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I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 3/90

on

ECSC, Euratom and NCI loans and borrowings of the Communities together with the replies of the
Commission
(90/C 160/01)

*(Observations pursuant to Article 206a, paragraph 4, of the EEC Treaty and Article 78f,
paragraph 4, of the ECSC Treaty)*

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1. INTRODUCTION

*Scope**General*

1.1. The Commission of the European Communities is empowered, under the terms of the Treaties and other legislation, to borrow funds in order to make loans for specified purposes. The current level of activity is of the order of 3 000 Mio ECU per annum (refinancing included). The balance of borrowings outstanding at 31 December 1989 was almost 16 000 Mio ECU.

1.2. From the Community's point of view, the practice of borrowing funds to make loans offers the considerable advantage of gaining the maximum impact on Community objectives at minimum cost. The proceeds of borrowing can be on-lent at rates calculated to cover the cost of borrowing together with the associated administrative costs. The return by way of interest and capital on loans can be utilized to service the original borrowings. As a result, no residual cost should fall on the Community. For the system to operate properly, however, it is essential that the Community's efforts in this direction should at least be competitive with other sources of investment finance such as commercial banks while remaining consistent with its own objectives.

1.3. The Court of Auditors has reviewed the Commission's management of these significant resources with particular attention to the economy and efficiency of the operations involved and the effectiveness of this form of intervention.

1.4. The Court does not question that the Commission should continue to retain responsibility for the loans and borrowing activities of the Commission as an independent means of intervention.

1.5. The Court's audit was concentrated on loans under Articles 54 and 56 of the ECSC Treaty, Euratom loans, New Community Instrument loans and borrowings under all three instruments. The Court's investigation related essentially to the instruments which provide the European Commission with the power to finance loans by borrowings. Accordingly, it did not cover loans from the European Investment Bank's (EIB) own resources or loans financed from the general budget of the European Communities. Nor did it cover loans and borrowings under the EEC Balance of Payments instrument although they are mentioned in this report for the sake of statistical and chronological completeness. As there was no agreement prior to June 1989 between the EIB, the Commission and the Court regarding the procedures for the implementation of the Court's on-the-spot audit of loan operations managed under mandate by the EIB, no on-the-spot tests were carried out in respect of Euratom and NCI loans.

Audit Approach

1.6. The study consisted of a review of the evolution of this activity since its inception in 1953; a systems-based examination of the current management of loans and borrowings; a series of missions to recipients of loans in some Member States supported by a wider circularization of customers throughout the Community; and an evaluation of the findings in terms of the objectives of the study. Account was also taken of the work of the Court in this field in recent years, particularly the 1982 special report on this subject ⁽¹⁾. It should be noted, however, that this report differs from the previous report in two important respects. Firstly, the 1982 report did not include the ECSC in its scope. Secondly, that report was mainly descriptive and critical of the establishment and management structure of

(1) OJ No C 319 of 6.12.1982.

Table 1 — Analysis of ECSC loans from borrowed funds

(Mio ECU)⁽¹⁾

	Disbursed to 21.12.1960 (estimate)	1961	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
I. Investments (Article 54)																														
Coal industries	133,45	1,2	6,6	4,3	23,2	31,5	18,7	8,6	23,8	6,8	—	17,5	7,6	54,2	62,2	160,9	179,9	216,9	262,5	237,6	233,2	30,6	256,3	257,2	12,7	—	103,6	283,2	—	43,4
Iron-ore mines	22,25	—	7,0	—	—	—	—	—	—	—	—	—	—	—	—	—	76,3	18,7	2,0	—	—	—	71,7	—	138,9	114,5	—	20,0	—	—
Steel industries	57,4	11,2	43,3	23,9	82,3	29,0	49,4	36,7	36,8	33,8	12,1	45,2	133,6	223,2	250,5	67,1	726,3	474,8	366,3	316,4	424,0	223,6	139,9	222,2	268,5	424,6	661,2	109,7	388,9	152,2
Thermal power-stations	—	—	—	—	—	—	—	—	—	—	1,8	4,3	7,1	0,6	11,3	—	—	—	35,1	41,1	90,0	26,6	40,9	128,4	65,8	60,8	8,7	123,3	9,1	—
Other	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	2,9	1,3	—	9,6	6,1	50,9	10,6	55,4	30,0	26,0	103,5	37,1	30,0
Total investments	213,1	12,4	56,9	28,2	105,5	60,5	68,1	45,3	60,6	40,6	13,9	67,0	148,3	278,0	324,0	228,0	982,5	713,3	667,2	595,1	756,8	286,9	559,7	618,4	541,3	629,9	799,5	639,7	435,1	225,6
II. Industrial reconversions (Article 56)	—	—	4,0	3,3	15,0	5,5	10,8	26,5	32,8	23,7	16,2	44,7	32,4	2,8	49,4	58,3	63,1	16,4	113,3	59,1	266,1	86,0	162,8	139,5	247,5	363,4	243,5	304,3	451,7	458,5
III. Workers' housing (Article 54(2))	20,1	2,0	1,6	14,2	2,1	—	—	—	—	1,1	—	—	0,8	0,8	0,4	0,5	4,0	1,7	1,4	3,9	3,3	5,3	2,0	10,4	16,9	10,4	8,4	13,5	9,0	5,7
Total (I+II+III)	233,2	14,4	62,5	45,7	122,6	66,0	78,9	71,8	93,4	65,4	30,1	111,7	181,5	281,6	373,8	286,8	1049,6	731,4	781,9	658,1	1026,2	378,2	724,5	768,3	805,7	1003,7	1051,4	957,5	895,8	689,8

⁽¹⁾ Until 1975 Mio UA, 1976-1980 EUA.

the more recent mechanisms while this report concerns itself more with the day-to-day management and the practical effects of loans and borrowings activities.

2. EVOLUTION OF THE INSTRUMENTS

Loans granted under the ECSC Treaty

2.1. Article 49 of the Treaty provides the ECSC with the power to contract borrowings as one means of funding the activities covered by the Treaty. Article 51 specifies, *inter alia*, that the High Authority/Commission may not use funds obtained by borrowing except to grant loans and that the High Authority/Commission shall not itself engage in the banking operations which its financial tasks entail.

2.2. Since the ECSC was not endowed with any capital at its inception in 1951, the first borrowings were conducted under special arrangements. In order to establish its creditworthiness and obtain access to money markets, the institution allocated part of the resources from a levy over the first years of its life to a guarantee fund. By 1961, the ECSC was able to dispense with the special arrangements and use its own assets to guarantee borrowings. Since that time, the ECSC has operated freely on financial markets, raising funds by public issue or by private loans from banks. It is ranked as a borrower of first-class status.

2.3. The funds raised by borrowings were used initially to co-finance investments in the coal and steel industries under Article 54(1) of the Treaty, with a small allocation to a scheme of housing for workers in these industries. *Table 1* shows the evolution of ECSC lending activity since 1960, the date from which consistent and comparable statistics were maintained. This indicates the substantial contribution to investment, particularly in the earlier years, and the growth in reconversion loans under Article 56 of the Treaty latterly. This trend is represented graphically in *Table 2*, which shows, in percentage terms, the share of total lending allocated to the various measures. Loans granted under Articles 54 and 56 may attract an interest subsidy financed out of the Operational budget of the ECSC. The following subsidy rates are applied:

(a) investment loans, three percent;

(b) reconversion loans:

(i) direct loans, two percent;

(ii) global loans, three percent;

(c) coal-consumption loans, three ECU per ton coal consumed.

Table 3 shows the volume of interest subsidies 1981 — 1989.

Loans granted under the EEC Treaty

Balance of payments loans

2.4. By 1975, loans and borrowings under the ECSC Treaty were well established, to the extent that the Community could be regarded, in effect, as an industrial development financing institution for the coal and steel industries. That year saw the next important development, with the introduction of the loan mechanism designed to support the balance of payments of Community Member States (BP) ⁽¹⁾. This measure was devised in response to the economic crisis caused by the increase in the price of petroleum products. It provided, subject to economic policy conditions determined by the Council for the lending to Member States of funds borrowed by the Community on the authorization of the Council. This mechanism has been amended twice. In 1985 the upper limit was raised from 6 000 to 8 000 Mio ECU. In 1988, under a new Regulation ⁽²⁾, the Council merged this mechanism with the medium-term financing facility — the other instrument for providing balance of payments support to Member States. The upper limit for loans granted under the new mechanism was set at 16 000 Mio ECU, 14 000 Mio ECU of which are normally financed by loans floated by the Community on the international capital markets.

(1) Council Regulation (EEC) No 397/75 of 17 February 1975, OJ No L 46 of 20.2.1975.

(2) Council Regulation (EEC) No 1969/88 of 24 June 1988, OJ No L 178 of 8.7.1988.

Table 2 — Analysis of ECSC loans from borrowed funds

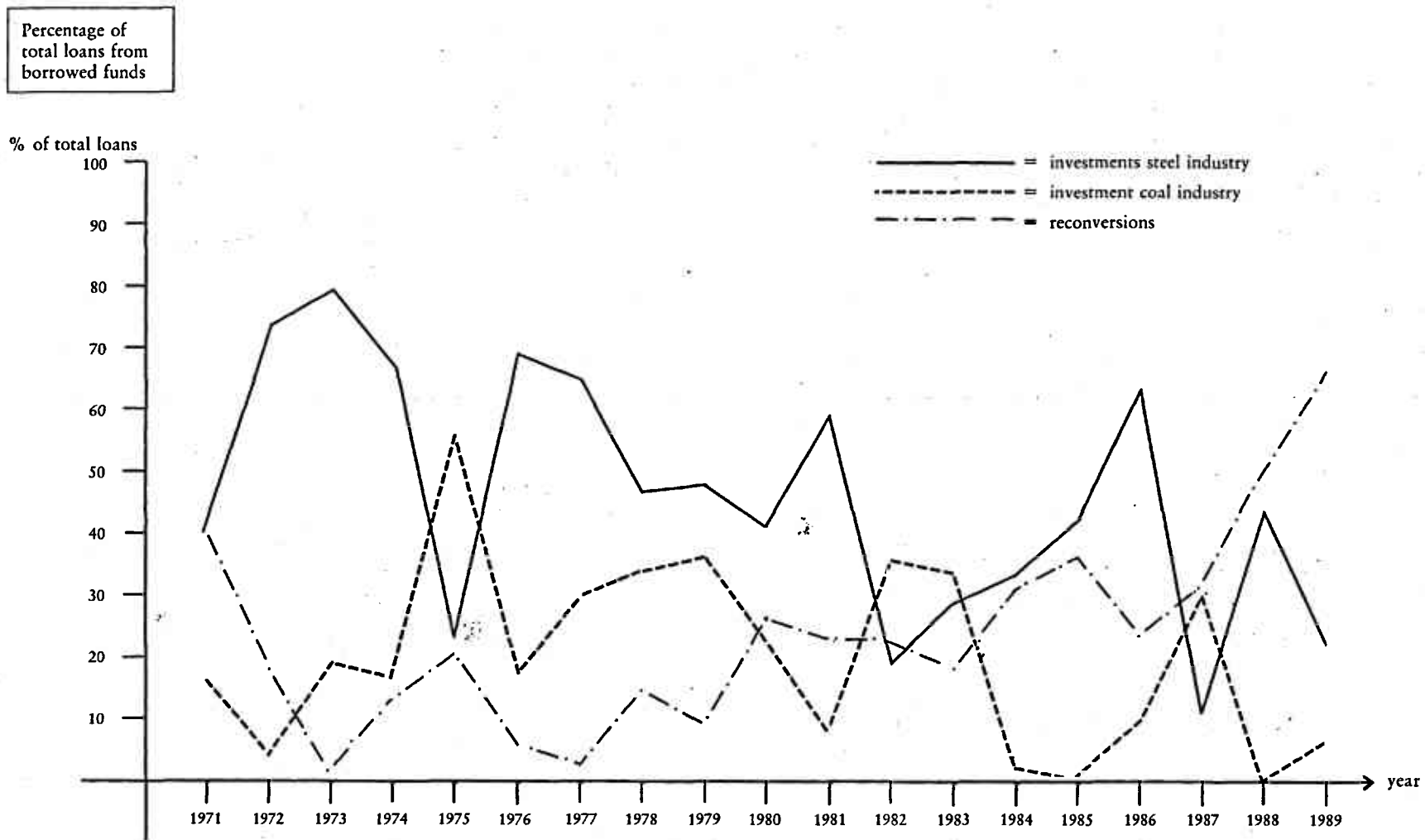


Table 3 — ECSC interest subsidies approved 1981-1989

(Mio ECU)

Article	1981	1982	1983	1984	1985	1986	1987	1988	1989	Total
54 (1) — Investment	7,0	5,8	1,7	3,3	—	1,1	—	—	—	18,9
54 (2) — Coal consumption	—	1,2	11,9	17,6	3,8	13,2	8,0	7,0	—	62,7
56 (2) — Re-conversion	26,2	38,9	44,0	63,0	60,0	70,5	40,3	55,3	60,7	458,9
Total	33,2	45,9	57,6	83,9	63,8	84,8	48,3	62,3	60,7	540,5

Euratom loans

2.5. As a further reaction to the energy crisis the Council, in 1977, gave the Commission power, on behalf of the European Atomic Energy Community (Euratom) to borrow funds for the purpose of making loans for the financing of nuclear power-stations ⁽¹⁾. The current ceiling for such loans is 3 000 Mio ECU.

New Community Instrument loans

2.6. Perhaps the most significant development concerning loans and borrowings occurred in 1978 when the Council approved the first interventions under the New Community Instrument (NCI). In order to stimulate economic activity and to take maximum advantage of the Community's standing on financial markets, the Commission was empowered to contract borrowings, the proceeds of which were to be lent to finance investment projects with certain specified objectives. To date the Council has approved four successive NCI programmes to a combined ceiling of 5 650 Mio ECU ⁽²⁾ together with two emergency programmes for the reconstruction of regions affected by earthquakes in Italy and Greece ⁽³⁾, of which 611 and 80 Mio ECU respectively were financed by the NCI. A Commission proposal for a fifth NCI programme did not receive Council approval.

⁽¹⁾ Council Decision 77/270/Euratom of 29 March 1977, OJ No L 88 of 6.4.1977.

⁽²⁾ — Council Decision 78/870/EEC of 16 October 1978, OJ No L 298 of 25.10.1978.

— Council Decision 82/169/EEC of 15 March 1982, OJ No L 78 of 24.3.1982.

— Council Decision 83/200/EEC of 19 April 1983, OJ No L 112 of 28.4.1983.

— Council Decision 87/182/EEC of 9 March 1987, OJ No L 71 of 14.3.1987.

⁽³⁾ — Council Decision 81/19/EEC of 20 January 1981, OJ No L 37 of 10.2.1981.

— Council Decision 81/1013/EEC of 14 December 1981, OJ No L 367 of 23.12.1981.

European Investment Bank

2.7. Although the activities of the EIB, other than its role as an agent of the Commission, are not covered by this study, the EIB is, in fact, an important constituent of the loans and borrowings instruments of the Communities. Established in 1958 under the Treaty of Rome, the EIB has become a highly significant source of development and investment finance. Its activity supplements and complements the interventions not only of the other loans and borrowings instruments but also those of the structural funds of the Communities. It pioneered the increasingly popular technique of global loans whereby large loans are made to recognized financial institutions for allocation, as smaller sub-loans, to approved projects.

Administration of the EEC loan instruments

2.8. The EEC loans and borrowings are administered on an extra-budgetary basis and are set out in the balance sheet of Community assets and liabilities.

2.9. The Commission has a direct legal obligation to service and repay borrowings contracted by it on behalf of the EEC. For this purpose the Commission's section of the general budget includes token entries which represent the budgetary guarantee for the EEC borrowing mechanisms as a precaution against any possible default by beneficiaries of the loans and primary guarantees.

2.10. BP loans are granted by the Council, the European Monetary Cooperation Fund ⁽⁴⁾ making the necessary arrangements for the administration of the loans.

⁽⁴⁾ Council Regulation (EEC) No 3181/78 of 18 December 1978, OJ No L 379 of 30.12.1978.

2.11. Euratom loans are granted by the Commission and administered by the EIB as the Commission's agent.

2.12. In the case of NCI loans, the Commission decides on the eligibility of projects while loans are granted and managed by the EIB under mandate from the Commission and at the latter's risk. In so doing, the EIB is required to exercise the same care as it would in operations involving its own resources.

2.13. The borrowings for all three EEC loan instruments are contracted by the Commission. In the case of NCI borrowings, the proceeds are, in most instances, transferred to a treasury account held and operated by the EIB at its own risk. All operations involving these loans are carried out through this treasury. On the other hand, a number of NCI borrowings are re-lent directly on a back-to-back basis, which consists of re-lending the same amount in the same currency for the same term.

Summary

2.14. At 31 December 1989 therefore the Communities had a variety of loans and borrowings instruments at their disposal for contributing to the achievement of their economic and social objectives. These range from the strictly sectoral (ECSC, Euratom), to the more flexible NCI and EIB mechanisms, to the particular economic context of BP loans. The utilization of these measures is demonstrated in *Table 4* which records the annual level of activity for each instrument from 1975 (when the first of the new measures was introduced) to 1989.

3. OBSERVATIONS ON THE MANAGEMENT OF THE INSTRUMENTS

Introduction

3.1. The Commission is as mentioned responsible for contracting borrowings in response to the demand for loans for all three EEC loan instruments. It is directly responsible for the management of ECSC loans and has

overall responsibility for NCI and Euratom loans, even if day-to-day management is performed by the EIB.

3.2. In order to test the quality of the Commission's management, the Court adopted an approach which consisted of:

- (a) the evaluation and testing of the various systems established by the Commission to discharge its responsibilities;
- (b) visits to and circularization of selected clients in order to obtain an impression of the Commission's relationships with its customers.

Systems assessment

3.3. The systems for the control of borrowings, loans and interest subsidies granted on the latter were identified, assessed and tested. The borrowings system is common to all three instruments and, since loans can be made only from borrowings, it was decided to base the tests on a random sample of borrowings between 1985 and 1988 for each instrument, weighted to take account of relative volumes. A sub-sample of the associated loans was taken in order to test controls on lending and, where applicable, interest subsidies. The results of these tests are as follows:

- (a) the Court's findings regarding the borrowings are presented in its Annual Report concerning the financial year 1988 ⁽¹⁾. In this report the Court recommended that the system should be improved and that tighter controls should be imposed to ensure that the improved system is applied in practice. The Court notes that the Commission has already begun to take steps, and has undertaken to take others to improve the transparency and the effectiveness of the existing rules regarding borrowings, whilst at the same time continuing to ensure that the Directorate-General concerned enjoys the requisite degree of autonomy;
- (b) the systems for authorization and disbursement of loans under all three instruments were identified and tested by means of the respective sub-samples. In general, the systems were sound and key controls had operated properly in the cases in the sample. Further tests on the Commission's management of ECSC loans after disbursement were performed, both at the Commission and at financial institutions receiving global loans for on-lending at the latter's risk to final beneficiaries. The Court found that the management of

⁽¹⁾ OJ No C 312 of 12.12.1989.

Table 4 — Loans and borrowings in the community 1975-1989

(Mio ECU)

ECU-rate at the end of the year	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
I. Borrowings received															
ECSC	731	956	729	981	837	1 004	325	712	750	822	1 265	1 517	1 487	880	913
Balance of payments	—	1 249	571	—	—	—	—	—	4 247	—	2 692	862	860	649	—
Euratom	—	—	99	72	153	181	373	363	369	214	344	488	853	93	—
NCI	—	—	—	—	178	305	339	566	1 617	967	860	541	611	1 058	522
Commission total	731	2 205	1 399	1 053	1 168	1 490	1 037	1 641	6 983	2 003	5 161	3 408	3 811	2 680	1 435
EIB	814	732	1 030	1 863	2 437	2 384	2 243	3 146	3 508	4 339	5 699	6 766	5 573	7 407	8 764
Community total	1 545	2 937	2 429	2 916	3 605	3 874	3 280	4 787	10 491	6 342	10 860	10 174	9 384	10 087	10 199
II. Loans issued															
ECSC	805	989	709	798	676	1 031	388	740	778	825	1 010	1 069	969	908	700
Balance of payments	—	1 249	571	—	—	—	—	—	4 247	—	—	862	860	—	—
Euratom	—	—	97	70	152	181	357	362	366	186	211	443	314	—	—
NCI	—	—	—	—	277	197	540	791	1 200	1 182	884	393	447	285	246
Commission total	805	2 238	1 377	868	1 105	1 409	1 285	1 893	6 591	2 193	2 105	2 767	2 590	1 193	946
EIB	917	947	1 391	1 966	2 281	2 724	2 524	3 446	4 146	5 007	5 641	6 678	7 003	9 118	11 556
Community total	1 722	3 185	2 768	2 834	3 386	4 133	3 809	5 339	10 737	7 200	7 746	9 445	9 593	10 311	12 502

Sources: Report on the borrowing and lending activities of the Community 1988 (SEC(89) 1625 final) and 1983 (COM(85) 413 final); EIB Annual Report 1988.

Note: The differences between the total figures relating to the Commission's borrowings and loan operations are due to the figures regarding borrowings including re-financing operations and to variations in the balance of undisbursed borrowings at the end of the year.

The differences between the figures relating to the EIB's borrowings and loan operations are due to the EIB's loan operations being financed from borrowings as well as from the EIB's own resources.

loans, both by financial institutions and the Commission, was carried out to an acceptable standard;

(c) ECSC interest subsidies are granted to projects satisfying certain conditions and subject to the availability of resources. Subsidies approved under the various articles in recent years are shown in *Table 3*. The Court has devoted considerable efforts during that time to examinations of the various programmes and its findings have been presented in its reports (Annexes to the Annual ECSC Reports) on the accounting and financial management of the European Coal and Steel Community. Tests conducted as part of this study indicated a welcome improvement in the management and control of these subsidies. In particular, prompt action was being taken to block or adjust interest subsidy payments when the necessary pre-conditions were not being met. Nevertheless, certain problems persist:

- (i) where global loans are concerned (Articles 54(2) and 56(2) of the ECSC Treaty), the sub-loans relate to capital projects but subsidies are granted as an incentive towards the achievement of objectives resulting from projects, i.e. increased coal consumption, job creation. The subsidy, nevertheless, is paid during the realization period of the project (i.e. before any results can be expected) on the basis that the benefits of the subsidy are most needed at that stage. However, when projects do not produce the anticipated results in terms of the scheme objectives, problems may arise in recovering subsidies already paid;
- (ii) the interest subsidy payable is based on periodic reports from sponsors of projects or, in the case of global loans, financial intermediaries. The Court established in the course of this study that little effective monitoring of information in these reports was carried out by the financial institutions. Details of coal consumed and jobs created provided by recipients of sub-loans were, with few exceptions, transmitted without verification to the Commission. The Court has previously criticized the Commission's failure properly to define the criteria governing entitlement to interest subsidy and both the Court and the Commission have discovered, as a result of their own monitoring missions, cases where figures in periodic reports

were difficult, if not impossible, to verify. The lack of effective monitoring by the financial institutions raises considerable doubts both as to the reliability of achievement, statistics, and the justification for the interest subsidy payments.

Relationship with clients

3.4. When an organization such as the Commission provides a service such as loans and interest subsidies, a measure of the quality of that service can usefully be obtained from the beneficiaries. The Court accordingly decided to pursue this aspect in the course of missions arranged, principally, to test financial intermediaries' control of Commission funds (see paragraph 3.3 (b)). Since only a limited number of institutions could be visited, it was decided to obtain a more representative sample by seeking the written views of the major recipients of both global and direct loans in as many Member States as possible.

3.5. Questionnaires were sent to 31 clients, of which 23 replied. In addition, missions were arranged to 10 other recipients of global loans. In total, therefore, replies were received from 33 of the Commission's major customers. The majority of correspondents simply answered the questions posed but some took the opportunity to elaborate, either on specific points or in general terms. On mission, it was possible to clarify some of the answers and to ask additional questions.

3.6. For the purpose of analysis, it was necessary to distinguish between replies from the banking sector(18) and replies from the industrial sector(15). The former, although they rated Commission loans of only moderate significance in their field of operation, enjoyed a good working relationship with the Commission. Such problems as were identified could be attributed mainly to the requirements of bureaucracy, but it was established on mission that even these had largely been eliminated in recent years. The relationship was clearly one of partnership. The industrial sector, on the other hand, accorded high significance to Commission loans but, while there appeared to be few serious problems, gave the impression of a strict banker/client relationship (see paragraph 6.1).

Summary

3.7. The Court is pleased to note that there have recently been improvements in loans management and, in par-

ticular, in the control of interest subsidies. The Court also notes the Commission's undertaking to improve the transparency and effectiveness of the rules governing their borrowing activities, and understands that these new rules will receive Commission approval in the near future.

4. OBSERVATIONS AS TO ECONOMY, EFFICIENCY AND EFFECTIVENESS

Introduction

4.1. Since the early 1960s, the Commission has been in a position to exploit its standing as a first-class borrower in financial markets to obtain funds for the ECSC at the best rates available. Initially, these funds were directed towards investment in the coal and steel industries but, latterly, increased emphasis has been given to stimulating investment intended to cope with the economic and social problems created by the crises in these industries (reconversion loans). The more recent instruments (BP, Euratom, NCI) have taken advantage of this favourable position also to provide funds for the purposes of these instruments. It is in this context, as a source of finance aiming to provide funds on the best terms available, that the economy, efficiency and effectiveness of the Commission's management has been considered by the Court.

Economy

4.2. There is no doubt that the Commission is in a favourable position to obtain the best terms available on world financial markets. The questions that this part of the study tries to answer are: 'Does the Commission in fact obtain the best terms and, when it does, are those terms reflected in the rates charged to customers?'

4.3. The answer to the first question was provided in Chapter 13 of the Court's Annual Report concerning the financial year 1988, which indicated that due to shortcomings in the Commission's internal procedures, the best offer of funds was not always accepted by the Commission. However, as a result of this report the Commission has taken and has promised positive steps to improve their internal procedures.

4.4. The answer to the second question posed above has been obtained from the views of customers. The general impression, both from interviews and the circularization of customers, is that Commission loans are competitive with other sources. A small number of customers, however, indicated that they considered that better terms were available elsewhere and, in the case of ECSC loans, that the interest subsidy was the main attraction.

4.5. Chapter 13 of the Court's Annual Report concerning the financial year 1988 refers, in paragraph 13.12, to 'arithmetical and methodological errors'. These are particularly evident in calculations of the total cost price ('prix de revient') of borrowings, the conditions to be applied to associated loans and the cost-benefit ratio of re-financing. Errors in these calculations can affect the issue price ('taux de versement') of loans and the interest rate charged on loans either initially or after re-financing. Simple arithmetical errors can have a random effect either increasing or reducing the cost to the customer (albeit, on occasion, substantially) but the Court discovered that the methodological errors resulted in an over-evaluation of costs and, accordingly, a higher charge than necessary to customers. The Court considers that the Commission should:

- (a) use actual costs where available, instead of estimates of fees and charges;
- (b) estimate fees and charges on the basis of previous similar cases. In this context, the Court also considers that the Commission should devise an index or data-bank of regular charges to facilitate accurate estimation;
- (c) establish 'internal rates of return' (IRR) for the purpose of actualizing costs arising in the future; and,
- (d) establish a sound methodology for dealing with re-financing operations, in order to avoid a lack of consistency and the impression of improvisation in the method applied to individual cases.

4.6. The Court has re-calculated the possible cost to beneficiaries in eight cases, utilizing a standard formula for IRR and taking account of actual costs (where available) and realistic estimates. The results are presented in *Table 5*, in the form of an indication of the additional costs which the Commission could have spared its customers by establishing sound and reliable methods as the basis for these complex calculations. The Commission has pointed out to the Court that it is in the process of devising a general methodology for the calculation of the cost price of

Table 5 — Re-calculation of interest rates on selected cases in Court's sample

Amount of borrowing	Life	Over-valuation of interest rate	Additional cost to beneficiary
18 Mio HFL	15 years	0,98 %	1,4 Mio HFL
200 Mio DM	7 years	0,12 %	1,2 Mio DM
800 Mio LFR	5 years	0,09 %	2,5 Mio LFR
600 Mio LFR	4 years	0,33 %	11,5 Mio LFR
200 Mio DM	1 year	1,01 %	2,0 Mio DM
50 Mio ECU	6 years	0,18 %	0,4 Mio ECU
55,75 Mio USD	6 years	0,33 %	0,7 Mio USD
250 Mio DM	10 years	0,22 %	4,1 Mio DM

borrowings and this general methodology will be annexed to the internal rules.

4.7. In addition to the above charges (and over-charges), borrowers under each instrument bear a margin designed to cover the associated administrative costs of the ECSC or the EIB (NCI and Euratom). It is also noted in this connection that most ECSC and NCI loans are global loans to financial intermediaries and that final beneficiaries (normally small and medium-sized enterprises) have to meet, in addition, the margin imposed by the intermediaries. Over the period 1985 to 1988 covered by the study, the Court noted that the ECSC margin was significantly higher than the EIB's margin on new loans. This margin, which, as the Court points out in its Annual Report concerning the financial year 1988, is fixed by the Commission, and in the Court's view seems unreasonably high both in relation to the EIB's rate and to the costs which it was intended to cover. However, between November 1988 and March 1989, this margin was reduced three times and now stands at a level comparable with that of the EIB. The Court has not, as yet, been able to check its effect. But it is possible that the necessary action has been taken to correct a significant source of over-charging in the ECSC cases examined by the Court. The Court is unable to comment on the reasonableness of the EIB's margin since the EIB has refused to provide supporting evidence, despite successive requests.

4.8. In recent years, increased emphasis has been given to re-financing — in 1988, 53 % of funds borrowed were for this purpose and in 1989, 36 %. This operation involves the premature redemption of existing borrowings in order to take advantage of better market conditions through replacement borrowings. Since, in the Commission's case, all existing borrowings have been allocated as loans and since the basic objective is to provide funds on the best terms available, the Court examined the extent to which the benefits of re-financing had been passed on to recipients of the original loans. These benefits can be substantial,

even without taking account of the potential benefits indicated in paragraphs 4.5 and 4.6. The Court's sample revealed improvements in interest rates on borrowings ranging from 0,50 — 7,17 percentage points, with an average benefit of about 3,15 percentage points. After deduction of related costs, the interest rate charged on loans associated with re-financed borrowings was reduced by 2,5 % on average. The Court observed, however, that no reduction was passed on in the case of loans made from the NCI Treasury. The benefits of re-financing the borrowings associated with such loans remained in the Treasury and accrued, ultimately, to the EIB.

Summary

4.9. The above evidence indicates that the Commission's preferential place in the borrowing market does not always benefit the final beneficiaries because the advantage can be diminished by the Commission's additional costs when fixing the terms of loans, either original or after re-financing. Furthermore, the Court noted that the substantial benefits of re-financing are not passed on to the recipients of NCI global loans. The Court is of the opinion that the Commission must ensure that funds are made available on the best possible market terms.

Efficiency

4.10. This part of the report tries to establish whether there is a continuing need for lending facilities offered by

the Commission, what form that need takes and whether the need is met in the most efficient way.

4.11. By far the largest part of the Commission's current lending activity, both under ECSC and NCI, is in the form of global loans. The attraction to recipients of ECSC loans, is that they can benefit from interest subsidies under Article 54(2) or 56(2) of the Treaty. The Court has been unable to establish the attraction of NCI loans since it did not, at the time of the audit, have access to the final beneficiaries. But, from the EIB's point of view, NCI loans provide a facility for clients in non-assisted areas in Member States, the EIB's own loans being directed mainly at the assisted areas.

4.12. The Commission's clients stressed the significance of interest subsidies. In some Member States, exchange risk cover was equally important and some clients whose Governments provided this facility maintained that there would be a continuing demand, even without interest subsidy. But, it is at least arguable that the volume of demand in some Member States would decline, if not cease, if the interest subsidies were abolished. The attraction of a subsidy is demonstrated in some Member States where institutions from which the Commission borrows will themselves borrow from the Commission, in order to obtain a subsidy. Indeed, in some cases, borrowed funds are simply returned to the lender with the benefit of the interest subsidy. In the Courts view the incidence of administrative costs associated with borrowing and lending in such cases is uneconomic. The Court does not ignore that the actual dispositions of the ECSC Treaty does not foresee the allocation of interest subsidies without corresponding ECSC loans. The Court invites the Commission to examine this situation.

4.13. In these circumstances, the Court attaches particular importance to a recent development in this area. At the instigation of the European Parliament, an amount of 10 Mio ECU was provided under the general budget of the EEC for the purpose of providing interest subsidies in favour of investments aimed at increasing employment. The Commission decided in 1986 to utilize these resources by providing as a pilot project interest subsidies on loans granted in Portugal, not by the Commission but by certain Portuguese banks from their own resources. The initiative suffered some initial problems mainly through inexperience of this type of operation and a failure to properly assess the administrative difficulties involved. However, it was much appreciated by the banks involved and produced benefits for the Commission, in terms of its objectives, at a very low cost.

4.14. Since the declared objective is to encourage alternative employment opportunities for redundant ECSC workers, there may be a case, in the interests of efficiency, for relating the subsidy to the realization and continued existence of projects in priority areas rather than to actual job creation, thus avoiding the problems related to the control as to the fulfilment of the obligation for the beneficiary to create a specific number of jobs, (see paragraph 3.3(c)(ii)).

Summary

4.15. While there may still be a need for Commission loans in some Member States, the real demand is for cheap finance. Loans at market rates are readily available in almost all Member States and the attraction of the Commission's loans lies in the interest subsidy combined, preferably, with exchange risk cover. With regard to the method of borrowing for on-lending the question arises if the pilot project in Portugal is not an initiative which could usefully be developed elsewhere. The administration of interest subsidies could be improved by a simplification of the conditions of entitlement which took account of the aims of the instrument and the circumstances encountered in practice.

Effectiveness

Introduction

4.16. The activity of borrowing and lending is undertaken not to make a commercial profit but as a means of achieving the objectives of the Communities. Since the Commission's loans are made to borrowers of national or international standing and are protected by first-class guarantees, the risk of default is very low. Accordingly, concerns such as profit margins, the collectability of debts, etc, which are of major importance to commercial banks, are, in the Commission's case, relatively unimportant. The Commission's main concern should be to ensure that its loans and borrowings activity contributes to the professed objectives of the instruments. The Court has, accordingly, tried to assess the effectiveness of this form of intervention in these terms.

ECSC

4.17. Since the ECSC was established, loans under Article 54(1) of the Treaty have contributed significantly to investments in the coal and steel industries. In recent years, however, successive crises and recessions in both industries have resulted in major interventions by Member States mainly with a view to rationalization of capacity and improved productivity. The consequences are reflected in the vast increases in social measures for these industries, to which the Community contributes. As regards loans, the terms of Article 54 are designed for expanding industries rather than those in recession. Also, some Member States are less willing to provide acceptable guarantees for companies facing financial difficulties and uncertain futures. Accordingly, the volume of loans has tended to stagnate, the sporadic demand being generated mainly in response to the economic policies adopted, from time to time, by individual Member States.

4.18. As regards other ECSC loans, the Court has recently, in its reports (Annexes to the ECSC Annual Reports 1986 and 1987) on the accounting and financial management of the European Coal and Steel Community, criticized the effectiveness of the Coal Consumption and the Workers' Housing Schemes. Statistics established at the end of 1987 on job creation under the Reconversion Scheme (Article 56(2)) suggest that while the scheme had contributed to the creation of substantially more jobs than estimated (59 000 compared with 29 000) the number filled by ex-ECSC workers was very small (4 000). The accuracy of these figures is, of course, qualified by the comments in paragraph 3.3 (c)(ii). It should also be recognized that the ECSC scheme was, in many Member States, implemented in conjunction with national initiatives of this nature and mainly in association with commercial banks.

4.19. Many projects examined by the Court in recent years had started before the decision on the ECSC loans and/or interest subsidy had been taken. The question arises as to whether these projects could not also have been carried out without this kind of support. While subsidy was appreciated by financial intermediaries, the reason was mainly because of its impact on a package of finance including the intermediaries' own resources. Indeed, one intermediary with substantial funds of its own indicated that the subsidy was required in order to match its competitors' terms. More than one intermediary stated that the decision to grant a subsidy would have no material affect in their assessment of commercial risk. If projects needed the subsidy to be viable, they would not be supported by the intermediaries.

Euratom

4.20. The effectiveness of Euratom loans is difficult to assess. Given the scale of Euratom projects and the political, economic and environmental arguments associated with them, it could hardly be argued that the Euratom contribution (up to 20 % of project costs) was of major significance in the decision to proceed. But, in terms of the objectives of the original legislation, these loans could be regarded as effective if they provided the necessary funds cheaper than other sources of finance. It is not possible to provide a conclusive answer to this question, but the level of demand over the years indicates that the Commission was at least competitive with the market. It could be argued, therefore, that this scheme has contributed, in a small way, to achieving the aims of the energy policy in force at the time of its introduction. Its current effectiveness is reflected in the low level of loans in recent years.

NCI

4.21. To the best of the Court's knowledge, no attempt has been made to assess the effectiveness of NCI loans. For example, one of the prime objectives of the NCI is to create employment yet the Commission statistics refer only to jobs estimated to be created rather than jobs actually created, even after the scheme has operated for some 10 years. The Court also noted that the degree of NCI penetration was uneven amongst Member States. Four Member States do not take NCI funds and the instrument has, accordingly, had no effect in these areas. Two more had not participated in NCI IV, the latest instrument, up to 31 December 1988, and of those which had, one had received more than 60 % of issues at that date. This uneven distribution indicates that NCI loans, which are issued on the same terms as EIB loans, enjoy no special advantage in the market place and that their attraction may owe more to the economic policies of particular Member States (as regards, for example, exchange risk cover) than to the intrinsic merits of the instrument.

Summary

4.22. There is certainly evidence that the Commission programmes have contributed to, for example, the creation of employment, but it is not clear whether the Community contribution was the motivating force, or whether it simply replaced other forms of finance which would have achieved the objective in any event. In order to ensure that Community objectives are being achieved in the most

effective manner, the Commission should review its procedures for monitoring and evaluating the information received in respect of projects funded by the various financial instruments of the Community.

5. 'JEAN MONNET' ISSUE

5.1. In June 1988, the Commission launched the 'Jean Monnet' issue amounting to 500 Mio ECU to serve as a 'benchmark' for this currency. From what it has said itself on the matter, it can be seen that it allowed itself to be guided by political considerations, to which it attributed superior importance, and as a consequence of giving political considerations priority the Commission was willing to run the financial risk of:

- (a) incurring the cost of maintaining funds on short-term deposit until required while paying long-term rates on the borrowing, and
- (b) ultimate loss if part of the funds raised could not be lent on terms at least equivalent to those of the borrowing.

5.2. In order to minimize this risk the Commission employed special financial techniques. It is as yet too early to determine whether this operation has involved any additional cost for the Commission, the EIB (which is responsible for the financial out-turn of the NCI Treasury) and ultimately, the final beneficiaries of loans from this borrowing. Indeed, the fortuitous movement in market rates could even produce a gain on sums necessarily placed on deposit.

6. GENERAL OBSERVATION

6.1. The evidence presented above leads the Court to the general conclusion that the loans and borrowings activity of the Commission has significantly evolved over the years. This evolution is due to the changing policy objectives of the Communities and the changing of the political and economic environment and has resulted in an adaptation of the structural character of the loans and borrowings activity of the Community as well as the application of new operational mechanisms. The Court notes in this context:

- (a) the change in the character of the Commission's and the EIB's NCI clients, from predominantly industrial or quasi-governmental organizations receiving direct loans to, in the main, banking institutions acting as financial intermediaries for global loans;

- (b) the growth in the re-financing activity to take advantage of the markets evolution;
- (c) a relative stagnation in the volume of loans;
- (d) the banking nature of some transactions, e.g. re-financing of NCI borrowings without passing on the benefits to final beneficiaries;
- (e) the raising in particular cases of borrowings in the absence of a demand for loans, although the statutory authority for borrowings for all instruments is dependent on the demand for loans;
- (f) the low priority given to measurement of achievement in terms of the objectives of the instruments.

7. RECOMMENDATIONS

7.1. In the Court's opinion, the loans and borrowings instruments of the Communities should remain, a means to further the objectives of the Communities. However, working practices could be better organized. Collaboration with the EIB is required in order to avoid the risk of duplication of effort. The Court considers that action is required to improve the economy and efficiency of the service and to measure its success in achieving the objectives of the various instruments.

7.2. The Court accordingly recommends:

- (a) that the Commission should comply to the basic principle, that borrowings cannot be made without a demand for loans and that the benefits of refinancing operations should be passed on to final beneficiaries;
- (b) that the Commission examines the possibilities to improve the impact of the ECSC operations by extending the experience of the pilot project in Portugal to other Member States. Such a development would also identify the Member States which required only interest subsidies and thus streamline the borrowing and lending activity;
- (c) in association with (b) above, the administration of interest subsidies should be simplified. Consideration should be given, *inter alia*, to:
 - (i) relating entitlement to a subsidy to realization of and continued existence of projects in priority areas on the assumption that job creation will follow automatically;

- (ii) pre-funding subsidies, in appropriate cases, to enable intermediaries to charge a net interest rate on their loans;
- (iii) integrating the subsidies with national or other Community initiatives, where possible;
- (iv) improving the incentive effect of subsidies by varying the rate in recognition of projects of particular Community significance;
- (v) reducing the volume of reports from intermediaries and/or final beneficiaries;
- (d) in general, the need for loans and/or interest subsidies should be identified and policies adopted to meet that need in the most efficient manner;
- (e) given a rationalization in administration and reporting, more effort should be devoted to establishing the effects of Community interventions. Economic and statistical analyses, even on a sample basis, could establish the actual, as compared to the estimated, impact of ECSC and NCI finance and indicate where and how funds should be allocated in future.

This report was adopted by the Court of Auditors at a meeting held on 10 May 1990.

For the Court of Auditors
Aldo ANGIOI
President

THE REPLIES OF THE COMMISSION

1. INTRODUCTION

1. Some of the observations on the management of borrowings contained in the special report were made in Chapter 13 of the Court's Annual Report for 1988. The Commission responded positively to these observations and has already taken the measures it promised in its replies to that report with a view to improving transparency and effectiveness in this field. Similarly, some of the observations on the management of loans were made by the Court in its Annual Report for 1986; here too, the Commission has already taken appropriate measures.

2. The Commission would stress that if loan instruments are to be used to the best effect, there must be close cooperation with financial institutions and in particular with banking networks. The Commission feels that in the steps it has taken, at no time has it lost sight of the political objectives and legal basis of its action.

3. Like the Court of Auditors, the Commission recognizes the need for constant review of the financial instruments currently available in order to improve their suitability, integration and effectiveness. It can give an assurance that it has been conducting such a review and will continue to do so, taking into account the constraints of the system and the opinions expressed by the various partners concerned.

2. EVOLUTION OF THE INSTRUMENTS

Loans granted under the EEC Treaty

Administration of the EEC loan instruments

2.9. The Commission would stress that the budgetary guarantee for Euratom and NIC operations is purely formal. The budget headings concerned have never had to be activated.

3. OBSERVATIONS ON THE MANAGEMENT OF THE INSTRUMENTS

Systems assessment

3.3

(c) (i) The Commission is very attentive to the problem raised by the Court and always keeps a close watch on the recovery of subsidies already paid out. So far no major problem or difficulty has been encountered in this field and the Commission's procedures have proved effective for many years now.

Besides, loan agreements have recently been improved precisely to provide further protection for the interests of the Commission and thus allow the smooth recovery of any undue subsidies.

(c) (ii) The Commission thinks that the rules for the granting of interest subsidies are quite adequate for the purpose they serve and are especially well received by the financial intermediaries with which it works. Moreover the Commission has substantially increased the number of inspection visits made to banks and to final beneficiaries of loans in order, *inter alia*, to give technical aid and to reduce the number of inaccurate reports submitted. The first positive results of this effort are already being felt. Given that it manages more than 10 000 loans and sub-loans, the Commission feels encouraged by the progress reports it receives from its clients and by the quality of the information being supplied at present.

It should also be pointed out that each report sent by a direct beneficiary or financial intermediary is examined by DG XVIII which uses it as a basis for preparing the payment order for the interest subsidy. DG XX then examines the report when it receives the payment order. Additional checks are carried out on a selection of reports during inspection visits to final beneficiaries and intermediaries.

In 1988 Financial Control devoted 35 man-days to such checks.

Relationship with clients

3.4 – 3.6 The Commission recognized that the replies to the questionnaire from financial intermediaries and loan beneficiaries might prove useful and the departments concerned gave their full cooperation to the Court in carrying out its investigations.

The replies received indicated that by and large the Commission's partners were satisfied with the services they were offered.

3.7 The Commission has indeed taken a series of measures designed to enhance the transparency and effectiveness of borrowing operations. The internal rules relating to these operations have been submitted for approval to the Member of the Commission responsible.

4. OBSERVATIONS AS TO ECONOMY, EFFICIENCY AND EFFECTIVENESS

Economy

4.3. The Commission can confirm that it has acted on the undertakings it gave in its reply to the Annual Report for 1988. It does all it can to invite competitive offers and always endeavours to obtain the best terms for borrowings. It has provided the Court with explanations for the very rare cases where it did not accept the offer which, mathematically speaking, appeared to be the best.

4.4 The Commission shares the Court's view that interest subsidies have a special attraction given the average cost of loans granted to beneficiaries. However, it would point out that the competitiveness of the Commission's loans in general is demonstrated by the fact that many firms in various Member States have had recourse to loans — both direct and global — which were largely unsubsidized.

The Commission wishes to qualify the claims of some clients that they were able to obtain better conditions 'elsewhere'. These must be exceptional cases where Member States offer loans as part of national aid measures on terms which do not match those ruling on the market.

4.5 – 4.6 As the Commission has indicated in its reply to the Annual Report, it has already tightened up checks on the reliability of total cost price calculations and devised a standard method to be applied to these calculations.

4.7 On the question of the margin charged on global loans by financial intermediaries, the Commission would stress that in this context, it is quite normal for financial institutions to receive payment for the work they have to carry out and to cover themselves against the risk of final beneficiaries defaulting on loans. The Commission feels that the rate it sets is quite acceptable.

As regards the ECSC margin imposed by the Commission, the method of calculation used is laid down in the internal rules. This margin has now been reduced and reflects the real costs borne by the Commission. It is only applied when loan contracts do not contain an indemnity clause covering all the risks assumed by the ECSC. When such a clause exists and when the intervention of a national agent is not required, the Commission does not include any margin and the rate of on-lending corresponds exactly to the actual costs of the funds raised.

In the past, the inclusion of a margin in the cost of loans was necessary to constitute a reserve in the ECSC balance sheet large enough to give lenders every assurance and thus secure for the ECSC the highest possible rating — a vital element in raising capital at the lowest cost. The size of the margin applied to loans was justified by a high-risk factor particularly during the most crucial phase of the restructuring of the coal and steel industry. The margin has been reduced in line with the general decrease in risk due in particular to the improvement in the industry's financial situation.

4.8 It is difficult to pass on the benefits of re-financing to the various recipients of loans from the proceeds of a single borrowing by the NCI Treasury. Not only are loans more numerous than borrowings and for different durations, but each loan is normally made up of several currencies, whereas a borrowing is made in a single currency. Moreover, the interest rates for NCI loans are linked to those applied by the EIB to similar operations where the same difficulties in passing on the benefits of re-financing are encountered.

In the Commission's view, re-financing operations are consistent with sound financial management and are launched whenever justified by market conditions.

The Commission would stress that it has always passed on the benefits of re-financing:

- direct to beneficiaries of loans forming part of ECSC, Euratom and NCI back-to-back operations;
- to the EIB in the case of operations involving the NCI Treasury. Full responsibility for the final result of these operations is assumed by the Bank in accordance with the cooperation convention between the Bank and the Commission.

Summary

4.9 As has already been indicated in the reply to paragraph 4.7, the margin currently applied to ECSC loans reflects the real costs borne by the Commission.

The success of global NCI loans is eloquent proof of the consistent demand for this type of financing even without additional benefits.

As stated in its reply to paragraph 4.8 it has always been the Commission's policy to pass on the benefits of re-financing.

Efficiency

4.12 As it has indicated in its reply to paragraph 4.4, the Commission is well aware of the attraction of interest subsidies but insists on the fact that the success of loans granted without subsidies confirms the general attraction of all its loans.

For the Commission, the important thing is that the rates obtained should be competitive. It would stress that only in rare cases have borrowed funds returned to the lenders and that only modest amounts were involved. These cases were justified by the fact that, in general, the lending institutions had offered the best conditions.

In any event, it cannot be concluded from this that funds return to the lending institutions and that they enjoy the benefit of the interest subsidies, since these subsidies are designed to benefit final beneficiaries and not intermediary banks.

4.13 The Commission will study carefully the results of the pilot project currently being carried out in Portugal. However, at this stage of the experiment, it can see certain disadvantages, in particular as regards the uncertain level of lending rates and the difficulty in monitoring the actual progress of the operation. It is also difficult to assess the economic and social impact of financing programmes, the importance of which is underlined by the Court.

4.14. It should be stressed that the 'social clause' as applied at present derives directly from the ECSC Treaty. However, as part of the implementation of the reform of the Structural Funds, the Commission has begun to simplify the rules and procedures for granting ECSC conversion loans. In this context, taking note of the Court's suggestion, the Commission will examine the possibility of establishing a more flexible link between the granting of interest subsidies and the creation of jobs.

Summary

4.15 In its reply to paragraph 4.4, the Commission confirmed that its loans are generally attractive. It will examine ways of improving the administration of interest subsidies in connection with the launching of multiannual schemes.

As regards the pilot project in Portugal, the Commission has already stated the disadvantages it sees in this project in its reply to paragraph 4.13 and feels that at this stage it is premature to suggest extending this kind of initiative to provide financial cover for all the needs of the ECSC priority areas.

Effectiveness

ECSC

4.17 There can be no doubt that in times of crisis or recession, budgetary intervention, especially at national level, and direct measures to assist the workforce tend to come ahead of ECSC loan instruments as a means of financing. However, this does not affect the intrinsic effectiveness of these instruments as might be inferred if reference is made solely to the volume of loans.

The Commission takes the view that the use of the loan instrument under Article 54 has the potential to respond to all situations (expansion, crisis or normal level of investment). It feels that loans will be used more and more to finance conversion initiatives supported by the Community in the context of the new legislation on the Structural Funds and instruments.

4.18 Like other Community structural operations, ECSC loans play a subsidiary role in relation to the overall conversion effort in most of the Member States. The Commission is convinced that ECSC loans have had a significant impact on eligible employment areas in terms of both job creation and the amount of investment mobilized. Even so, the Commission accepts that the various firms involved, and in particular financial institutions, include their own assessment of the commercial risk they are assuming in financing conversion schemes.

As regards the number of jobs created, the Commission shares the Court's view that the accuracy of this figure is relative. Nevertheless, it would point out that, over the years, ECSC financing of investment in conversion schemes has increasingly formed part of a whole series of measures aimed at renewing the economic fabric of the ECSC employment areas.

Euratom

34.20 The Commission notes with satisfaction the Court's acknowledgement that the Euratom loans were competitive.

It feels that they made a contribution to achieving the aims of Community energy policy at that time.

NCI

4.21 The Commission would point out that it views the effectiveness of NCI loans in overall terms, with particular attention being paid to the implications of the EEC's financial capacity and of the specific nature of the instrument. As regards geographical distribution of funds, if NCI IV loans and their counterparts — loans from the EIB's own resources — are taken together, there is a good balance, since those countries which have not received NCI loans (in particular Germany) have taken part in the 'parallel' EIB operation.

Summary

4.22 The Commission shares the Court's view that it is difficult to isolate and quantify the impact of Community measures when they form part of a whole series of measures which cannot easily be regarded individually.

However, it would remind the Court that to evaluate its operations it has strengthened the unit responsible for monitoring loans and increased the number of inspection visits (doubling it in 1989).

5. 'JEAN MONNET' ISSUE

5.1–5.2 The Commission felt that the time was ripe to launch an issue in ecus large enough to serve as a 'benchmark' for transactions in this currency and to establish the credibility of the ecu on the international markets.

These objectives, which are of importance for the implementation of economic and monetary union, were achieved.

The financial techniques used by the Commission for this operation make it possible to confirm that there is no risk of losses nor of the emergence of additional costs for the Communities.

6. GENERAL OBSERVATIONS

6.1 (c) The Commission would point out that the 'stagnation in the volume of loans' is the inevitable result of the fact that the NCI and Euratom ceilings have been reached.

6.1 (d) The Commission would remind the Court that, as indicated in its reply to paragraph 4.8, it has, for its part, always passed on the benefits of re-financing.

6.1 (e) The Commission maintains that it complies with the basic principle of borrowing only to satisfy actual demand for loans.

6.1 (f) The Commission has not given lower priority to measurement of achievement in terms of the objectives of the instruments concerned. Its aim has been — and will continue to be — to adjust this measurement to that

applied at different operational levels by its partners in conversion projects.

7. RECOMMENDATIONS

7.2 (b) As has already been pointed out in the replies to paragraphs 4.13 and 4.15, the Commission does not share the Court's view on the virtues of extending to other areas the practices followed in Portugal.

7.2 (c) (i) The Commission would remind the Court that it has begun to consider the possibility of making the link between interest subsidies and the creation of jobs more flexible.

7.2 (c) (ii) The Commission will consider whether moves should be made in the direction recommended by the Court.

7.2(c) (iii) The Commission is at present studying the possibility of closer links between the granting of subsidized loans and other Community instruments.

7.2 (c) (iv) The Commission will examine the Court's suggestion.

7.2 (c) (v) The Commission welcomes the Court's recommendation. It feels that the frequency of these reports should also be reduced.

7.2 (d) The Commission would point out that the granting of loans is increasingly connected with investment programmes; this implies that requirements have to be assessed in advance and measures must be carried out in accordance with existing policies.

7.2 (e) The Commission will try to follow the Court's recommendation in its action to give effect to the reform of the Structural Funds.

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