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EU Support to Ukraine is Changing the Rules of Macro-Financial Assistance

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Key Points

- The EU has decided to borrow and lend €18 billion to support the Ukrainian government in 2023 and is working on a larger facility for the coming years.
- To implement this support, several rules that governed EU Macro-Financial Assistance to third countries have been set aside.
- EU loans to Ukraine are directly secured against the EU budget and include several subsidies.
- The MFA+'s new structure has few immediate effects for the financing or accountability of the EU's lending, but it might prove a challenge to the EU's credit rating if the facility is expanded.

Introduction

Since the start of Russia's full-scale invasion of Ukraine in February 2022, the European Union (EU) has increased the amount of financial support that it has provided to the Ukrainian government. After several emergency loans were issued over the course of the year, the Council and the European Parliament agreed in December 2022 to provide up to €18 billion in Macro-Financial Assistance Plus (MFA+) to Ukraine in 2023. It is the largest MFA programme of this kind to date.

The MFA+ also entails financial risks for the EU. Given Ukraine's high financing needs, which are estimated at between €35 billion and €52 billion this year alone, and its burgeoning debt-to-GDP ratio, it will be difficult for the country to avoid debt restructuring (Peters 2023, IMF 2023). Although it remains unlikely that Ukraine will default on its loans from the EU, such a scenario would trigger the budgetary guarantees underpinning the MFA+ to cover losses and repay the funds that the EU borrowed on capital markets to support Ukraine.

This policy brief explains how the EU has reformed the budgetary guarantee structure for the MFA+ to Ukraine. To ensure sufficient loss provisions, the loans have been moved from a dedicated External Guarantee Fund to the EU budget. In political and financial terms this move has few immediate consequences. However, it could pose a problem to the EU's AAA credit rating, especially if the facility is expanded in the future.

Macro-Financial Assistance

Macro-Financial Assistance is a well-established policy instrument under which the EU has lent money to third countries in its neighbourhood since 1990. For instance, during the COVID-19 crisis, the EU provided €3 billion in MFA to ten neighbouring countries. MFA loans usually complement assistance from the International Monetary Fund and aim to support a country's Balance of Payments.

Since loans to third countries were considered of greater risk than those to EU Member States (European Court of Auditors, 1992, pp. 186-188), the EU has a dedicated guarantee structure for MFA loans. After the first MFA loans had been directly secured against the EU budget, the Edinburgh European Council in 1992 agreed to set up an External Action Guarantee Fund (European Council, 1992), which managed loan loss provisions for MFA loans after 1994.[1]

The most recent reform to the EU's budgetary guarantee structure took place in 2021. At this time, all the EU's budgetary guarantees were pooled in a newly-created Common Provisioning Fund (European Commission, 2021) and loan guarantees for MFA programmes were budgeted as part of the Neighbourhood, Development, and International Cooperation Instrument/Global Europe (NDICI) which merged various external policy instruments.[2]

Though MFA programmes are created by separate pieces of legislation, the financial guarantees follow the same template. For each loan, the EU previously set aside 9% under the External Action Guarantee.[3] At the end of 2022, the EU guaranteed roughly €2.5 billion through that instrument (European Commission, 2023).

Guaranteeing MFA+ to Ukraine

Over the course of 2022, the EU passed four MFA support loans for Ukraine. The first loan of up to €1.2 billion was agreed on 24 February.[4] Two exceptional MFA loans of €1 billion and €5 billion were agreed in July[5] and September.[6] Finally a new instrument, called MFA+, which includes loans and grants up to €18 billion to be disbursed in 2023, was agreed in December.[7]

The loans had to accommodate the conflicting demands of supporting war-torn Ukraine and protecting the EU budget against the financial risks that these loans represented. To do so, two changes to the guarantee structures of the loans were implemented.

First, following Russia's invasion it has become likely that Ukraine will not repay the loans fully. The EU has accounted for this financial risk by raising the provisioning rate for all loans to Ukraine from 9% to 70% in the July MFA. Such a high provisioning rate exceeded the NDICI framework.[8]

Second, the increased loan volumes and the high provisioning rates meant that the External Action Guarantee was insufficient to backstop the loans. Initially the EU handled this by ringfencing the loans and topping up the existing guarantee fund. The July MFA stated that the loan to Ukraine would be guaranteed separately from other MFA loans.[9] In September, additional Member State guarantees of €3.66 billion were included to reinforce the Common Provisioning Fund.[10]

For the €18 billion MFA+ a completely new structure was implemented. This loan is no longer secured against the Common Provisioning Fund, but against the EU's budgetary headroom.[11] To do so, the Council had to amend the EU's Multiannual Financial Framework (MFF) to allow for the mobilization of funds 'over and above the MFF ceilings' in case the guarantee for the MFA+ was activated.[12] Since the MFA+ loan is directly secured against the EU budget, it is no longer secured by paid-up loss provisions.

[1] Regulation (EC Euratom) 2728/94
[2] Regulation (EU) 2021/947, Art. 31
[3] Regulation (EU) 2021/947, Art. 31.5
[4] Decision (EU) 2022/313
[5] Decision (EU) 2022/1201
[6] Decision (EU) 2022/1628
[7] Decision (EU) 2022/2463
[8] Decision (EU) 2022/1201, Art. 7
[9] Decision (EU) 2022/1201, Art. 7
[10] Decision (EU) 2022/1628, Art. 9
[11] Decision (EU) 2022/2463, Art. 16.3
[12] Council Regulation (EU, Euratom) 2022/2496, Art. 1

Implications of the New Guarantee Structure

This new guarantee structure has some advantages: notably, the EU does not need to put aside roughly €13 billion in guarantees this year while still ensuring that the Member States guarantee the repayment of the EU's debt associated with the loan.

Similarly, the political and financial control over the MFA+ loans is largely unaffected by the new guarantee structure because they are governed by provisions in the EU Budget Regulation.[13] As the loans go 'over and above' MFF appropriations, they could even be increased without further changes to the EU's budget.

However, the new guarantee structure may have longer-term repercussions for the EU's AAA-credit rating. Since 2022, the EU raises the funds for both NextGenerationEU and MFA+ loans under single label EU bonds (European Commisssion, 2022). If the guarantee for the MFA+ is drawn, the EU's ability to mobilise the funds from Member States will be tested. Any hiccups in that process could affect the credit rating of all the bonds that the EU issues.

The Way Forward

In order to provide economic support to Ukraine, the EU has overhauled the budgetary guarantees for new MFA+ loans. The new guarantee structure is significant for EU public finance because it secures MFA+ loans directly against the EU budget, similar to those of SURE and NextGenerationEU. This means that the largest, and perhaps most risky, loan to a third country in the EU's history is guaranteed under the EU's multiannual financial framework.

The MFA+ to Ukraine hence clearly represents a new EU financial assistance instrument. In addition to the new guarantee structure, the MFA+ includes an interest rate subsidy and the EU has waived the management fees of the loan. By comparison, the MFA for Moldova agreed last year still adheres to the NDICI template.[14]

The decision to secure the MFA+ against the EU budget has also set a precedent that will likely affect further support to Ukraine. In advance of last month's Ukraine Recovery Conference in London, the European Commission outlined a proposal to establish a new 'Ukraine Facility' of up to €50 billion, with a loan portion secured against the MFF.[15] With the costs of financing Ukraine's reconstruction and recovery estimated at €383 billion and rising, the Ukraine Facility is likely to be the start of an even bigger financial commitment to this country, whether it joins the EU or not (World Bank 2023). As long as there is a robust consensus in favour of supporting Ukraine, the new guarantee structure may be the best way for the EU to provide large volumes of support. However, it could require politically difficult decisions if it should become necessary to write down one of the EU's loans to Ukraine.

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[13] Regulation (EU, Euratom) 2018/1046, Art. 220.5

[14] Decision (EU) 2022/563

[15] COM(2023) 337 final

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Further Information

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