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REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

ON THE BORROWING AND LENDING ACTIVITIES OF THE EUROPEAN COMMUNITIES IN 2005

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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 European Parliament each year of the use made of these instruments.

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 European Investment Bank (EIB) loans guaranteed by the Union budget in the South-Eastern Neighbours, in the Mediterranean countries, in Latin America and Asia and in South Africa.

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 third countries and of the interest subsidies and guarantees associated with Community loans. In addition, it provides information on Euratom's lending activities.

The tables to 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 2005

In order to finance the lending activities decided by the Council, the Commission is empowered to borrow, on behalf of the respective Community (EC, Euratom), funds on the capital market[2]. One borrowing for macro-financial assistance in 2005 was raised to grant a loan to Serbia and Montenegro. There were three borrowings under the Euratom loans instrument to finance one loan to a nuclear plant in Bulgaria and two loans for the same purpose in Romania.

Despite the above-mentioned factors, total borrowing by the European Communities and the EIB increased in 2005 by 6% to EUR 52.9 billion, against EUR 49.9 billion the previous year (see Table 1.1), mainly due to an increase in borrowing by the EIB.

Taking into account repayments, cancellations and exchange-rate fluctuations, the total amount of borrowings outstanding at 31 December 2005 was EUR 250.1 billion, 15.5% up on 2004 (see Table 1.2).

The breakdown of borrowings by currency (see Table 1.3) shows a decrease in the share of EUR-denominated borrowings in 2005 to 37.5% from 44.9% in 2004 of all issues, while issues in other Community currencies increased from 13.0% to 23.0%. Non-Community currencies took a smaller share of borrowing, decreasing from 42.0% to 39.5% of the total. Issues in USD were down from 41.6% to 27.9%. In 2005, after swaps, 97.3% of the loans

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1 Legal base: Council decision 97/256/EC for the first global mandate and 2000/24/EC, as amended, for the second mandate and also Decisions 98/348/EC, 98/729/EC, 99/786/EC, 2000/24/EC, 2000/688/EC, 2000/788/EC, 2001/777/EC, 2001/778/EC, 2005/47/EC and 2005/48/EC.

2 The ECSC treaty expired in 2002. The ceilings for the New Community instrument (NCI) have been fully used and the last borrowing under NCI was fully amortised in 2004. No funds were raised for these instruments and there will be no new lending activities for them.

were on a variable-rate as compared to 100% in 2004 (figure before swap : see Table 1.3 in Annex).

2. LENDING IN NON-MEMBER STATES[3]

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 at the time of the Decision (Armenia, Bulgaria, Czech Republic, Hungary, Lithuania, Romania, Russia, Slovakia, Slovenia and Ukraine).

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

2.2. The Community's Macro-Financial Assistance

Macro-financial assistance (MFA) 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 Bretton Woods institutions, balance-of-payments support to certain countries facing transitional macro-economic difficulties. The Community's assistance focuses on neighbouring regions, such as the Western Balkans and the Caucasus. 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.

Grants and loans disbursed under this instrument are listed in the annex (see Table 2.2). Moreover, information is also given in the annual Commission Report on the implementation of MFA to third countries[4].

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3 In 2005 there were no lending activities to Member States by the Communities. As the accession of ten new Member States took place on 1 May 2004, the guaranteed loans to these countries ceased to be considered as external actions from that date.

4 COM(2006)391 and its annex SEC(2006)938.

2.3. EIB Lending in 2005 in the South-Eastern Neighbours, the Mediterranean, Asia & Latin America and Republic of South Africa

Section 2.3 constitutes the annual report for 2005 to be submitted to the European Parliament and the Council in accordance with Article 2 of Council Decision 2000/24/EC.

2.3.1. EIB Objectives and Priorities

In the **South-Eastern Neighbours**, the Bank has been active in 2005 in both the Acceding and Accession States (Bulgaria, Romania, Croatia and Turkey) as well as continuing to support investments in the countries of the Western Balkans in various sectors (mainly infrastructure, health and education and SMEs).

The EIB gives 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*, are given priority in the framework of the gradual adaptation of the legislation of the countries concerned to that of the EU. The EIB also supports SMEs and other industrial initiatives, in particular Foreign Direct Investment (FDI), either directly or through its global loan instrument, in particular when involving EU partners.

The EIB continued lending under the mandate for special lending action for selected environmental projects in **North-Western Russia** that expired in May 2005 (two projects were signed in April and May for EUR 60 million in St. Petersburg, bringing total signatures under this mandate to EUR 85 million), and carried out significant preparatory work viz the second Mandate (EUR 500 million up to July 2007) for **Russia, Ukraine, Moldova and Belarus**, approved by the Council in December 2004 and for which the Guarantee Agreement was signed with the Commission in December 2005. The Commission, the EIB and the European Bank for Reconstruction and Development (EBRD) also worked on preparing a tripartite Memorandum of Understanding concerning the implementation of the possible next Mandate currently under discussion (2007-2013) for operations in Russia, Eastern Europe and Southern Caucasus[5] and Central Asia[6].

In the **Mediterranean region**, the Bank's lending under mandate is carried out by the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) and takes place mainly within the framework of the Euro-Mediterranean Partnership, in support of the economic development of the countries concerned. EIB lending supports 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. In order to complement the remaining amount available under the existing mandate (EUR 248 million), an interim EIB facility could be launched in 2006, allowing the Bank to pursue an appropriate level of operations in the Mediterranean countries before the entry into force of the future mandate.

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5 Ukraine, Moldova, Belarus, Armenia, Azerbaijan, Georgia.

6 Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

In addition to its lending under the EuroMed II 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 the Mediterranean Partnership Facility.

EIB own resources lending under mandate is further complemented by interest subsidies (for loans in the environmental sector) and by risk capital from EU budgetary sources and managed by the Bank. Operations continued under the Technical Assistance FEMIP Support Fund, which utilises funds granted by the European Commission under the MEDA regulation. 2005 was the first operational year of the FEMIP Trust Fund created in mid-2004 to complement the Technical Assistance Fund by focusing on upstream technical assistance and risk capital operations.

Formalising a longstanding relationship, a Memorandum of Understanding on an enhanced strategic partner for cooperation in the African countries was signed in 2005 between the European Investment Bank, the European Commission and the African Development Bank. To combine resources and increase cooperation with bilateral development finance institutions from the Member States that also operate in the Mediterranean, the EIB signed an agreement with twelve such institutions last year. In addition, it signed a letter of intent with the *Agence Française de Développement* and the KfW Development Bank.

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. Since the Tsunami of end-2004, reconstruction efforts are also eligible for EIB support.

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. In addition to its lending operations, the EIB provided management support to the EU Commission for its Risk Capital Facility.

A summary of the activity developed by the EIB since 2001 can be found in table 2.3.1.

2.3.2. Lending Activity

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

2.3.3. Risk Sharing

Council Decision 2000/24/EC[7], 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, in the case of a non-sovereign project guarantee for political reasons only, but for any reason in the

[7] Council Decision 2000/24/EC 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 2005, 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.

case of a sovereign project guarantee. Such a call would be for the full loan amount outstanding, since, in practice, any loan is covered to the extent of 100%, subject to the overall 65% limit for the total liability of the guarantee.

Risk-sharing at 31 December 2005 is shown in tables 2.3.3 and 2.3.3(bis) - separately for each mandate (risk-sharing percentage unchanged since end-2001 for the 1st Mandate).

2.3.4. Cooperation with other Institutions

During 2005, the Bank's activities in the Accession and Acceding States were conducted within the framework of the EU programme to help these 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 co-financed 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.

Co-financing contributions to projects financed by the EIB in 2005 are shown in annex (Tables 2.3.4/2.3.5). Additional projects were cofinanced in the framework of the Bank's Pre-Accession Facility, which is outside the scope of this report.

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

Total EIB lending in the ACP/OCT amounted to EUR 537 million in 2005, of which EUR 151 million from the Bank's own resources and EUR 386 million from risk capital (see Table 2.4).

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 2004 the Council decided to grant a Community guarantee to the European Investment Bank against losses under loans for certain types of projects in Russia, Ukraine, Moldova and Belarus (2005/48/EC). The overall ceiling of the credits opened shall be EUR 500 million and the EIB shall benefit from an exceptional Community guarantee of 100 %.

On 22 December 2004 the Council decided to amend Decision 2000/24/EC to take into account the enlargement of the European Union and the European Neighbourhood Policy (2005/47/EC).

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

South-Eastern Neighbours	9,185 million
Mediterranean countries	6,520 million
Latin America and Asia	2,480 million
Republic of South Africa	825 million
Turkey	450 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). This 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 loans ceiling has not been reached.

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 2005 (the sixth year of the new mandate) the EIB signed loan agreements for a total of EUR 3,618 million, bringing total lending under the new mandate to EUR 17,238 million corresponding to 89% of the ceiling, with risk-sharing equivalent to 17% of the loans signed.

The detailed situation relating to guarantees is set out in the six-monthly report by the Commission on guarantees covered by the general budget[8].

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[9]. 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. Risk Capital

Under the successive Lomé Conventions and the Cotonou Agreement, the EIB carries out risk capital operations in the ACP region, which are financed by the EDF budget. A breakdown of the operations is given in annex (see Table 2.4).

8 COM(2005) 699 and SEC(2005) 1769.
9 COM(2000) 524 of 6 September 2000.