COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 3.9.2004
SEC(2004) 1073 final

REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

ON THE BORROWING AND LENDING ACTIVITIES OF THE EUROPEAN COMMUNITIES IN 2003

{SEC(2004) 1074}

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INTRODUCTION

The Council decisions establishing the various lending instruments of the European Communities require the Commission to inform the Council and Parliament each year of the use made of these instruments.

As the appropriations allocated by the Council to the New Community Instrument (NCI) have been used up and the European Coal and Steel Community (ECSC) Treaty expired in 2002, no new lending activities took place under these instruments. Therefore, this report contains only information concerning the repayment of the respective loans (see the section 1.).

As for lending activities outside the Community, the decisions adopted in 1997 and 2000[1] require the Commission to inform the Council and Parliament on an annual basis of the situation regarding EIB loans guaranteed by the Union budget in Central and Eastern Europe, in the Mediterranean countries, in Latin America and Asia and in South Africa. These same obligations were extended in 1998 to the EIB's loans to the former Yugoslav Republic of Macedonia (Decision 98/348/EC) and to Bosnia and Herzegovina (Decision 98/729/EC), in 1999 to the loans to Turkey (Decision 99/786/EC), in 2000 to the loans to Croatia (Decision 2000/688/EC) and Turkey-SAP (Decision 2000/788/EC) and in 2001 to the loans to the Baltic regions of Russia (Decision 2001/777/EC) and to Serbia and Montenegro, the former Federal Republic of Yugoslavia (Decision 2001/778/EC).

In order to meet these information requirements, this report describes the operations for each of the areas concerned. To complete the picture of lending activities, it also gives a brief summary of the macro-financial assistance provided by the Community to the countries of Central and Eastern Europe and of the interest subsidies and guarantees associated with Community loans. In addition, it provides information on Euratom's lending activities.

The tables on this report are published in a Commission Staff Working Paper. References to tables in the text refer to the Staff Working Paper.

1. BORROWING ACTIVITIES IN 2003

In order to finance the lending activities decided by the Council, the Commission is empowered to borrow, on behalf of the respective Community (ECSC, EC, Euratom), funds on the capital market. However, given that the NCI ceilings have been fully used up and the ECSC Treaty expired in 2002, no funds were raised under these instruments in 2003. The borrowing for macro-financial assistance in 2003 was raised to grant loans to Serbia and Montenegro, the former Yugoslav Republic of Macedonia (fYROM) and Romania. There was only one borrowing under the Euratom loans instrument, to finance a loan to Bulgaria.

Despite the above-mentioned factors, total borrowing by the European Communities and the European Investment Bank (EIB) increased in 2003 by 10.5% to EUR 42.1 billion, against EUR 38.1 billion the previous year (see Table 1.1 in annex), mainly due to an increase in borrowings by the EIB.

[1] Decision 97/256/EC for the first global mandate and 2000/24/EC, as amended, for the second mandate.

Taking into account repayments, cancellations and exchange-rate fluctuations, the total amount of borrowing outstanding as at 31 December 2003 was EUR 196.4 billion, 7.1% up on 2002 (see Table 1.2 in annex).

The breakdown of borrowing by currency (see Table 1.3 in annex) shows a decrease in the share of Euro borrowings in 2003 to 54.9% from 59.0% in 2002 of all issues, while issues in other Community currencies increased from 17.7% to 19.1%. Non-Community currencies took greater share of borrowing, increasing from 23.3% to 26.0% of the total. Issues in US dollars were up from 21.6% to 23.0% on strong market demand and supported by very low interest rates and a weakening of the US Dollar/Euro exchange rate.

Low interest rates and economic and financial uncertainties led the European Institutions to continue to favour variable-rate loans. Such borrowings accounted for 99.3% in 2003 against 85.5% in 2002.

As mentioned above, there was no new borrowing with regard to the NCI in 2003. Only one GBP borrowing was outstanding at the end of 2003 (see Table 1.4).

2. LENDING IN NON-MEMBER STATES[2]

2.1. Overview

Financial support for non-member States that have concluded cooperation agreements with the Community takes a variety of forms depending on the geographical areas concerned and the objectives pursued. It generally takes the form of bilateral loans (macro-financial support or balance-of-payments support), where the Community helps to re-establish a country's macro-economic balance. The Commission administers these financial operations under decisions of the Council.

In other cases loans are granted either in the form of direct financing for individual projects or of global loans to banks, which then allocate funds to smaller-scale local projects. The EIB manages these loans on its usual terms, generally with the guarantee of the Union budget.

The Euratom loans instrument is available for financing operations in Member States and certain non-member States (Armenia, Bulgaria, Czech Republic, Hungary, Lithuania, Romania, Russia, Slovakia, Slovenia and Ukraine are eligible).

The geographical regions for which the Community conducts lending activities are listed in annex (see Table 2.1).

[2] There were no lending activities to Member States by the Communities.

2.2. The Community's macro-financial assistance

Macro-financial assistance in the form of loans is, by its very nature, exceptional and forms part of the efforts of the international community to provide, in conjunction with the Breton Woods institutions, balance-of-payments support to certain countries facing transitional macro-economic difficulties. The Community's assistance focuses on neighbouring regions, such as Central and Eastern Europe, the Western Balkans, the Caucasus and the countries of the southern Mediterranean. Disbursements are subject to the beneficiary countries meeting objectives for macro-economic stabilisation and structural reforms. In these circumstances, the number of operations undertaken each year is limited, and it is difficult to make valid comparisons for the assistance given from one year to the next. However, as the candidate countries make significant progress toward macro-economic adjustment and ten of these countries joined the European Union on 1st May 2004, macro-financial assistance in this region has been progressively phased out. In contrast, the Western Balkans region has increasingly benefited over recent years from Community macro-financial assistance, which also includes a significant grant component.

In the Western Balkans, the Council approved in 2003 supplementary macro-financial assistance in the form of a loan of EUR 25 million to Serbia and Montenegro, accompanied by a grant of up to EUR 45 million.

Regarding non-member States, no other decision of the Council took place regarding macro-financial assistance.

Loan disbursements (see Table 2.2 in annex) for a total amount of EUR 118 million were completed in 2003 in favour of Serbia and Montenegro (EUR 40 million), the former Yugoslav Republic of Macedonia (EUR 28 million) and Romania (EUR 50 million).

Assistance in the form of outright grants totalling EUR 85 million was also paid out in 2003, of which EUR 7 million went to Tajikistan, EUR 25 million to Bosnia and Herzegovina, EUR 35 million to Serbia and Montenegro and EUR 18 million to the former Yugoslav Republic of Macedonia (see footnotes of Table 2.2 in annex).

2.3. EIB lending in 2003 in Central and Eastern Europe, the Mediterranean, Asia & Latin America and the Republic of South Africa[3]

Section 2.3 constitutes the annual report for 2003 to be submitted to the European Parliament and the Council in accordance with Article 2 of Council Decision 2000/24/EC, as amended.

[3] Legal base: Council decisions 97/256/EC, 98/348/EC, 98/729/EC, 99/786/EC, 2000/24/EC, 2000/688/EC, 2000/788/EC, 2001/777/EC and 2001/778/EC.

2.3.1. EIB Objectives and Priorities

In **Central and Eastern Europe**, the Bank has again been active in the accession countries, helping them to progress with their preparations for accession and European integration (the Bank also assists the other applicant countries)[4]. In addition, the Bank has developed a significant level of activity in the countries of the Western Balkans by supporting investment projects in Albania, Croatia, Serbia and Montenegro and the former Yugoslav Republic of Macedonia. In 2003 the Bank made its first investments in the health and education sectors in pursuit of one of its major new objectives.

Also in 2003, the Bank made its first loan under the Special Lending action for selected environmental projects in North-Western Russia.

The EIB gave priority to upgrading, modernising and developing the communications and energy sectors, with particular emphasis on Trans-European Networks (TENs) on the basis of the road and rail corridors defined by the Pan-European Conference of Transport Ministers as development priorities for the medium term.

Environmental issues related to EIB projects, as well as environmental projects per se, were given priority during the gradual adaptation of the legislation of the countries concerned to that of the EU. The EIB also supported SMEs and other industrial initiatives, either directly or through its global loan instrument, in particular for those involving EU partners.

In the **Mediterranean region**, the Bank's lending under mandate takes place mainly within the framework of the Euro-Mediterranean Partnership, in support of the economic development of the countries concerned. EIB lending supported individual investment projects and, through the global loan mechanism, smaller projects and SMEs, while at the same time strengthening the financial sector in the various countries. The lending window available under the TERRA (Turkey Earthquake Reconstruction and Rehabilitation Action) Programme (Council decision 99/786/EC) has now been fully utilised, while lending continued under the Turkey Special Action Programme (Council decision 2000/788/EC).

Under the terms of the Euro-Mediterranean Partnership, EIB lending from own resources is complemented by interest subsidies (for loans in the environmental sector) and by risk capital from EU budgetary sources, managed by the Bank.

In addition to its lending under mandate and at the request of the Council, the Bank has continued with its programme of lending from its own resources, without budgetary guarantee, under its Facility for Euro-Mediterranean Investment and Partnership (FEMIP).

In **Asia and Latin America**, the Bank finances projects that are of interest to both the Community and the countries concerned – cofinancing with EU promoters, transfer of technology, cooperation in the fields of energy and environmental protection.

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[4] In addition to its activities under mandate in the framework of the Council Decisions, the Bank has renewed its substantial Pre-Accession Facility for lending from its own resources without budgetary guarantee, to help the countries that have applied for EU membership.

In the **Republic of South Africa**, the Bank's objective is to contribute to the successful implementation of the country's reconstruction and development programme.

A summary of the activity undertaken by the EIB outside European Union since 1999 can be found in annex (see Table 2.3.1).

2.3.2. Lending Activity

The breakdown by country and by sector can be found in annex (see Tables 2.3.2 a-f).

2.3.3. Risk Sharing

Council Decision 2000/24/EC[5], as amended, provides Community guarantee global coverage for 65% of the overall amount of loans signed. Under the risk-sharing arrangements, EIB loans with non-sovereign project guarantees are covered only for political risk by the Community guarantee, whereas loans with sovereign project guarantees are covered for all risks by the Community guarantee. The Bank would call the Community guarantee for an individual loan only if the project guarantee for that loan failed to reimburse the Bank. Such a call would be for the full loan amount outstanding.

1st Mandate: (Council Decision covering period 31.01.1997 to 31.01.2000)

No further loans were signed under the 1st Mandate in 2003 so the levels of risk-sharing achieved under the 1st Mandate have not changed. In terms of percentage of risk sharing compared to the total ceiling, these levels were 81% for ALA, 26% for CEEC and 3% for the Mediterranean.

2nd Mandate: (Council Decision covering period 1.02.2000 to 31.01.2007)

The cumulative total for risk-sharing projects since the start of lending activity under the Council Decisions established since 1st February 2000 was EUR 2 068 million at the end of 2003, i.e. 10.6% of the overall lending ceiling and 19.1% of lending to date.

In **Central and Eastern Europe and the Balkans,** EIB lending based on risk sharing reached a total of EUR 585 million, or 6% of the lending ceiling for those countries and 15% of lending in the region to date.

In the **Mediterranean** region, two loans were signed under the risk-sharing arrangement in 2003, bringing the total to around 5% of the mandate ceiling and 6% of total amounts signed. Projects are often signed with governments or public bodies (in accordance with the programming procedures inherent in the **Euro-Mediterranean Partnership)**, and thus the risk-sharing total for the Mediterranean countries still remains relatively low.

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[5] Council Decision 2000/24/EC, as amended, invites the Bank "to aim to cover the commercial risk on 30% of its lending under this Decision from non-sovereign guarantees as far as possible on an individual regional mandate basis. This percentage shall be expanded upon whenever possible insofar as the market permits". During 2003, the Bank continued to work towards the risk-sharing objective with, however, the target increased to 30% instead of 25% as under the first mandate.

In **Asia and Latin America** (ALA), risk sharing in respect of EIB lending reached a total of EUR 1 160 million representing 47% of the mandate ceiling and 79% of lending in the region to date.

A first risk-sharing loan of EUR 30 million was signed in the **Republic of South Africa** in 2003, representing 4% of the mandate ceiling and 6% of amounts signed.

Risk-sharing at 31 December 2003 is shown in annex (see Tables 2.3.3), separately for each mandate.

2.3.4. Cooperation with Other Institutions

In the countries that are **candidates for EU membership**, the Bank's activities are conducted within the framework of the EU programme to help the candidate countries to prepare for accession, in particular by financing investment aimed at integrating their infrastructure with that of the EU and by assisting SMEs. Whenever possible, projects are cofinanced with other institutions. The Bank's activities thus form part of a concerted approach that is pursued in close cooperation with the Commission and, as appropriate, with the international financial institutions working in the countries concerned.

The Bank cooperates closely with the PHARE/ISPA Programme, with which it has developed a productive relationship, much appreciated by the beneficiary countries. In addition to frequent PHARE assistance during the pre-investment phase to ensure that the necessary studies and technical assistance are implemented in support of EIB projects, the Bank also cooperates with PHARE in cofinancing infrastructure projects.

Cofinancing contributions to projects financed by the EIB in 2003 are described below and shown in annex. Additional projects were cofinanced in the framework of the Bank's Pre-Accession Facility, which is outside the scope of this report.

For **South-Eastern Europe**, the Bank continued its active participation with the Commission and other IFIs in an Infrastructure Steering Group, to help with the upstream preparation of projects and policy coordination (see Table 2.3.4 in annex).

In the **Mediterranean** region, the Bank's operations are conducted within the framework of EU policy and form part of a concerted approach that is pursued in close cooperation with the Commission and, as appropriate, with other IFIs, including through cofinancing operations. The contributions of these institutions to projects financed by EIB are shown in annex (see Table 2.3.5).

In **Asia and Latin America,** the Bank continues to finance projects that are of interest to both the EU and the country concerned. The mutual interest of the loans signed in 2003 is described in annex (see Tables 2.3.6). The Bank cooperates with other IFIs in Asia and Latin America whenever possible.

2.4. Signatories of the Lomé/Cotonou Conventions - Lending Activity

Total EIB lending in the ACP/OCT amounted to EUR 463.2 million in 2003, of which EUR 177.6 million was from the Bank's own resources and EUR 285.6 million from risk capital. This includes the first loans under the Cotonou Agreement, which came into force on 1st April 2003 (see Table 2.4)[6].

3. BUDGETARY IMPACT OF LENDING

Lending activities have an impact on the Union budget when they are accompanied by Community guarantees, interest subsidies or special conditions comparable to risk-bearing operations for the lender.

3.1. Budget guarantees

On 22 December 1999 the Council decided on a general renewal of the Community guarantee for EIB loans outside the EU for a period of seven years (Council Decision 2000/24/EC; OJ L 9 of 13 January 2000). This decision was amended once in 2001 (2000/688/EC and 2000/788/EC).

On 6 November 2001 the Council decided to extend this scheme to EIB loans concluded in Yugoslavia by including this country in the group of central and eastern European countries (Council Decision 2001/778/EC).

The new ceilings for each area are as follows (in EUR)[7]:

Turkey	450 million
Central and Eastern Europe	9 280 million
Mediterranean countries	6 425 million
Latin America and Asia	2 480 million
Republic of South Africa	825 million

The overall ceiling for the guarantee is therefore EUR 19 460 million, and the Commission budget covers 65% of that amount (compared with 70% under the previous mandate). The new decision calls on the EIB to seek other sources of (commercial) guarantee from its financial intermediaries where possible and sets a target rate of 30% of the ceiling (as opposed to 25% under the previous mandate).

This guarantee programme will expire on 31 January 2007; it may automatically be extended by six months if the loan ceiling has not been reached.

6 EIB Annual Report 2003 on Investment Facility ACP EU Cotonou Partnership Agreement http://www.eib.org/Attachments/country/if_annual_report_2003_en.pdf

7 The Commission has carried out a mid-term review of the mandates and proposed changes that are expected to be adopted formally by the Council in 2004.
COM(2003) 603.

The Commission budget covers furthermore 65% of a maximum amount of EUR 600 million to Turkey (TERRA) for which no risk-sharing was requested.

During 2003 (the fourth year of the new mandate) the EIB signed loan agreements for a total of EUR 3 199 million, bringing total lending under the new mandate to EUR 10 776 million corresponding to 55.4% of the ceiling, with risk-sharing already equivalent to 19.1% of the loans signed.

On 6 November 2001 the Council decided to grant a 100% Community guarantee to the European Investment Bank against losses under lending operations for environmental projects in the Baltic regions of Russia for a total amount of EUR 100 million (Council Decision 2001/777/EC).

The detailed situation relating to guarantees is set out in the six-monthly report by the Commission on guarantees covered by the general budget.

3.2. Interest subsidies

Interest subsidies were granted under a number of Community programmes both inside and outside the Union. At the Council's request, the Commission drew up an overall assessment report on this subject[8]. Most of these programmes have been completed and no longer have any impact on budgetary expenditure. In annex, the Table 3.2 lists the programmes which are still under way and the amount of interest subsidy paid during the years under review.

3.3. Venture capital

Under the agreements with the Mediterranean countries and the Lomé Convention, concessionary loans are made by the EIB involving special conditions regarding duration or debt consolidation, which enable them to be treated as capital investments. The operations carried out in the Mediterranean region are financed by the general budget, and in the ACP by the EDF budget. A breakdown of the operations is given in annex (see Table 2.4).

8 COM(2000) 524 of 6 September 2000.