



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

**LIMITS IMPOSED BY THE GUARANTEE FUND MECHANISM ON  
COMMUNITY LOANS AND LOAN GUARANTEES  
IN RESPECT OF THIRD COUNTRIES**



## 1. INTRODUCTION

The Guarantee Fund has been in existence on a legal basis since 31 October 1994.<sup>1</sup> Payments into the Fund are drawn from the guarantee reserve, representing the amount of provisions made on new loan and loan guarantee operations outside the Community. The annual amount of the reserve is entered in the financial perspective and represents a constraint which indirectly limits the Community's loan and loan guarantee capacity in respect of third countries.

This constraint is such that if the amount of the reserve and the guarantee mechanism remain unchanged, it would be impossible simply to renew the EIB's multiannual loan allocations at their present level while maintaining a minimum macro-financial assistance capacity. The European Council meeting in Cannes confirmed the Union's intention of strengthening its financial cooperation with partner third countries, in particular the central and east European countries (CEECs) and the Mediterranean countries (MED). The European Council also agreed to increase the appropriations for direct budget aid which the Community provides for these countries. This communication explores the various options for reconciling the objectives which the Union might wish to adopt with regard to loans to third countries with the budget discipline imposed by the guarantee mechanism established to protect the Community budget from possible default by its debtors.

The Commission also recently presented the report the Council had requested concerning the advisability of reducing the extent of the guarantee granted in respect of EIB loans to third countries. In the next few months, the Commission intends to propose the renewal of guarantees on allocations for EIB loans mobilized in respect of third countries. These proposals will take account of the conclusions which the Council might wish to draw on the basis of the present communication and of the report on guarantees in respect of EIB loans.

## 2. THE DISCIPLINE IMPOSED BY THE GUARANTEE MECHANISM

In the main, the action covered by the Guarantee Fund mechanism consists of:

- operations guaranteeing EIB loans outside the Community;
- Euratom operations outside the Community;
- loans for macrofinancial assistance to third countries.

The Community's macrofinancial assistance to third countries is of a one-off, exceptional nature and is liable to vary considerably, up or down, from one year to the next. On the other hand, EIB and Euratom loan decisions are necessarily reflected in multiannual commitments. The EIB and Euratom loans taken into account in the provisioning of the Guarantee Fund are determined on the basis of

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<sup>1</sup> Council Regulation (EC, EURATOM) No 2728/94 of 31 October 1994, OJ No L 293, 12.11.1994.

scheduled signatures of such loans, as shown in the financial statements attached to Council Decisions.

The Guarantee Fund is provisioned only for operations decided by the Council after 1 January 1993. Much of the EIB's present lending activity to third countries (the bulk of the commitments in the Mediterranean) stems from the implementation of allocations approved prior to 1 January 1993. For this reason, the provisioning basis should broaden from 1997, when allocations for EIB loans to Mediterranean third countries will have to be renewed. The volume of operations covered by the provisioning mechanism will therefore automatically will be substantially increased from 1997.

The constraint imposed by the guarantee mechanism which would then cover all the lending and guarantee activities in relation to third countries will be such that it seems impossible simply to maintain operations at their present level. The volume of loans authorized by the guarantee mechanism is between ECU 2 300 million and ECU 2 500 million a year whereas the expected volume of loan and guarantee operations, without envisaging any increase in the allocations, should be between ECU 2 800 million and ECU 3 100 million a year.

If none of the present rules is changed, there will be a shortfall equivalent to some ECU 600 million a year in the lending capacity required in order simply to maintain the financial allocations at their present level beyond 1996. Before these allocations are renewed in any way, choices will therefore have to be made so as to ensure that the Community's external financial commitments are compatible with the discipline imposed by the guarantee mechanism.

Here, there are four variables to be taken into consideration:

(i) The amount of financial commitments for loans and loan guarantees

These commitments were of the order of ECU 2 300 million in 1994, ECU 585 million of which were for macrofinancial assistance measures, while some ECU 1 700 million related to the EIB's external lending activities. This amount is determined by individual loan decisions (e.g. macrofinancial assistance to the Ukraine), individual loan guarantee decisions (e.g. EIB loan to South Africa), and decisions on guarantee allocations (e.g. EIB allocations for CEECs).

(ii) The amount of the budget reserve for guarantees from which payments are made into the Guarantee Fund

This reserve is entered into the financial perspective to 1999. It is ECU 323 million in 1995 and will rise to ECU 356 million in 1999. The reserve allows a lending capacity of ECU 2 200 million or so in 1995, which could rise to ECU 2 500 million or so in 1999.<sup>2</sup>

(iii) The rate of coverage of the guarantee granted by the Community budget for EIB loans

This rate is currently 100% for all loans signed, except loans to Mediterranean third countries, which are covered by a blanket guarantee of 75% of the outstanding amount.

(iv) The provisioning rate of the Guarantee Fund

This was 14% when the guarantee mechanism came into force at the end of 1994. Because the Guarantee Fund was activated to cover defaults, this rate rose to 15% at the beginning of 1995 for all new operations, under the terms of the Fund Regulation. Also according to the Regulation, the rate is to be reviewed when the Guarantee Fund reaches 10% of the guaranteed outstanding amount, and in any case no later than 1999.

### 3. POSSIBLE OPTIONS

#### 3.1 **No change in the guarantee mechanism. No change in the guarantee reserve. Lending and guarantee operations are adjusted downward.**

This option consists of adjusting our loan and guarantee operations to the lending capacity authorized by the guarantee reserve and the guarantee mechanism in force. Given the multiannual measures already approved or in the course of adoption (e.g. Euratom, EIB loans to South Africa or Turkey), the real capacity for new loans and guarantees is only ECU 1 800 million in 1997. This is not enough to renew the EIB's multiannual allocations at the present nominal level (i.e. approximately, each year, ECU 250 million for the developing countries in Latin America and Asia (DCLAA), ECU 1000 million for the CEECs, ECU 620 million for the MED countries, ECU 150 million for South Africa)<sup>3</sup>. This capacity is even less adequate in view of the need to allow for a loan capacity for macrofinancial assistance operations, which are not multiannual, and which would thus be ruled out since there would be no balance available out of the guarantee reserve.

#### 3.2 **Increasing the loan and guarantee capacity by increasing the budget reserve for guarantees.**

This option consists of softening the budget constraint by adjusting budget funds in line with the objectives which the Union might adopt in this area. This choice means that the financial perspective to 1999 would have to be revised.

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<sup>3</sup> Such a renewal in nominal terms would actually mean a slow decrease in real terms. On the residual loans capacity, see Annex I.

An increase in the reserve of the order of ECU 100 million would enable EIB operations and macrofinancial assistance to be maintained at their present level.

On the hypothesis that the Union wished to increase the allocations for EIB loans to CEECs and to the MED countries by an amount comparable for instance to the increase agreed at the Cannes European Council for budget appropriations in favour of these countries, this would mean multiannual allocations for loans of some ECU 350 million a year for the DCLAA, ECU 1000 million a year for the MED countries and ECU 1 500 million a year for the CEECs (this apportionment would be in line with the equilibrium of budget funds approved at Cannes between the CEECs and the MED countries). In order to attain this target while maintaining a reasonable margin of manoeuvre (some ECU 700 million per year) for macro-financial assistance the guarantee reserve would have to be increased by some ECU 220 million a year from 1997.

### **3.3 No change in the reserve. Increase in the loan and guarantee capacity by changing the guarantee rate on EIB operations**

This option is specifically assessed in the report which the Commission recently presented at the Council's request. One of the points taken into account by the assessment is the wish to limit the Community budget's exposure and the need to keep the Bank's credit rating intact, so as to guarantee that it has access to the financial markets on the most favourable terms.

Except for the MED countries where the rate of guarantee is 75% of the outstanding amount, the rate is now 100% of the outstanding amount by region (CEECs, DCLAA, South Africa), and could be brought down.

Assuming that the rate of guarantee is reduced to 75% for all the EIB's external operations, and on the basis of maintaining macrofinancial assistance at its 1994 level, the capacity for new EIB loans would increase by some ECU 400 million, from ECU 1 200 million to ECU 1 600 million or so in 1997.<sup>4</sup> Unless the Community's capacity for macrofinancial assistance is reduced further, this amount is insufficient to renew the EIB's loan allocations at their present level.

This option is with all the more reason insufficient to allow the proposed increase in the multiannual allocations for EIB loans, in line with the budget appropriations agreed at the Cannes European Council.

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<sup>4</sup> See Table, Annex I.

### **3.4 No change in the reserve. Increase in the loan and guarantee capacity by reducing the provisioning rate**

The Guarantee Fund Regulation foresees that, when the amount of the Fund reaches the target amount of 10% of the outstanding amount, the provisioning rate will be reviewed. It would then be consistent to reduce this rate, presently 15%, down to 10%.

The Guarantee Fund would reach its target amount by the end of 1997 if no substantial defaults arise meanwhile. Possible defaults could however delay a revision of the provisioning rate.

Any change of the provisioning rate before 1999, and before the Fund reaches its target amount, requires a modification of the Regulation.

Reducing the provisioning rate from 15% to 12% is insufficient to renew EIB allocations at their present level while maintaining macrofinancial assistance at a level close to that of 1994, unless it is assumed that the guarantee on EIB operations is at the same time reduced to 75% (see Annex 2, Table B). However, reducing the provisioning rate to 12% is not sufficient to increase the multiannual allocations for EIB loans, in line with the budget appropriations agreed at Cannes, even if the rate of guarantee of EIB operations is reduced to 75%.

If the provisioning rate on new operations is reduced to 10%, it will be possible to renew the EIB multiannual allocations at their present level while maintaining our capacity for macrofinancial assistance, and to increase the allocations in the proportions envisaged at Cannes for budget appropriations, provided the guarantee rate for the EIB is cut to 75% (see Annex 2, Table C).

However, the disadvantages of such changes in the provisioning rate are that the Guarantee Fund will be established more slowly (especially if it is required to cover large defaults), and the date at which the target amount of the Guarantee Fund (10% of the guaranteed outstanding amount) could be attained will be postponed by several years. Moreover, slowing the establishment of the Fund increases the risk of falling below 50% of the target amount in case of significant defaults. In such a case, if the exceptional refinancing measures envisaged in the Regulation consist of drawing on the reserve for guarantees, then the expected outcome pursued by reducing the provisioning rate could be neutralized.

**CAPACITY FOR LOANS AND LOAN GUARANTEES TO THIRD COUNTRIES  
ALLOWED FOR BY THE GUARANTEE FUND MECHANISM  
as of 7.6.1995**

	mio ECU					
	1994	1995	1996	1997	1998	1999
1. Reserve	318	323	326	336	346	356
2. Scheduled - operations (a)	1818	1827	1893	452	375	412
- provisioning (b)	254.52	260.5	269.25	65.88	54.25	58.88
3. Margin	24.28 (*)	62.50	56.75	270.13	291.75	297.15
<b>4. Capacity for new loans</b>		<b>417</b>	<b>378</b>	<b>1801</b>	<b>1945</b>	<b>1981</b>
5. 1994 level of operations	<b>2341</b>					
- macro-financial assistance	<b>585</b>					
- EIB 1994 external operations signatures	<b>1756</b>					
Scenario						
6. Provisioning assuming macro-financial assistance at 1994 level		38.25	87.75 (c)	87.75	87.75	87.75
7. Reserve headroom for additional EIB operations (3-6)		24.25	0	182	204	209
8. Potential EIB loans						
- guaranteed at 100%		162	0	1216	1360	1396
- guaranteed at 75%		216	0	1621	1813	1861

(a) On the basis of operations decided, proposed and under preparation.

Includes provisioning on the Euratom loans on the basis of scheduled signatures until 1999. Excludes EIB envelopes in the Mediterranean, which are not presently subject to provisioning (approved before the 1.1.1993).

(b) 14% rate for operations approved between 1.1.1993 and 1.1.1995. 15% rate for operations as from 1.1.1995

(c) In 1996 the reserve would not allow for the assumed macro-financial assistance level.

(\*) Provisions on 1993 operations have also been deducted from the 1994 reserve.

ANNEX 2  
TABLE A

**Implementation of the Guarantee Fund Mechanism**  
Low hypothesis

	ECU million	1995	1996	1997	1998	1999
Reserve		323	326	336	346	356
<b>EIB commitments</b>						
MED		62	223	792	772	732
CEECs		1121	1114	1000	1000	1000
ALA		139	361	250	250	250
South AF.		125	175	150	150	150
Total EIB		1447	1873	2192	2172	2132
<b>EURATOM commitments</b>		50	200	200	200	200
<b>Total commitments for projects</b>		1497	2073	2392	2372	2332
Average provisioning rate		14.1	14.3	15	15	15
Required provisioning of Guarantee Fund		211	288	329	327	322
<b>Balance of payments loans</b>		700	700	700	700	700
Provisioning rate		15	15	15	15	15
Required provisioning of Guarantee Fund		105	105	105	105	105
Total provisioning of Guarantee Fund		316	393	434	432	427
<b>Budgetary margin (+) or requirement (-)</b>		7	-67	-98	-86	-71
Total external commitments		2197	2773	3092	3072	3032
Loan capacity allowed by the Guarantee Fund mechanism		2243	2323	2438	2500	2556
Residual capacity (+) or requirement (-)		46	-450	-654	-572	-476

**Characteristics of the low hypothesis:**

1. Mediterranean: renewal at the end of 1996 of the allocation at its existing level, i.e. ECU 3 100 million from 1997 to 2001. Turkey: ECU 150 million per annum committed from 1996.
2. CEECs: renewal at the end of 1996 of the allocation at its existing level, i.e. ECU 3 000 million per annum from 1997 to 1999.
3. South Africa: implementation of the decision in 1995, renewal at a similar level from 1997.

NB: The ECU 700 million for macrofinancial assistance are a margin for action rather than a forecast. Lending capacity is calculated here by taking account, from 1996, of the 75% coverage rate on EIB operations in the Mediterranean. It is not therefore directly derived from the amount in the reserve.

**Low hypothesis: variant with the guarantee on all  
EIB operations lowered to 75% in 1996.**

	en Mécus	1995	1996	1997	1998	1999
Provisioning required of Guarantee Fund		316	346	382	379	375
<b>Budgetary margin (+) or requirement (-)</b>		7	-20	-46	-33	-19

**Variant on the low hypothesis:**

The guarantee on all EIB external operations is reduced from 100% to 75% of outstanding loans from 1996. Linear application from 1996 of the 75% out of the level for which provisioning exists.

ANNEX 2  
TABLE B

**Implementation of the Guarantee Fund Mechanism**

Low hypothesis

Variant: provisioning rate lowered to 12% in 1996 and EIB guarantee to 75%

	ECU million	1995	1996	1997	1998	1999
Reserve		323	326	336	346	356
<b>EIB commitments</b>						
MED		62	223	792	772	732
CEECs		1121	1114	1000	1000	1000
ALA		139	361	250	250	250
South AF.		125	175	150	150	150
Total EIB		1447	1873	2192	2172	2132
<b>EURATOM commitments</b>		50	200	200	200	200
<b>Total commitments for projects</b>		1497	2073	2392	2372	2332
Average provisioning rate		14.1	14	12.3	12.2	12.1
Required provisioning of Guarantee Fund		211	225	227	223	218
<b>Balance of payments loans</b>		700	700	700	700	700
Provisioning rate		15	12	12	12	12
Required provisioning of Guarantee Fund		105	84	84	84	84
Total provisioning of Guarantee Fund		316	309	311	307	302
<b>Budgetary margin (+) or requirement (-)</b>		7	17	25	39	54
Total external commitments		2197	2773	3092	3072	3032
Loan capacity allowed by the Guarantee Fund mechanism		2243	2946	3344	3461	3575
Residual capacity (+) or requirement (-)		46	173	252	389	543

ANNEX 2  
TABLE C

**Implementation of the Guarantee Fund Mechanism**

Variant: EIB allocations increased, guarantee rate on new allocations for EIB operations in third countries is lowered to 75% in 1996.  
Provisioning rate lowered to 10% in 1996.

	ECU million	1995	1996	1997	1998	1999
<b>Reserve</b>		323	326	336	346	356
<b>EIB commitments</b>						
MED		62	223	1172	1152	1112
CEECs		1121	1114	1500	1500	1500
ALA		139	361	350	350	350
South AF.		125	175	150	150	150
<b>Total EIB</b>		1447	1873	3172	3152	3112
<b>EURATOM commitments</b>		50	200	200	200	200
<b>Total commitments for projects</b>		1497	2073	3372	3352	3312
Average provisioning rate		14.1	14	10.4	10.4	10.3
Required provisioning of Guarantee Fund		211	225	268	267	261
<b>Balance of payments loans</b>		700	700	700	700	700
Provisioning rate		15	10	10	10	10
Required provisioning of Guarantee Fund		105	70	70	70	70
<b>Total provisioning of Guarantee Fund</b>		316	295	338	337	331
<b>Budgetary margin (+) or requirement (-)</b>		7	31	-2	9	25
<b>Total external commitments</b>		2197	2773	4072	4052	4012
<b>Loan capacity allowed by the Guarantee Fund mechanism</b>		2243	3086	4050	4145	4262
<b>Residual capacity (+) or requirement (-)</b>		46	313	-22	93	250

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# DOCUMENTS

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