



EUROPEAN COMMISSION

Brussels, 4.3.2010
COM(2010)69 final

**REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL
ON BORROWING AND LENDING ACTIVITIES
OF THE EUROPEAN UNION IN 2008**

TABLE OF CONTENTS

1.	Introduction	3
2.	Lending activities of the European Union	4
2.1.	Description	4
2.2.	BOP facility.....	6
2.3.	MFA facility.....	7
2.4.	Euratom facility.....	8
3.	Borrowing activities of the European Union	9
3.1.	Description	9
3.2.	BOP	9
3.3.	MFA	10
3.4.	Euratom.....	10
4.	European Investment Bank — lending operations outside the Community	11
4.1.	EIB lending activities	11
4.1.1.	Description	11
4.1.2.	Volume of signatures	12
4.1.3.	Impact of EIB lending activities on EU budget	12
4.2.	EIB borrowing activities	13

1. INTRODUCTION

The Council decisions establishing the various lending instruments of the European Union require the Commission to inform the Council and the European Parliament, each year, of the use of these instruments. In order to meet these information requirements, this report describes the lending operations for each of the areas concerned.

In particular, this report gives a brief presentation of lending and borrowing activities under the balance-of-payment support to non-euro area Member States (BOP), and the macro-financial assistance provided by the Community to third countries (MFA), as well as guarantees associated with Community loans. In addition, it provides information on Euratom lending and borrowing activities.

To complete the picture of lending activities, the respective Council decisions¹ for EIB lending activities outside the Community require the Commission to inform the Council and the Parliament on an annual basis of the situation regarding European Investment Bank (EIB) financing operations (loans and loan guarantees) guaranteed by the Union budget in the pre-accession countries, the Mediterranean, Eastern Europe, the Southern Caucasus and Russia, Asia and Latin America and the Republic of South Africa.

¹ Council Decision 97/256/EC, as amended by Council Decisions 98/348/EC and 98/729/EC, covering the period 01.02.1997-31.01.2000 (the '1997-2000 General Mandate'), and Council Decision 2000/24/EC, replaced by Council Decision 2008/580/EC of 23 June 2008 (codified version), covering the period 01.02.2000-31.01.2007 (the '2000-2006 General Mandate'). Council Decision 1999/786/EC (Turkey Earthquake Reconstruction and Rehabilitation Action (TERRA)) forms an extension of the general mandates. Furthermore, Council Decision 2001/777/EC established a special lending action for selected environmental projects in the Baltic Sea basin of Russia under the Northern Dimension. Council Decision 2005/48/EC established a separate mandate for certain types of projects in Russia and Western NIS (Ukraine, Republic of Moldova and Belarus). Finally, Council Decision 2006/1016/EC established a new general mandate covering the period 01.02.2007-31.12.2013 (the '2007-2013 General Mandate'), replaced by Decision 2009/633/EC of the European Parliament and of the Council.

2. LENDING ACTIVITIES OF THE EUROPEAN UNION

2.1. Description

Financial support for non-member States and for non-euro area Member States is provided by the Commission under different legal bases, depending on the geographical areas concerned and the objectives pursued.

Financial operations administered by the Commission under various Council decisions generally take the form of bilateral loans (macro-financial support to non-member States (MFA) or balance-of-payments support to non-euro area Member States (BOP)), where the Community helps to re-establish a country's macro-economic balance. The Euratom lending instrument is available for financing operations in Member States and certain non-member States (Armenia, Russia and Ukraine).

Each MFA, BOP or Euratom loan disbursement is based on a back-to-back operation. In other words, the amounts due (interest and/or principal), currency and payment dates of the loans match the amounts due, the currency and payment dates of the underlying borrowing transaction.

Table 1: Loan disbursements for macro-financial assistance, Euratom to non-member States, and Balance of Payments loans to non-euro Member States

	EUR million								
	2001	2002	2003	2004	2005	2006	2007	2008	Total
Romania			50						50
Subtotal 'Enlargement' countries (Member States as of 01.01.2007)	0	0	50	0	0	0	0	0	50
Albania ⁽¹⁾						9			9
Bosnia and Herzegovina ⁽²⁾	10			10		10			30
fYRoM ⁽³⁾	10	12	28						50
Serbia and Montenegro ⁽⁴⁾	225		40		15				280
Tajikistan ⁽⁶⁾	60								60
Lebanon ⁽⁷⁾									0
Sub total MFA	305	12	168	10	15	10	0	0	479
Euratom⁽⁸⁾	40	40	25	65	215	51	39	16	491
BOP⁽⁹⁾								2000	2000
Grand Total	345	52	143	75	230	70	39	2016	2970

(1) A grant of EUR 3 million was disbursed to Albania in 2005 and a further grant of EUR 13 million in 2006.

(2) Disbursement of the loan was accompanied by disbursements of grants of EUR 10 million in 2000. A further grant of EUR 15 million was paid in 2001 and of EUR 25 million in 2003. In 2005 EUR 15 million grants were disbursed.

(3) Former Yugoslav Republic of Macedonia. A grant of EUR 10 million was disbursed in 2001, one of EUR 10 million in 2002 and another of EUR 18 million in 2003.

(4) One grant of EUR 115 million was paid to Serbia and Montenegro in 2002, one of EUR 35 million in 2003, one of EUR 10 million in 2004 and another of EUR 25 million in 2005.

(5) In 2001 EUR 35 million were disbursed to Kosovo and EUR 13 million to Montenegro, granted in the form of budgetary support. In the same year a further grant of EUR 15 million was disbursed to Kosovo, followed by another one of EUR 15 million in 2002.

(6) Tajikistan: This loan was accompanied by the disbursement of grants totalling EUR 14 million. A further grant of EUR 7 million was paid in 2003 (although decided in 2002), and the same amount in 2005 as well as in 2006.

(7) Macro-financial assistance to Lebanon in the form of EUR 50 million in loans. One disbursement of EUR 25 million took place in June 2009. A first payment of grant of EUR 15 million was disbursed in December 2008.

(8) Including Bulgaria and Romania (Member States as of 01.01.2007)

(9) On 2 December 2008 the ceiling for the maximum amount of loans granted to non euro-area Member States under the BOP facility was increased from EUR 12 billion to EUR 25 billion. On 18 May 2009 the limit was increased to EUR 50 billion.

Other grant disbursements for the period 2001 – 2008:

Exceptional financial assistance. Grant disbursements to Armenia and Georgia totalling, respectively, EUR 8 million and EUR 10 million in 1998 and EUR 4 million and EUR 9 million in 1999. A further grant of EUR 6 million was made to Georgia in 2001. A grant of EUR 11 million was paid to Armenia in 2002. Further grants to Armenia of EUR 5.5 million and Georgia of EUR 6.5 million were paid in 2004. In 2005, EUR 1.5 million grant was paid to Armenia. In 2006, Georgia received two grants of EUR 11 million each.

Republic of Moldova: a grant of EUR 25 million was paid in two tranches in 2008.

2.2. BOP facility

The activation of the Balance-of-Payments (BOP) to non-euro area Member States was the major event of the year 2008 in the lending (and borrowing) operations of the European Community.

The following is a summary of the main characteristics of the BOP facility, the key activities in 2008 and the expected evolution in the coming years.

BOP assistance takes the form of medium-term loans provided by the Commission and is generally provided in conjunction with financing provided by the IMF and other multilateral lenders, such as the EIB, the EBRD or the World Bank, or bilateral assistance from Member States. The facility is exceptional in nature and is mobilised on a case-by-case basis. Potential beneficiaries are the Member States outside the euro area² dealing with serious balance-of-payments difficulties. The assistance is of a macro-economic nature (i.e. not linked to a specific use of the funds as in the case of project assistance). It is released on the provision that economic policy conditions are met and is aimed at easing the recipient Member States' global external financing constraints and restoring the viability of the balance of payments. Such policy conditions are agreed by the Commission (following consultation with the Economic and Social Committee) and the Member State in a memorandum of understanding signed prior to the implementation of the loan agreements. The assistance underpins the implementation of adjustment measures designed to remedy these difficulties. The verification of such measures will be a condition precedent for the disbursement of any instalment under the loan.

Created in 1975³, several operations aimed at supporting the balance of payments of Member States under particular financial threats or difficulties were put in place by the Community, in the following twenty years, with loans funded by borrowings.

The increased number of eligible Member States following enlargement and the intensity of the international financial crisis called for the BOP facility to be activated and extended in December 2008⁴ from EUR 12 billion to EUR 25 billion in order to respond to the potential needs. Another increase to EUR 50 billion of the overall loan facility ceiling was decided in May 2009⁵ in order to continue being able to react quickly to any further demand for BOP assistance.

In 2008, the facility was reactivated to help non-euro Member States overcome balance of payments difficulties resulting from the financial crisis. On 4 November 2008⁶ the Council

² On 1 October 2009, the following Member States had not adopted the euro: Bulgaria, the Czech Republic, Denmark, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Sweden and the United Kingdom.

³ Council Regulation (EEC) No 397/75 of 17 February 1975 establishing a new mechanism known as the Community Loan Mechanism (CLM) to help some EC countries overcome unsustainable current account imbalances caused by the first oil shock.

⁴ Council Regulation (EC) No 1360/2008 of 2 December 2008 amending Regulation (EC) No 332/2002 establishing a facility providing medium-term financial assistance to Member States' balances of payments.

⁵ Council Regulation (EC) No 431/2009 of 18 May 2009 amending Regulation (EC) No 332/2002 establishing a facility providing medium-term financial assistance to Member States' balances of payments.

⁶ Council Decision 2009/102/EC of 4 November 2008.

decided to provide medium-term financial assistance to Hungary of up to EUR 6.5 billion under the balance of payments facility for non-euro Member States. The EU financial assistance was provided to restore investor confidence at a time when Hungary was seriously threatened by difficulties in its balance of current payments as a result of heightened financial market volatility and uncertainty as well as a severely disrupted funding environment for most of the last quarter of 2008. The intention was to disburse the EUR 6.5 billion loan in four instalments. On 9 December 2008 a first instalment of EUR 2 billion was disbursed. The balance was to be disbursed in 2009⁷ or in 2010 as the economic policy conditions are gradually met.

BOP is expected to represent a substantial part of future EU lending activity in terms of volume. In 2009, the Council decided to support two additional countries under the BOP facility:

- EUR 3.1 billion for Latvia (Council Decision 2009/290/EC of 20 January 2009), and
- EUR 5 billion for Romania (Council Decision 2009/459/EC of 6 May 2009).

2.3. MFA facility

Detailed information on MFA operations can be found in the annual Commission Report to the Council and the European Parliament on the implementation of MFA to third countries⁸. The main characteristics of the MFA facility, the key activities in 2008, and the expected evolution in the coming years can be summarised as follows.

Macro-financial assistance (MFA) in the form of loans and/or grants supports the political and economic reform efforts of the beneficiary countries and is implemented in association with the Bretton Woods institutions. Key features of the Community MFA are: the exceptional character of this assistance, the fact that it complements financing from the International Financial Institutions (IFIs), and macroeconomic conditionality. In close coordination with the International Monetary Fund (IMF) and the World Bank, Community MFA, tailored to the needs of a specific country, has supported several third countries with the overall objective of stabilising the financial situation and establishing market-oriented economies.

The MFA loans are generally disbursed in several instalments, as and when macroeconomic conditionality milestones are met. Each disbursement is subject to a borrowing transaction by the Commission. Should a situation of default arise as a result of failure by the beneficiary country to honour its repayment obligations, the Commission may activate the Guarantee Fund for External Actions⁹ so that the corresponding borrowing by the Commission is not affected.

Grants and loans disbursed under this instrument since 2001 are listed in Table 1 above.

The key MFA activities in 2008 relate to negotiations with the relevant authorities and focused on the following:

⁷ Two additional tranches of EUR 2 billion and EUR 1.5 billion were disbursed in March and July 2009 respectively.

⁸ Not yet published for 2008. For 2007, see COM/2008/520.

⁹ See Council Regulation (EC, Euratom) No 480/2009.

- The terms of the assistance to Lebanon (Memorandum of Understanding and Loan Agreement signed on 18 and 19 December 2008 respectively). The MFA programme with Lebanon consists of a grant of EUR 30 million and a loan of EUR 50 million, both to be disbursed in two instalments. The payment of the first tranche of the loan (EUR 25 million) was made in early June 2009, and the release of the second tranche is planned for 2010 (subject to the fulfilment of the conditionalities attached to this assistance).
- The regularisation of the split between Serbia and Montenegro of the MFA loans granted in favour of the former Federal Republic of Yugoslavia. On 2 October 2008, the Council adopted Decision 2008/784/EC establishing a separate liability of Montenegro and reducing proportionately the liability of Serbia with regard to the long-term loans granted by the Community to the State Union of Serbia and Montenegro (formerly the Federal Republic of Yugoslavia) pursuant to Decisions 2001/549/EC and 2002/882/EC¹⁰, authorising the Commission to sign a separate loan agreement with the authorities of Montenegro. This decision is simply the outcome of Montenegro's independence in June 2006 and of an agreement reached between Serbia and Montenegro in July 2006 to allocate external liabilities between the two separate states. It does not create any new obligations for the Community and has no budgetary implications. Once a separate loan agreement with Montenegro is concluded and enters into force (expected by the end of 2009), Serbia's current liabilities will be readjusted.
- In 2008 the Commission completed the implementation of the macro-financial assistance programme totalling EUR 45 million for the Republic of Moldova decided by the Council on 16 April 2007. The second and third instalments of the grant (EUR 10 million and EUR 15 million respectively) were released in June and December 2008. The programme was part of the financing package in support of the Government's arrangement with the IMF under the Poverty Reduction and Growth Facility (PRGF) dating back to May 2006 and expiring in May 2009.
- In December 2008, the Commission released the first grant instalment of EUR 15 million under the programme of macro-financial assistance to Lebanon approved on 10 December 2007.
- There were no loan disbursements under MFA in 2008.

MFA focuses on neighbouring regions, such as the Western Balkans and the Caucasus. The impact of the prevailing economic and financial crisis has been particularly severe in those regions. As a result, several pre-accession and neighbouring countries have approached the Commission formally or informally with requests for MFA, and the Community faced intense activity in 2009 to meet the demands under this facility. It is difficult to predict for how long such a high demand will persist, but in any case it will be linked to an overall return to normality in the more economically developed countries.

2.4. Euratom facility

The Euratom loan facility may be used to finance projects within Member States (Council Decision 77/270/Euratom) or in certain third countries (Ukraine, Russia or Armenia) (Council Decision 94/179/Euratom). These loans are off-budget operations that the Commission

¹⁰ OJ L 269, 10.10.2008, p. 8.

finances back to back by borrowing from the financial market. In 1990 the Council fixed a borrowing limit of EUR 4 billion, of which some EUR 3.4 billion have been decided. In 2002 the Commission proposed an increase in the borrowing limit from EUR 4 billion to EUR 6 billion, for which agreement has not yet been reached at the Council.

Euratom activities in 2008 focused on the second disbursement (USD 22 million) under the K2R4 project. On 29 September 2004 the Commission approved a loan for a total amount in EUR equivalent to USD 83 million for the safety upgrade of the nuclear power units known as Khmelnytsky Unit 2 and Rovno Unit 4 (K2R4) in Ukraine. The loan became effective on 7 July 2006 after verification that all conditions precedent of the loan agreement had been satisfactorily fulfilled. A first tranche of EUR 39 million was disbursed on 15 March 2007. On 6 October 2008, a second tranche of USD 22 million (EUR 15.2 million equivalent) was disbursed, following the corresponding borrowing operation.

In 2009 lending and borrowing activity was to include the disbursement of the third (and last) tranche¹¹ under the loan agreement for the K2R4 project (USD 10.3 million) in Ukraine.

3. BORROWING ACTIVITIES OF THE EUROPEAN UNION

3.1. Description

In order to finance the lending activities decided by the Council, the Commission is empowered to borrow funds on the capital market on behalf of the respective Community (EC, Euratom). For each instrument (BOP, MFA and Euratom loans) the borrowing and lending mechanism operation is determined in its respective legal base. There is a strict 'back-to-back' link between a borrowing operation and the related lending operation, which ensures that the EU budget is free of any interest rate or foreign exchange risk.

3.2. BOP

In November 2008 the EC concluded a EUR 6.5 billion loan commitment to the Republic of Hungary under the BOP facility. A first instalment of EUR 2 billion was financed on 9 December 2008 via the issuance of a 3 year bond.

This bond issuance succeeded in bringing the EC as issuer back to the euro benchmark bond market. The bond was very well received in the market. As investor interest was very strong, the bond was quickly oversubscribed. All important investor classes were represented in the final distribution, including central banks, investment funds, bank treasuries and insurance companies. The bond price was close to the best in its reference group, the Sovereign Supranational Agency Sector (SSA), in line with issuers such as EIB, KfW and SFEF.

¹¹ The last tranche was disbursed in October 2009.

The secondary market performance was very satisfactory and confirmed the EC's strong standing as a first class benchmark bond issuer. This standing was reinforced with subsequent benchmark bonds issued throughout 2009, building on the foundations laid with the 2008 benchmark issuance.

3.3. MFA

There was no funding under macro-financial assistance in 2008.

3.4. Euratom

An amount of USD 22 million was raised for Euratom in 2008.

Table 2: Volume of borrowing operations by financial instrument from 2001 to 2008¹²

	EUR million							
	2001	2002	2003	2004	2005	2006	2007	2008
MFA	305	12	118	10	15	19		
Euratom	40	40	25	65	215	51	39	16
BOP								2000
Total	345	52	143	75	230	70	39	2016

¹² More information on the EC bonds can be found at http://ec.europa.eu/economy_finance/financial_operation_instruments/market_operations59_en.htm.

Table 3: Total borrowing of the European Union — outstanding amounts at the end of each period 2000-2008⁽¹⁾

EUR million

	ECSC	Euratom	BOP	MFA	Total European Union
2000	2 039			1 656	3 695
2001	1 386	40		1 633	3 059
2002	713	80		1 379	2 172
2003	431	105		1 372	1 908
2004	423	170		1 214	1 807
2005	440	385		1 080	1 905
2006	436	436		969	1 841
2007	400	474		786	1 260
2008	266	484	2 000	654	3 404

⁽¹⁾ The conversion rates used are those of 31 December of each year. Original amount of borrowings, plus or minus repayments of the principal, cancellations, annulments and exchange-rate adjustments.

4. EUROPEAN INVESTMENT BANK — LENDING OPERATIONS OUTSIDE THE COMMUNITY

4.1. EIB lending activities

4.1.1. Description

Loans granted by the EIB from its own resources are either in the form of direct financing for individual projects or global loans to financial intermediaries, which then allocate funds to smaller-scale local projects. Some of the EIB loans outside the Community benefit from a guarantee of the European Union budget and are, unless otherwise specified, the focus of this report. Under the current external mandate, the EIB can also provide loan guarantees. A wider range of financial instruments (including equity in certain cases) is used by the EIB under its own risk facilities¹³ and when it manages Community or Member States' resources (notably in the Mediterranean and ACP countries). A separate report will review the EIB operations carried out under the external mandate.

¹³ In July 2009, the Board of Governors approved extensions to the EIB's Pre-Accession Facility and Mediterranean Partnership Facility II so as to enable indirect equity investments in infrastructure funds.

4.1.2. Volume of signatures

The total volume of EIB operations signed increased by 20 % to EUR 57.6 billion in 2008, of which an amount of EUR 51.5 billion was signed with Member States and EUR 6.1 billion with partner countries.

EIB lending in non-member States in 2008 — Overview

EUR million

	EU Budget and EDF resources ⁽¹⁾	Own resources under Community / Member States' Guarantee	Own resources under EIB own risk facilities	TOTAL
Pre-Accession countries (Mandate 2007-2013)		2 009	1 444	3 453
Neighbourhood and Partnership countries (Mandate 2007-2013)	62	1 365	33	1 460
ALA — Asia and Latin America (Mandate 2007-2013)		469		469
RSA — South Africa (Mandate 2007-2013)		203		203
ACP-OCT countries ⁽²⁾	336	225		561
Total	398	4 270	1 477	6 145

⁽¹⁾ Granted and administered by the EIB out of the budgetary resources of the EC or the European Development Fund (EDF).

⁽²⁾ Africa, Caribbean, Pacific / Overseas Countries and Territories.

4.1.3. Impact of EIB lending activities on EU budget¹⁴

The EIB provides project financing both inside and, with a partial guarantee from the EU budget, outside the EU. Lending activities have an impact on the EU budget when they are

¹⁴ For the impact of guarantees given to EIB and the impact of EU own risk lending, see report on guarantees covered by the budget at 31.12.2008, COM2009 (398).

accompanied by Community guarantees, interest subsidies or special conditions comparable to risk-bearing operations for the lender.

On 19 December 2006, the Council granted a Community guarantee to the EIB against losses under loans and loan guarantees for projects outside the Community (Decision 2006/1016/EC¹⁵), replaced by Decision 2009/633/EC of the European Parliament and of the Council of 13 July 2009¹⁶). The Community guarantee is restricted to 65 % of the aggregate amount of credits disbursed and guarantees provided, less amounts reimbursed, plus all related sums. The maximum ceiling for EIB financing operations carried out under this mandate in 2007-2013 is EUR 27 800 million consisting of a basic ceiling of EUR 25 800 million and an optional mandate of EUR 2 000 million, its activation being decided by the Council and the Parliament based on the outcome of the mid-term review in 2010.

4.2. EIB borrowing activities

Under the 2008 funding programme the EIB raised an amount of EUR 59.5 billion. This represents a significant increase over 2007 (EUR 54.7 billion i.e. +9%). This substantial increase was realised in 2008 in a difficult funding environment. It was characterised by volatility, market uncertainty, and from mid-October, a severely disrupted funding environment. Therefore, reliance on larger, liquid transactions and low levels of demand for structured issues continued.

¹⁵ OJ L 414, 30.12.2006, p. 95.

¹⁶ OJ L 190, 22.07.2009, p. 1.