

# Banking on Europe Policy Brief

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## How Next Generation EU Will be Paid Off

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### Key Points

- As part of Next Generation EU (NGEU), the European Union (EU) has borrowed funds for the first time to provide grants to member states. Starting in 2028, the EU will repay these borrowings from its budget.
- Under the 2020 Own Resources Decision, the member states have earmarked funds over and above what is necessary to amortise outstanding borrowings.
- Current discussions about the creation of new Own Resources to pay off borrowings for NGEU grants appear, for this reason, to be driven by institutional interests rather than financial necessity.
- It seems unlikely that member states will be compelled by the EU's pandemic-related debt repayments to create additional sources of revenue for the Union's budget.

### Introduction

The creation of NGEU marked a turning point in EU public finance. Over EUR 400 billion of the funds that the Commission borrows on capital markets for its pandemic recovery programme will be disbursed in grants, rather than on-lent to the member states. But unlike national debt, the EU's debt cannot be rolled over in perpetuity: by 2058, the borrowings for NGEU will have to be paid off. To repay borrowings associated with these grants, the Commission will, therefore, have to mobilise funds from the EU budget for debt repayment for the first time in the EU's history.

The question of how to pay for NGEU is related to a political agreement between the Commission, the Council, and the Parliament in

2020 to create new Own Resources. It is often suggested that the EU needs new Own Resources to be able to pay off NGEU. In June 2023, the Commission proposed a revision of the EU's Own Resources Decision that would formalize these new sources of revenue.<sup>1</sup>

However, as this policy brief explains, the member states have already ensured that sufficient funds are available to pay off NGEU borrowing. A look at the repayment schedule of NGEU debt and the process for mobilising budgetary funds shows that new Own Resources are not a financial necessity. Consequently, the obligation to pay off NGEU gives the Commission little leverage to compel the Council to agree to new Own Resources.

### The Two Ceilings in the EU budget

To understand the importance of Own Resources for repaying NGEU, one needs to recall how the EU budget is financed. Spending allocations that are part of the EU budget are capped annually by the EU's Multiannual Financial Framework (MFF). For the year 2023,

for instance, that ceiling is set at €169 billion.<sup>2</sup> To finance this spending, the EU can draw on several Own Resources, but over 70% of its revenue comes from the so-called Gross National Income (GNI) contribution. The GNI contribution is adjusted in line with the EU's

<sup>1</sup> COM(2023) 331 final/2

<sup>2</sup> COM(2023) 336 final

actual spending per year and capped at 1.4% of GNI, that is, an amount higher than the MFF (European Commission, 2023). The difference between the MFF ceiling and the GNI ceiling is sometimes referred to as the EU's 'budgetary headroom'.

Most EU borrowing operations are covered by this headroom, which provides, among other things, the guarantee for some lending operations of the EIB and the EU's financial assistance to third countries. While NGEU borrowing sits outside the MFF, it is still subject to the GNI ceiling under the Own Resources, but with an additional ceiling.

To ensure that sufficient funds will be available to pay off NGEU, the Council in the 2020 Own Resources Decision agreed to a separate increase in the GNI ceiling of 0.6%, which are only available for NGEU. In other words, funds borrowed under the NGEU are covered by the usual headroom and by the extraordinary additional ceiling, which applies until funds under NGEU are fully repaid by the end of 2058 at the latest.<sup>3</sup> All in all, the Commission will be able to call up funds of up to 2% of GNI from member states (1.4 % of GNI to finance the MFF and an additional 0.6 % of GNI to finance NGEU).

## The Debt Profile of NGEU

NGEU has a total funding volume of €803 billion in 2023 prices. The largest part of that envelope will fund the Recovery and Resilience Facility (RRF), which comprises up to €386 billion in loans to member states and up to €338 billion in grants. The remainder, €83 billion, will contribute to other EU programmes, such as Horizon Europe and ReactEU.

How much precisely will be borrowed under NGEU remains to be seen. Member states have until August 2023 to request loans from the RRF. So far, ten countries have requested loans and/or indicated their intention to do so (Commission 2023b). At present, a total of about €313 billion could be allocated via RRF loans. Together with the programme and grant element of NGEU, the Commission would have to borrow a total of over €723 billion.

Even if all non-repayable support under NGEU was eventually granted, the annual debt service would be limited. The Own Resources Decision imposes a cap on annual repayments of 7.5% of the grant portion or about €30 billion per year.<sup>4</sup> The Commission (2021) calculated that '[a]n amount of €15-16 billion in current prices corresponds to a linear repayment profile.' Given that the Commission can refinance its debt if necessary, it will likely be able to align the maturity profile of its debt with these requirements. In 2023, it already plans to roll over or pay off €35 billion (European Commission 2023a, p. 780).

By contrast, the temporary 0.6% increase in Own Resources creates over €100 billion per year in budgetary headroom (European Commission, 2023c). The EU has amply sufficient budgetary headroom to pay off NGEU under current legislation.

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<sup>3</sup> Art 5.2, last paragraph and Art. 6, Council Decision (EU, Euratom) 2020/2053

<sup>4</sup>Art 5.2, last paragraph, Council Decision (EU, Euratom) 2020/2053

## The Politics of New Own Resources

When NGEU was created, the Commission, Council, and Parliament signed an interinstitutional agreement (2020), in which they agreed to work towards introducing new sources of revenue sufficient to cover the repayment of NGEU borrowing. In line with that agreement, the Commission has proposed to create three new Own Resources. It wants to earmark 75% of the revenue from the agreed Carbon Border Adjustment Mechanism for the EU budget, 30% of the revenue from the EU's carbon Emission Trading System, and to introduce a levy of 0.5% on large multinational companies profits.<sup>5</sup>

The Commission estimated that these three new Own Resources could generate about €17 billion per year after 2026. This amount would be sufficient to cover the average amortisation

costs of NGEU borrowings (European Commission, 2023d). However, even if these new Own Resources were agreed upon, they could not technically be used to repay that debt. The EU's budgetary principle of universality prohibits the earmarking of revenue in this way.

Moreover, it can be doubted whether these new Own Resources will be agreed upon. The European Parliament has already expressed its support for the package,<sup>6</sup> but the legislation is held up in the Council. Amendments to the Own Resources Decision require unanimity among the member states, as well as ratification by national parliaments. The Commission noted in June 2023 that the Council had not made substantial progress on the issue.

## The Future of the EU's Debt

When NGEU was created, member states already had to make provisions for paying off the grant elements of this programme. The headroom under the GNI ceiling is amply sufficient to cover the costs of repaying NGEU expenditures until 2058 and it provides a clear separation between financial allocations for the budget and NGEU.

It is therefore misleading to think that the new Own Resources under discussion at the moment are strictly necessary to repay the EU's borrowings. If the source of revenue for repayment were still uncertain, the EU could hardly hold on to its AAA credit rating.

Instead, it appears that the current discussion on new Own Resources may be driven by institutional interests, rather than financial requirements. The current GNI

contributions are limited in time and do not constitute resources that fall under the principle of universality, as they are only callable for repayments under NGEU. New sources of revenue would increase the EU's financial autonomy, irrespective of what they are used for. The member states may hesitate for precisely this reason to agree to such a far-reaching change in the EU's finances.

Looking ahead, we are sceptical that the non-repayable part of NGEU will ultimately lead to the creation of significant new Own Resources. While new sources of revenue may emerge over time, they are neither necessitated by the EU's pandemic response nor politically at the forefront of governments' priorities.

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<sup>5</sup> COM/2023/331 final

<sup>6</sup> European Parliament legislative resolution of 23 November 2022 on the proposal for a Council decision amending Decision (EU, Euratom)

2020/2053 on the system of own resources of the European Union (COM(2021)0570 – C9-0034/2022 – 2021/0430(CNS)). P9\_TA(2022)0404

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## Further Information

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