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SPECIAL FUNDS AND SECURITY POLICY:

Endowing the German Energy and Climate Fund with autonomous borrowing powers

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Abstract

With the Russian war of aggression against Ukraine, energy security and independence have become the new imperative for German policymakers. Under these circumstances, an accelerated transformation towards climate neutrality serves both ecological as well as security policy goals. It requires massive public investments over a very short period of time. To finance this, the *Bundeswehr* Special Fund, announced by the German government in February 2022, should be complemented by a special fund for energy security and independence. To this end, we call for the existing *Energie- und Klimafonds* (Energy and Climate Fund, EKF) to be endowed with autonomous borrowing powers and its exemption from the so-called 'debt brake' to be enshrined in the German constitution.

This has already happened for the *Bundeswehr* Special Fund, which provides legal certainty for upcoming investments. With 260 billion euros, the necessary federal investment and funding for both special funds is comparable to the financial volume raised for reunification via special funds.

Introduction

The Russian war of aggression against Ukraine has led to a sea change in Germany's foreign and security policy. In a special session of the German Parliament on 27 February 2022, Chancellor Olaf Scholz proclaimed a *Zeitenwende* (change of eras) and called for large-scale rearmament — a step that had long seemed unthinkable.

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However, after the attack ordered by Russian President Vladimir Putin, the German Government broke with a number of long-held taboos, agreeing to exclude Russian banks from the SWIFT banking communications network; freeze the reserves held by the Russian Central Bank in Germany; and supply additional weapons to Ukraine. Subsequently, Chancellor Scholz announced that Germany would create a *Sondervermögen* (special fund) to borrow an additional 100 billion euros and invest them in upgrading the German *Bundeswehr* (armed forces) (Scholz 2022).

Special funds are financing vehicles that are separate from the regular federal budget and, in some cases, can fund themselves by issuing bonds on the capital market. In contrast to the Federal Government's core budget, which is renegotiated annually, special funds can secure earmarked funds for a longer period of time. In this respect, they represent a parallel budget that is not subject to the regular political cycles and thus comes with greater planning security, which is particularly useful for long-term investments.

The creation of the *Bundeswehr* Special Fund marks a change in Germany's policy towards its military. After reunification in 1990, Germany significantly scaled back its military spending, perceiving it as a 'peace dividend' related to the end of the Cold War (Bardt 2021), and even though that trend has subsequently reversed, with military spending increasing from 33 billion euros in 2013 to 47 billion euros in 2021 (SIPRI 2022), Germany consistently failed to meet the two percent of GDP target for military spending, very much to the frustration of some of its NATO allies. Still, low military spending has been very much in line with German post-war society and its anti-militaristic attitudes, with the armed forces viewed with a critical eye by large parts of society, in particular since the suspension of compulsory military conscription in 2011. Austerity measures in military procurement coincided with a decline in military supply chains and the armed forces' general lack of readiness (Clement 2014). The new *Bundeswehr* Special Fund is intended to provide further financial power in order to remedy these problems and enable Germany to meet the agreed NATO target for defence spending (BMF 2022b).

However, the immediate war-induced reaction to rearm and bolster defence spending does not address the most important challenge that Germany is facing in this change of eras: its energy dependence on Russia. In the last few decades, Germany has put itself on an ambitious path to simultaneously exit nuclear energy and reduce carbon emissions. This *Energiewende* (energy transition) policy agenda is the result of long-standing political demands made by large parts of the German population and can be regarded as a case in point for the bottom-up translation of political preferences. The rejection of nuclear power and concerns with climate change lie at the heart of Germany's Green Party. Entering state parliaments in the 1980s, the Greens introduced the nuclear phase-out during its time in government from 1998 to 2005. Since the 2021 election, they have been in charge of the federal ministries for energy and climate change, as well as foreign policy. While the energy transition was successful in promoting the expansion of renewables, it did not address the energy dependence on Russian gas. That substantial dependence is now problematic. Therefore, the current German 'Traffic Light Coalition' — the Federal Government is made up of the 'red' social democrats, the 'yellow' liberals, and the Greens — is facing the policy challenge of having to align Germany's energy policy with its security interests.

Against this backdrop, we propose that Germany should significantly expand public investment in energy, industry and buildings in order to reduce its need for gas imports and take a major step towards energy security and independence. To finance the necessary investments, the *Energie- und Klimafonds* (Energy and Climate Fund, EKF) — an already existing special fund — should complement the new *Bundeswehr* Special Fund and be endowed with autonomous borrowing powers. The EKF should be allowed to borrow at least 160 billion euro until 2030 — an average of 20 billion euros per year — which is the same amount as the *Bundeswehr* Special Fund. The credit authorisation for the EKF should be anchored in the German constitution to provide legal certainty.

Special funds as an economic policy tool in Germany

Special funds have a long tradition in Germany (Jaeger, Haas, und Teitge 2021). For instance, the public railway and postal corporations — *Deutsche Bundesbahn and Deutsche Bundespost* — were organised as special funds until their privatisation in 1993 and 1994. Their status as special funds can be traced back to a law passed in 1924, which allowed the *Reichsbahn* and the *Reichspost* to issue their own bonds (Reiter 1967). After the Second World War, the *Lastenausgleichsfonds* (Burden Sharing Fund) was a special fund intended to provide financial compensation to Germans who had suffered special property damage or other disadvantages as a result of the war. In addition, funds from the Marshall Plan (European Recovery Plan, ERP) for German reconstruction were collected in the ERP Special Fund, which in turn could be used as equity to borrow on the market (Deutsche Bundesbank 1998).

In the 1990s, the costs of German reunification were partly shouldered by special funds. For example, the *Fonds Deutsche Einheit* (German Unity Fund), created in 1990, collected financial resources on the market and made them available to the new *Länder* (states) until the end of 1994 to finance projects such as infrastructure investments. Converted to 2021 prices, the fund had a financial value of 97.2 billion euros (cf. Zinsmeister 2009, 148). In addition, the *Erblastentilgungsfonds* (Redemption Fund for Inherited Liabilities), created in 1993, took over the liabilities of the former German Democratic Republic (GDR). The *Ausgleichsfonds Währungsumstellung* (Compensation Fund for Currency Conversion) served the compensation claims of credit institutions and foreign trade companies in East Germany. The *Treuhandanstalt* (Trust Agency) was also able to take on debts according to the 1992 Treuhand Credit Taking Act. From 1995 onwards, the liabilities of the *Treuhand* and the *Ausgleichsfonds Währungsumstellung* were taken over by the *Erblastentilgungsfonds*. In 2021 prices, the Erblastentilgungsfonds thus had a value of 202.2 billion euros (cf Zinsmeister 2009, 147). Thus, the total financing value of the two special funds for reunification (the *Fonds Deutsche Einheit* and the *Erblastentilgungsfonds*) amounted to almost 300 billion euros in today's prices.

There is no doubt that the reconstruction of Eastern Germany is not purely a success story. However, the special funds were an important building block of the more successful aspects of reunification. They prevented the Eastern German state functions from collapsing in disorder and made it possible to modernise the East German infrastructure, expand the road network, build commercial and industrial facilities, and renovate housing. An entire national economy had to be structurally rebuilt. This required long-term commitment with financial planning that went beyond budget periods. The amount of investment gives an idea of the substantial financial resources that have to be mobilised by the state to drive economic transformation.

Special funds in the debt brake regime

In 2009, a cross-party commission tasked with reforming the structure of German federalism, which was perceived as excessively expensive and bureaucratic, recommended the introduction of a *Schuldenbremse* (debt break) in the German constitution, the *Grundgesetz*. The debt brake is the most obvious symbol of the doctrine of a *schwarze Null* (black zero), indicating the normative conviction that sovereign debt is to be avoided and that the treasury budget should be balanced. Since this objective had often clashed with reality and difficulties have been faced implementing it, the so-called Federalism Commission II decided it was a good idea to elevate this norm to the constitutional level. Today, the debt brake is anchored in Articles 109 and 115 of the *Grundgesetz*. It states that the Federal Government may only finance itself by borrowing at the level of 0.35 percent of GDP per year, adjusted for cyclical fluctuations. While the debt brake has been in force since 2011, it has only been binding since 2016. Importantly, all federal special funds are also subject to the debt brake.

In principle, a financing challenge such as that of German reunification could not be met under the current debt brake regime — unless an exception were to be made. The *Grundgesetz* provides for two possibilities: natural disasters or extraordinary emergencies beyond the control of the state (*Grundgesetz* Article 109, paragraph 3 and Article 115, paragraph 2). In this case, the Federal Government may also borrow beyond the 0.35 percent limit. The COVID-19 crisis was classified as such an emergency situation. This allowed the Federal Government to borrow to the extent it deemed appropriate to combat the pandemic and support the economy.

If an exceptional circumstance is invoked, there are no clear limits to borrowing in accordance with the debt brake. At the same time, unused borrowing authorisations — i.e. permission granted by Parliament to issue additional bonds — can also be shifted to special funds and used at a later date. This is the strategy that the Traffic Light Coalition had agreed on in the coalition agreement (SPD, Grüne and FDP 2021). Thus, at the end of 2021, 60 billion euros that had remained unused from the original COVID-19 aid were allocated to the EKF.

Just like the other special funds, the EKF — which is due to be renamed the *Klima- und Transformationsfonds* (Climate and Transformation Fund, KTF) (BMWi 2021) — acts outside the core federal budget to make important expenditures for future technologies and climate protection. However, it has no independent borrowing authority to issue bonds. The EKF receives allocations from the federal budget and income from European and national emissions trading. Even the 60 billion euros authorised borrowing decided on by the Traffic Light Coalition is merely allocated from the federal budget.

To introduce the *Bundeswehr* Special Fund, the Traffic Light Coalition has found a way to circumvent the debt brake: it explicitly exempts the *Bundeswehr* Special Fund from the debt brake in the *Grundgesetz*. An additional clause has been added to Article 87a, authorising the Federal Government to introduce the Bundeswehr Special Fund, giving it borrowing powers, and explicitly noting that the debt brake, described in Articles 109 and 115, should not be applied (Bundesrat 2022). This allows new bonds to be issued for the Bundeswehr Special Fund while leaving the debt brake formally untouched.

This approach offers yet another piece of evidence that in practice the constitutional status of the debt brake regime has proved problematic. It prevents the Federal Government from reacting appropriately to situations such as war or climate change, because neither features in the very narrow definition of 'exceptional circumstances'. The

Bundeswehr Special Fund demonstrates the necessity of finding workarounds in order to be able to make sufficient public investments. In principle, a fundamental reform of the debt brake — for instance, through a new non-partisan commission that reassesses Germany's fiscal policy instruments in the current change of eras — seems urgently needed in view of the increasing acrobatics of budgetary law. Nevertheless, such a fundamental reform of the debt brake is not in sight in the current legislative period. Therefore, anchoring the special fund in the *Grundgesetz* is a pragmatic solution to an acute problem.

Energy security and independence as core issues of the new security policy

Although it is the central measure of the change of eras, at best the planned introduction of the *Bundeswehr* Special Fund only covers a part of the new security policy challenge. The war in Ukraine has reminded us of the long-known deficits of the *Bundeswehr*, which the new special fund is supposed to remedy, but above all the war has demonstrated Germany's considerable energy dependence on Russia. From a security policy perspective, this dependence currently weighs more heavily than the *Bundeswehr's* lack of equipment, since Germany is not directly involved in the conflict militarily, but indirectly through the sanctions policy. Energy security and independence have suddenly become core issues of a new security policy.

Germany's energy dependence on Russia is particularly strong with regard to gas, which is mainly used for three purposes: energy generation, to heat buildings and in industrial processing (BMWi 2022). On the one hand, this dependence is the result of a German energy policy that in recent decades has relied on the principle of 'change through rapprochement' — a strategy that in hindsight has not worked. On the other hand, the dependence is a consequence of a lack of strategic investments by the public sector and the growth targets for renewable energies being too low (Agora Energiewende and Wattsight 2020).

To start with, the energy transition was delayed due to the discussions around nuclear power. In 2000, the Red-Green Federal Government decided on a phase-out. In 2010, Chancellor Angela Merkel backtracked from the phase-out; but after the reactor accident in Fukushima in 2011, she backtracked from the backtrack, having lost a lot of time along the way. The move away from nuclear energy was primarily offset by the expansion of renewable energies. While the share of renewables in gross electricity generation was still 20 percent in 2011, it rose in the following years and reached a record of 44 percent in 2020. However, especially in recent years, the expansion of renewables has been increasingly delayed and also stymied by the failure to raise the expansion targets. As a result, the share of natural gas in gross electricity generation has not fallen in recent years, but has stagnated at around 15 percent (AG Energiebilanzen 2022).

Secondly, the provision of heat for buildings has hardly changed at all in the last few years. Fossil energies continue to dominate here. At 46 percent, gas is the decisive factor for heating spaces and for hot water production. Renewables are only at 17 percent. The most effective measures against fossil energy dependency in the building sector would be building renovation and the use of heat pumps, but the renovation rate lags behind the necessary target rate. Instead of the current rate of around 1 percent, it would need to rise to 1.5 or even 2 percent in order to achieve energy sovereignty in the building sector (Luderer, Kost, and Sörgel 2021).

Finally, the German industry is particularly dependent on gas. A total of 27 percent of gas consumption in Germany is accounted for by the industrial sector. Gas is used primarily in the generation of process heat. The largest consumers are the chemical industry as well as food and tobacco production (BMWi 2022). Energy savings could be achieved primarily through energy efficiency improvements. Here, too, the use of heat pumps and the integration of green hydrogen into the production processes are central.

In order to reduce the dependence on Russia, alternative sources of gas are currently being sought. However, simply shifting the import of fossil fuels from one (despotic) country to another cannot be a sustainable long-term solution, because it creates new dependencies. Instead, energy security and sovereignty are central cornerstones of a strategy that relies entirely on the climate neutrality of the local economy. Hence, the Green Transition (Deleidi, Mazzucato and Semieniuk 2020; Kedward, Gabor, and Ryan-Collins 2022; Mazzucato and Semieniuk 2017, 2018; Mikheeva and Ryan-Collins 2022; Semieniuk and Mazzucato 2018) is becoming a core issue of the new security policy.

The financing needs for energy security and independence

Extensive public investment is imperative for the success of the undoubtedly challenging transformation of the German economy towards energy security and independence. Table 1 shows a calculation based on Krebs and Steitz (2021) of the public investment and funding measures from the Federal Government needed up to 2030 to achieve the goal of climate neutrality. These cover the energy sector, industry, buildings, transport and innovation. They amount to a total of 425 billion euros (such figures are estimates and always subject to great uncertainty. Nevertheless, they are good initial indications for a detailed discussion of investment needs in Germany).

Part of this funding requirement is already covered by the climate protection programmes of the previous government — notably the Climate Protection Programme 2030, the Corona-related Economic Stimulus Programme 2020 and the Immediate Climate Protection Programme — and by the second supplementary budget of the Traffic Light Coalition. The planning period for these programmes runs until 2025. Altogether, the measures so far comprise an investment and funding sum of 148.6 billion euros, exclusively at the federal level. Public investments at state or municipal level are not included here. Most of the public funding is channelled through the EKF. In addition to the national measures, European funds are also used for climate protection. These, however, partially cover the expenditures of the Economic Stimulus Package 2020 and are therefore not listed separately here. Overall, based on these figures, there is a financing gap of 276.4 billion euros, which is not covered by previously planned climate protection or investment programmes.

In the areas that are crucial for energy security and especially for independence from gas imports, the financing deficit amounts to a total of 196.7 billion euros: energy industry 112.8 billion euros, buildings 62.8 billion euros and industry 21.1 billion euros. By far the largest single item in the financing requirement is the promotion of private investment in the energy sector with 150 billion euros. The largest part of this — amounting to 145 billion euros — is for the *Erneuerbare Energien Gesetz* (Renewable Energy Law, EEG) and the so-called *EEG-Umlage* financed by the Federal Government (including both old and new plants) in the period up to 2030.
The *EEG* is a feed-in-tariff scheme which guarantees renewable energy producers a pre-defined fixed tariff for every kilowatt hour they supply. The electricity is sold by transmission network operators on the electricity exchange. Since the prices on the exchange are lower than the pre-defined tariffs, the transmission network operators are reimbursed for the difference — the *EEG-Umlage*. Until recently, the *EEG-Umlage* was financed by households via their electricity bill, but as of July 2022, the Federal Government alone is responsible for the disbursement of the *EEG-Umlage*.

According to the Federal Government's estimates, however, the costs of assuming the *EEG-Umlage* will be significantly lower than estimated by Krebs and Steitz (2021), which is why the financing deficit is comparatively high. Electricity exchange prices have risen sharply since mid-2021. The amount required for the *EEG-Umlage* has fallen in line with this. If, on the other hand, exchange prices fall again in the future, the *EEG-Umlage* will rise again and place a correspondingly greater burden on the EKF.

In order to ensure energy security and independence, and to close the calculated financing deficit, additional financial resources are needed. A special fund endowed with its own credit authorisation, which, as the *Bundeswehr* Special Fund, is exempt from the debt brake, can provide this in the long term. The simplest and most practicable solution at present would be to provide the already existing EKF with a credit authorisation and to secure this in the *Grundgesetz*.

Table 1: Financing needs not covered — up to 2030 (in € billion)

	Financing needs		**Financing needs already covered**				
	Federal investments	Promotion of private investment	Climate protection programme 2030	Economic stimulus programme 2020	Immediate Climate Protection Programme	Second Supplementary budget 2021	**Financing deficit**
Energy generation	20	150	2,6	9,0	0,7	45,0	112,8
Industry		25	3,1		0,9	0,0	21,1
Building		100	14,3	2,0	5,5	15,4	62,8
Traffic	50	50	16,6	15,2	1,0	0,0	67,2
Innovation	20	10					30,0
Rest			*17,4*				*-17,4*
Total	90	335	54	26,2	8	60,4	**276,4**
Of which in the EKF			*38,9*	*26,2*	*5,7*	*60,4*	

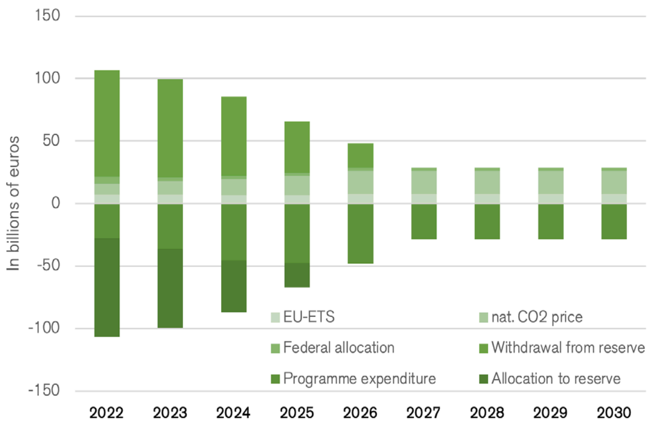
Source: Krebs and Steitz (2021), BMF (2019, 2022c, 2022a), BMWi (2020), BReg (2021, 2022)

A complementary special fund for energy security and independence

The EKF is the central financing instrument for the energy transition and climate protection in Germany. It finances projects such as the refurbishment of buildings, the decarbonisation of industry or the expansion of the charging station infrastructure (BMF 2021). The change of eras should now place the EKF at the centre of strategic considerations on energy security and independence. It should become a central component of Germany's new security policy.

As Figure 1 shows, the EKF has so far financed its expenditure through revenues from European emissions trading, national carbon pricing, allocations from the federal budget and the withdrawal of financial resources from reserves.

Figure 1: The EKF's financial planning



Source: BMF (2022c)

According to the Traffic Light Coalition's current budget plan, the EKF comprises programme expenditures totalling 158 billion euros between 2022 and 2025. In the process, annual expenditure will rise from 27.8 billion euros to 47.8 billion euros over the course of the financial plan. Compared to the original plans of the Merkel IV government, the Traffic Light Coalition wants to spend an additional 60 billion euros (BMF 2022c).

However, the 60 billion euros from the second supplementary budget 2021 are fraught with great uncertainty, as the decision on the lawsuit filed by the CDU/CSU parliamentary group on the financial resources is still pending. If the lawsuit is upheld, the EKF's entire financial planning will collapse. The largest item of additional investment and funding would disappear. Legal certainty, however, is a necessary condition for carrying out large-scale investments. Without it, the goals of the EKF cannot be achieved. But even if the constitutional challenge fails, significant long-term funding gaps remain. Not only will the 60 billion euros be completely used up by 2026, but the reserves built up by previous governments will also be continuously reduced, so the reserves of 31.5 billion euros at the end of 2020 will fall to 19.5 billion euros at the end of 2025, despite the financial injection from the second supplementary budget in 2021.

The numbers from 2026 onwards, shown in Figure 1, are assumptions. On the one hand, we assume that the withdrawal from the EKF reserves will behave similarly to previous years. Thus, 2026 is the last year in which part of the expenditure can be financed from the accumulated reserves. On the other hand, the revenue from the national carbon price is capped at just under 18.5 billion euros, which should correspond to the upper end of expected revenue (from 2026, the national CO2 price is to 'float' between 55 and 65 euros per tonne of carbon. For a price of 55 euros/tCO2 in 2025, the German Government estimates revenues at around 15.7 billion euros. Should the CO2 price be set at 65).

The assumed revenues from European emissions trading amount to 7.5 billion euros. This sum is likely to be higher than the actual revenues from the EU's Emission Trading System (ETS). For comparison: in 2021, when record prices of 80 euros per tonne of carbon were achieved, the revenues added up to 5.3 billion euros (DEHSt 2022). According to the federal government's financial plan, ETS auction revenues will amount to about 7 billion euros in 2023 and then fall again slightly. The allocations from the federal budget will also fall in the planning period, from just under 6 billion euros in 2022 to 2.2 billion euros in 2025 (BMF 2022c). For the years 2026 to 2030, we therefore assume allocations of 2.5 billion euros. In total, our generous estimate of the annual revenue of the EKF amounts to 28.5 billion euros from 2027 — the first year without a withdrawal from the reserve.

The decline in programme expenditure is also expected to be correspondingly dramatic. If expenditure of 48 billion euros can still be made in 2026, it will only be 28.5 billion euros in the following year — a minus of 40.5%. The long-term project of climate neutrality, and with it the goals of energy independence and security, are thus seriously endangered. From 2027 onwards, crucial investment funds are missing.

The total financing deficit calculated on the basis of Krebs and Steitz (2021) is only partially covered by the revenues we estimate from the federal allocation, the national carbon price and the EU ETS. Thus, between 2027 and 2030, the EKF can — on a generous estimate — expect revenues totalling around 114 billion euros. Consequently, an uncovered financing deficit of 162 billion euros remains until 2030. If energy security and independence are to be achieved as the supporting pillars of a climate-neutral economy, the EKF must receive the authorisation — and exemption from the debt brake in the *Grundgesetz* — to borrow this sum on the market.

According to our proposal, the EKF should be able to borrow at least 160 billion euros by 2030. On average, the new borrowing would amount to 20 billion euros per year over eight years. This corresponds to the annual amount budgeted for the *Bundeswehr* Special Fund, which will borrow 100 billion euros over a period of five years. Since interest rates are currently still at a comparatively low level, the financing conditions for this project are favourable. By way of comparison: when the special assets for the reunified Germany were launched, the yield on ten-year federal bonds was between 6 and 9 percent in the period from 1990 to 1995.

Conclusion

If the *Bundeswehr* Special Fund is accompanied by an expanded EKF as a special fund for energy security and independence, this combination would mean an investment and funding sum of at least 260 billion EUR for the proclaimed change of eras. This sum is roughly comparable to the financial volume provided for reunification through special funds. At the same time, the financing costs of such a future package are significantly lower than the 'unification costs', due to interest rates currently being low.

Reunification was a historic event that required a long-term financial commitment. With the help of the special funds, the East German infrastructure could be expanded and modernised. The change of eras in security policy caused by the war in Ukraine once again calls for a far-reaching commitment on the part of the state. An accelerated transformation towards climate neutrality simultaneously serves ecological and security policy goals. The ecological transformation will thus become the core issue of the new security policy. This can only be achieved with massive public investment. What is needed for this is a special fund for energy security and independence with its own credit authorisation, which is exempt from the debt brake, secured by the *Grundgesetz*. The most practicable solution would be to endow the already existing EKF with corresponding rights.

About this brief

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