be insufficient.

[15] Cf. German Bundestag, Budget Committee, Subcommittee on European Union Issues, minutes No. 20/16, summary of the 16th meeting on 22 September 2023, agenda item 3.

additional funding need of **€20.6 billion**. This means that the forecasted interest expenditure – even under the baseline scenario – would have already more than doubled in the current MFF.

At the special meeting of the Council on 1 February 2024, the member states agreed on how they intend to cover this additional expenditure.[16]

Basic information

The MFF is usually established for a period of seven years. The MFF lays down the annual **ceilings** on commitment appropriations by category of expenditure and the annual ceilings on payment appropriations. This means that the MFF sets the maximum amount of funds that the European Union may commit and spend each year.

The MFF allows ceilings to be shifted between individual budget headings during the budget negotiations. There are instruments that allow a limited amount of unused funds to be reallocated across headings or years, such as the **Single Margin Instrument** and the **Flexibility Instrument**. In the annual budget preparation procedure, the EU Parliament may also set, to a certain extent, new spending priorities. For example, the Parliament has the right to reduce the funds allocated to an EU programme and, by the same amount, increase interest spending. Such redeployments are in general limited to 15 per cent of the total programme amount over the entire duration of the respective programme under MFF 2021-2027.[17]

However, the crucial factor for the transfer of funds from the federal budget to the European Union are not the ceilings set in the MFF, but the actual outflows from the EU budget. The share to be borne by the federal budget is therefore based exclusively on the actual disbursements made from the EU budget and currently amounts to just under 24 per cent.

Overall, this means the following:

1. If fewer funds than planned are disbursed from the EU budget, the actual transfers from the federal budget to the EU budget will also be lower than estimated. Compared to the initial estimate, this would alleviate the strain on the federal budget by the funds that are not used.
2. In the event that a certain amount of unused funds is instead shifted to interest expenditure via the Single Margin or the Flexibility Instrument, the potential relief for the federal budget will not be achieved to that extent.

[16] Special meeting of the European Council (1 February 2024) – Conclusions EUCO 2/24.
[17] Interinstitutional Agreement of 16 December 2020 (footnote 5), point 18.

3. If funds that would be regularly disbursed for other EU programme are redeployed to cover interest expenditure, there will be no direct impact on the federal budget.

Some member states usually receive higher amounts from the EU programmes than they provide to the EU budget. We believe that it is unlikely that these **net beneficiaries** have any significant incentive to reduce the funds allocated to EU programmes in order to use them to cover interest expenditure incurred. Instead, net beneficiaries possibly might prefer that, to cover interest expenditure, unused funds are used and, if necessary, even additional contributions are called from the national budgets.

Cascade mechanism

At the above-mentioned special meeting of the EU Council, the member states agreed to proceed in **three steps** (cascade mechanism) to cover the interest expenditure for the Recovery Fund in the period from 2025 to 2027.[18]

Step 1: the member states intend to **fully use** the interest expenditure already laid down in the MFF.

Step 2: additional interest expenditure is to be covered by a **reprioritisation** ("real" redeployment) and by using the Instrument for a Single Margin and the Flexibility Instrument. This means that the member states have agreed that during the negotiations on the annual budget, **funds may be shifted across programmes in order to cover interest expenditure**.

In addition, by means of these two instruments, member states intend to use previously unused funds to cover interest expenditure. To this end, they have increased the allocations to the Flexibility Instrument by €2 billion. They also intend to draw on unused funds from the Brexit Adjustment Reserve (BAR) and the European Globalisation Adjustment Fund (EGF) to cover the additional funding needs of €15.3 billion or €20.6 billion (under the stress scenario) respectively.

Step 2 aims to cover a total of 50 per cent of the additional expenditure. According to the Federal Ministry of Finance, it was not possible to attribute a binding effect to the target figure of 50 per cent agreed by the Council in the revised MFF Regulation.[19] The reason for this is that, according to the ministry, the final decision rests with the EU Parliament and needs to be made in the annual budget preparation process.

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[18] Cf. ibid., points 15 et seq.: The cascade mechanism is specified in the regulation on the revision of the current MFF. Cf. Council Regulation (EU, EURATOM) 2024/765 of 29 February 2024 amending regulation (EU, Euratom) 2020/2093 laying down the multiannual financial framework for the years 2021 to 2027, OJ EU L of 29 February 2024.

[19] The target figure is only mentioned in the recitals. Cf. ibid., recital 12.

Step 3: a new instrument will be introduced over and above the MFF ceilings (**EURI-Instrument**). The amount of funds mobilised in this step is to be based on the total amount of decommitments made since 2021. The corresponding appropriations have been cancelled, for example because member states have requested the funds too late or because they have not met funding requirements. No more pro-rata payments would have to be made from the federal budget for such funds under "normal circumstances".

As a result, the recourse to step 3 would lead to additional burdens on the federal budget even under the current MFF. If the funds mobilised are not sufficient to cover interest expenditure in full, member states would have to provide the remaining amount through a final backstop. The ceiling for own resources, raised by 0.6 per cent of EU gross national income, would cover such additional calls.

Figure 1

Step 3: the cascade mechanism will put additional burdens on the federal budget

Increased interest expenditure does not put an additional burden on the federal budget if it is compensated by "real" redeployments under the current MFF in step 2. The resources that need to be mobilised under step 3 go beyond the ceilings of the current MFF and increase the transfer of federal funds.

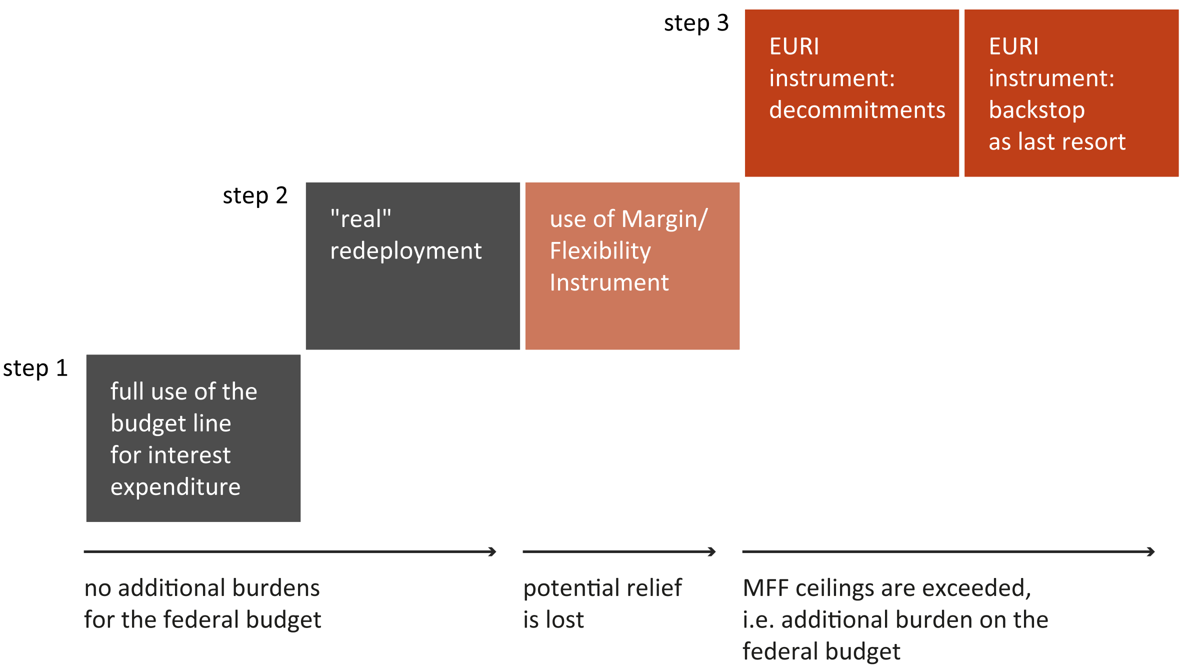

Figure: Bundesrechnungshof. Source: European Council.

Commission proposal for covering interest expenditure under the current MFF

It was possible to fully fund the expected additional interest expenditure in 2024 through a redeployment of funds in the EU budget. In principle, the cascade mechanism provides for half of the additional expenditure in the years 2025 to 2027 to be mobilised under step 2 and 3 respectively. In the course of the audit, the Federal Ministry of Finance explained how the Commission intends to cover the additional expenditure. However, we do not embrace the figures provided by the Commission.

The European Commission aims at mobilising a total of **€8.6 billion** under **step 2** by using the Single Margin Instrument to shift so far unused funds of €1.5 billion to cover interest expenditure. Using the Flexibility Instrument, the Commission is able to increase the appropriations for interest expenditure by another €5.2 billion. In order to cover additional interest expenditure, the Commission also intends to mobilise unused funds of €1.9 billion from the BAR and the EGF. Since the respective appropriations have not yet been disbursed, they could have potentially reduced the burden on the federal budget. In addition, if such amounts are used under step 2, they are no longer available for other EU programmes.

The actual impact of such redeployments on the federal budget depends on whether and to what extent these funds would have been used in the remaining MFF period. However, the Commission is not yet planning any "real" redeployment from other EU programmes, which would mean that estimated expenditure on EU programmes would be cut to cover interest expenditure.[20]

If extra expenditure on interests amounts to €15.3 billion as assumed in the baseline scenario, the aforementioned amount of €8.6 billion is sufficient to cover 50 per cent of this expenditure via step 2. However, if the stress scenario with additional expenditure of €20.6 billion materialises, additional "real" redeployments would have to be undertaken at the expense of other EU programmes in order to meet the target. If this is not achievable in the budget negotiations, the remaining amount of €1.7 billion[21] would have to be mobilised additionally at step 3 by calling in more funds from the member states.

Under **step 3**, the Commission currently expects decommitments of €10.6 billion, which is sufficient to cover 50 per cent of the additional expenditure, both in the baseline and in the stress scenario. However, under the stress scenario, this amount would not be sufficient to cover any additional needs under step 2 if the remaining amount of €1.7 billion could not be

[20] The EU Commission has announced that it will present funding proposals for the EURI-interest line during the annual budget procedure on 12 June 2024.

[21] 50 per cent of the additional expenditure of €20.6 billion corresponds to an amount of €10.3 billion. This is the starting point for the calculation: €10.3 bn - €8.6 bn = €1.7 bn.

mobilised in the budget negotiations. In this case, the national budgets would have to provide another €1.4 billion[22] as a backstop.

As a result, additional expenditure on interests will only have no negative impact on the federal budget if "real" redeployments are made at the expense of other EU programmes (see figure 1). If, instead, unused funds are shifted to cover interest expenditure by means of the Single Margin Instrument or the Flexibility Instrument, the federal budget does not benefit from the potential relief.

In any case, the decommitments used under step 3 lead to an additional burden on the federal budget. This is because the respective funds would have actually been cancelled and it would no longer be possible to use them. Moreover, the use of the backstop would further increase the transfers from the federal budget.

In view of the additional interest expenditure to be incurred in the years 2025 to 2027, the Federal Government should work towards ensuring, at the Council, that the EU mobilises at least 50 per cent of the funds under step 2 in the budget negotiations, as provided for under the cascade mechanism. The Federal Government should seek to ensure that this is achieved through "real" redeployments from other EU programmes wherever possible. If this does not prove successful – meaning that only unused funds are mobilised under step 2 – and the remaining funds are called under step 3 via the backstop, the national budgets of the member states would de facto have to bear the entire additional interest expenditure burden.

In the extreme case – that is, under the stress scenario – the member states would have to transfer an additional €20.6 billion to the EU budget. Of this amount, a total of around €5 billion would have to be borne by the federal budget, spread over the years 2025 to 2027.

5 Basis for the projection of debt servicing from the EU budget

5.1 Funding strategy of the EU Commission

In its funding strategy, the Commission decides when, in what volume and with which maturities it issues EU bonds on the capital market. The EU has also issued bonds in the past, but at irregular intervals and in considerably smaller volumes. The funds raised were passed

[22] At step 3, decommitments were €10.6 bn and additional expenditure on interests was €10.3 bn. This results in a surplus of €0.3 bn. This is the amount by which any outstanding amount under step 2 would be deducted: €1.7 bn - €0.3 bn = €1.4 bn.

on to third parties as loans. The volume, timing and term of the funds raised on the capital market matched the terms of the loans granted (back-to-back financing).

As to the Fund, however, the timing of disbursements cannot be fully planned. The Commission disburses grants from the RRF when the member states have reached the agreed milestones and targets and submitted their payment requests, and when the Council has approved these requests. This is another reason why the Commission has developed a diversified funding strategy. It provides for the Commission to pool the proceeds from the EU bonds and to disburse the funds as soon as the Council has approved the member states' payment requests. The bond volume is generally based on the expected disbursements.

Since early 2023, the Commission has been using the diversified funding strategy as a single method for issuing EU bonds for various purposes. The aim is to plan all its borrowings in a coherent manner and choose a cost-optimised maturity structure. It uses the EU bonds issued to finance not only the Fund, but also, for example, the so-called Macro-Financial Assistance+ package for Ukraine.[23]

Since June 2021, the Commission has issued EU bonds with a total volume of €286 billion under the diversified funding strategy.[24] The bonds have terms to maturity of 3 to 30 years. The average maturity is 13.6 years. Depending on the repayment schedule, the Commission needs to refinance bonds upon maturity. The respective bonds' interest costs are determined by the coupon payments and the price discounts to the nominal value (disagio).

In addition to EU bonds, the Commission also utilises short-term debt securities under its diversified funding strategy. They have a term to maturity of three or six months and are intended to prevent potential liquidity problems for the Commission. The debt securities do not have coupons. Instead, interest costs are incurred through debt discounts.

5.2 Debt service determinants

The total amount of the annual debt service for the grants – consisting of interest payments and debt repayments – is a function of

- the total volume of grants disbursed;

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[23] See COM (2023) 461 final of 28 July 2023, Report from the Commission to the European Parliament and the Council, Semi-annual report on the implementation of borrowing and debt management operations and related lending operations under Article 12 of Implementing Decision C (2022)9700, 1 January 2023 – 30 June 2023, page 1 seq. As part of the macro-financial assistance+, the EU provided Ukraine with loans on very favourable terms amounting to €18 billion in 2023.

[24] See COM (2024) 93 final of 22 February 2024, Report from the Commission to the European Parliament and the Council, Semi-annual report on the implementation of borrowing and debt management operations and related lending operations under Article 12 of Implementing Decision C (2022)9700, 1 July 2023 - 31 December 2023, page 6.

- the repayment schedule and thus the existing remaining debt (portfolio of EU bonds that have not been repaid); and
- the interest burden linked to the remaining debt.

The **total volume of grants** disbursed determines how much the EU budget has to repay in aggregate. The **repayment schedule** distributes repayments over the years. It thus specifies the remaining debt in the individual years and hence also impacts annual interest payments. An initially high repayment leads to the effect that the remaining debt falls more swiftly and interest payments decrease. The **interest burden for the remaining debt** depends on the interest rates at which the Commission has issued the respective bonds on the capital market.

Generally, interest rate and maturity of a financial investment correlate positively. The longer the term to maturity, the higher the interest rate.[25] Bonds with shorter maturities hence make it possible to reduce interest expenditure. On the other hand, longer maturities reduce the risk of interest rate changes and allow better long-term planning of interest expenditure. Market interest rates may change significantly over time.

As a result, the Commission may significantly shape the interest burden on its debt portfolio by means of its issuing strategy – in particular by choosing the timing of financing or refinancing. For example, in June 2021, the Commission was able to issue the first EU bond for the Fund with a maturity of ten years at a very low interest rate of 0.09 per cent. In September 2023, it had to accept an interest rate of 3.48 per cent for an EU bond with the same term to maturity.[26]

5.3 Assumptions for the projection

In the following chapter 6, we analyse how different repayment schedules affect the annual distribution of debt servicing and total payments. To this end, we have to make assumptions about future developments.

Overall, three different periods may be distinguished on the basis of the information available on the bond issues:

- Period 1: bond issues in the years 2021 to 2023;
- Period 2: bond issues in the years 2024 to 2027; and
- Period 3: repayment period from 2028 at the earliest to 2058 at the latest.

[25] As a rule, this applies to a normal interest rate structure. In the exceptional case of an inverted yield curve, interest rates are higher for shorter maturities than for longer maturities. In the case of a flat yield curve, market interest rates do not depend on the maturity of an investment.

[26] An overview of all bonds issued is available at: https://commission.europa.eu/strategy-and-policy/eu-budget/eu-borrower-investor-relations/transactions-data_en.

By the end of 2023, the Commission had disbursed €182.5 billion in grants from the Fund.[27] For **period 1**, it is also known which bonds the Commission issued at what maturities and interest rates.[28] Only a portion of these bonds were used to finance the Fund. According to our calculations, the bond portfolio linked to the Fund's grants totalled €190.9 billion by year-end 2023.[29]

For **period 2,** we need to make various assumptions for our calculations, as it is largely a future period. The first key assumption is that the Commission will pay out the grants of €421.1 billion from the Fund in full by year-end 2026. This means that our projections for interest payments and debt repayments represent an upper limit in this respect. This means that the Commission will have to issue further bonds totalling €230.2 billion during this period in addition to the €190.9 billion already financed by year-end 2023. We are following the Commission's forecast as to the timing of grant payments.[30]

We further assume that the Commission will maintain its funding strategy. This means that it will set bond maturities as in 2021 to 2023. We assume this for both new issues and refinancing activities that are due in 2024 to 2027. We additionally assume that the yield curve of mid-March 2024 will not change over the entire projection period.

For the refinancing of maturing bonds after the start of repayments in **period 3,** we assume that the effective interest burden on the bond portfolio will not change. A long-term forecast of interest rates up to 2058 is difficult. The extent to which the interest burden on the bond portfolio will change by 2058 depends in particular on when bonds expire and need to be refinanced. In the case of an early repayment, only a few refinancing steps will have to be taken. In this case, our calculations are susceptible to future interest rate changes only to a minor degree. However, the later the debt is repaid, the more frequently bonds have to be refinanced. In this case, our calculations are more susceptible to future interest rate changes.

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[27] Of this, €141.6 billion was paid out for grants from the RRF; a further €40.9 billion was paid out for programmes in the EU budget. In addition, €79.2 billion was paid out in RRF loans. See COM (2024) 93 final of 22 February 2024 (footnote 24) page 1.

[28] See the overview of the bond issues of the European Union (footnote 26).

[29] The Commission has taken a buffer into account when borrowing funds. This allows it to give funds even if the member states request higher payments than it had previously forecast. This explains why the funds raised for the grants exceed the grants paid out at the end of 2023. To calculate the borrowing needed for grants, we adjusted all bond issues for the share of disbursed loans. The issues from 2023 onwards also had to be adjusted for the Macro-Financial Assistance+ for Ukraine.

[30] European Commission (2023), Report from the Commission to the European Parliament and the Council: Long-term forecast of future inflows and outflows of the EU budget (2024-2028), COM (2023) 390 final, 20 June 2023, p. 19.

6 Projection of debt service depending on the repayment path

6.1 Repayment schedules analysed

The repayment schedule for the grants sets the timing of the repayments and thus also particularly determines the annual interest expenditure and the points in time at which the Commission must refinance bonds. The schedule is hence critical for the overall burden on the EU budget. The bodies responsible may only select repayment schedules that are in line with the own resources decision. In particular, the debt must be repaid by year-end 2058 at the latest and needs to be reduced steadily and predictably. The annual repayment must not exceed 7.5 per cent of the total amount of grants disbursed.[31]

In our audit, we analysed four different repayment schedules with

1. equal annual debt repayments starting 2028;
2. debt repayments as late as possible;
3. the earliest possible repayment of debt; and
4. annual debt repayments starting 2028, which are stable as a percentage of projected GDP.

Repayment schedule 1 is similar to the repayment scenario presented by the Commission.[32]

Repayment schedules 2 (repayment as late as possible) and 3 (repayment as early as possible) represent extreme cases that are to show the limits within which the total burden on the EU budget may vary.

According to the current legal situation, the member states' contributions to the EU budget are primarily a function of their respective share of EU GNI. Germany's share is currently just under 24 per cent. Projections by the Commission show that Germany's share in EU GNI would always be just under a quarter until 2058.[33] If the legal situation remains unchanged, it could hence be assumed that Germany – via the EU budget – would have to bear just under a quarter of the total debt service – depending on the respective repayment schedule. We therefore expect Germany's share in the debt service to be a steady 24 per cent.

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[31] See Article 5 (2) of the own resources decision (footnote 3).

[32] See footnote 4. The repayment scenario of the Commission ends in 2056. In our repayment schedule 1, we have provided for repayment until the end of the repayment period in 2058.

[33] European Commission, 2024 Ageing Report, Economic and Budgetary Projections for the EU Member States (2022-2070), Institutional Paper 279, Country fiches, April 2024. Projections up to 2058 are only available for gross domestic product (GDP), but not for gross national income (GNI). We have therefore assumed in all projections up to 2058 that the GDP and GNI of the European Union will not differ significantly. This assumption appears reasonable. For example, the EU's 2023 GDP only deviated from the EU's 2023 GNI by just under 1 per cent.

6.2 Repayment schedule 1: Equal annual repayments starting in 2028

If the annual repayment is evenly spread over the period 2028-2058, the European Union will repay the total **grants of €421.1 billion** in equal annual instalments over 31 years. This means that it annually repays an amount of €13.6 billion.[34]

The annual payments to be made under this repayment schedule in the period from 2028 to 2058 are illustrated in figure 2. According to this schedule, the annual debt service (interest payments and debt repayments) is highest at the beginning of the repayment period. Based on our calculations, the annual debt service will amount to €25 billion in 2028. As the remaining balance of debt decreases, the debt service as a whole will also gradually decline.

Under repayment schedule 1, the EU budget would have to make **interest payments totalling €213 billion.** As the grants amount to just over €421 billion, the **debt service** would amount to a nominal total of **€634 billion**. **Of this total amount, €152 billion would be covered by Germany's contributions to the EU budget, which would have to be paid from the federal budget.**

If inflation[35] is taken into account and the cash value is based on 2024 prices, the total burden for the EU budget is **€455 billion** in 2024 prices.

[34] For the short-term bonds, we generally assume that the EU Commission holds a portfolio of €10 billion and that it will reduce this in parallel to the portfolio of EU bonds. This means that the portfolio of short-term bonds will decrease at the same rate as the portfolio of bonds.

[35] We have assumed an annual inflation rate of 2 per cent until 2058. This corresponds to the ECB's inflation target of 2 per cent in the medium term. At this inflation rate, one euro in 2058 would only be worth "less than half" in terms of purchasing power.

Figure 2

Equal repayments: debt service declining steadily

Debt servicing will be €25 billion in 2028 and will fall steadily until 2058. The repayment amounts remain the same, while interest expenditure falls as the remaining debt decreases.

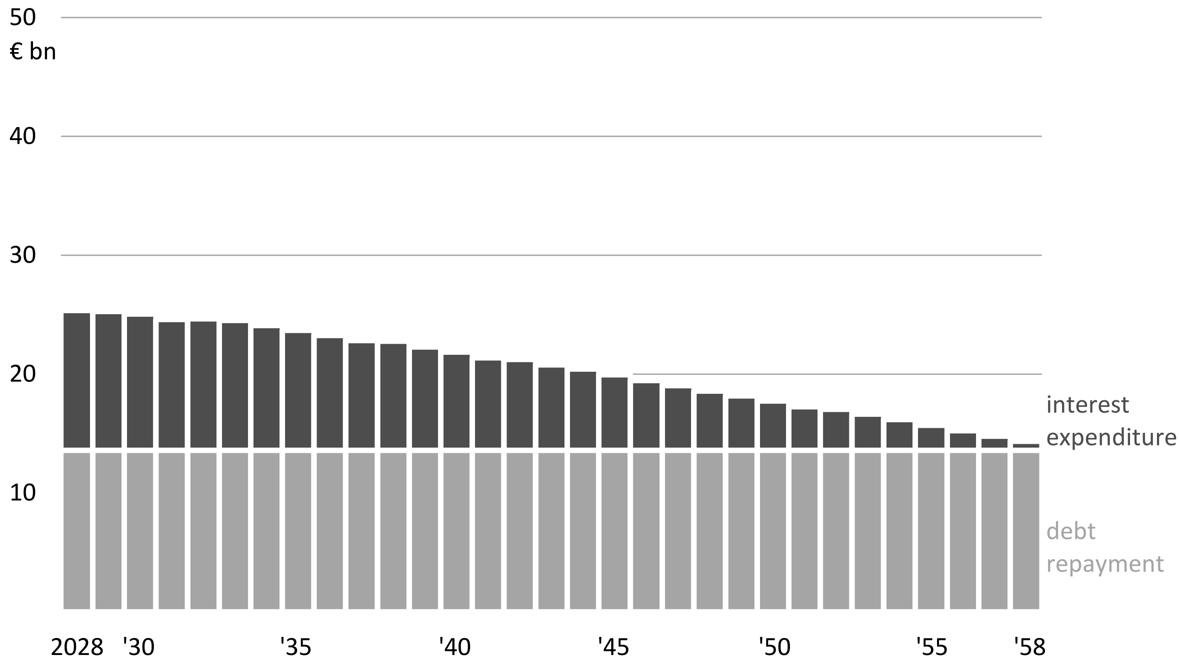

Figure: Bundesrechnungshof. Source: own calculations (for assumptions see 5.3).

6.3 Repayment schedule 2: repayment as late as possible

If repayments are made as late as possible, they are spread over as few years as possible towards the end of the repayment period. It should be noted that the annual repayment must not exceed 7.5 per cent of the total grant amount disbursed,[36] i.e. the maximum annual debt repayment amount is €31.6 billion. This means that, according to repayment schedule 2, it will take at least 14 years to fully repay the balance due: In 2045, €10.2 billion in repayments are to be made, and between 2046 and 2058, the maximum amount allowed needs to be repaid each year. In the years prior to 2045, the European Union will only pay interest and restructure the debt.

Late repayment makes the projections more uncertain because debt will be restructured by the Commission more often and for higher volumes than in the case of equal repayments. As a result, the projections depend to a greater extent on the future market interest rate, which is currently still unknown.

36 Article 5 (2.3) own resources decision (see footnote 3).

Figure 3 shows the annual interest payments and debt repayments on the basis of the latest possible repayment. Until the start of repayment in 2045, €12 billion in interests will be paid each year starting 2028 according to this repayment schedule. In 2046, the EU will repay the maximum amount of €31.6 billion for the first time. Together with interest payments, debt service will then reach €45.3 billion. After this date, debt service will continue to fall steadily.

Under repayment schedule 2, the EU budget would have to make **interest payments totalling €331 billion.** The **debt service** would amount to a nominal total of **€752 billion**. **Of this total amount, €180 billion would be covered by Germany's contributions to the EU budget, which would have to be paid from the federal budget.**

If inflation is taken into account and the cash value is based on 2024 prices, the total burden for the EU budget is **€483 billion in 2024 prices.**

Figure 3

Late repayment: annual debt service towards the end of the repayment period will reach almost €45 billion

Until 2044, the EU only pays interest on the bond portfolio and will reschedule maturing bonds. After that, repayments will start. As a result, debt servicing expenditure will rise sharply towards the end of the period.

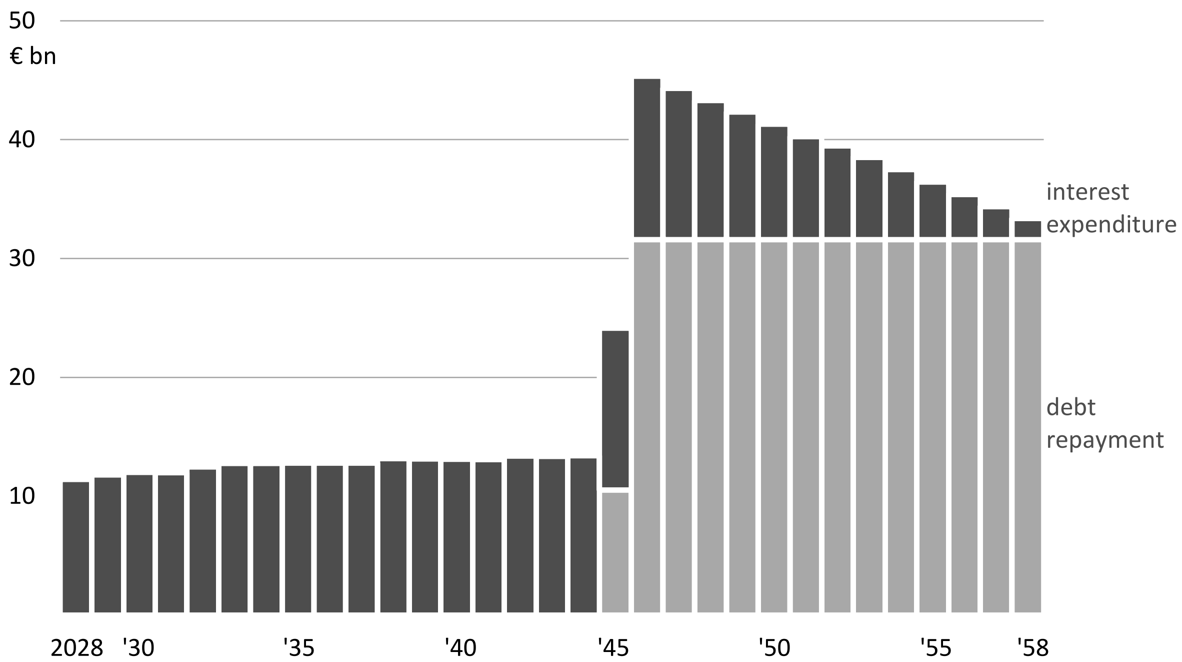

Figure: Bundesrechnungshof. Source: own calculations (for assumptions see 5.3).

6.4 Repayment schedule 3: repayment as early as possible

The EU has issued bonds with a range of different maturities. These bonds must be repaid or rescheduled upon maturity. If the EU intends to repay the bonds as early as possible, starting in 2028, it can do so by allowing the respective bonds to "expire" at maturity. For repayment schedule 3, this means: the timing of the EU's bond repayment depends on the maturity structure of the bonds issued up to 2027.

Another option for the EU would be to repay the debt more quickly by buying back bonds on the market. However, this seems unlikely since the EU has used bonds not only to fund the grants for the Recovery Fund, but also, among other things, to fund the loans and, starting in 2023, all debt-financed EU programmes.[37]

If the EU allows the bonds to expire, it will have to bear a considerable burden, especially in the years 2028 to 2041.[38] In these years, the EU will face high repayments; at the same time, interest expenditure will also be particularly high due to the still substantial remaining debt. For example, in 2029, 2031 and 2032 alone, debt service under this repayment schedule will exceed €40 billion per year. From 2042 onwards, however, the debt service will be less than €20 billion per year. Figure 4 illustrates the annual debt service for repayment schedule 3.

Under repayment schedule 3, the EU budget would have to make **interest payments totalling €153 billion.** The **debt service** would amount to a nominal total of **€574 billion**. **Of this total amount, €138 billion would be covered by Germany's contributions to the EU budget, which would have to be paid from the federal budget.**

If inflation is taken into account and the cash value is based on 2024 prices, the total burden for the EU budget is **€440 billion in 2024 prices**.

[37] If the EU bought back a proportion of the issued bonds before they expire in order to repay the grants provided under the Recovery Fund, the volume of bonds on the market would decrease. This would affect the liquidity and the tradability of these bonds. It might also have a negative impact on future bonds issued by the European Union.

[38] In two years, the repayment of debt under this repayment schedule would be above the maximum amount of 7.5 per cent set by the own resources decision. We have therefore assumed that the European Commission will refinance the amount that exceeds 7.5 per cent and that relates to the bonds maturing in those years. For this refinancing, the European Commission will reschedule the debt by means of one-year bonds. The Commission would thus repay the relevant amount with a one-year delay.

Figure 4

Early repayment: the annual debt service will initially rise to more than €43 billion

The EU repays the bonds at maturity. This means that the burdens are particularly high at the beginning of the repayment period, but then decrease significantly towards the end.

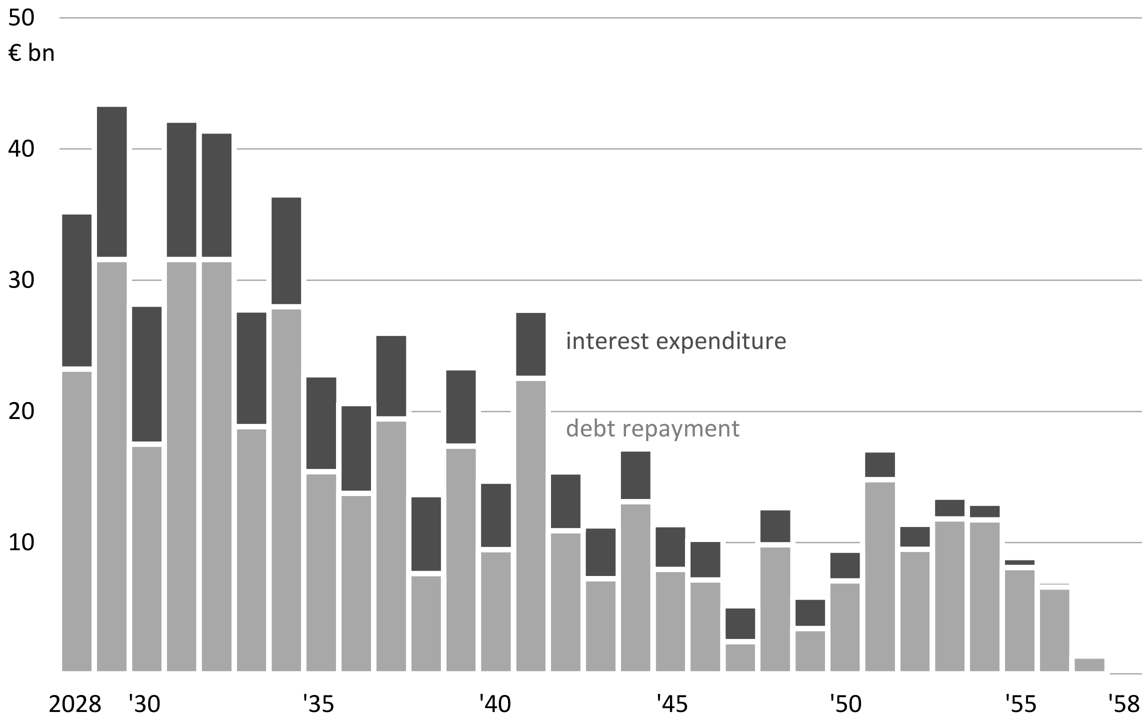

Figure: Bundesrechnungshof. Source: own calculations (for assumptions see 5.3).

6.5 Repayment schedule 4: stable ratio of repayment to projected GDP

It is expected that economic performance – i.e. the GDP – in the EU will increase in nominal terms over the decades to come. In this context, both a stable annual repayment and a repayment as early as possible, tend to lead to a gradual decrease of repayments expressed as a percentage of GDP. A conceivable option would be hence to gradually increase the annual repayments in order to keep the ratio to GDP – and thus the "effective burden" – stable.[39] In this case, the annual repayments would have to increase in line with the GDP growth rate.[40] Since the annual growth rates up to 2058 are unknown because they relate to

[39] Cf. Feld, Nöh, Reuter and Yeter (2021), Von der Corona-bedingten Schuldenaufnahme zur Wiedereinhaltung der Schuldenbremse, Perspektiven der Wirtschaftspolitik, 22(4), 330-349.

[40] GDP is the usual indicator for measuring a country's economic prosperity. We have therefore used GDP in our analysis. Transfer payments to the EU are measured in GNI units.

the future, we have based our assessment on projections made by the Commission as to the EU's annual potential growth.[41] Under repayment schedule 4, maturities of the bonds need to be chosen in line with GDP projections.

Figure 5 shows the annual debt service for this repayment schedule. As specified, the annual repayments increase in nominal terms over time. At the same time, the annual interest payments show a trend going into the opposite direction, so that the total burden remains relatively stable over time and amounts to just under €20 billion per year.

Under repayment schedule 4, the EU budget would have to make **interest payments totalling €248 billion.** The **debt service** would amount to a nominal total of **€669 billion**. **Of this total amount, €161 billion would be covered by Germany's contributions to the EU budget, which would have to be paid from the federal budget.**

If inflation is taken into account and the cash value is based on 2024 prices, the total burden for the EU budget is **€463 billion in 2024 prices**.

[41] European Commission, 2024 Ageing Report, Economic and Budgetary Projections for the EU Member States (2022-2070), Institutional Paper 279, Country fiches, April 2024.

Figure 5

If repayment is stable as a percentage of projected GDP, absolute repayment increases over time

Absolute repayment increases, while interest payments decrease over time. Overall, the debt service is thus spread equally over the years.

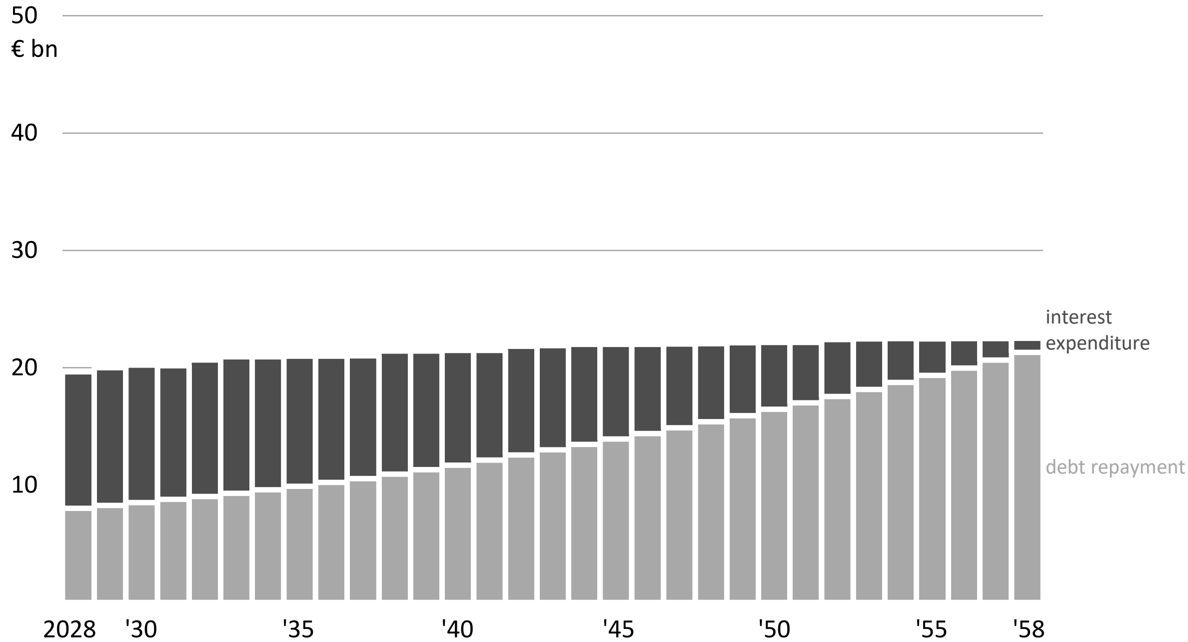

Figure: Bundesrechnungshof. Source: own calculations (for assumptions see 5.3).

6.6 Summarised assessment

All in all, it may be stated that the debt service for the Fund will place a significant burden on the EU budget over many years, **with the burden varying considerably depending on the repayment schedule selected.** The nominal interest expenditure alone amounts to a minimum of €153 billion (early repayment) and a maximum of €331 billion (late repayment). The difference corresponds to an additional 116 per cent on the lower value.

Depending on the repayment schedule, the EU budget will have to incur nominal expenditure totalling a minimum of €574 billion (early repayment) and a maximum of €752 billion (late repayment). The difference is a nominal amount of **€178 billion**. This corresponds to an increase of **more than 30 per cent** on the lower value.

However, the expenditure is to be incurred at different times. For ease of comparison, we have adjusted the values for inflation and calculated the cash values in 2024 prices. The "ranking" of the repayment schedules remains the same. However, the cash values are closer to each other, with values between €440 billion and €483 billion. Adjusted for inflation, the additional expenditure on the lower value falls to **€43 billion** or **10 per cent**.

Overall, it should be noted that the burdens would be lowest with early repayment. An early repayment reduces interest payments. For example, interest expenditure would be more than twice as high (116 per cent) if repayment is made late. However, with early repayment, the annual burden on the EU budget would also be very high in early years. Adjusted for inflation, late repayment would lead to additional expenditure of 10 per cent compared to an early repayment. Moreover, it would go hand in hand with increased uncertainty. The values for the two other repayment schedules lie in between (see Figure 6).

Depending on the repayment schedule, the federal budget would hence face a nominal debt service burden of between €138 billion and €180 billion.

Figure 6

Early repayment minimises debt service burden

Early rather than late repayment lowers the debt service burden by a nominal €178 billion. This advantage is put into another perspective when looking at cash values. In 2024 prices, the difference, however, still amounts to €43 billion.

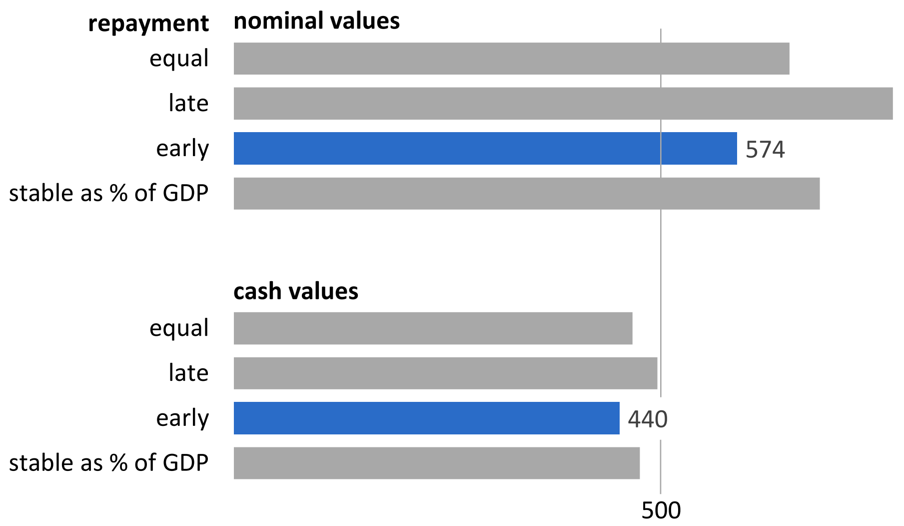

Figure: Bundesrechnungshof. Source: own calculations (for assumptions see 5.3).

6.7 Comments by the Finance Ministry

The Finance Ministry essentially commented on repayment schedules 2, 3 and 4.

It stated that a **late repayment** with a focus on payments in the years 2045 to 2058 could possibly have an impact on the interest payments that the EU needed to make on the capital markets. The Finance Ministry added that such a repayment schedule also included significant political risks, as unforeseen developments could arise.

The Finance Ministry further believes that an **early repayment** would make it more difficult to draw up and implement the budget, as the amounts required to service the debt would –

especially in the first few years – fluctuate significantly. Moreover, a declining liquidity of EU bonds on the market could adversely impact interest costs.

Eventually, the Finance Ministry is of the opinion that an annual repayment that is **stable as a percentage of GDP** might only be implemented if GDP is calculable in the long term and will reliably increase by a certain percentage. The Finance Ministry stated that it was unclear, however, how to deal with sudden economic slumps or longer phases of stagnation. The maturities of the bonds would also have to be selected in such a way that they reliably took into account GDP trends. The Finance Ministry further added that, due to the required lead time, it was unclear whether such a repayment schedule could be implemented.

6.8 Final conclusion

From the Finance Ministry's comments we conclude that it has a certain preference for equal annual repayments (repayment schedule 1). Only in the case of the other repayment schedules the Finance Ministry points to various risks and potential difficulties linked to the practical implementation. However, we believe that an early repayment (repayment schedule 3) should be preferred, as it makes possible significant savings in interest payments and reduces risks.

Furthermore, we see no practical issues in drawing up a repayment schedule based on the projected potential growth (repayment schedule 4). The relevant data is already available. On this basis, the repayment schedule and the bonds' maturities may be determined. Unexpected economic downturns also lead to an increase in the burden of debt servicing – measured against GDP – not only for this but also for the other repayment schedules. This also applies to the Commission's repayment scenario.

It is important that our assessment of the higher burdens and the significant risks of a late repayment is shared by the Finance Ministry. The Federal Government should therefore – with the support of the German Parliament – work at EU level to ensure that a binding repayment schedule is agreed prior to 2028. We believe that the repayment schedules 1, 3 and 4 set out above are a **good starting point** for the negotiations. If it is not possible to agree on a binding repayment schedule beforehand, this could lead to the start of repayment being postponed further and further, which would ultimately result in late repayment.

7 Reducing national debt service burdens

7.1 New own resources do not reduce the member states' debt service burdens

Facts and figures

Pursuant to Art. 312 TFEU, the annual budgets of the European Union shall comply with the ceilings of the MFF. The MFF sets the annual maximum ceilings for commitment appropriations per category of expenditure and for payment appropriations. As a rule, the MFF is prepared for a period of seven years.

Pursuant to Art. 311 TFEU, the EU budget is, without prejudice to other revenue, financed entirely from own resources. To this end, the member states ratify the own resources decision, which defines the type of own resources and the own resources ceiling. The own resources ceiling defines the maximum amount of own resources that the EU may collect from the member states. It is higher than the annual expenditure ceilings so that the EU may fulfil its payment obligations even in the event of an unexpected economic downturn.[42] Both the own resources ceiling and the annual ceilings laid down in the MFF are set in EU GNI units.

Pursuant to the own resources decision of 14 December 2020, which is applicable from 1 January 2021, the EU budget is based on the following four categories of own resources:

- **Traditional own resources** which consist almost exclusively of customs duties levied by the member states;
- **VAT own resources** resulting from a notional harmonised VAT base of each member state;
- The own resources based on the quantity of non-recycled plastic packaging waste (**plastic levy**); and
- The so-called **GNI own resources.**

While the **traditional own resources** are a **direct source of income** for the EU, the **other own resources** are essentially **national contributions** transferred by the member states to the EU budget. The GNI own resources represent a residual figure. This means that if the other own resources are not sufficient to cover the predetermined financial needs, the EU draws on the GNI own resources. In line with the respective share in EU GNI, the EU calls in the funds from the member states to cover the remaining financial needs. The EU is

[42] See Deutsche Bundesbank, Der EU-Haushalt und seine Finanzierung: Rückschau und Ausblick, Monthly Report of April 2020, page 45 et seq., cf. page 46.

therefore always in the position to cover its predefined financial needs, as the GNI rates of call are adjusted to the financial needs.

Due to the significant burdens from the Fund-related debt service, there is a threat of increasing GNI rates of call. The member states and the Commission therefore agreed in 2020 to work towards the introduction of new own resources. In doing so, they also aim at mitigating the increase in GNI own resources.[43]

The Commission proposed new own resources. These include own resources based on a revised EU emissions trading system, a carbon border adjustment mechanism, a share of the profits of multinational corporations[44] that are redistributed to the member states as well as on the basis of statistics on corporate profits.

As a first step, the own resources decision of 14 December 2020 introduced the plastic levy as a new own resources category for the current MFF as from 2021. So far, it is borne by the federal budget. This means that the plastic levy for Germany is calculated on the basis of the amount of plastic waste. The federal budget then raises such funds from all revenues and transfers them to the EU. Hence, it is the taxpayers who have to pay for the plastic levy so far. In return, the amount of own resources that must be transferred in line with the GNI share is reduced. The overall burden on the federal budget does not change or changes only insignificantly with the introduction of the plastic levy.[45]

The Federal Government intends to pass on the plastic levy to the enterprises that produce the plastic waste not before 1 January 2025. The enterprises could then pass on all or part of the plastic levy to the consumers. This will change which parts of the German economy effectively bear the burdens imposed by the plastic levy. This could create incentives for consumers and enterprises to avoid plastic waste. However, the overall burden on the German economy from the transfers to the EU would not be directly reduced by reallocating the plastic levy.

Conclusions

New own resources are not required to ensure that the EU is in the position to fulfil its repayment obligations from the Fund's bonds at any time. This is because, ultimately, the GNI own resources always cover the EU's financial needs, especially as the member states have endorsed an increase of the own resources ceiling by 0.6 per cent of the EU GNI when establishing the Fund.

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[43] Interinstitutional Agreement of 16 December 2020 (footnote 5), annex II, letters E to G.

[44] Implementation of Pillar 1 of the OECD's two-pillar project.

[45] See Busch/Kauder (2022), Braucht die EU neue Eigenmittel? IW-Report, number 3, Cologne, Germany. Annual transfers to the EU currently amount to just under €40 billion. According to the German Finance Ministry, previous data show that the plastic levy translates into an average €164 million relief of the federal budget per year by replacing GNI own resources.

In addition, new own resources do not alleviate the pressure on the member states' debt service. This is because even with new own resources, the EU's financial needs must always be covered by the member states. As long as the size of the EU budget remains the same, the total contributions payable by the national economies do not change.

Moreover, new own resources do not "appear from nowhere". Rather, creating new resources generally draws on the economic output or the assets of the member states' economies. This means that even if new own resources place an additional burden on a member state's enterprises or consumers instead of the public budget, they ultimately take funds from the national economy. Such funds can hence no longer flow into the national budgets in the form of national taxes or levies. It is true that new own resources may reduce transfers of GNI own resources. However, they have the effect that other contributions of the same amount need to be paid, with such contributions no longer being available to the tax authorities as a potential tax base.

The debt service for the Fund's bonds can therefore not be used as a justification for the creation of new own resources. This is another reason why we continue to question as to whether new categories of own resources would create additional benefits or whether they would instead further increase the lack of transparency and the complexity of the own resources system.[46]

Comments by the Finance Ministry

The Finance Ministry replied that own resources, which would have to be paid by enterprises or consumers on the basis of new taxes or levies and which had not yet been included in the national budgets, could alleviate the pressure on the member states' debt service. To give an example, the Ministry referred to the proposal for new own resources based on the **carbon border adjustment mechanism**.

Additionally, the Finance Ministry stated that new own resources did not necessarily have to be built on a basis that is available to the national tax authorities as a tax base. Such own resources would hence have no impact on the member states' revenues. The Ministry reiterated the example of the carbon border adjustment mechanism.

Final conclusion

We reaffirm our view that own resources – regardless of their respective "packaging" – generally resort to a national economy's economic performance or assets. Even new own resources that are not predicated on the national tax base are likely to indirectly reduce such

[46] Communication to the Federal Ministry of Finance about our audit on potential effects of the further development of the EU's own resources system of 5 May 2020 (ref.: I 3 (I 7) - 2019 - 0821/VIII 2 - 2019 - 0851).

tax base. And even if new taxes or levies only burden non-EU-based enterprises, they are still likely to generally result in burdens for the national economies.

For example, a carbon border adjustment mechanism could lead to higher prices for intermediate products, which would make end products more expensive on the domestic market and/or reduce corporate profits. If corporate profits fall, the member states lose revenue from the taxation of such profits. If the prices of end products rise, consumers tend to reduce the consumption of such products and/or tend to be unable to afford other products. In this case, sales tax revenues, for example, could fall.

New own resources may thus change how burdens are distributed. However, the EU's funding must always, in essence and for the most part, be borne by the national economies.

7.2 Utilising leeway created through real GDP growth for debt servicing

Our calculations show that the debt service for the Fund will place a considerable burden on the EU budget in the coming decades (cf. chapter 6). The EU and some member states could argue in favour of passing on all or part of this burden to national budgets. The debt service would thus burden on national budgets that, due to high national debt and many other challenges, have limited room for manoeuvre, which is hence likely to narrow even further.[47] At the same time, however, the EU budget legislator does not want the debt service to lead to inappropriate cuts in programme spending or in investment instruments within the EU budget.[48]

Against this background, we examined as to how the burdens of debt servicing may best be distributed between the EU budget and the national budgets. Our analysis is based on the following considerations:

- The Fund is not only supposed to make a significant contribution to overcoming the Covid-19 pandemic. The aim is also to increase **economic growth**, create jobs and make the member states more resilient to future crises through productivity-enhancing investments and reforms.[49]
- The Fund is also intended to support the **green and digital transition** within the EU.
- If the Fund is successful, it should lead the member states – and thus the EU as a whole – onto a **higher growth path.** Additionally, it is to ensure that future crises lead to less severe economic slumps and thus welfare losses.

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[47] Destatis, national accounts, debt ratios of the EU member states, gross debt (consolidated) in per cent of GDP.

[48] Interinstitutional Agreement of 16 December 2020 (footnote 5), annex II, letter E.

[49] Article 1 (2) of Council Regulation (EU) 2020/2094 of 14 December 2020 establishing a European Union Recovery Instrument to support the recovery in the aftermath of the COVID-19 crisis.

- Moreover, the Fund provides significant **additional funds for investments**, e.g. for climate protection and digital transition projects. Some investments are thus **actually made earlier**. In this respect, the Fund's financial resources – if used appropriately and effectively – may also be considered as **an advance use of future EU budgets**.

The EU budget's expenditure ceilings are set in EU GNI units. With regard to the options as to funding the interest payments and debt repayments for the Fund from the EU budget, this means the following:

- If the **ceilings** in the EU budget are **kept stable as a percentage of GNI,** the EU budget's room for expenditure increases automatically in absolute terms as EU GNI rises. This results in additional **leeway in the EU budget** which may be used for interest payments and debt repayments.
- If **expenditure incurred for EU programmes** is kept **stable after adjusting for inflation**, our calculations show that real growth over the coming decades will always be sufficient in total **to fund** interest payments and debt repayments for the grants awarded under the Fund **in full from the EU budget – without any additional burden on national budgets**.

Regarding the entire repayment period from 2028 to 2058, this applies for all four repayment schedules. Only under the 2028-2034 MFF, the leeway is not sufficient for two repayment schedules, namely for equal and early repayments. In this case – only under the 2028-2034 MFF – additional burdens would be placed on the member states.

The EU could make debt service payments for the grants provided under the Fund entirely from the EU budget without reducing expenditure at EU level or significantly increasing the member states' EU contributions – and thus the burden on national budgets. To this end, the EU only needed to keep spending on programmes and investment instruments in the EU budget stable in real terms. Real economic growth would automatically create room for manoeuvre in the EU budget. When designing the binding repayment schedule, the member states could be guided by the anticipated room for manoeuvre.

Figure 7

Room for manoeuvre through real growth is generally sufficient to service debt

If the ceilings in the EU budget as a percentage of GNI as well as the inflation-adjusted expenditures are kept stable, the leeway created by real economic growth is sufficient to service the Fund’s debt. Only as to the 2028-2034 MFF, the funding requirement is higher with early or equal repayment.

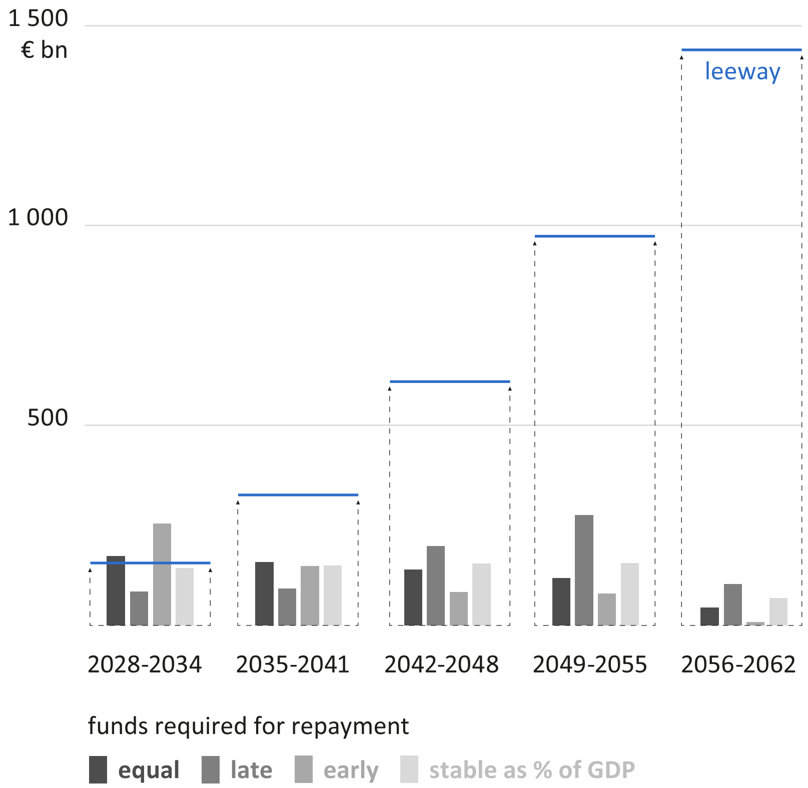

Figure: Bundesrechnungshof. Source: own calculations (for assumptions see 5.3).

7.3 Summarised assessment and recommendation

The member states use the negotiations on the respective MFF to specify how much funding they make available to the EU. In future, they will also – in addition to the "usual" EU budget items – have to decide how the debt regarding EU bonds is to be serviced. This defines the EU's financial needs for the period of the respective MFF. The funds then flowing out of the EU budget are generally covered by the member states’ own resources. The question as to which sector of the national economies actually has to provide such own resources does not need to be answered when it comes to calculating the aggregate transfer payments to the EU.

The member states could reduce the national burden linked to the debt service for EU bonds by using the leeway resulting from real growth in the decades to come. Adjusted for inflation, they could keep spending on programmes and investments stable and still repay the Fund's debt – without a noticeable additional burden on national budgets. In particular, if the growth effects targeted by the Fund can be achieved, it would be reasonable to use the resulting leeway for debt servicing.

In view of the limited financial leeway in the federal budget and the numerous challenges already looming, such as demographic change or investments in climate protection, the digital transformation and defence as well as the repayment of emergency loans, the Federal Government should adopt this position on the design of the repayment schedule in the negotiations at EU level.

8 Conclusion

Our calculations show that the debt service for the Fund will place a considerable burden on the EU budget in the decades to come. Since the EU is financed from the value created in the member states, the national economies will ultimately always have to service the debt. Even new own resources will not change this fact.

Public debt and annual budget deficits are already high in many member states. Demographic change and the need for investments in areas such as climate protection, digital transformation and defence are likely to reduce the room for manoeuvre even further, and any deficits are likely to increase. Against this backdrop, it can be assumed that the member states will face challenging consolidation efforts – even without the debt service for the Fund. The member states could therefore be interested in reducing the burdens resulting from debt servicing at national level.

The burden on member states from debt servicing can differ significantly depending on the repayment schedule. For example, there is a nominal difference of €178 billion between early and late repayment. Even adjusted for inflation, the difference between these two extreme cases is still €43 billion. Late repayment hence leads to considerable additional expenditure. The member states can reduce or avoid this additional expenditure if they agree on a repayment schedule at an early stage that does not provide for a late repayment.

If they fail to do so, this could lead to the start of repayments being postponed further and further. Actually, the repayment schedule which comes with late repayment and the highest expenditure would then be implemented. Another disadvantage of a late or no agreement is that the Commission does not have the information to determine the best maturities and volumes for the bond issues under its portfolio strategy. This is likely to lead to higher interest expenditure.

Additionally, our calculations show that the leeway in the EU budget resulting from real economic growth in the decades to come is large enough to service debt completely from the "normal" EU budget.

With regard to the debt service for the Fund, the Federal Government should thus – with the support of the German Parliament – ensure at EU level that

- the funds to cover additional interest expenditure in the years 2025 to 2027 are made available, where possible, through "real" redeployments from other EU programmes;
- a binding repayment schedule is agreed prior to 2028;
- this repayment schedule, if possible, is based on the repayment schedules 1, 3 or 4 set out above; and
- the leeway in the EU budget resulting from real economic growth, given that the ceilings as a percentage of GNI and other expenditure are kept stable after adjustment for inflation, is used for debt servicing.

The burdens arising from the debt service could also serve as an opportunity and impetus to review selected EU programmes in terms of their effectiveness and efficiency in the negotiations at EU level in order to decide on their continuation and, if possible, to create additional leeway. The aim should be to only fund those programmes from the EU budget that are verifiably efficient and effective in terms of the objectives.

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