COMMISSION OF THE EUROPEAN COMMUNITIES

COM(93) 212 final

Brussels, 17 May 1993

COMMUNICATION FROM THE COMMISSION

concerning the Intervention of the European Investment Bank

in Central and Eastern European countries

Proposal for a

COUNCIL DECISION

granting a Community guarantee
to the European Investment Bank
against losses under loans
for projects
in Central and Eastern European countries
(Poland, Hungary, the Czech Republic, the Slovak Republic,
Romania, Bulgaria, Latvia, Estonia, Lithuania and Albania)

(presented by the Commission)

COMMUNICATION FROM THE COMMISSION

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A. COMMUNITY COMMITMENTS IN CENTRAL AND EASTERN EUROPEAN COUNTRIES (CEEC): DECISIONS REGARDING THE EIB

1. Since the Arche summit (July 1989), the Commission has coordinated the financial assistance of G-24 and has established progressively, since 1991, a series of bilateral Agreements with the CEEC. These Agreements include activities of different types: direct aid, technical assistance and balance of payments loans as well as EIB loans guaranteed by the Community. Regarding the latter, it is to be noted that these countries explicitly requested these types of loans at the time of the Agreements.

2. In October 1989 the Council invited the Bank, who agreed, to make loans to Poland and Hungary. On 12 February 1990, (1) the Council decided to provide Community budget guarantees for a three year period for loans not exceeding ECU 1 billion.

3. On 14 May 1991, the Council extended its invitation to the Czech and Slovak Federal Republics, Bulgaria and Romania. The Council Decision (2) set a ceiling of ECU 700 million for a two year period.

   The two decisions mentioned above will shortly expire.

4. At their meeting held on 11 November 1991, Ministers from the G-24 confirmed the extension of their economic assistance to Estonia, Latvia and Lithuania. Accordingly, an ECOFIN Council Decision offering a Community guarantee to EIB loans of up to ECU 200 million in these countries was approved on 15 February 1993.

5. At the Tirana Conference on 22 and 23 July 1992, the Community and its Member States agreed to mobilize all the means at their disposal in order to help the economy of Albania, by far Europe's poorest country. Therefore, the Commission proposed to the Council that it should invite the EIB to undertake a programme of loans totalling ECU 50 million, benefitting from Community budget guarantees as well as interest subsidies, in this country.

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(1) Council Decision 90/62/EEC of 12 February 1990.
(2) Council Decision 91/252/EEC of 14 May 1991.

6. In December 1992, the European Council in Edinburgh invited the Council and the EIB, in full consultation with the Commission, to give urgent and sympathetic consideration to the establishment of a new, temporary lending facility of ECU 5 billion within the EIB. The purpose of this new facility, itself an element of the economic growth initiative, would be to accelerate the financing of capital infrastructure projects in the Community, notably connected with the Trans-European Networks. This new facility may also be extended to projects involving the countries of Central and Eastern Europe to the extent that they are of mutual interest and ensure the inter-operability of networks with the Community.

B. EIB ACTIVITIES IN THE CEEC

7. At the end of 1992, the EIB concluded loan contracts in the two groups of countries mentioned in Table 1 (Poland and Hungary; ex-Czechoslovakia, Romania and Bulgaria) for a total amount of ECU 820 million. Furthermore, projects under formal appraisal and in an advanced stage of preparation amount to approximately ECU 700 million. When financing operations at an earlier stage of processing are included (approximately ECU 500 million), the total amount under consideration (approximately ECU 2000 million) exceeds the guarantee granted. Therefore, the Bank has sufficient leeway to choose those projects which meet the Community's objectives and to exhaust the authorised ceiling (see Table 1, column 1).

As regards the loan **time profile**, a comparison of the time lapse between the contracts signed and projects in an advanced stage of preparation (Table 1, lines 2 and 3) shows that, logically, the early stages of this action were slow; first of all, the Bank must secure contacts with new financial partners and then it must ensure that the projects submitted are sound; when these preliminary phases are mastered, the pace accelerates.

Table 1. EIB activities in the CEEC at the end of 1992 (mio ECU)

	Poland	Hungary	Czech and Slovak Rep	Romania	Bulgaria	TOTAL
Number of operations	6	7	1	1	2	17
Signed contracts	290	305	85	25	115	820
Operations at advanced stage	105	100	303	113	73	694
TOTAL	395	405	388	138	188	1514
Guarantee	1000		700			1700

Source: EIB

8. The **geographical distribution** of the loans is indicated in Table 1. This table shows that the loans already signed in Poland and Hungary account for approximately two thirds of their ceiling. It can also be observed that the EIB's lending activity in the remaining four countries, although more recent, is proceeding rapidly.

The relative importance of the loans signed in Poland and Hungary reflects, on the one hand, the fact that economic reforms and the decision to grant EIB loans to these countries began a year earlier than in the remaining countries in the group; consequently, the Bank was able to start its loan programme earlier. On the other hand, these two economies are at a relatively more advanced stage in their development and, therefore, better able to absorb and manage the EIB loans.

The distribution of the signed loans across sectors (Table 2), shows that global loans to SMEs form by far the most important group, followed by the telecommunications and energy sectors. These are areas in which the EIB has a long experience and have been selected, by common agreement, as priority objectives.

Table 2. Distribution of signed projects by sectors (mio ECU)

Sector	Poland	Hungary	Czechoslov	Romania	Bulgaria	TOTAL
1. Transport (road and rail)	20	50	-	-	-	70
2. Air traffic	50	20	-	-	-	70
3. Energy	50	50	-	25	45	170
4. Telecommunications	70	80	-	-	70	220
5. Global loans (SME)	100	105	85	-	-	290
TOTAL	290	305	85	25	115	820

Source: EIB

C. IMPACT OF THE EIB ACTIVITIES IN THE CEEC

9. It is difficult to evaluate quantitatively the impact of the activities of the EIB as yet, given that most of the projects supported by the Bank are still in progress. Furthermore, EIB loans should be regarded as part of the overall effort by the Community to assist the economic development of the CEEC (an indication of which is given in Table 3) and consequently, their economic impact cannot be estimated separately.

This said, it should be noted that the share of EIB loans in the financing of the projects in the CEEC stands at 38% (see Table 4). This figure underlines the important leverage effect of the EIB interventions in the investment efforts of those countries.

There is no doubt that these projects will have a very positive effect on the economies of those countries: the direct creation of new jobs, in particular through global loans to SMEs, the improvement of the investment environment, etc. This is particularly true thanks to the role played by the EIB loans in the financing of investment in basic infrastructure (see Table 2), which is essential for the development of the private sector.

Table 3: Community assistance to CEEC (mio ECU)

	1991	1992
Budgetary funds (PHARE)	759	1445
Balance of payments loans (signed)	695	785
EIB loans (signed)	285	320
TOTAL	1739	2550

Moreover, there are also important indirect effects produced by the activities of the Bank in the CEEC. The Bank's operations in the region give foreign investors a clear signal of the political commitment of the Community to help the CEEC to succeed in this challenging period. This commitment inspires confidence and draws additional private foreign investment to the region.

D. OBSTACLES ENCOUNTERED AND WAYS TO OVERCOME THEM

10. The EIB has encountered a number of obstacles in the execution of its tasks. These obstacles are in general the result of the particular circumstances these countries are currently facing and the difficulties they are going through in this transitional stage. They could be grouped as obstacles arising from:

- the general economic situation and the heavy bureaucratic procedures;

- the lack of adequate institutions and/or human resources. This is particularly serious in the identification of projects and reflects the relevant country's restricted capacity in the preparation of proposals. It also compels the Bank to participate much more in the preparation of studies and other necessary activities prior to the investment;

- the lack of domestic partners. As mentioned before, the EIB loans represent only a fraction of the projects' total cost, the rest having to be financed by other international institutions (particularly EBRD and IBRD, etc.), and by the States concerned, regional and local authorities and other private investors. It is not, however, always easy to find the adequate national partners to complete the financing of a project.

  More specifically, the lack of the financial intermediaries through which to channel the EIB loans has represented a particular hurdle in the Bank's activities regarding SMEs.

- budget limitations and constraints. These countries apply, with the support of the IMF, very strict budgetary policies and this limits their ability to embark on much needed but costly investments.

11. Much needs to be done to improve the "structure d'accueil" for the EIB loans. As an example, one could mention the need for these countries to foresee in their budgets enough room for the guarantees required for the EIB loans.

    There is no doubt, however, that the efforts already made by these countries, with the support of the Community's aid through the PHARE programme, have already contributed to the easing of some of the difficulties encountered by the Bank.

    More generally, the ever closer cooperation with the other institutions active in the region will render the Community's actions in general, and the EIB's in particular, more dynamic and efficient.

CONDITIONS OF EIB LOANS IN THE CEEC

In general terms, the EIB operates in these countries as it does in the Community. The Bank issues commercial paper and makes loans, passing on to the borrower, following the customary rules, the conditions obtained by the Bank. These are long-term fixed-rate loans, benefitting from a grace period determined by the characteristics of the project.

1. *Currencies: in one or several currencies, following the customer's requirements and the Bank's resources. In all cases, operations are labelled in ECU.*

2. *Duration: this is a function of the type of project and the nature of the borrowing. In general:*
   - *industrial projects : 10 to 12 years;*
   - *infrastructure projects : 12 to 15 years (exceptionally 20 years).*

3. *Interest rate: the rate of borrowing from the market incremented by 0.15% to cover administrative expenses.*

   This is regardless of the nationality of the customer, the project's location or the customer's risk.

   The interest rate is conditioned by the currency requested and is normally fixed for the duration of the contract; other formulae could be considered.

4. *Payment : in the same currency as the loan; usually in 6-month instalments (following a grace period of ± 3 years determined according to the project characteristics).*

5. *Call for tender: the Community regulations regarding international competition apply; usually, the guarantee of the State concerned is requested, although other first-class guarantees could be envisaged.*

6. *In the case of large projects, the borrowers in the countries in question are often public firms or financial institutions controlled by the State.*

E. COOPERATION WITH OTHER INTERNATIONAL INSTITUTIONS

12. The EIB in its report *"The countries of Central and Eastern Europe and the European Investment Bank"*, analyses in detail the collaboration with other international institutions active in the area. The report underlines especially the close collaboration among them all, each offering the CEEC their particular expertise. In almost every large project for which much finance is required, there are two, and sometimes three, institutions working jointly; it is evident however, that in a more general context, the complementary role played by the different institutions manifests itself, not only through the shared financing, but also through their specific responsibilities.

The **World Bank** acts mainly in the elaboration of appropriate sectoral policies, defining in this manner the environment and the priorities required for the transition of the CEEC to a market based economy.

The **EBRD**, active both as a development bank and a commercial one, is in particular engaged in the reforms of the banking and the financial sector and in the development of the private sector. To this end, the EBRD has a number of specialised instruments.

The **EIB** remains a financing institution specialising in investment projects. It has long experience in Community policies, both within and outside the Community. In agreement with these policies, the Bank's financing operations in the CEEC, although mainly oriented towards infrastructure projects, benefit also the industrial sector and in particular the SMEs.

Finally, cooperation with the **Commission** has taken place mainly through the PHARE programme. A number of feasibility studies have been financed by the programme at the request of the Bank, and under the latter's supervision, to help in the preparation of projects.

The table below (Table 4) gives a picture of collaboration between international institutions in the CEEC countries.

Table 4 Share of the international financial institutions in projects financed by the EIB (% total)

EIB	EBRD	IBRD	Other (1)	TOTAL (2)
38.0	14.5	11.4	36.1	100

(1) States, public bodies or other domestic financial sources
(2) The total represents the cost of projects for all sectors in which the EIB has intervened.

INTERNATIONAL FINANCIAL INSTITUTIONS PROVIDING INVESTMENT FINANCE IN CENTRAL AND EASTERN EUROPE

	Project Finance		Large Fast Disbursing Policy-Based loans	Host Government guarantees	Private Sector	Public Sector
	Loans	Equity				
WORLD BANK	Yes	No	Yes	Required	Yes	Yes
IFC	Yes	Yes	No	Excluded	Yes	No
EIB	Yes	No	No	Required	Yes, especially SMEs	Yes
EBRD	Yes	Yes	No	According to circumstances	Yes	Yes

F. THE NEW PROGRAMME

13. The present proposal has a dual aim. Firstly, to provide Community budget guarantees for an indicative three-year period for loans not exceeding ECU 3,000 million so as to allow EIB operations in the CEEC to continue and secondly, to incorporate all EIB operations in this region in a single framework.

14. The renewal of the Community guarantees to EIB loans in the CEEC countries stems from the fact that the potential demand for credit, as shown by the above analysis of the existing programme, will continue to be large in the near future as the process of economic and social development of these countries is still far from complete. Likewise, the need for external financing in these countries remains very high. Given, then, the important role played by the EIB in the financing of projects in the area, especially in infrastructure, the continuation of the Bank's operations would seem to be essential. It should also be noted that the EIB loans fall within the framework of the European Cooperation Agreements which were signed for an unlimited period with these countries at the end of 1991.

    To strengthen the initiatives' coherence and to increase the flexibility and efficiency of the Bank's operations, the Commission estimates that in future all EIB activities in the CEEC, so far decided on a broadly bilateral basis, should be incorporated in a single framework. This framework should also include the initiatives already approved in favour of Estonia, Latvia and Lithuania and those proposed for Albania. The proposed framework would be suitable as these countries share common characteristics and face similar problems as well as being in line with the usual EIB practice of making loans by geographical areas or by group of countries when operating outside the Community (e.g. Lomé, Mediterranean countries).

    This framework would imply:

    i) a single ceiling of ECU 3000 million for the whole region, without specifying limits per country, set for an indicative three-year period.

       The estimation of the proposed ceiling is based on the evolution of the EIB loans to the CEEC which at present stands at ECU 800-900 million a year. It includes the ceiling already agreed to for loans to Estonia, Latvia and Lithuania as well as the ceiling proposed for Albania and takes into consideration the "new, temporary lending facility" within the EIB decided by the European Council in Edinburgh.

ii) that EIB loans should have the same financial conditions regardless of the country concerned.

iii) that priorities continue to be the areas defined in the Community guidelines:

- the rehabilitation and development of the basic infrastructure, particularly those connected with Trans-European networks;
- areas such as energy, research, telecommunications, the environment;
- support for the private sector, notably SMEs, and promotion of private investment.

It should be added further that the Commission has proposed the setting up of a Fund for an appropriate cover for loan guarantees within the framework of the budgetary procedures. In this regard, the above arrangements will then be governed, unequivocally, by these budgetary guarantee rules.

The Commission intends to conduct, in close collaboration with the EIB, a detailed examination of all the arrangements governing the granting of Community budget guarantees supporting EIB loan operations to third countries as well as the outlook for the development of these operations over the coming years.

G. CONCLUSIONS

15. Accordingly, the Commission requests the Council:

1. to invite the EIB to continue with its loan operations to projects in Poland, Hungary, the Czech and Slovak Republics, Romania, Bulgaria, Estonia, Latvia, Lithuania and Albania;

2. to decide that, subject to the approval of the EIB Board of Governors, EIB loans for a maximum sum of ECU 3,000 million for an indicative three-year period should be made available to these countries. These loans will be covered by the Community's budgetary guarantee;

3. to include in this maximum the ceilings already decided in favour of Estonia, Latvia and Lithuania, as well as the ceiling proposed for Albania;

4. to adopt the attached decision.

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THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 235 thereof,

Having regard to the proposal from the Commission,[1]

Having regard to the opinion from the European Parliament,[2]

Whereas the peoples of Central and Eastern Europe have close ties and a common destiny with the peoples of the Community; whereas these ties have been strengthened by the trade and cooperation agreements signed for an unlimited period;

Whereas these countries (Poland, Hungary, the Czech Republic, the Slovak Republic, Romania, Bulgaria, Latvia, Estonia, Lithuania and Albania, hereinafter referred to as "Central and Eastern European countries") are undertaking major political and social reforms and have embarked on a fundamental restructuring of their economies; whereas the Ministers of the Group of 24 welcomed this at their meeting on 11 November 1991 and decided to extend G-24 coordinated economic assistance to them;

Whereas these economic reforms will make a decisive contribution to the rapid establishment of mutually beneficial economic and commercial links between these countries and the Community;

Whereas, in particular, there is a great need for capital investment in these countries; whereas this investment requires external finance; whereas the European Investment Bank (hereinafter referred to as "the Bank") could make an important contribution;

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1 OJ No C

2 OJ No C

Whereas the Bank is completing an initial three-year loan programme for Poland and Hungary[3] and a two-year programme for the Czech and Slovak Republics, Bulgaria and Romania[4], with encouraging results according to the Bank's report on this first phase; whereas, under the Europe Agreements signed on 16 December 1991, these programmes should be renewed;

Whereas similar provisions have been approved for the Baltic States and proposed within the Council for Albania;

Whereas the Edinburgh Council of 12 December 1992 called on the Council and the Bank to create a new, temporary lending facility within the Bank to finance infrastructure projects, notably those relating to trans-European networks; whereas these networks may include projects involving Central and Eastern European countries in so far as such projects present a common interest;

Whereas, in future, the Bank's activities in all these countries must be accorded uniform treatment within an overall framework;

Whereas the Council has called on the Bank, and the Bank has agreed, to continue its operations in support of investment projects carried out in those countries by offering it the guarantee provided for in this Decision;

Whereas this guarantee is subject to the conditions set out in Regulation [5]OJ establishing a Guarantee Fund for the Community's external lending activities; whereas the Bank and the Commission will adopt the procedures for granting the guarantee,

3) Council Decision 90/62/EEC of 2 February 1990.

4) Council Decision 91/252/EEC of 14 May 1991.

5)OJ No

HAS DECIDED AS FOLLOWS:

Article 1

1. Subject to an overall ceiling of ECU 3 000 million, the Community shall guarantee in full vis-à-vis the European Investment Bank any payments not received by it but due under loans granted for a period of some three years in accordance with its usual criteria to Central and Eastern European countries.

2. The above guarantee ceiling shall include the provisions adopted in respect of investment in Estonia, Latvia and Lithuania and proposed in respect of investment in Albania.

Article 2

The operations referred to in Article 1 shall be subject to the arrangements laid down in the Regulation establishing a Guarantee Fund for the Community's external lending activities, and in particular the payment procedures spelt out in Article 2.

Article 3

The Commission shall inform Parliament and the Council every six months of the situation regarding the loans signed. To that end, the Bank shall regularly transmit to the Commission the appropriate information.

Article 4

The Commission shall inform Parliament and the Council each year of the loan operations and shall, at the same time, submit an assessment of the operation of the scheme and of coordination between the financial institutions operating in that area.

Article 5

The Bank and the Commission shall fix the terms on which the guarantee is to be given.

Done at Brussels,

For the Council

The President

FINANCIAL STATEMENT

1. Budget heading concerned

Article B0-212 and Article B0-... of the reserve to be set up: Guarantee of the European Economic Community to the European Investment Bank for loans in third countries in Central and Eastern Europe.

2. Legal basis

To be provided by the proposed decision, on the basis of Article 235 of the Treaty.

3. Classification of expenditure

Compulsory.

4. Description of, and justification for, the operation

The budget entry is intended to provide budgetary back-up for guarantees offered by the European Community to the European Investment Bank to cover loans which the Bank has been asked to extend to finance projects in Central and Eastern European countries.

5. Nature of the expenditure and method of calculation

(a) Nature of the expenditure

A guarantee to the European Investment Bank.

(b) Method of calculation

A token entry is proposed, given that the amount and timing of any call on this budget heading cannot be calculated in advance and, furthermore, it is to be hoped that this entry will not be called on.

6. Financial impact on appropriations for operations

Only in case of a call on the guarantee.

7. Financing of expenditure for operations

- If need be, the article will be endowed with funds via transfers, via re-utilization of amounts repaid (under Article 27(3) of the Financial Regulation) or via a supplementary and/or amending budget.
- In order to meet its obligations, the Commission may undertake debt service provisionally by drawing on its liquid assets. In this case, Article 12 of Council Regulation (EEC, Euratom) No 1552/89 of 29 May 1989 is applicable.

8. Financial impact on staff cost and operations

Not applicable.

9. Forecast of the schedule of loans to be signed while the decision is in force (1)

Year		Amount (mio Ecu)
1993		—
1994		765
1995		965
1996		1270
	TOTAL	3000

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(1) Forecast is subject to revision according to the date of the decision's approval. (Working hypothesis, September, 1993)

ISSN 0254-1475

COM(93) 212 final

DOCUMENTS

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Catalogue number : CB-CO-93-243-EN-C

ISBN 92-77-55836-9

Office for Official Publications of the European Communities
L-2985 Luxembourg