COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

on the implementation of macro-financial assistance to third countries in 2008

{SEC(2009) 1279}

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1. INTRODUCTION

This report provides a general overview of the EU macro-financial assistance to third countries, including historical background, a summary of the operations in 2008, information regarding the most recent operations in the candidate and potentially candidate countries as well as in Neighbourhood countries together with statistical tables of the different operations carried out since 1990.

The results of the recent evaluations that have been carried out in 2008 are also included in this report. The objective of the evaluations is to assess the impact of macro-financial assistance on the relevant aspects of the economic stabilisation process and the implementation of structural reforms in the recipient countries. Progress in this respect also reflects the degree to which the corresponding economic policy conditions attached to the EC macro-financial assistance have been met.

Moreover, as regards the recommendation of the Court of Auditors in their special report of March 2002 on improvement of financial management in the beneficiary countries, the Commission has carried out since 2004, with the assistance of an audit firm, several operational assessments of the financial circuits and procedures related to macro-financial assistance in every beneficiary country. The conclusions of these assessments are being duly taken into account in the elaboration of the policy conditions attached to the implementation of this assistance.

This report is submitted in accordance with the Council decisions regarding Community macro-financial or exceptional financial assistance to third countries and follows on from the reports presented in previous years. A more detailed report (working document of the Commission services SEC(2009…) providing economic and financial information regarding the beneficiary countries is released in parallel.

2. OVERVIEW

2.1. Background

Macro-financial assistance (MFA) supports the political and economic reform efforts of the beneficiary countries and is implemented in association with support programmes from the IMF and the World Bank. MFA incorporates a set of principles reaffirmed by the Council in its conclusions of 8 October 2002, which underline the exceptional character of this assistance, its complementarity to financing from the International Financial Institutions (IFIs) and its macroeconomic conditionality. In close co-ordination with the IMF and the World Bank, Community MFA, tailored to specific country needs, has supported several third countries with the overall objective of stabilising the financial situation and establishing market-oriented economies.

2.2. Macro-Financial Assistance in 2008

No new decision was adopted by the Council in 2008.

Disbursements of macro-financial assistance amounted to EUR 25 million for the Republic of Moldova in the form of grant and EUR 15 million also in the form of grant for Lebanon.

2.3. Synthesis of the most recent operations in the beneficiary countries

2.3.1. Western Balkans

Kosovo

The only ongoing MFA operation in the Western Balkans is a budget support grant to Kosovo (under UNSCR 1244/99) of an up to EUR 50 million approved by the Council in November 2006 (Council Decision 2006/880/EC, O.J. L339/36, 6.12.2006). As conditions agreed in a Memorandum of Understanding (MoU) signed with the authorities in December 2007 for the release of this assistance have not been met, the full amount of EUR 50 million could not be released in 2008 and remains outstanding. On 11 July 2008 however, in a Donors' Conference chaired by the Commission to support Kosovo's financing needs for the period 2008-2011, the Commission made a conditional pledge of additional MFA support of up to EUR 100 million, also in the form of budget support grants.

Montenegro and Serbia

On 2 October 2008, the Council adopted Decision 2008/784/EC establishing a separate liability of Montenegro and reducing proportionately the liability of Serbia with regard to the long-term loans granted by the Community to the State Union of Serbia and Montenegro (formerly the Federal Republic of Yugoslavia) pursuant to Decisions 2001/549/EC and 2002/882/EC[1] authorising the Commission to sign a separate loan agreement with the authorities of Montenegro. This decision is the mere outcome of the independence of Montenegro in June 2006 and of an agreement reached between Serbia and Montenegro in July 2006 to allocate external liabilities among the two separate states. It is not creating any new obligations for the Community and has no budgetary implications.

Once a separate loan agreement with Montenegro was concluded and entered into force, Serbia's current liabilities were readjusted by an exchange of letters between the Commission and Serbia.

2.3.2. Eastern Neighbourhood Countries

The Republic of Moldova

In 2008, the Commission completed the implementation of the macro-financial assistance programme decided by the Council on 16 April 2007 totalling EUR 45 million. The second and third instalment, respectively, EUR 10 and 15 million, were released in June and December 2008. The programme was part of the financing package in support of the government's arrangement with the IMF under the Poverty Reduction and Growth Facility (PRGF) dating back to May 2006 and expiring in May 2009.

Georgia

1 OJ L 269, 10.10.2008, p. 8

The programme amounting to EUR 33.5 million in grants, adopted in January 2006, could not be completed. Under this programme, a total amount of EUR 23 million had been disbursed in 2006. However, the review of the conditions for the disbursement of the third and last tranche could not be completed in 2008 (like in 2007) as one of the specific conditions for the release of the tranche was not met: the law regarding the organisation of the external audit was not passed as foreseen by the Parliament. This last instalment has therefore not been disbursed, and the programme has now expired. At the same time, in October 2008, at a Donor Conference held in Brussels, the Commission pledged a new MFA programme for Georgia, in the form of grants of up to EUR 46 million. The support was pledged in the context of the international effort to help Georgia overcome the consequences of the August 2008 conflict with Russia.

2.3.3. Mediterranean countries

Lebanon

In December 2008, the Commission released the first grant instalment of EUR 15 million under the programme of macro-financial assistance approved on 10 December 2007. The programme consists of a grant of EUR 30 million and a loan of EUR 50 million, both to be disbursed in two instalments. The payment of the first tranche of the loan (EUR 25 million) was finally made in early June 2009. The second tranche is planned to be released before the end of 2009 subject to the fulfilment of the conditionalities attached to this assistance

3. GEOGRAPHICAL DISTRIBUTION AND EVALUATIONS OF MACRO-FINANCIAL ASSISTANCE

3.1. Geographical distribution

The EC MFA is intended to support macroeconomic stabilisation of the beneficiary countries and ease their balance of payments (and budget) difficulties. It plays also a very useful role in promoting structural reform. The highest volumes of MFA operations were decided and disbursed in the first years of transition to democracy and market economy in the countries of Central and Eastern Europe.

Over the years, the number of countries to which the Community extended such support expanded, as a growing number of countries neighbouring the EU faced balance of payments difficulties and committed themselves to programmes of economic reform. This led to a change in the geographic balance of assistance from the early years, when most beneficiary countries were countries in Central and Eastern Europe. Hence, since 2000, MFA has been exclusively provided to the Western Balkans (73% of the decisions from 2000 to 2008) and to the NIS countries. The only exception was in 2007 when the Council adopted a Decision on an assistance programme in favour of Lebanon.

3.2. Evaluations

The Commission has implemented an evaluation programme in order to assess the impact of MFA in each of the beneficiary countries. The analyses are carried out by external consultants selected by an open call for tender under the supervision of a "Steering Committee". Since 2004, a total of 7 evaluations have been carried out. Two evaluations were completed in 2008 for Albania and Serbia and Montenegro; the main observations are the following:

3.2.1. Albania

The evaluation assessed Macro Financial Assistance (MFA) provided by the European Commission to Albania in the period April 2004 to July 2006. The MFA consisted of a loan of EUR 9 million and a grant of EUR 16 million that was disbursed in two tranches.

Net impact on macroeconomic stabilisation originated from a direct effect stemming from an increase of budgetary funds in 2006 and 2007, and an indirect effect resulting from channelling public wages through the banking sector which led to an increase in credit facilities. The accumulative effect on GDP growth in the period 2004-2008 is expected to be between 0.1 and 0.6 percent. This is accompanied by a slightly higher inflation and minimally weaker Lek exchange rate.

The evaluation concluded that the MFA had a very limited but positive impact on the medium and long term external sustainability prospects of Albania. Some positive effects can be ascribed to a small direct effect on economic growth in the period 2004-2008. MFA impact on other aspects of external sustainability has been negligible.

3.2.2. Serbia and Montenegro

The evaluation assessed Macro-Financial Assistance (MFA) to Serbia and Montenegro provided in the period November 2002 to February 2006.

The MFA operation allowed for a slightly more expansionary macroeconomic policy which marginally improved economic growth performance. However, the direct short-term macroeconomic impact of the operation was very small. This was mainly because of the relatively small size of the operation. Potentially, MFA assistance could provide more substantial impact on the medium-term macroeconomic outlook through acceleration of structural reforms.

The evaluation concluded that MFA had positively contributed to the medium to long-term external sustainability prospects, albeit this net impact was likely limited and indirect. The primary channel through which MFA acted in this respect appears to be the enforcement of structural reforms and improved overall macroeconomic management.

Evaluations of MFA programmes for Georgia and the Republic of Moldova are on-going and their final reports should be made available in the third quarter of 2009. In addition it has been decided to carry out a meta-evaluation in order to assess the global impact of macro-financial assistance. The first results of this study are expected in the second semester of 2009.

4. IMPROVING FINANCIAL MANAGEMENT IN BENEFICIARY COUNTRIES: THE OPERATIONAL ASSESSMENTS

In 2008 one follow-up operational assessment was carried out (in Kosovo). Between 2004 and 2007, seven operational assessments were completed in countries benefiting from macro-financial assistance (Albania, Armenia, Serbia-Montenegro, Bosnia and Herzegovina, Georgia and Kosovo). The work programme of each operational assessment is elaborated in co-operation with a consulting firm and includes information contained in available reports issued by other donors, and notably the PEFA assessments. Follow up missions have been undertaken (in Albania, Armenia, Tajikistan, Georgia and Kosovo) in order to assess the improvements implemented in the national administrations following the first missions.

The investigations focus, on the one hand, on the independence of the Central banks and on the functioning of their accounting departments. One the other hand, they examine the budget process, the functioning of the treasury departments, the internal audit, human resources and IT departments of the Ministries of Finance. The functioning of the external audit institutions is also reviewed in order to assess their control effectiveness.

The conclusions of the operational assessments are communicated to the national authorities which have the opportunity to comment the analysis contained in the reports.

For each country, the assessments concluded that "The framework for sound financial management is effective" based on the consultant's analyses who pointed out however the need for a number of improvements. The most serious weaknesses that have been detected in the Ministries of Finance are the absence of a single treasury account, of appropriate accounting systems and written procedures, or the low quality of the procurement procedures. The capacity of the internal control had, for every Ministry, to be strengthened with the recruitment of skilled auditors and the implementation of special training sessions. In some cases, macro-economic forecast departments appeared unable to fulfil their role and the independence of the external audit institutions was not considered as sufficient.

With a view to improving the public finance management of the beneficiary countries, recommendations have been addressed to the national authorities to correct weaknesses. Some of these recommendations are considered as prior actions that have to be fulfilled before disbursement can be made. This has been the case for the strengthening of the internal control department within the Ministry of Finance or the adoption of instructions containing minimal requirements regarding the segregation of duties as regards accounting, authorizing and payment functions.

Four years after the beginning of these operational assessments and despite delays in the implementation of some of the requested modifications, the Commission has noticed real improvements, at all level in the public finance management of the beneficiary countries.

5. REQUESTS AND FUTURE COMMISSION PROPOSALS

The global economic and financial crisis means that many pre-accession and neighbourhood countries are faced with an economic slowdown and a deteriorating budget situation; in each of these countries a substantial financial gap is emerging. The IMF is the main institution dealing with the consequences of the economic crisis, particularly in view of the fact that it has benefited from a substantial increase in resources, including a sizable contribution from

European Union Member States. While the IMF will be in the lead in responding to the crisis in countries neighbouring the European Union, the funding it is providing may still not be sufficient to cover these countries' external financing needs. In this context, EU macro-financial assistance could, in helping to narrow the external financing gaps and alleviate pressure on foreign exchange reserves in the pre-accession and neighbourhood countries, support economic stability and reforms in this region closely linked to the EU.

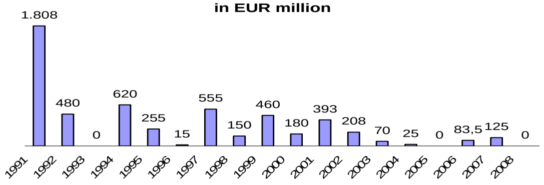
Several pre-accession or neighbourhood countries have requested MFA from the EU. Among the pre-accession countries Serbia, Bosnia and Herzegovina and Montenegro have in recent months requested new macro-financial assistance, either formally or informally. More requests from the Western Balkan countries cannot be excluded. As regards neighbourhood countries, Georgia, Ukraine, Armenia and most recently Belarus and the Republic of Moldova have requested macro-financial assistance. Finally countries not belonging to the immediate neighbourhood of the EU have approached the Commission with requests for MFA: the Kyrgyz Republic and Tajikistan. Also Iceland that was particularly affected by the global financial crisis (collapse of the exchange rate and of its banking system) has requested for financial assistance from the EU. The Commission is examining these requests and - in the course of 2009 – is likely to make formal proposals for new MFA decisions for several of the requesting countries.

Table 1. Macro-financial assistance, 1990-2008
Maximum amounts authorised, millions euro

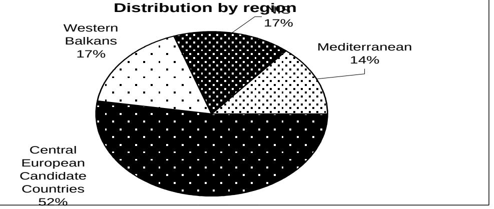
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Totals
By region																				
Central European Candidate Countries	870	1.220	410		255			250		300										**3.305**
Western Balkans			70		35			40		160	55	393	190	70	25		50			**1.088**
NIS					130	255	15	265	150		125		18 (a)				33,5	45		**1.037**
Mediterranean		588			200													80		**868**
Total amounts authorised	**870**	**1.808**	**480**	**0**	**620**	**255**	**15**	**555**	**150**	**460**	**180**	**393**	**208**	**70**	**25**	**0**	**83,5**	**125**	**0**	**6.297,0**
out of which, straight grants		28	70		35			95		70	90	168	130	45	16		83,5	75		**905,0**
		Interest subsidies to Israel	Albania		Albania			Armenia and Georgia (95)		Bosnia (40) fYRoM (30)	Kosovo (35) Montenegro (20) Tajikistan (35) Republic of Moldova (15)	fYRoM (18) Serbia and Montenegro (120) Kosovo (30)	Serbia and Montenegro (75) Bosnia (40) Republic of Moldova (15) (b)	Serbia and Montenegro (45)	Albania (16)		Kosovo (50) Georgia (33,5)	Republic of Moldova (45) Lebanon (30)		

(a) net amount taking into account (b) and, for Ukraine, new loan of EUR 110 million together with simultaneous cancellation of EUR 92 million out of the EUR 150 million loan decided in 1998.
(b) grant of EUR 15 million and simultaneous cancellation of the EUR 15 million loan decided in 2000

Graph 1a. Maximum amounts authorised by year, in EUR million



Graph 1b. MFA 1990-2008, authorisations Distribution by region



Graph 1c. MFA 2000-2008, authorisations Distribution by region

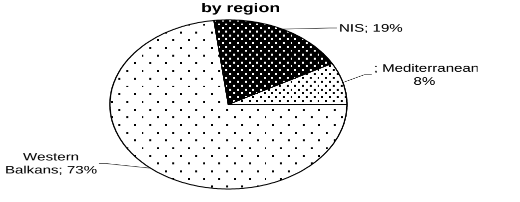


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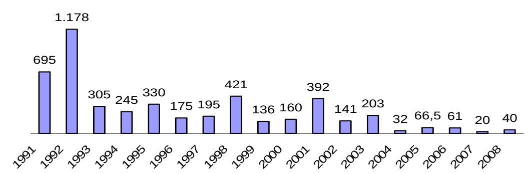
Table 2. Macro-financial assistance, 1990-2008
Disbursements, millions euro

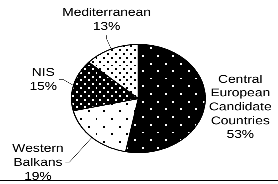
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Totals
By region																				
Central European Candidate Countries	350	695	705	270	70	80	40	70	250	40	160			50						**2.780**
Western Balkans			35	35		15	20	25	15	25		312	130	146	20	58	32			**973**
NIS					25	135	115	100	156	71		80	11	7	12	8,5	29	20	25	**795**
Mediterranean			438		150	100													15	**703**
Total amounts disbursed	**350**	**695**	**1.178**	**305**	**245**	**330**	**175**	**195**	**421**	**136**	**160**	**392**	**141**	**203**	**32**	**66,5**	**61**	**20**	**40**	**5.251**
out of which, straight grants			63	35		15	20		18	28	85	105	141	85	22	51,5	42	20	40	**770,0**
			Israel (28) Albania (35)	Albania		Albania	Albania		Armenia (8) Georgia (10)	Armenia (4), Georgia (9), Bosnia (15)	Bosnia (10) fYRoM (20) Kosovo (35) Montenegro (20)	Bosnia (15) fYRoM (10) Kosovo (15) Serbia and Montenegro (ex FRY) (35) Georgia (6) Tajikistan (14)	Armenia (11) Kosovo (15) Serbia and Montenegro (115)	Bosnia (25, Serbia and Montenegro (35), fYRoM (18), Tajikistan (7)	Serbia and Montenegro (10) Armenia (5,5) Georgia(6,5)	Serbia and Montenegro (25) Bosnia(15) Albania(3) Armenia (1,5) Tajikistan (7)	Albania (13) Tajikistan (7) Georgia (22)	Republic of Moldova (20)	Republic of Moldova (25) Lebanon (15)	

NB: 2000 figures include disbursements in favour of Bosnia, fYRoM and Montenegro which, for technical reasons, took place in early January 2001.
2001 figures include disbusements in favour of fYRoM and Tajikistan which, for technical reasons, took place in early January 2002.
2002 figures include disbursements in favour of Bosnia and Tajikistan which, for technical reasons, took place in early 2003.

Graph 2a. Amounts disbursed by year, in EUR million



Graph 2b. MFA 1990-2008, disbursements, Distribution by region



Graph 2c. MFA 2000-2008, disbursements, Distribution by region