

COMMISSION OF THE EUROPEAN COMMUNITIES

COM(89) 627 final

Brussels, 5 January 1990

Proposal for a
COUNCIL DECISION

providing medium-term financial assistance for HUNGARY

(presented by the Commission)

A MEDIUM TERM LOAN TO HUNGARY

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I. THE BACKGROUND

In a letter addressed to the President of the ECOFIN Council and to the President of the Commission on November 15, the Prime Minister of Hungary requested EC financial assistance. The Minister of Finance of Belgium (a country which represents Hungary at the IMF) had foreshadowed such a request already in September when he suggested that a medium term balance of payments loan be extended to Hungary. Reference to such financial assistance to Hungary is also to be found in the Commission's 25 September action plan for Poland and Hungary. The General Affairs Council on 3 October received favourably the Commission's action plan.

At the meeting of the members of the European Council in Paris on Saturday November 18, the Community's leaders endorsed financial assistance to Hungary, subject to an agreement with the IMF - the conclusion of which the Community leaders expressed the wish to see expedited.

The Hungarian government have always considered free access to capital markets to be a key element of their financial policy. However, with its foreign debt steadily increasing (it now stands near \$ 20 bn), Hungary's debt servicing capability is being further hampered by a deterioration of the current balance (-\$ 1.5 bn in 1989).

Hungary's request for medium term financial assistance is justified on several grounds.

- first such a loan will be a concrete expression of the Community's support to Hungary's political move towards democracy.
- second, a medium term loan will help financially to restructure Hungary's foreign debt helping it to refinance maturities on financial markets.
- third, a medium term loan would make sense economically, for it will allow Hungary to implement structural reforms with medium term positive effects on the country's debt servicing capability.

II. FEATURES OF THE LOAN THE COMMUNITY SHOULD BE CONSIDERING

For these three reasons, the Community should respond positively to Hungary's request for medium term financial assistance.

The proposed loan should have as an added feature, a quick disbursing, sizeable first tranche. In order to meet its financial obligations, Hungary will need significant new foreign credit in the first quarter of 1990. Front-loaded financial support should accompany a front loaded (i.e. an accelerated) reform programme, while helping the country preserve its creditworthiness. Hungary has regularly serviced its debt and has never asked the Paris Club for debt rescheduling.

The setting up of a medium term facility for Hungary would be an exceptional, non recurrent measure, tailored to Hungary's particular situation.

The terms and conditions of a Community loan to Hungary should be fully supportive of related assistance efforts by other institutions and non-member countries. The terms of the forthcoming IMF programme will reflect the amount of external assistance that Hungary will be receiving.

III. SETTING THE GUIDELINES FOR THE COMMISSION'S NEGOTIATION WITH THE HUNGARIANS

The Commission should be empowered to proceed according to the following guidelines.

First, the Community's offer should be clearly subject to Hungary's reaching an agreement with the IMF.

Second, since Hungary's foreign debt is owed mostly to private creditors, financial support from the Community should be based on an understanding between Hungary and its banking syndicates that Hungary's present mix of public and private obligations will remain unchanged. The country will be requested to negotiate at once with its creditor banks to secure fresh private money.

Third, the terms and conditions associated to financial support for Hungary put forward by the Commission will have to take into consideration both the need for structural reforms of the Hungarian economy and the need for consistency with the terms and conditions of a macroeconomic nature put forward by the IMF. They should focus on activating market mechanisms; on fostering demonopolisation and entrepreneurship; on promoting price deregulation and financial intermediation; and on reducing public subsidies, -- all with the help of external support.

Both micro- and macroeconomic conditions are needed; Community assistance (and its terms) should be consistent with those agreed with the IMF and the World Bank.

The disbursement by tranches should facilitate the periodic review of Hungarian policy and its implementation.

IV. LEGAL AND BUDGETARY ASPECTS

By offering medium term financial support to Hungary, the Community would be breaking new ground.

- First, it will help a non Member State progress towards democracy and a market economy.
- Second, it will be assuming a significant risk, different from the one associated with balance of payments lending to Member States.

The procedure will be founded on article 235 of the Treaty.

II

(Preparatory Acts)

COMMISSION

Proposal for a Council Decision providing medium-term financial assistance for Hungary

COM(89) 627 final

(Submitted by the Commission on 6 December 1989)

(90/C 20/08)

THE COUNCIL OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Economic Community, and in particular Article 235 thereof,

Having regard to the proposal from the Commission,

Having regard to the opinion of the European Parliament,

Having regard to the action plan adopted by the Commission on 25 September 1989,

Having regard to the conclusions of the General Affairs Council of 3 October, reiterated in the agreements of the special meeting of the European Council on 18 November,

Whereas the people of Hungary have close historic links with the people of the Community, and whereas that country is undertaking fundamental political and economic reforms and has decided to adopt a market economy model;

Whereas these reforms will strengthen mutual confidence and bring Hungary closer to the Community;

Whereas the granting of the medium-term loan is an appropriate measure to facilitate the adjustment of the Hungarian economy in order to reap the full benefits of an economy based on market principles; whereas the conditions and terms of the loan should emphasize necessary structural adjustment as well as being consistent with the terms and conditions put forward by the IMF; whereas an agreement with the IMF on a stabilisation programme is necessary and should be concluded quickly; whereas assurances should be sought that Hungary has negotiated satisfactory terms with its private creditors to ensure their continued participation;

Whereas the economic reforms will contribute to mutually beneficial economic and commercial relations between Hungary and the Community; and whereas these relations will promote throughout the Community a harmonious development of economic activities;

Whereas examination by the Commission, in collaboration with the Monetary Committee, has shown a marked deterioration of the economic situation of Hungary;

Whereas the Hungarian Government has applied to the Community for a medium-term loan;

Whereas the Community should take the appropriate measures to cover itself against losses due to any failure on Hungary's part to fulfil the payments to the loan;

Whereas the authority required to set up this loan is not embodied in the Treaty,

HAS DECIDED AS FOLLOWS:

Article 1

The Commission is empowered to conclude, on behalf of the Community, a borrowing programme of a maximum of ECU 1 000 million with a duration of up to five years and to subscribe and execute all appropriate documents in that connection for the purpose indicated in Article 2.

Article 2

The Commission is authorized to lend the proceeds to Hungary in order to overcome structural adjustment problems. The Commission is empowered to negotiate and monitor implementation over time of a structural adjustment programme with the Hungarian authorities so as to facilitate the evolution of Hungary's economy towards a market orientated system in a stable macro-economic environment.

FINANCIAL RECORD

1. Budget line concerned

Article (998) guarantee for EEC loan to Hungary

2. References (legal base)

Article 235 of the Treaty

3. Classification of the Expenditure

Obligatory

4. Description and justification for the action

a) Description of the action

Creation of a facility (limited in time and subject to a ceiling) providing medium term financial assistance for Hungary.

b) Justification for the action

- Hungary needs financial assistance to overcome serious adjustment problems in its transition towards an economy based on market principles.

- The budget entry is intended to provide a budgetary support for guarantees offered by the European Community to cover loans extended to Hungary.

5. Nature of the expenditure and method of calculation

a) Nature of the expenditure

A guarantee to EEC loans.

b) Method of calculation

A token entry is proposed given that the amount and timing of any call on this budget line cannot be calculated in advance and furthermore it is to be hoped that this budget entry will not be called on.

6. Effect of the action on intervention credits

Only in the case of an effective call on the guarantee.

7. Financing of Intervention expenditure

- Endowment of the line by transfer, by reutilisation of reimbursed amounts (art. 22(3) of the Financial Regulation of 1977), or by amended and/or supplementary budget.

- In order to fulfill its obligations, the Commission can provisionally ensure the debt service with funds from its treasury. In that case, article 12 of the Council Regulation (EEC, Euratom) no.1552/89 of 29.5.1989 will apply.

