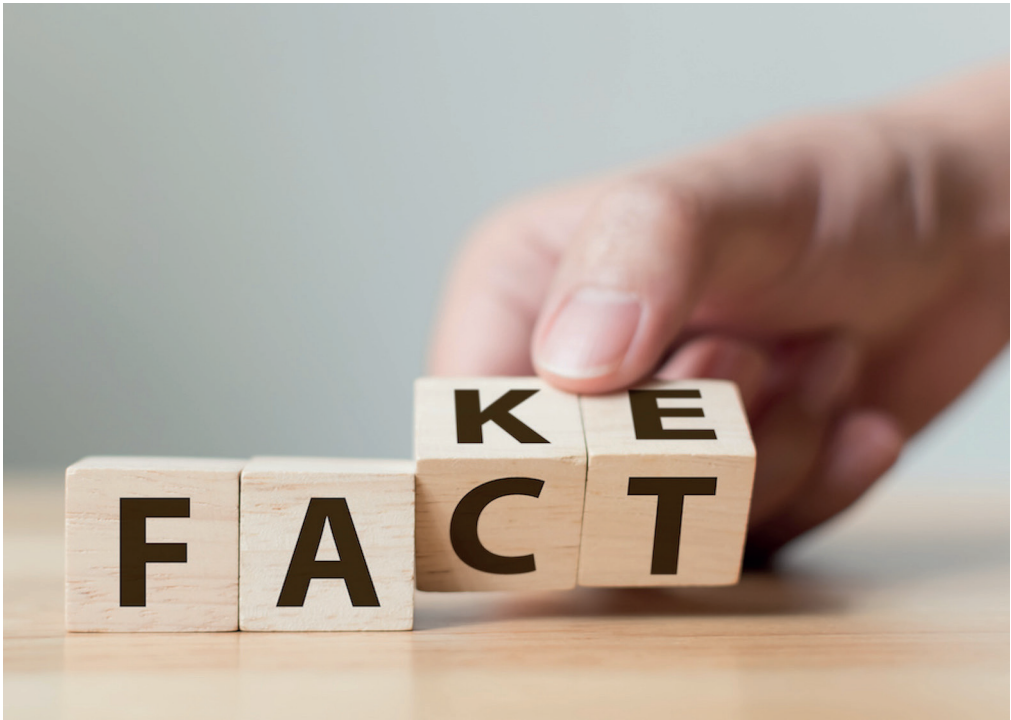


THE GREAT

EU BUDGET

DECEPTION

*The EU 2021-2027 Multiannual Financial Framework and
Coronavirus Recovery Fund: a dagger aimed at the Republic of Ireland
– or a con trick on all EU citizens and financial market investors?*



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Introduction

THE EUROPEAN UNION reached an agreement on its next budget for the period 2021-27 at an “ECOFIN” European Council summit meeting lasting from 17th to 21st July. It included the Coronavirus Recovery Fund, a €750bn borrow-and-spend exercise. The borrowings will be taken up by the European Union, and are therefore on a joint-and-several-liability basis: each Member State is liable for the whole amount. In principle any calls for extra money from Member States to cover the debt service on the borrowings would be shared out pro-rata according to each Member State’s Gross National Income (GNI) compared to EU-27 GNI. But if one Member State could not meet their share of the call, their GNI is backed out of the EU-27 GNI figure, and the remaining Member States’ GNI figures are divided into the GNI of the EU-26, then EU-25, then EU-24, and so on until there is only one Member State left. The payment due from the last Member State is its own GNI divided by the EU-1 GNI – and that will work out to a liability to pay 100% of the debt. The usage of the EU as the borrowing vehicle has been hailed as a breakthrough – even though the EU has borrowings already – because it shows the Member States acting in concert and creating debts that are backed by all EU taxpaying entities.

Indeed that is the case, but this should not be at all to the taste of the citizenry of Member States, because of the means arrogated to itself by the EU to make this come about. Nor should it be to the taste of financial market investors. Be that as it may, vociferous and immediate opposition came from within the Republic of Ireland, and on the basis of a fear that the Republic of Ireland would be a major payer-in, rather than a taker-out.

Executive Summary

It is impossible for any Member State to say for sure at this stage that they will be a net-loser or net-winner from the Coronavirus Recovery Fund or from the next EU cash budget. This is not just because the documentation is impenetrable but because of the joint-and-several-liability basis of the borrowings to be taken up by the EU: no-one can yet know which Member State will have to pay back and how much. Outrage emanating from the Republic of Ireland is premature on that score.

Outrage should, however, be emanating from the citizenry of the EU as a whole. Firstly the framework and controls around the EU's budget, how much it can spend on its citizens' behalf and how much it can borrow, have been dissolved. Secondly, the debts are only affordable out of the EU's new taxes, which impose a major burden on Member States but which, because the EU categorises them as its Own Resources and due to the EU directly, can be eliminated from the Member States' cash contributions. This diminishes the appearance of the cash contributions and misrepresents the total cost of EU membership. Thirdly, the EU has manipulated the meaning of Article 122 of the Treaty on the Functioning of the EU to set up the Coronavirus Recovery Fund. Article 122 is to do with the giving of "Union Financial Assistance" in the case of natural disasters. It says nothing about the "Union Financial Assistance" being spent on anything other than direct and immediate remedying of the disaster. It says nothing about the affected Member State having to wait 2-3 years for relief. It certainly says nothing about the affected Member State having to submit a national recovery plan in order to access the relief. These are major conditions not grounded in Article 122, and their imposition represents a major power grab by the EU apparatus. It is surprising that no commentators or politicians have argued that these conditions are beyond the EU's powers – "ultra vires".

Financial market investors and credit rating agencies should also be outraged, as the new budget dissolves the representation that the EU borrows only to lend the proceeds back-to-back: over half of the Coronavirus Fund will be distributed as grants. The manner of the establishment of the Coronavirus Recovery Fund argues with the representation that EU borrowings are based on Treaty: the basis being so very thin in this case, one is left to wonder where the legal basis is for the European Financial Stabilisation Mechanism (EFSM), the Balance of Payments Facility and the Multilateral Financial Assistance, and still more for the EU's various guarantees to the EIB. Credit rating agencies have represented to investors, as a line of credit protection behind EU bonds,

that the EU can call upon an extra €30-40bn per annum from Member States, but the assumptions that this was based on have been contradicted by the new budget. The new budget as a whole of €1.8trn is much larger than 1.4% of EU-27 GNI, which the ECOFIN summary states is the Multiannual Financial Framework: this means that the EU's borrowings are not part of the EU budget (if that is understood to mean the Multiannual Financial Framework) and are therefore not controlled by and subject to the Council Decision on the system of the European Communities' own resources (2007/436/EC, Euratom). In other words, what was agreed by the Council of Ministers in July has dissolved the basis for and controls on the EU budget and borrowings, and undermined the representations made by credit rating agencies to financial market investors, which can only have been based on information and representations made to the credit rating agencies by the EU itself.

Lastly the EU has further expanded a form of borrowing that does not track into the Eurostat figures on the Member States' "General government gross debt". Eurostat's are the anchor figures for measuring Member State compliance with the Stability and Growth Pact and the Fiscal Stability Treaty. Debts of public sector entities such as power, water and transport utilities already fall outside, as do financings under the InvestEU model and the European Investment Bank's own coronavirus response, and an undisclosed portion of the debts between EU central banks within the TARGET2 payment system. This is a further trick played on financial market investors and has not been picked up on by credit rating agencies – the total amount of debt weighing down on Member States is far higher than is recorded by Eurostat. Eurostat-recorded levels of debt are falling, while total debt is rising. The Coronavirus Recovery Fund adds a large amount of debt into an existing channel and exacerbates this divergence between Member State debt as officially recorded and the true figure.

In sum, the outcome of the ECOFIN summit was a major power grab by the EU apparatus, and one scarcely if at all within their legal powers. It is both a democratic outrage and a financial one, both for the suppliers of money – financial market investors and their helpmeets the credit rating agencies – and for receivers and re-payers, the EU's citizenry.

Initial reaction in the Republic of Ireland to the new EU Budget

MAJOR CONCERNS have been raised in the Republic of Ireland that the new EU budget (the 2021-2027 Multiannual Financial Framework or MFF) will plunge it into the status of one of the largest net contributors, despite its small population. There is additional concern that Ireland's contributions will be based on its Gross Domestic Product (GDP) – which is inflated by the so-called “leprechaun economy” (tax-based profit shifting by multinationals) - and not on Ireland's Gross National Income (GNI). A country's GNI is frequently lower than its GDP, but in Ireland's case the disparity is severe (see “The Irish Economic Miracle – Fact or Fiction” by Ewan Stewart and Bob Lyddon, 2019, Global Britain).

Senan Molony claimed in The Irish Independent (www.independent.ie) on 22/7/20 that Ireland would pay €3,200 to every EU citizen during the 2021-2027 MFF, and that Ireland's net cash contribution would be €15.7bn – the fifth highest overall and the second highest per capita¹.

“The Journal”, on the other hand, (www.thejournal.ie) stated on 21/7/20 that Ireland would receive €3bn through the Coronavirus Recovery Fund and more through other “budget instruments”, and that the legal power for the EU to do this was vested in Article 122 of the treaty (The Treaty on the Functioning of the EU or TFEU), pursuant to which the EU had already borrowed €100bn under SURE, a jobs safety net scheme².

Gript.ie was critical of the plan, showed an Allocation Table purporting to demonstrate Ireland's cash contribution and receipts and the same €15.7bn deficit, and angsted because the table referred to GDP when calculating each country's share of the budget³. It opined that the EU's document issued as ECOFIN's “Special meeting of the European Council (17, 18, 19, 20 and 21 July 2020) – Conclusions” was “typically impenetrable”⁴.

Our view is that the Allocation Table is not definitive or final, either for the Coronavirus Fund or for the MFF. We can find no evidence that the MFF and Ireland's contribution to it have suddenly been switched from a GNI basis to a GDP one⁵. But someone has to pay in, now or later.

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1. <https://www.independent.ie/irish-news/ireland-to-pay-over-3200-to-eu-for-every-man-woman-and-child-in-the-country-over-the-next-seven-years-39389257.html> accessed on 10.8.20
 2. <https://www.thejournal.ie/eu-recovery-fund-ireland-5155487-Jul2020/> accessed on 10.8.20
 3. <https://gript.ie/ireland-eu-budget-contribution-going-up/> accessed on 10.8.20
 4. EUCO 10/20, Brussels 21.7.20
 5. EUCO 10/20 page 65; point 151

Nevertheless we agree wholeheartedly that ECOFIN's document is impenetrable. Furthermore the MFF is a democratic outrage and a deception played on the EU's citizenry and financial investors alike, as well as being a power grab.

EU representations to financial market investors and credit rating agencies

EU presentations to investors⁶ and EU briefings to credit rating agencies⁷ have repeatedly inferred that the EU's borrowings were governed directly by the TFEU and were part of the MFF framework. Credit rating agencies have then given out that borrowings were backed, during the 2014-20 MFF, by the €30-40bn per annum that was the difference between the MFF ceiling set at 1.23% of EU GNI and the 0.97% of EU GNI that the EU was spending in cash⁸. With average EU GNI of about €125trn per annum between 2014 and 2020, the cash budget (Payments Appropriation) would sit at around €125bn per annum and the Commitments Appropriation for backing borrowings and guarantees at €32.5bn per annum⁹.

The Commitments Appropriation was assumed to refer to amounts incurred as financial commitments on borrowings or guarantees in the current MFF that might – but would not for certain – materialise as cash payments in a future MFF. Amounts would not for certain materialise as cash payments because the EU's borrowings were relayed as loans, or else were guarantees for loans or investments made by the European Investment Bank (EIB) or European Investment Fund (EIF), and loans should be repaid by their borrower, whilst investments should show a return.

The accumulation of amounts incurred over all Commitments Appropriation is (or was) known as the "Reste à liquider", but the ECOFIN document¹⁰ says this will rise to only €308bn during the 2021-27 MFF, even though the EU will borrow €750bn, and there are €159bn in loans and guarantees outstanding already, with another €26bn in the pipeline during the current MFF, making €185bn in all at the end of the 2014-2020 MFF. Again, previous assumptions about the "Reste à liquider" must now themselves be liquidated.

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6. European Union Investor Presentations of December 2010 and July 2015
 7. Moody's Rating Report on the European Union 30 September 2015
 8. "Overview and Outlook" on page 1 of Moody's Rating Report on the European Union 30 September 2015; summaries of recent rating agency reports on page 7 of European Union Investor Presentations of July 2015
 9. EU's "GNI_data_collection_2019" with current foreign exchange rates applied to non-Euro currency figures, totalled and averaged to reach average EU GNI, with factors of 0.97% and 0.26% applied
 10. EUCO 10/20 page 12; point 7

How the EU Budget was assumed to have been set and where the new MFF diverges

The instrument governing the budget was the Council Decision on the system of the European Communities' own resources (2007/436/EC, Euratom) and it supposedly set a budget ceiling of 1.23% of GNI¹¹.

Now the ceilings in that document have been suspended and exceeded. The EU has set a much higher budget as a percentage of EU GNI than for the previous MFF. It is a Payments Appropriation of 1.40% of EU GNI and a Commitments Appropriation of 1.46%¹². The Commitments Appropriation is now only related to possible delays in the dispensing of the Payments Appropriation, and is no longer (and supposedly never was) linked to the funds and guarantees, overturning existing assumptions¹³. The difference between the two now needs to be understood as a timing issue, whatever the EU may have said about it before.

If that is the case, what was the legal mechanism for setting up the funds and guarantees that already exist? Indeed, what is the legal basis for the assumption that the EU can call up €30-40bn per annum from Member States if the funds or guarantees go bad? Even the Appropriations stated above are not, however, the ceiling. For 2021-27, the EU has set an "overall budget" of €1.82trn, of which €1.07trn is shown as the MFF and €750bn is shown as "Next generation EU", or the Coronavirus Recovery Fund¹⁴. €1.82trn is €260bn per annum over the 7 years, which is 1.8% of average EU GNI (based on EU-27 GNI of €13.5bn in 2018, and an average EU-27 GNI for €14.3bn for 2021-27 if the 2018 figure expands by 1% per annum, although in 2020 it will have contracted)¹⁵.

- The "overall budget" is now apparently not synonymous with the MFF, as was previously thought.
- The €750bn of borrowings are now apparently not part of the MFF and are not restricted by it, as was previously thought.

So what is legal mechanism for setting up the Coronavirus Recovery Fund, whose amount is over 4 times the aggregate of the EU's loans and guarantees now?

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11. COUNCIL DECISION of 7 June 2007 on the system of the European Communities' own resources (2007/436/EC, Euratom)
 12. EUCO 10/20 page 63; point 140
 13. EUCO 10/20 pages 66-7
 14. https://ec.europa.eu/info/live-work-travel-eu/health/coronavirus-response_en accessed on 10.8.20
 15. Figures derived from EU's "GNI_data_collection_2019"

New EU borrowings are only thinly based on Treaty

The EU has represented that its borrowings are governed by Treaty. Article 122 of the TFEU, which Ireland's "The Journal" claims is behind the fund, allows that "the [European] Council, on a proposal from the Commission, may grant, under certain conditions, Union financial assistance", and this is indeed the way in which matters were presented by the Commission to ECOFIN, which consists of Finance Ministers or heads of government of all Member States and is thus a valid meeting of the European Council.

However the triggering event for this "Union financial assistance" should be where a "Where a Member State is in difficulties or is seriously threatened with severe difficulties caused by natural disasters or exceptional occurrences beyond its control". Article 122 should only be invoked in the case of "natural disasters or exceptional occurrences beyond its control" affecting one Member State at a time, not all of them at once. Failing other available mechanisms, the Commission has overlooked the exact wording of Article 122 so as to shoehorn its proposal into this Article and thereby legitimize it, dissolving any protection the wording might have afforded to individual Member States and their citizenry.

Relationship of EU borrowings to Treaty and to Council Decision in the new world

The TFEU must now be construed as not limiting the EU apparatus directly, but as conferring delegated powers on it, through which, in an emergency declared as such by itself, the EU can melt any controls on it as easily as ice cream. Even the Council Decision on the system of the European Communities' own resources was easily overturned to meet the needs of the moment, to increase the centralised powers of the EU apparatus, and to diminish Member State controls and protections.

One must conclude that EU borrowings are no longer limited by their sitting within the processes and controls of the MFF.

EU borrowings are no longer limited in their relationship to EU GNI through the mechanisms of the Council Decision on the system of the European Communities' own resources

EU borrowings no longer result in back-to-back loans, as was represented repeatedly to financial market investors, since a substantial portion of the €750bn of borrowings will be relayed as grants¹⁶.

16. European Union Investor Presentation of December 2010 slide 14, and slide 3 of the presentation of July 2015

The €750bn is not even being made available immediately, to meet needs of Member States existing now, as must have been contemplated when Article 122 was drafted, such as if the Netherlands had suffered a repeat of the 1953 floods.

The €750bn need not be used to remedy the direct results of coronavirus, such as to replenish medical supplies: it can be used to remedy matters that may or may not have been caused by coronavirus, directly/indirectly, definitely/arguably etc..

The €750bn will be disbursed over a period of years and - the grants at least - subject to each supplicant Member State submitting its Gosplan – its national coronavirus recovery plan – to the EU apparatus for approval, another major power grab.

Manner of exploitation of Article 122 is a major expansion of the power of the EU apparatus

Article 122 is thus a rather threadbare legal cover for this exercise and has been adopted selectively by the EU apparatus: to create the right to borrow a huge sum as “Union financial assistance”, without at once disbursing that money to remedy the natural disaster that has supposedly occurred, allowing expenditure of the money on indirect and uncertain effects of coronavirus, and mandating in exchange the exercise a degree of control over Member States that is not mentioned in Article 122 as going hand-in-hand with the receipt of Union Financial Assistance in this eventuality.

Selective usage of law in this way is undemocratic. Law should bind the law-giver as much as the law-taker, but the legal framework in which the EU operates appears to grant it a get-out-of-jail-free card which would certainly not be available were it to be governed by English law.

Impact of the new borrowings on future MFFs

The debt drawdown during 2021-27 will result in a very low net interest burden on the EU cash budget in the short term, limited to the shortfall on interest receivable on the €390bn being disbursed as grants, compared to the interest payable on the entire €750bn¹⁷. Any shortfall is likely to be minimised by the negative rates conjured up by the ECB; indeed, not receiving negative loan interest on the grants portion could actually result in additional Own Resource in 2021-27.

17. Page 3; point A6

This fool's paradise will not last. The €750bn of debt will be repayable up to 2058, with maximum 7.5% falling due each year¹⁸. That is €56.25bn, 52% (or €29bn) of which will have no borrower repayments against it. The EU's annual cash budget now is around €135bn so such debt payments would shrink the remaining cash budget by 20% if they were due now.

Of course the EU say that the extra debt payments will be covered from its Own Resources, and particularly from the new taxes – like the Financial Transaction Tax – that it is introducing. VAT, customs levies, and sugar levies are already counted as the EU's Own Resources, such that the Member State cash contributions can be presented as lower than they are – as if all of the EU's resources were not either diverted from the resources of Member States, or caused to be imposed and collected by Member States when the Member State might not have chosen to place that imposition on its businesses, citizens and economy¹⁹.

This is all blarney. The Coronavirus Recovery Fund is an example of the EU lending the Member States their own money and demanding it back later. The cost will be highly deflationary in the medium term, and will necessitate either (i) raised payments to the EU (under whatever budget heading and however well disguised) and an equal-and-opposite cut in the funds available for the day-to-day running of the Member State or (ii) a cut in the funds available for the day-to-day running of the EU. It is reminiscent of the Glasgow Rangers borrowing scheme in 2014 to hypothecate future season ticket sales, as if the proceeds of those sales were not needed to keep the club running for the season to which they pertained²⁰.

New EU borrowings expand one of the hidden lines of public sector debt

What the Coronavirus Recovery Fund also does is to vastly expand a category of EU public sector borrowing, which already existed, which was believed by the public and by investors as being limited by Treaty and by EU statute, but which was really limited by only one thing: the Sword of Damocles of joint-and-several liability²¹. This Sword was the threat of retribution from the citizenry of the few solvent Member States on their elected representatives if the latter permitted large borrowings at the EU level, from which their own Member State benefitted only minimally, but where there was a risk that their Member State might have to repay the entire amount in the case that none of the other Member States were able to.

18. Page 3; points A7 and A8

19. EUCO 10/20 page 64: "New Own Resources"

20. <https://www.bbc.co.uk/sport/football/26358424> accessed on 10.8.20

21. "Overview and Outlook" on page 1 of Moody's Rating Report on the European Union 30

Now that the solvent Member States have allowed that protection for their citizenry to be dissolved, the EU can add a large block of debt that fails to track into the Member States' "General government gross debt", as recorded by Eurostat, this being the anchor figure for measuring compliance with the Stability and Growth Pact, and the Fiscal Stability Treaty (under which Member State debt is supposed to fall to 60% of GDP by 2030)²².

The other three lines of hidden EU public sector debt

Eurostat's definition of "General government gross debt" already fails to capture the following public sector liabilities:

1. Debts of public sector entities such as water, energy and transport utilities, these being typical borrowers from the European Investment Bank (EIB)
2. Payment liabilities of public sector entities under commercial contracts upon which the debt service depends of projects set up under the InvestEU programme
3. Debts of EU central banks to one another within the Eurosystem "TARGET2" payment system, which are not secured by bonds that are captured within "General government gross debt"²³

EIB's volumes of direct loans to EU public sector entities have been expanding steadily since the Euro financial crisis in line with the decision by Angela Merkel and Francois Hollande to "fully mobilise the EIB".²⁴

InvestEU and the EIB's own coronavirus response are meant to create €950bn of finance for projects, with the finance being taken up by special purpose companies who have a contract to build and maintain an asset to be used and rented by a public sector entity.²⁵ The InvestEU model replicates the UK Private Finance Initiative model, except that the EIB and EIF became involved because the EU had identified that the private finance markets were unwilling to commit to the highest risk tranches of finance – so of course it is only right that the EU taxpayer be put at the highest risk (the supposedly unacceptable alternative being that the project is declared unfinanceable and does not go ahead).²⁶

22. <https://ec.europa.eu/eurostat/en/web/government-finance-statistics/data/main-tables> accessed on 10.8.20

23. Eurostat state that the definition is contained in the TFEU; it does not embrace debts of central banks

24. <https://uk.reuters.com/article/uk-germany-merkel/merkel-backs-stronger-european-investment-bank-idUKBRE83R02120120428> accessed on 10.8.20

25. "Managing Euro Risk", by Bob Lyddon, David Blake and Barney Reynolds, Politeia, 2020, Annex 2 on the EIF pages 105-110 and Annex 3 on InvestEU (aka the European Fund for Strategic Investments) pages 111-6

26. <https://www.fi-compass.eu/news/2015/10/efsi-and-esif-complementarity-not-overlap> accessed on 11.8.20

The European Central Bank's figures on TARGET2 show balances owing between EU central banks broadly of net-net €250bn and net €1.3trn, but we know neither what the gross balances were before the end-of-day netting, nor how much is new indebtedness between Member States (incurred via their central banks) which is not captured in Eurostat figures already²⁷. This latter qualification exists because the gross balances can either be a deposit of one central bank with another, or a borrowing via overdraft. A depositing central bank receives no collateral, but a borrowing central bank must post up collateral in favour of the lending central bank. The collateral must be on the ECB's list of bonds that are eligible as collateral for Eurosystem payment operations, and all bonds (but not loans) that represent part of the "General government gross debt" of an EU Member State will be on the list. The list, though, has many more bonds besides (e.g. bonds issued by banks, other public sector entities, securitisation vehicles). If a TARGET2 debt is collateralised with a bond issued by, for example, the Republic of Austria, there is no increment to overall EU public sector debt. But if a TARGET2 debt is collateralised by a bond issued by Deutsche Bank, there is an increment, as there is when the TARGET2 liability is a deposit and there is no collateral at all. As a result it is opaque what the gross TARGET2 balances are and to what extent they represent increments to the "General government gross debt" of the EU-27 as recorded by Eurostat²⁸.

Status and trajectory of Eurostat's EU-27 "General government gross debt"

Eurostat gives EU-27 "General government gross debt" at the end of 2019 as €10.8trn, and as 77.8% of EU-27 GDP of €13.9trn²⁹. We can at least add to that €750bn for the EU Coronavirus Recovery Fund and €950bn for InvestEU and the EIB's coronavirus response. This leaves out the direct debts of many public sector entities and any figure relating to TARGET2, but it already lifts the debt figure to €12.5trn, or 90% of GDP. Since EU-27 GDP has fallen in 2020, the EU's debt-to-GDP ratio could already be over 100% - but this will not alter the Eurostat figures or interfere with measures of compliance based on Eurostat's figures, because debt is building up through all the mechanisms that elude Eurostat, and is being reduced in the ones that are captured.

In fact there is a tremendous incentive to build up all those levels of debt that fall outside Eurostat's figures and this is what the InvestEU and the Coronavirus Recovery Fund achieve (as do the EIB and TARGET2).

27. <https://sdw.ecb.europa.eu/reports.do?node=1000004859> accessed on 12.8.20

28. "Managing Euro Risk", by Bob Lyddon, David Blake and Barney Reynolds, Politeia, 2020, Annex 1 pages 102-4 point (e)

29. https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=sdg_17_40&plugin=1 accessed on 10.8.20, from which EU-27 was extrapolated

Summary

The EU's public sector debt is ballooning at every level that is hidden from view, and the Coronavirus Recovery Fund is another example of this. The reference figures for compliance with the Stability and Growth Pact, and the Fiscal Stability Treaty can be shown to be falling, at the same time as the total debt resting on Member States' capacity to pay is rising.

It is a great plan, as long as all the lines of new EU Own resources materialise, as long as EU citizens do not regard those Own Resources as indirect taxes on themselves just like VAT, the sugar levy, import duties et al, as long as the credit rating agencies do not notice that the EU budgetary framework and controls – upon which these agencies have based their analysis and recommendations to investors – have been bypassed and dissolved, as long as Eurostat do not realise how partial and misleading their statistics are, as long as institutional investors continue to believe that the entities in the EU apparatus are of high credit quality, as long as EU GNI and GDP recover, and as long as financial markets continue to believe that the EU is on a pathway to compliance with the Fiscal Stability Treaty, whose objective is to prove that the euro is a real and unitary currency, and not a synthetic one like its predecessors the European Currency Unit and the European Unit of Account.

Or one can just regard the whole thing as a con trick played on EU citizens and on financial market investors, as well as a colossal and possibly definitive power grab by the EU apparatus from the citizenry of the Member States – and not just from the citizens of the Republic of Ireland. That should be of some comfort to them at any rate.