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The Commission's Unified Funding Approach Unlocked: More concessional Macro-Financial Assistance

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Key Points

- Since 2023, the European Commission has operated a Unified Funding Approach, through which it funds all its financial assistance instruments.
- The Unified Funding Approach has allowed the Commission to extend loans with maturities of up to 40 years to third countries.
- In its support to Ukraine, the EU has added further grant elements by waiving interest rates and loan administration costs.
- Such concessional terms are unprecedented, showcasing how the Commission has been transformed not just as a borrower, but as a regional financial stability provider.

The EU's latest MFA programmes

In the first half of 2024, the European Union (EU) adopted three significant financial assistance programmes for third countries. The Ukraine Facility included €33 billion in loans as budget support; the Reform and Growth Facility for the Western Balkans comprised €4 billion in financial assistance loans; and another €1 billion was made available to Egypt as short-term Macro-Financial Assistance.

This policy brief argues that these financial assistance loans come with hitherto unseen concessional loan conditions. These loans come with extremely long maturities as the first EU financial support programmes to be financed under the EU's unified funding approach (Spielberger, 2023a). Moreover, the loans include further grant elements that make them attractive to borrowers.

The EU's readiness to grant loans at such advantageous terms shows how its new borrowing operations have made a wider range of financial operations possible. Yet there are pitfalls to selectively offering concessional terms and relying on loans as part of the EU's neighbourhood policy.

Concessional loans and MFA

Concessional loans are often defined as lending extended by creditors at terms that are below market terms (Scott, 2017). They usually include lower interest rates or longer maturities than would otherwise be available, as well as grace periods that allow the debtor to defer principal repayment. The degree of concessionality, or 'grant element', refers to the degree to which such a loan is more advantageous for the borrower than market funding (Scott, 2017).

Traditionally, the EU has provided Macro-Financial Assistance to top up existing (non-concessional) International Monetary Fund (IMF) programmes in neighbouring countries at more attractive terms. While IMF Balance-of-Payments programmes for those countries have maturities between 3.5 and 10 years (IMF

2023a; 2023b), the EU previously offered up to 15 years, lower interest rates, and more attractive repayment models. The offer of more attractive conditions has long underpinned the claim of 'EU added value' of participating in such programmes (Mathis et al., 2021).

Longer maturities

Until 2020, EU Macro-Financial Assistance was funded under a back-to-back approach whereby the European Commission would issue a bond and forward its proceeds to the recipient at identical conditions. Under this back-to-back funding approach, 15 years was the maximum duration available, given the Commission's unwillingness to issue longer-term debt.

However, in 2023, the Commission implemented a Unified Funding Approach whereby borrowed funds would go into a pool that financed all its financial instruments (Spielberger, 2023a). The Commission's borrowing operations to fund MFA have since been delinked from outstanding MFA loans.

Moreover, as the Commission may now roll over borrowings, the new funding approach created the technical conditions for lending at longer maturities. The 2022 MFA+ loan to Ukraine, the first programme funded this way, and this year's Ukraine Facility both come with maturities of up to 35 years.[1] The EU's 'short-term' Macro-Financial Assistance to Egypt will likewise mature after 35 years.[2] Loans under the Western Balkans Facility can even go up to 40 years.[3] Such long-term financing is uniquely attractive – even loans to EU member states under the Recovery and Resilience Facility must be repaid after 30 years.

Grant elements

There are further sweeteners to the EU's recent loans. The interest rates that the EU can offer are already below those that the recipients could usually pay. However, the Western Balkans Facility additionally includes a 10-year grace period, twice what the Commission has offered on previous programmes.

To make its loans to Ukraine more concessional, the EU has bent some of its self-imposed rules governing financial assistance. Usually, loan recipients are required to cover the Commission's loan administration costs.[4] Under the Ukraine Facility, however, these costs, as well as interest payments are waived annually, subject to Ukraine meeting the programme conditions.

Initially, the budgetary resources to pay for these 'grant elements' came from the EU's Neighbourhood, Development and International Cooperation Instrument - Global Europe (NDICI-GE). This meant that these loan subsidies threatened to eat into other EU spending priorities in the Eastern neighbourhood. However, during the mid-term revision of the Multiannual Financial Framework (MFF) in 2023, the EU created a separate 'Ukraine Reserve'[5] which, under the Ukraine Facility provides for these grant elements.[6]

[1] Art. 22.2, Regulation (EU) 2024/792
[2] Art. 5.2, Council Decision (EU) 2024/1144
[3] Art. 17.3, Regulation (EU) 2024/1449
[4] Art. 220.5(e), Regulation (EU, Euratom) 2018/1046
[5] Art 10b, Council Regulation (EU, Euratom) 2020/2093
[6] Art 6.1 and Art 34.6 Regulation (EU) 2024/792

Conclusion

Macro-Financial Assistance has long been about providing concessional financial support to countries in the European neighbourhood. However, with the Ukraine Facility and subsequent instruments, the EU has made its instruments more attractive for recipients, in part thanks to the new unified funding approach.

The increasing use of concessional loans raises two important questions about the EU's financial capabilities. First, one should not underestimate the impact of these new programmes on the EU's public finances. In a past Policy Brief (Spielberger, 2023b), we have seen that the demands of the EU's support to Ukraine have required new budgetary guarantee mechanisms. Creating a new budgetary instrument to subsidise loans to third countries is another way of leveraging the EU's new borrowing powers that may reshape the financial structure of the EU's neighbourhood policy.

Second, it remains unclear under which conditions the EU subsidises Macro-Financial Assistance. The generous terms of the loans to Ukraine can reasonably be justified based on the devastating economic impact that the war has created in the country. However, the reasons for granting similarly concessional terms to Egypt and investments in the Western Balkans are less compelling. If highly concessional loan conditions are to become the norm under the unified funding approach, the EU should revisit and clarify the principles underpinning MFA (European Parliament and Council, 2013), rather than suspend its current framework.

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Further Information

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