

COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION TO THE COUNCIL

REVIEW OF THE FACILITY PROVIDING MEDIUM-TERM FINANCIAL ASSISTANCE FOR MEMBER STATES' BALANCES OF PAYMENTS

Council Regulation 88/1969/EEC

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1. Introduction

Medium-term financial assistance for Member States' balances of payments is currently governed by Council Regulation 88/1969/EEC of 24 June 1988⁽¹⁾. This Regulation merged into a single facility two previously existing mechanisms :

- a) the Medium-term Financial Assistance (MTFA)⁽²⁾ introduced in 1971 as one of the first steps of Institutional monetary arrangements to achieve by stages economic and monetary union, and to implement Article 108 of the EEC Treaty, and
- b) the Community Loan Mechanism (CLM)⁽³⁾, created in 1975 in relation to the difficulties arising from the first oil crisis. By subsequent adjustments, the purpose of the mechanism was broadened to balance of payments difficulties in general.

Article 12 of the regulation in force stipulates that

"Before 31 December 1992, the Council shall examine, on the basis of a report from the Commission, after the Monetary Committee has delivered an opinion and after consulting the European Parliament, whether the facility established still meets, in its principle, arrangements and ceiling, the need which led to its creation."

The present report was prepared in response to this mandate.

2. Main provisions of the Regulation

Purpose

The purpose of the facility is to provide medium-term financial support to Member States which are experiencing, or are seriously threatened with, difficulties in their balance of current payments or capital movements.

A principal feature of the facility is its preventive character. Lending to a Member State should take place soon enough in order to enable that Member State to adopt, in good time, economic policy measures likely to prevent the occurrence of an acute balance of payments crisis and to support its effort towards convergence.

Form of assistance

Fund raising on the capital markets and onlending to the Member States concerned are the preferred financial arrangements of the present facility. However, the granting of financial assistance funded through credits from other Member States has been retained as an alternative, if capital market conditions make fund raising unsatisfactory.

(1) O.J. N° L 178/1 of 8.7.1988

(2) O.J. N° L 73/15 of 27.3.1971

(3) O.J. N° L 46/1 of 20.2.1975

Implementation of the facility

The decision to grant the loan is taken by the Council, acting by qualified majority, on a proposal from the Commission based on the economic situation of the Member State and the adjustment programme presented in support of its application. The Commission consults the Monetary Committee before making its proposals.

The initiative for the implementation of the facility is taken either by the Commission, in accordance with the Article 108 of the EEC Treaty in agreement with the Member State seeking financial assistance, or by a Member State experiencing balance of payments difficulties.

Conditionality and monitoring

The granting of the loan is linked to the adoption by the beneficiary Member State of economic policy measures designed to re-establish, or ensure, a sustainable balance of payments situation.

The Commission verifies at regular intervals, in collaboration with the Monetary Committee, that the economic policy of the Member State is in line with the conditions approved by the Council. The release of the consecutive loan instalments (as a rule the funds are disbursed in two or three instalments) is conditional on the verification that the agreed economic policy terms were respected, or that corrective action is taken, or agreed, in order to remedy the situation, in the event of divergence from the targets set.

3. Use of the facility

Since it was reformed in 1988 the mechanism was activated once, in 1991, in favour of Greece⁽¹⁾. The loan was to be made available in three instalments, the first of which (ECU 1.0 bn) was disbursed in April 1991.

The use of the previous mechanisms which gave rise to the present facility is shown in Annex I and their evolution in Annex II.

Concerning the above loan to Greece and in connection with the degree of fulfilment of the economic conditions during the first year of the implementation of the adjustment programme, it is noted that although the balance of payments target was reached other, key, economic policy targets were missed. This situation renders the improvement in the balance of payments fragile, and the pace of convergence slow.

The conditionality issue is examined further below, in heading 5 "Specific arrangements and ceiling".

(1) Council Decision 91/136/EEC of 4 March 1991
O.J. N° L 66/22 of 13.3.1991

4. The facility in the transition to EMU

The question arises whether the present balance of payments facility should be maintained during the post-1992 transitional period to the third stage of EMU.

The co-ordination of economic and monetary policies and progress towards convergence would diminish the risk of balance of payments difficulties, while free capital mobility would, in principle, facilitate financing of payments imbalances.

However, since no single currency and central monetary authority will be in place during the transitional period, the maintenance of the facility is considered necessary in averting balance of payments crises and reducing the adverse effects of balance of payments difficulties.

The mechanism would facilitate market integration by supporting the efforts of Member States experiencing balance of payments difficulties to make the necessary adjustments without recourse to protective measures. In the event of external disturbances or other occurrences of a temporary character, the activation of the facility would enable Member States concerned to cope with the situation without putting at risk the implementation, or the pace, of their convergence programmes.

The stabilising role of the facility would be most probably necessary, in ensuring an undisturbed movement to EMU, for those Member States exposed to the risks of a completely open financial system and free capital mobility, also vis-à-vis third countries, after long periods of tight regulations in domestic financial markets and external financial flows. These considerations are even more relevant than in the past, taking account of the narrowing scope for currency realignments inside the EMS as the third stage of EMU approaches.

With regard to the free mobility of capital it is noted that, although it is an element which enhances, under normal circumstances, the capability of financing external deficits through the capital account, it may accentuate balance of payments difficulties emanating from other sources.

The possibility of balance of payments crises during the transition to EMU is taken into account in the new Treaty. Article 108 of the EEC Treaty, which together with Article 235 form the legal basis for the facility, has been transcribed by the Treaty on European Union as Article 109 h of the EEC Treaty. This Article will continue to apply until the end of the second stage. It will continue to apply during the third stage for Members with a derogation, as long as that derogation lasts.

5. Specific arrangements and ceiling

The issues examined in this section refer to the implementation of the facility, the economic conditionality linked to the granting of the financial assistance, the financial operations involved in the Community's borrowing and on-lending activity as well as to the ceiling.

The review of these arrangements did not reveal any need for adjustment. Regarding loan conditionality, it is noted that the facility is flexible enough in order to take account of the requirements of convergence.

Implementation

The facility showed a satisfactory degree of flexibility : its implementation from receipt of Member State's request for assistance up to the effective disbursement of funds, takes weeks rather than months. Although this flexibility may reflect also the fact that some preparatory work had been done prior to the official request for assistance, such as informal contacts and capital market research, it remains, nevertheless, a noteworthy performance and responds to an explicit objective of the facility "*..to ensure that, if required, medium-term financial support is provided quickly, especially where circumstances call for immediate action*" (Fourth recital of the Regulation).

Regarding the form of financing, the preference for capital market financing introduced by the present Regulation, simply made explicit a long established practice. All activations of the mechanisms for balance of payments assistance, with the exception of the first in 1971, took the form of Community borrowing on the financial markets and on-lending to the Member concerned. The preference for this form of funding is justified : it enhances facility's operational rapidity and flexibility and enables the Community to use its excellent credit-worthiness to obtain funds at very advantageous terms in favour of the Member State in balance of payments difficulties.

Financial operations

According to the Regulation, the refinancing and restructuring of the loan is possible, if the market conditions permit, at the request of the beneficiary. These arrangements must not imply an extension of the duration or the increase of the amount of the loan.

Refinancing operations did, in fact, take place when favourable market developments prevailed and ensured considerable gains in favour of the borrower Member State. The costs linked to these operations were borne by the beneficiary Member State.

Conditionality

Taking account of the policy instruments and performance criteria introduced in order to facilitate and monitor progress towards EMU, it is necessary that explicit links be established between these arrangements and the loan conditionality.

The present facility provides the flexibility for establishing such links. In fixing the economic conditions which accompany the loan, the Council decision can give due consideration to the requirements of convergence and gradual elimination of excessive deficits.

In operational terms, such links would involve the following :

- a) An obligation, on the part of a Member State seeking financial assistance, to adopt a multiannual programme consistent with the objectives of ensuring lasting convergence necessary for the achievement of EMU, while restoring a sustainable balance of payments situation.
- b) An automatic review by the Council of the convergence programme of a Member State, with a view to adapting it, if necessary, to the new situation in the event of
 - a request, from that Member State, for financial assistance in order to cope with difficulties, or threat of serious difficulties, in its balance of payments;
 - significant divergences from targets regarding implementation, by that Member State, of the economic conditions accompanying the granting of financial assistance.

Ceiling

The outstanding amount of loans to be granted under this facility is limited to 16.000 Million ECU. A ceiling of 14.000 Million ECU is set on the amount of funds the Commission can borrow, on the financial markets, in order to onlend to Member States in regard to this facility. Taking account of loans granted, including undisbursed commitments and repayments received and scheduled to be effected until the end of this year, the total lending capacity of the mechanism at 31.12.1992 will be about 13.000 million ECU or 11.000 million ECU through capital market financing. This lending capacity will be increased, through further repayments by around 630 million ECU by the end of March 1993.

The above lending margins are considered as adequate to meet requests for balance of payments assistance by Member States. This appraisal takes account of the recent request by Italy for such an assistance. It is felt, therefore, that the current ceiling does not need adjustment.

A re-examination of the operation of the facility before the end of 1996 would allow a reappraisal of the adequacy of the present ceiling.

6. Conclusions

The main conclusions of the report are as follows :

- balance of payments difficulties may arise during the transition to EMU, despite an expected higher degree of convergence and easier financing of payments imbalances through capital mobility;
- the mechanism would constitute the instrument through which financial assistance can be provided in the context of the new Article 109 h of the EEC Treaty, which is identical to the existing Article 108 of this Treaty and which will cease to apply from the beginning of the third stage. It will continue though to apply to Member States with a derogation;
- the mechanism would facilitate market integration by supporting the efforts of Member States facing balance of payments difficulties to make the necessary adjustment in order to remedy the situation without recourse to protective measures. In the event of balance of payments difficulties of a temporary character the activation of the mechanism would enable Member States concerned to cope with the situation without putting at risk the implementation, or pace, of their convergence programmes;
- As to the specific arrangements and ceiling of the mechanism, the experience until now and the transition to EMU do not call for adaptations. In regard to the issue of conditionality, it is noted that the mechanism allows for the possibility of establishing explicit links between the economic conditions fixed by the Council, in its decision to grant the loan, and the requirements for convergence, notably avoidance of excessive deficits, in preparing for EMU.

In view of the above the Commission considers that the present facility should remain in place during the transition to the third stage of EMU.

The mechanism could be again reviewed by the end of 1996 in the light of subsequent developments.

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ANNEX I

USE OF BALANCE OF PAYMENTS MECHANISMS

<u>Year</u>	<u>Beneficiaries</u>	<u>Amount</u>	<u>Mechanism</u>
1974	ITALY	1159.2 Mio UA (1)	Medium-term financial Assistance of 1971
1976	ITALY (10/13) IRELAND (3/13)	(1100 Mio USD (500 Mio DM	Community Loan Mechanism
1977	ITALY	500 Mio USD	"
1983	FRANCE	4000 Mio ECU	"
1985	GREECE	1750 Mio ECU	"
1991	GREECE	2200 Mio ECU (2)	Medium-term financial Assistance of 1988 (Single facility)

(1) Units of account (1 UA = 1.2 USD)

(2) In three instalments :
the first instalment of 1000 Mio ECU was disbursed in April 1991

EVOLUTION OF COMMUNITY BALANCE OF PAYMENTS MECHANISMS

	<u>Medium-Term Financial Assistance</u>	<u>Community Loan Mechanism</u>	<u>Single Facility</u>
Creation :	1971 Council Decision	1975 Council Regulation	1988 Council Regulation
Legal basis	Art. 103 and 108 of EEC Treaty	Art. 235 of EEC Treaty	Art. 108 and 235 of EEC Treaty
Decision to grant fin. assistance	Qual. Majority	Unanimity	Qual. Majority
Form of assistance	Credits by Member States	Capital market financing	Preference for capital market financing. Credits from Member States retained as alternative
<u>Ceiling</u>			
1971	2.000 Mio UA ⁽¹⁾		
1975		3.000 Mio US\$	
1978	14.100 Mio ECU		
1980	14.370 Mio ECU		
1981		6.000 Mio ECU	
1985		8.000 Mio ECU	
1986	13.925 Mio ECU		
1988	-----	Merged -----	16.000 Mio ECU

(1) Units of Accounts