

Community loans to third countries: Guarantee Fund and new Member States, transfer from the Fund to the budget

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The Guarantee Fund for external actions was set up by Council Regulation 2728/94/EC *establishing a Guarantee Fund for external actions*. For a summary of the Regulation see CNS/1993/1004. The main purpose of the Fund is to ensure that Community creditors can be reimbursed in the event of any default by the beneficiaries of loans granted or guaranteed by the Communities. The Fund covers the risk of loans and loan guaranteed to third countries. Its main task is to act as a “shock absorber” for the EU’s budget.

Three different lending instruments benefit from the guarantee namely:

- guarantees of the European Investment Bank (EIB) **external lending**;
- Euratom **external lending**; and
- Macro-financial Assistance (MFA) **loans to third countries**.

In 1994 a second amendment to the Regulation was adopted, which stipulates that in cases where a third country becomes a Member State of the European Union, the Fund’s coverage of the corresponding guaranteed lending is withdrawn and the Union budget will directly cover these guarantees. Accordingly, and as a result of this amendment, in early 2005 a total amount of EUR 339 million was reversed to the Community budget, with a resulting reduction in the EU’s budget.

Performance of the Fund: 2003-2006:

The Commission report states that the Fund has fulfilled its main objective efficiently. It has prevented any disruption of budgetary implementation that would otherwise have occurred as a result of defaults on lending operations guaranteed by the Union budget. Had it not been for the Fund, the Communities would, on several occasions, have had to use budgetary resources to pay for activations of guarantees resulting in a redeployment of appropriations in the course of the budget’s implementations. Since 2003, four calls, totalling EUR 9.2 million have been handled through Fund. All concerned guarantees issued to the EIB for loans in the Republic of Argentina. The Fund has recovered all capital and interest due from the Republic of Argentina. Only penalty interest of USD 1.4 million or EUR 1.2 million are still to be recovered by the Fund.

The Commission points out though that the recent low default related losses should not be mistaken as a sign of decreased risk for the Fund. In the case of a civil war situation, for example, the calls on the Fund could increase substantially – as witnessed with the former Federal Republic of Yugoslavia.

Concerning the Fund’s assets, the report states that the volume of the Fund has decreased since 2001 when the Fund reached its peak of EUR 1.8 billion. This decrease is mostly a result of the accession of ten new Member States in May 2004. A further significant development is the decision by the Commission to present its financial statements according to the IPSAS inspired principles in 2005. This could impact upon the valuation of the fund’s portfolio.

On the matter of budgetary discipline the Commission points out that as of 2007 the reserve mechanisms will cease to exist in its present form. Budgetary discipline will be maintained through other mechanisms. For example:

- The EIB's multi-annual external lending mandate will be limited over the 2007-2013 period;
- Macro-financial Assistance loans are subject to individual decisions by the Council; and
- Euratom lending has a ceiling of EUR 4 billion, of which around 85% will have already been used. The remaining margin stands at around EUR 600 000.

New provisioning mechanism:

In April 2005, the Commission adopted a proposal for a new provision mechanism for the Fund. (See CNS /2005/0025). The proposed new mechanism is based on provisioning linked to the outstanding amount of loans and guaranteed loans – i.e. on actual net disbursements or disbursements minus amortizations minus cancellations. Thus, under the new system, only one single annual transfer will be needed – contrary to the existing system whereby several annual transfers between the Fund and the Budget are undertaken. The single annual transfer is determined as the difference between the target amount of the Fund at year-end and the value of the Fund's assets at year end.

In order to maintain the Fund' main purpose (to act as a shock absorber for the budget) a smoothing mechanism has been introduced in the proposal, which will cap the annual amounts to a maximum of EUR 100 million per annum. This means that losses exceeding this cap will be paid back into the Fund over several years.

The Commission believes that the main advantages of a new provision mechanism are:

- Improved efficiency of budgetary means and a reduced number of annual transfers between the Union budget and the Fund. And
- Provisioning based on the variations of the observed net-disbursements, thereby creating greater transparency and improving the precision of the budgetary programming.

The new provisioning is a "technical" improvement. It does not change the principle of the Fund namely that the value of its assets should be equivalent of the target amount (9% times the total amount of outstanding guaranteed lending.). Further, the new provision will be much stricter in maintaining the relation between the amount of guaranteed loans and the assets of the Fund. The overall budgetary needs, during the forthcoming Financial Framework, will under the new mechanism, remain substantially lower than would be the case under the present mechanisms.

At the same time, the Commission gives warning that "shocks" such as important calls on the Fund or outflows due to the accession of new Member States or IPSAS-accounting standards-induced fluctuations, will have a direct impact on the funding needs for the Fund. As a result, any slightly higher volatility of the provisioning needs, which is the price for the improved mechanisms, will have to be absorbed in budgetary terms.

Outlook:

In early 2007, upon the accession of Bulgaria and Romania to the EU, an amount of about EUR 260 million will be reversed from the Fund's assets to the Union budget – thereby reducing the size of the Fund.

The report also ponders the role of the EIB in managing the assets of the Fund, on behalf and under the supervision of, the Commission. Experience has shown that the Bank has always performed this task most satisfactorily. The cost of this arrangement has, however, been raised. A further issue are the fees the EIB receives from the management of the Fund's assets. The Commission is, therefore, evaluating whether it should take over the management of the Fund's assets itself.

To conclude, the report notes that since 1994 the Fund has performed its main tasks satisfactorily. The new Commission proposal, if adopted, will improve budget efficiency considerably. At this stage, no further legislative proposal is required. However, a new comprehensive report will be finalised in 2010 at the latest – or at an earlier stage if there is a need to change the parameter of the Fund.