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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 2006

{SEC(2007)1079}

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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 respective Council decisions[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 (SEN), in the Mediterranean countries (MED), in Asia and Latin America (ALA) and in the Republic of South Africa (RSA).

In order to meet these information requirements, this report describes the lending operations for each of the areas concerned. To complete the picture of lending activities, it also gives a brief summary of the borrowing activities undertaken in order to finance the lending activities, 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 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 (hereinafter referred to as the “Annex”)[2].

1. BORROWING ACTIVITIES IN 2006

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[3].

Total borrowing by the European Communities and the EIB decreased in 2006 by 3.8% to EUR 48.1 billion, against EUR 50.0 billion the previous year (see table and graph in Section 1.1 of the Annex). More than 99% of this amount has been borrowed by the EIB. This decrease in borrowing activities can be explained by a marginally reduced borrowing activity of EIB following a somewhat slower pattern of loan disbursements and treasury liquidity considerations as well as by the absence of new Decisions concerning Euratom, macro-financial assistance and the balance of payments loans.

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1 Council Decision 97/256/EC, as amended by Council Decisions 98/348/EC and 98/729/EC, covering the period 01.02.1997 to 31.01.2000 (hereinafter the "First General Mandate"), and Council Decision 2000/24/EC, as amended by Council Decisions 2000/688/EC, 2000/788/EC, 2001/778/EC, 2005/47/EC and 2006/174/EC, covering the period 01.02.2000 to 31.01.2007 (hereinafter the "Second 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. Finally, Council Decision 2005/48/EC established a separate mandate for certain types of projects in Russia and Western NIS (Ukraine, Moldova and Belarus).

2 SEC(2007)1079.

3 As the ECSC Treaty expired in 2002, there has been no new borrowing on behalf of the ECSC.

Taking into account repayments, cancellations and exchange-rate fluctuations, the total amount of borrowings outstanding at 31 December 2006 was EUR 248.4 billion, 0.7% down on 2005 (see Table 1.2 in the Annex).

The breakdown of borrowings by currency (see Table 1.3 in the Annex) stays at the same level of 37.9% in the share of EUR-denominated borrowings in 2006 of all issues. Issues in other Community currencies decreased from 23.0% to 16.6%. Non-Community currencies took a higher share of borrowing, increasing from 39.5% to 45.4% of the total. Issues in USD were up from 27.9% to 30.4%. In 2006, after swaps, 94.5% of the loans were on a variable-rate as compared to 97.3% in 2005 (figure before swaps: see Table 1.3 in the Annex).

2. LENDING IN NON-MEMBER STATES[4]

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 by EIB on its own resources 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. Some of these loans benefit from a guarantee of the Union budget.

The Euratom lending instrument[5] is available for financing operations in Member States and certain non-member States (Armenia, Bulgaria[6], Czech Republic, Hungary, Lithuania, Romania[7], Russia, Slovakia, Slovenia and Ukraine).

The geographical regions in which the Community conducts lending activities are listed in the 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

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[4] In 2006 there were no lending activities to Member States by the Communities. With the accession of Bulgaria and Romania to the Union on 1 January 2007, the guaranteed loans to these countries cease to be considered as external actions from that date.

[5] Council Decision 77/270/Euratom, as amended by Council Decision 94/179/Euratom. The ceiling for borrowing to fund Euratom lending was originally fixed by Council Decision 77/271/Euratom. Subsequently, the ceiling was raised by various amendments of the latter decision, the latest of which (Council Decision 90/212/Euratom) increased it by 1 000 million ECU to 4 000 million ECU.

[6] Member State as of 1 January 2007.

[7] Member State as of 1 January 2007.

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) which shows that in 2006 an amount of EUR 19 million has been disbursed under existing MFA decisions. No new MFA decisions were taken in 2006. Moreover, information is also given in the annual Commission Report on the implementation of MFA to third countries.

2.3. EIB Lending in 2006 in the South-Eastern Neighbours, the Mediterranean, Asia & Latin America and Republic of South Africa

This section constitutes the annual report for 2006 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

2006 was the last full year of operations under the mandates covering EIB financing outside the EU over the period 01.02.2000 to 31.01.2007[8]. The Commission and the EIB have throughout the year participated in negotiations, including negotiations in the Council, for the renewal of the external mandate for the period 2007-2013, finally concluded and formalised by Council Decision 2006/1016/EC on 19 December 2006[9].

The general lending priority for EIB in regions outside the EU is to support the Community's policy objectives. The regional objectives take into account the specific characteristics and priorities of each region.

In the **South-Eastern Neighbours**, the Bank was active in 2006 in both the Acceding and Candidate States (Bulgaria, Romania, Croatia, Turkey and the former Yugoslav Republic of Macedonia) 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. In the wake of the accession of Bulgaria and Romania, Memoranda of Understanding were signed as frameworks for the EIB's support to both countries' respective investment programmes covering all key economic sectors. The EIB continued also to support investments in the other countries of the Western Balkans (Albania, Bosnia and Herzegovina, Montenegro[10] and Serbia) with the aim of facilitating their ongoing integration process into the EU. More generally, EU and EIB support aims to foster political and economic reform and to encourage social reconciliation in the region.

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

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8 The EIB's operations in the African, Caribbean and Pacific regions are not covered in this report as they are carried out in the framework of the Cotonou Partnership Agreement signed in 2000 for a 20-year period.

9 OJ L 414 of 30.12.2006, p. 95.

10 Data in this report represent loans signed with Serbia and Montenegro as a State Union, i.e. before the entry into force of new legal framework put in place following the independence of the Republic of Montenegro.

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 private sector development (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.

In the **Mediterranean region**, the Bank's lending is carried out under the Facility for Euro-Mediterranean Investment and Partnership (FEMIP) mainly within the framework of the Euro-Mediterranean Partnership, in support of economic and social modernisation and enhanced regional integration. FEMIP focuses its activities on support for the private sector and on creating an investment-friendly environment, mainly by financing enabling infrastructure for economic development. Furthermore, in line with EU priorities, FEMIP supports sustainable energy development, competitiveness and security of supply. In November 2006, the Ecofin Council decided to reinforce FEMIP and marked two specific priority areas: private sector development and reinforcement of partnerships in order to increase partner countries' involvement.

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. The EIB also supported reconstruction efforts in the aftermath of the Tsunami disaster of December 2004. In this context, the geographical scope of the ALA mandate was broadened to include the Maldives.

In the **Republic of South Africa**, the Bank has been mandated to focus on infrastructure projects of public interest and private sector support, including SMEs. The Bank's operations have further to be complementary to the Community assistance policies, programs and instruments in South Africa, whose overriding objective is the reduction of poverty and inequality.

A summary of the activity developed by the EIB in the relevant regions since 2002 can be found in Table 2.3.1 of the Annex.

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. Guarantee Coverage

2.3.3.1. Blanket guarantee

Council Decision 2000/24/EC, as amended, provides Community guarantee coverage of 65% to the whole mandate. This means that the Community guarantee is restricted to 65% of the overall amount of loans signed, but that within this aggregate ceiling, defaults on individual loans are de facto covered up to 100%.

2.3.3.2. Risk sharing

The Community Guarantee under the general mandates covers all credit risks, unless the risk-sharing arrangements apply, in which case the Community Guarantee covers only specific political risk, whereas non-political risks are borne and mitigated by the Bank. Decision 2000/24/EC, as amended, invites the EIB to apply risk-sharing arrangements in 30% of its lending under the Decision (as opposed to 25% under the First General Mandate) [11].

At end-2006 the Bank had achieved a level of 18% of risk-sharing as a proportion of cumulative lending under mandate against the risk-sharing objective of 30%. It is recalled, however, that a full analysis of the actual sharing of risk between the Union budget and the EIB should also take account of operations signed on EIB own resources without the Community guarantee coverage under the Pre-Accession and Mediterranean Partnership Facilities as well as individual operations with the specific Article 18 authorisation of the Bank's Board of Governors. While these fall beyond the scope of this report, it is noted that most of the lending operations in the new Member States before accession were indeed carried out under the Pre-Accession facility. Including loans signed under these Pre-Accession Facilities into the overall risk-sharing proportion would increase this ratio from 18% up to around 50%.

On a regional basis, the risk-sharing objective was met and exceeded in **Asia and Latin America**, where 72% of loans were signed under the risk-sharing regime. This level of risk-sharing was enabled by the specific nature of the ALA mandate and the strategic objectives for EIB lending in that region placing a major focus on support to private European initiatives (foreign direct investment, transfer of technology and know-how).

Both in **South Eastern Europe** and in the **Mediterranean**, risk-sharing operations represented 11% of lending under mandate. In accordance with the programming procedures of the countries concerned, most projects financed by the EIB under mandate are in the public sector and therefore outside the scope of risk-sharing. Moreover, in the Mediterranean region, private-sector promoters experience difficulties to gain access to external (including European) banks willing to provide guarantees acceptable to the EIB under its current guidelines.

In the **Republic of South Africa**, 10% of loans were risk-sharing.

A summary of the regional breakdown of risk-sharing under mandate can be found in the following table, while tables 2.3.6 to 2.3.9 in Annex identify the individual risk-sharing loans signed during 2006.

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[11] 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".

Second General Mandate (Council Decision 2000/24/EC covering the period 01.02.2000 to 31.01.2007)

EUR million

	Mandate Ceilings Second General Mandate	Amount of loans signed at 31.12.2006	No. of loans signed with risk-sharing	Amount of loans signed with risk-sharing	Percentage of risk-sharing achieved (relative to mandate ceiling)	Percentage of risk-sharing achieved (relative to loan signatures)
SEN	9 185	9 142	33	1 003	11%	11%
Mediterranean	6 520	7 177[12]	13	807	12%	11%
ALA	2 480	2 425	38	1 756	71%	72%
RSA	825	837[13]	2	80	10%	10%
TOTAL	**19 010**	**19 581**[14]	**86**	**3 646**	**19%**	**18%**

Under the First General Mandate, a level of 24% of risk-sharing of total lending was reached against a target of 25%.. In terms of lending compared to the regional ceilings, the levels were 81% for ALA, 26% for Central and Eastern Europe Countries (CEEC) and 3% for the Mediterranean.

First General Mandate (Council Decision 97/256/EC covering the period 31.01.1997 to 31.01.2000)

EUR million

	Mandate Ceilings First General Mandate	Total amounts of loans signed at 31.12.2006	No. of loans signed with risk-sharing	Amount of loans signed with risk-sharing	Percentage of risk-sharing achieved (relative to mandate ceiling)	Percentage of risk-sharing achieved (relative to loan signatures)
CEEC	3 520	3 446	21	896	25%	26%
Mediterranean	2 310	2 310	5	71	3%	3%
ALA	900	900	17	730	81%	81%
RSA	375	375	0	0	0%	0%

12 Total signatures net of cancellations in Mediterranean: EUR 6 427 million.

13 Total signatures net of cancellations in RSA: EUR 764 million.

14 Total signatures before deduction of cancellations: EUR 19.58 billion.
Total signatures net of cancellations: EUR 18.28 billion.

fYRoM	150	150	0	0	0%	0%
TOTAL	**7 255**	**7 180**	**43**	**1 697**	**24%**	**24%**

2.3.4. EIB cooperation with the Commission and other institutions

The Bank and the Commission cooperate closely in order to prepare and co-finance EIB projects with a Union budgetary contribution. In 2006, EIB lending continued to be complemented with *interest subsidies* (4 new environmental loans in the Mediterranean), *technical assistance* (EUR 12.3 million in grants generally to finance feasibility studies, capacity building, project management or evaluation) as well as *Structural and Cohesion Funds* (in particular PHARE and ISPA).

In addition to the traditional forms of collaboration, the EIB was requested by the European Commission to *provide advisory services for the implementation of its support to the Risk Capital Facilit*y in South Africa. EIB's role is to advise the Commission in the design and establishment of the facility and then to participate in the technical evaluation and approval of the proposals for investment, without itself having any involvement in the financial management of the funds. In the Mediterranean, in addition to providing EIB loans from own resources, FEMIP also operates as a provider of private equity financed through the Union budget.

In 2006, a Memorandum of Understanding was signed between the European Commission, the European Bank for Reconstruction and Development (EBRD) and the EIB, to reinforce the cooperation of the three institutions in Eastern Europe and the Southern Caucasus, in Russia and in Central Asia. This enhanced cooperation aims to bring together the expertise, capacity and comparative advantages of each participant for the successful implementation of the European Neighbourhood Policy, the EU-Russia Strategic Partnership and the EIB and EBRD mandates, for the benefit of the partner countries involved.

More generally, EIB and Union budget financing is coordinated with European bilateral agencies (agreements with the *Agence Française de Développement*, the KfW Development Bank and the European Development Finance Institutions) and other International Finance Institutions (IFIs) whenever possible. Co-financing is actively pursued and has become a regular feature of EIB-supported projects. Joint action with institutions that are specialised in dealing with broader sectoral and policy issues ensures in many cases the effectiveness of sectoral reforms and increases the viability of investment projects that, once completed, are likely to operate within an improved regulatory framework. In 2006, 80% of EIB lending under the SEN mandate was co-financed with multilateral, bilateral and national institutions. In the Mediterranean, projects with co-financing represented 60% of EIB lending in the region. Co-financing contributions to projects financed by the EIB in South-Eastern Europe and in the Mediterranean are shown in tables 2.3.3 and 2.3.4 in Annex.

In **Asia and Latin America,** the Bank continued to finance projects that are of interest to both the Community and the country in which the project is implemented. Co-financing with IFIs is presented in Table 2.3.5 in the Annex, while the mutual interest of the individual loans signed in 2006 is described in Table 2.3.5 (a) in the Annex.

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

Total EIB lending in the ACP/OCT[15] amounted to EUR 745 million in 2006, of which EUR 167 million from the Bank's own resources and EUR 578 million funded by the European Development Fund (EDF)[16]. While these operations fall beyond the scope of this report[17], a summary of their regional and sectoral breakdown is presented in the Annex in 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 amend Decision 2000/24/EC to take into account the enlargement of the European Union and the European Neighbourhood Policy (Council Decision 2005/47/EC[18]).

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

South-Eastern Neighbours	**9 185**
Mediterranean countries	**6 520**
Latin America and Asia	**2 480**
Republic of South Africa	**825**
Turkey (Customs Union Special Action Programme (SAP))	**450**
Overall ceiling	**19 460**

The Community guarantee is restricted to 65% of the aggregate amount of the credits opened, plus all related sums (compared with 70% under the First General Mandate). Furthermore, 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 (Council Decision 2005/48/EC[19]). The overall ceiling of the credits opened is EUR 500 million and the EIB benefits from an exceptional Community guarantee coverage of 100%.

15 Africa, Caribbean, Pacific / Overseas Countries and Territories.

16 The resources of the Investment Facility may be used inter alia for ordinary loans, conditional, subordinated or participating loans, convertible bonds, guarantees and equity participations.

17 EIB Annual report 2006 on Investment Facility ACP EU Cotonou Partnership Agreement http://ww.eib.org.

18 OJ L 21, 25.1.2005, p. 9

19 OJ L 21, 25.1.2005, p. 11.

The guaranteed lending period expires on 31 January 2007 but will be automatically extended by six months if the lending ceilings have not been reached by this date. It is expected that the Bank will sign contracts for 2 projects totalling about EUR 230 million before the mandate expires.

During 2006 (the seventh year of the Second General Mandate) the EIB signed loan agreements for a total of EUR 2 805 million, bringing total lending under this mandate to EUR 18 280 million corresponding to 96% of the ceiling.

The detailed situation relating to guarantees is set out in the six-monthly report by the Commission on guarantees covered by the general budget[20].

On 19 December 2006, the Council decided to grant a Community guarantee to the EIB against losses under loans and loan guarantees for projects outside the Community (Council Decision 2006/1016/EC[21]). 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 the EIB financing operations carried out under this mandate is EUR 27 800 million through the 2007-2013 period, consisting of a basic ceiling of EUR 25 800 million and an optional mandate of EUR 2 000 million the activation of which will be decided by the Council based on the outcome of the midterm review in 2010.

The different regional ceilings (indicative sub-ceilings shown in *Italics*) are as follows (in EUR million):

Pre-Accession countries			**8 700**
Neighbourhood and Partnership countries			**12 400**
	Mediterranean	***8 700***	
Eastern Europe, Southern Caucasus and Russia		***3 700***	
Asia and Latin America			**3 800**
	Latin America	***2 800***	
	Asia	***1 000***	
Republic of South Africa			**900**
Basic ceiling			**25 800**
Optional mandate			**2 000**

20 COM(2007) 66 and SEC(2007) 241.

21 OJ L 414, 30.12.06, p.95.

3.2. Interest Subsidies

Interest subsidies were granted under a number of Community programmes both inside and outside the Union. Most of these programmes have been completed and no longer have any impact on budgetary expenditure. In the Annex, Table 2.5 lists the programmes which are still under way and the amount of interest subsidy paid during the years under review.

3.3. EIB financing from EDF resources

Under the successive Lomé Conventions and the Cotonou Agreement, the EIB carries out financing operations in the ACP region, which are funded by the EDF budget[22]. A breakdown of the operations is given in the Annex (see section 2.4).

[22] These operations are outside the scope of this report.