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2010/0390 (COD)

Proposal for a

DECISION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

providing further macro-financial assistance to Georgia

SEC(2010) 1617 final

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EXPLANATORY MEMORANDUM

(1) Context of the proposal

- **Grounds for and objectives of the proposal**

The EU completed in early August 2010 the disbursement of a EUR 46 million macro-financial assistance (MFA) operation to Georgia approved by the Council in November 2009. The assistance, which was provided in the form of grants, was part of a pledge of two possible MFA operations of the same amount made by the European Commission at the International Donors' Conference of October 2008[1]. The approval of the second MFA was conditional on the continued existence of external financing needs over and above those covered by the IMF arrangement.

In a letter from 10 May 2010, the Georgian Minister of Finance requested the activation of the second part of the Commission pledge of EU funds, amounting to EUR 46 million. In this context, a European Commission team visited Georgia in early September to assess the country's macroeconomic situation and prospects in 2010-11, focusing on the balance of payments and budgetary needs.

The Commission considers that the activation of the second part of the MFA pledged in 2008 is warranted. Although the Georgian economy is recovering (following the double shock caused by the military conflict with Russia of August 2008 and the global financial crisis), the balance of payments and budgetary position remain weak and vulnerable. In particular, the lingering effects of the conflict with Russia, including the blockade of most direct trade with this country and the failure of foreign direct investment (FDI) inflows to recover to their pre-crisis level, combined with a still very sizeable current account deficit and substantial debt repayment obligations (with a serious bunching expected for 2012-14), leave the balance of payments fragile.

In this context, the Commission proposes a further MFA to Georgia, amounting to EUR 46 million. The EU MFA would be aimed at contributing to covering the country's external financing needs, as identified in cooperation with the IMF in the context of the IMF Stand-By Arrangement (SBA) of USD 1.17 billion, in place since October 2008. The proposed assistance would be provided half in grants and half in loans.

The new MFA would contribute to help Georgia to address the economic consequences of the conflict with Russia and the global crisis. The new MFA will support the economic reform agenda of the government. It would reduce the short-term financial vulnerability still faced by the economy, while supporting reform measures aimed at achieving a more sustainable balance of payments and budgetary situation over the medium-term. The assistance would also promote policy measures to strengthen public finance management (building on those of the previous operation and of the EU's sectoral budgetary support operation), as well as measures to foster economic and financial integration with the EU, in particular by exploiting the potential offered by the future Association Agreement, which aims at concluding a Deep and

[1] The total assistance pledged at this Donors' Conference by the EC amounted to up to EUR 500 million and was aimed at supporting the Georgian economy in the aftermath of the August 2008 armed conflict with Russia and in the context of the global financial crisis.

Comprehensive Free Trade Agreement between the two parties.

The proposed new MFA would be exceptional and limited in time and is intended to run in parallel to the SBA. It will complement support from international and bilateral donors.

- **General context**

In the aftermath of the double shock of the military conflict with Russia of August 2008 and the global crisis, the Georgian economy is showing signs of recovery. Following two years of low or negative growth, 2010 is expected to see the revival of economic activity. While 2009 saw a contraction of real GDP by 3.9%, the first half of 2010 recorded a strong growth of 6.6% (on an annual basis). Annual CPI inflation is expected to pick up and reach over 8% by end-2010, partly reflecting the increase in prices of imported cereals. On the back of the economic recovery, the government has decided to tighten its budgetary and monetary policies. Under the programme agreed with the IMF, the fiscal deficit is to be reduced from 9.2% of GDP in 2009 to 6.3% in 2010 and 4.8% of GDP in 2011. Monetary policy began to be tightened in the summer, with the key policy interest rate being moderately increased, to keep inflation under control.

While the economic recovery seems to be taking hold, the economic situation remains vulnerable as the financing of the large current account deficit remains uncertain. By weakening domestic demand, the crisis contributed to a halving of the current account deficit in 2009. However, the deficit remains very large and is projected to reach 12.0% of GDP in 2010, and the situation is not expected to improve in 2011. Georgia's exports continue to suffer from the trade embargo imposed by Russia in 2006 and extended in 2008.

For 2010-11, the financing of the current account is still uncertain. FDI inflows were negatively affected by the crisis and are projected to decline even further in 2010, while not much recovery in FDI inflows is expected in 2011. This disappointing performance of FDI inflows puts at risk the financing of the current account and the build up of international currency reserves and shows that foreign investor confidence, which experienced a dramatic blow due to the military conflict with Russia in 2008, has still not returned. It also reflects the loss of steam of the privatisation process, as many of the most attractive state assets have already been sold.

Although gross international reserves have recovered from a trough of USD 1.5 billion trough reached during the crisis to USD 2.1 billion at the end of September 2010, they remain at a suboptimal level, particularly since this recovery has partly been achieved by borrowing from the IMF. Net international reserves have actually declined from USD 850 million in September 2008 to USD 740 million in September 2010. A further vulnerability in the balance of payments relates to the high level of external public debt and a significant need for a debt roll-over in the coming years.

In September 2008, the IMF approved an 18-month Stand-By Arrangement for Georgia, worth USD 750 million. During the third programme review, approved by the IMF Executive Board in August 2009, the Stand-By Arrangement was extended until 14 June 2011 and the financing package increased, bringing the total Stand-By Arrangement programme to USD 1.17 billion. The programme remains on-track: on 9 July 2010, the IMF Board completed the sixth review of the IMF Stand-By

Arrangement, concluding that performance under the programme has been broadly satisfactory. The next IMF review, which combines the seventh and the eight reviews, is scheduled for November 2010.

The overall support package for 2008-2010 pledged by the international donor community at the 2008 Donors' Conference amounted to USD 4.5 billion, including USD 1 billion from the USA, USD 200 million from Japan, USD 173 million from the EU Member States and USD 2.4 billion from the Multilateral Financial Institutions. The total public sector commitment amounted to USD 2.6 billion and the disbursements related to this commitment have been largely frontloaded.

- **Existing provisions in the area of the proposal**

None

- **Consistency with the other policies and objectives of the Union**

Georgia is one of the EU partner countries in the framework of the European Neighbourhood Policy (ENP). The EU-Georgia ENP Action Plan was adopted in November 2006 for a period of five years. The European Union has a vital interest in seeing stability, better governance and economic development at its Eastern borders. To this end, the Eastern Partnership initiative was officially launched by the EU and the six partner countries during the Prague Summit on 7 May 2009.

The European Commission pledged up to EUR 500 million of assistance to Georgia at the October 2008 International Donors' Conference. The sources of the funding include both programmed funds under the envelope of the European Neighbourhood and Partnership Instrument (ENPI) and crisis instruments, such as the Instrument for Stability, Humanitarian Aid and Macro-Financial Assistance. The package provides a direct response to the economic and social hardships the country endured as a result of the military conflict in August 2008 and the consequence of the global financial crisis. The EU MFA complements other assistance instruments by providing short-term macroeconomic support to Georgia in the context of the IMF-supported Stand-By Arrangement. It also complements the ENPI budget support, which contributes to covering Georgia's financing needs and is linked to specific sectoral reforms.

The proposal for the new MFA to Georgia is fully consistent with the guidelines for the MFA, as provided by the Council conclusions of 2002 on MFA and the accompanying letter of the Council President to the Commission President. In particular, and as explained in more detail in the Staff Working Document accompanying the Commission's proposal, the proposal is consistent with the following guidelines: exceptional character, political preconditions, complementarity, conditionality and financial discipline.

(2) Consultation of interested parties and impact assessment

- **Consultation of interested parties**

MFA is provided as an integral part of the international support to Georgia's post-conflict economic recovery. The Commission services cooperated closely with the World Bank in the preparations for the International Donors' Conference and consultations on the implementation of the pledged package have been held with the multilateral and bilateral donors. In the preparation of this proposal for MFA, the Commission services have consulted with the International Monetary Fund. The Commission consulted the EU Member States in the Economic and Financial Committee before submitting its proposal for MFA. The Commission has also been in regular contact with the Georgian government.

- **Collection and use of expertise**

An Operational Assessment verifying the quality and reliability of Georgia's public financial circuits and administrative procedures will be carried out by the Commission with the assistance of external experts.

- **Impact assessment**

The MFA and the economic adjustment and reform programme attached to it will help alleviate Georgia's short-term financing needs while supporting policy measures aimed at strengthening medium-term balance of payments and fiscal sustainability, raising sustainable growth and promoting economic integration and regulatory convergence with the EU. It will also help improve the efficiency and transparency of public finance management, building on the positive impact of the previous MFA operation in the country. MFA will also support the macroeconomic stabilisation and structural policies of the programme agreed with the IMF.

(3) Legal elements of the proposal

- **Summary of the proposed action**

The European Union shall make MFA available to Georgia, half of which will be provided as grants and half as loans, for a total maximum amount of EUR 46 million. The assistance will contribute to cover Georgia's residual external financing needs in 2009-2011, as identified by the Commission based on the estimates of the IMF.

The assistance is planned to be disbursed in 2011 in two equal instalments, each of them consisting of a grant and a loan element. The assistance will be managed by the Commission. Specific provisions on the prevention of fraud and other irregularities, consistent with the Financial Regulation, will be taken into account. The disbursement of the first instalment is expected to take place in the first quarter of 2011. The second instalment, conditional on a number of policy measures, could be disbursed in the third quarter of 2011.

As usual with the MFA instrument, the disbursements would be conditional on successful programme reviews under the IMF's Stand-By Arrangement. In addition, the Commission and the Georgian authorities would agree on specific structural reform measures in a Memorandum of Understanding. In the context of the previous MFA operations, the Commission services have worked closely with the Georgian authorities on public finance management (PFM) reforms that aim at establishing a more transparent, coherent and accountable PFM system. In the new MFA operation, the scope of the policy conditionality would be enlarged, notably to measures aimed at fostering the economic and financial integration as well as regulatory harmonisation with the EU in selected areas, under the ENP Action Plan and taking into account the new context created by the plan to conclude an Association Agreement between the EU and Georgia. Following the successful implementation of the last MFA, in which the Georgian authorities demonstrated the political will and the capacity to implement structural reforms, the Commission believes that also this second MFA operation would contribute to the implementation of the government's agenda of structural reforms. The conditions will be consistent with the priorities of the EU-Georgia ENP Action Plan.

The decision to disburse half of the proposed assistance in grants and the other half in loans is justified by Georgia's level of development (as measured by its per capital income) and debt indicators, and the recent improvement in the country's economic situation. The full use of grants in the previous operation had to be understood as an exceptional decision justified by the very difficult circumstances Georgia found itself in late 2008. The blend of grants and loans is also consistent with the fact that Georgia has been a blend country for the World Bank since January 2009. For the upcoming World Bank operations, the country is expected to receive one third of the World Bank assistance in the form of the IDA lending, while two thirds of the assistance are expected to be provided on IBRD terms.

- **Legal basis**

The legal basis for this proposal is Article 212 of the TFEU.

- **Subsidiarity principle**

The proposal falls under the mixed competence of the EU. The subsidiarity principle applies to the extent that the objectives of restoring short-term macroeconomic stability in Georgia cannot be sufficiently achieved by the Member States alone and can therefore be better achieved by the European Union. The main reasons are the budgetary constraints met at the national level and the need for strong donor coordination in order to maximise the scale of assistance.

- **Proportionality principle**

The proposal complies with the proportionality principle: it confines itself to the minimum required in order to achieve the objectives of short-term macro economic stability and does not go beyond what is necessary for that purpose.

As identified by the Commission based on the estimates of the IMF in the context of the Stand-By-Arrangement, the amount of the assistance corresponds to 14% of the residual financing gap for the period 2009-2011. This is deemed an appropriate level of burden-sharing for the EU, given the assistance pledged to Georgia by EU Member States and other bilateral donors and multilateral creditors.

- **Choice of instruments**

Proposed instruments: other.

Other instruments would not be adequate because, in the absence of a framework regulation for the Macro-Financial Assistance instrument, ad hoc Council decisions under Article 212 of the TFEU are the only available legal instrument for this assistance.

Project finance or technical assistance would not be suitable to address these macroeconomic objectives. The key value added of the MFA in comparison to other EU instruments would be to alleviate the external financial constraint and to help create a stable macroeconomic framework, including by promoting a sustainable balance of payments and budgetary situation, and an appropriate framework for structural reforms. By helping to put in place an appropriate overall framework for macroeconomic and structural policies, MFA can increase the effectiveness of the actions financed in Georgia under other, more narrowly focused EU financial instruments.

(4) Budgetary implications

The grant element of the assistance of EUR 23 million would be financed from commitment appropriations of the 2011 budget, under the budget line 01 03 02 (Macroeconomic assistance), with payments taking place in 2011.

In line with the Guarantee Fund Regulation[2], the provisioning of the Guarantee Fund is expected to take place in 2013 and to amount to a maximum of EUR 2.1 million. This corresponds to 9% of the EUR 23 million loan expected to be disbursed in 2011.

(5) Additional information

- **Review/revision/sunset clause**

The proposal includes a sunset clause. The proposed MFA would be made available for 2.5 years starting from the first day after the entry into force of the Memorandum of Understanding.

[2] Article 5 of Council Regulation (EC, Euratom) No 480/2009 of 25 May 2009 establishing a Guarantee Fund for external action (codified version). The provisioning is appropriated from "the provisioning of the Guarantee Fund" (budget line 01 04 01 14).

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THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the functioning of the European Union, and in particular Article 212 (2) thereof,

Having regard to the proposal from the Commission[3],

After transmission of the draft legislative act to the National Parliaments,

Acting in accordance with the ordinary legislative procedure[4],

Whereas:

(1) Relations between Georgia and the European Union are developing within the framework of the European Neighbourhood Policy. In 2006, the EU and Georgia agreed on a European Neighbourhood Policy Action Plan identifying medium-term priorities in EU-Georgia relations. In 2010, the EU and Georgia launched the negotiations of an Association Agreement that is expected to replace the existing Partnership and Cooperation Agreement. The framework of EU-Georgia relations is further enhanced by the newly launched Eastern Partnership.

(2) The extraordinary European Council on 1 September 2008 confirmed the EU's willingness to strengthen EU-Georgia relations in the aftermath of the armed conflict in August 2008 between Georgia and Russia.

(3) Georgian economy has been affected by the international financial crisis since the third quarter of 2008, with declining output, falling fiscal revenues and rising external financing needs.

(4) At the International Donors' Conference held in October 2008 the international community pledged support to Georgia's economic recovery in line with the Joint Needs Assessment carried out by the United Nations and the World Bank.

(5) The European Union announced up to EUR 500 million of assistance to Georgia.

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3 OJ C […], […], p. […].

4 Position of the European Parliament of … 2010 and Decision of the Council of … 2010.

(6) Georgian economic adjustment and recovery is supported by financial assistance of the International Monetary Fund (IMF). In September 2008, the authorities of Georgia agreed with the IMF on a Stand-By Arrangement of USD 750 million to support Georgian economy to achieve the necessary adjustment to the economic crisis.

(7) Following a further deterioration of the economic situation and a necessary revision of the programme's underlying economic assumptions as well as higher external financing needs, an agreement was reached between Georgia and the IMF for an extension by USD 424 million of the Stand-By Arrangement, which was approved in August 2009 by the IMF Board.

(8) The European Union intends to provide, in 2010-2012, under the European Neighbourhood and Partnership Instrument (ENPI), budget support grants of a total of EUR 37 million per year.

(9) Georgia has requested European Union macro-financial assistance in view of the worsening economic situation and outlook.

(10) Given that there is still a residual financing gap in the balance of payments, macro-financial assistance is considered an appropriate response to Georgia's request under the current exceptional circumstances to support economic stabilisation in conjunction with the current IMF programme.

(11) The European Union macro-financial assistance should not merely supplement programmes and resources from the IMF and the World Bank, but should ensure the added value of Union involvement.

(12) The Commission should ensure that the Union macro-financial assistance is legally and substantially in line with the measures taken within the different areas of external action and other relevant Union policies.

(13) The specific objectives of the Union macro-financial assistance should strengthen efficiency, transparency and accountability. These objectives should be regularly monitored by the Commission.

(14) The conditions underlying the provision of the Union macro-financial assistance should reflect the key principles and objectives of the Union’s policy towards Georgia.

(15) In order to ensure efficient protection of the European Union’s financial interests linked to this macro-financial assistance, it is necessary that Georgia adopts appropriate measures relating to the prevention of, and the fight against, fraud, corruption and any other irregularities linked to this assistance. It is also necessary that the Commission provides for appropriate controls and that the Court of Auditors provides for appropriate audits.

(16) The release of the European Union financial assistance is without prejudice to the powers of the budgetary authority.

(17) This assistance should be managed by the Commission. In order to ensure that the European Parliament and the Economic and Financial Committee are able to follow the implementation of this Decision, the Commission should regularly inform them of developments relating to the assistance and provide them with relevant documents.

(18) According to Article 291 of the Treaty on the Functioning of the European Union, rules and general principles concerning mechanisms for the control by Member States of the Commission's exercise of implementing powers shall be laid down in advance by a regulation adopted in accordance with the ordinary legislative procedure. Pending the adoption of that new regulation, Council Decision 1999/468/EC of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission[5] continues to apply, with the exception of the regulatory procedure with scrutiny, which is not applicable,

HAS ADOPTED THIS DECISION:

Article 1

1. The European Union shall make available to Georgia macro-financial assistance, with a maximum amount of EUR 46 million, with a view to supporting Georgia's economic stabilisation and covering its balance of payments needs as identified in the current IMF programme. Of this amount, up to EUR 23 million shall be provided in the form of grants and up to EUR 23 million in the form of loans. The release of the proposed macro-financial assistance is subject to the approval of Budget 2011 by the Budgetary Authority.

2. To finance the loan component of the assistance, the Commission is empowered to borrow the necessary resources on behalf of the European Union. The loan shall have a maximum maturity of 15 years.

3. The release of the European Union financial assistance shall be managed by the Commission in a manner consistent with the agreements or understandings reached between the IMF and Georgia and with the key principles and objectives of economic reform set out in the EU-Georgia Partnership and Cooperation Agreement. The Commission shall regularly inform the European Parliament and the Economic and Financial Committee, of developments in the management of the assistance and provide them with relevant documents.

4. The European Union financial assistance shall be made available for two years and six months starting from the first day after the entry into force of the Memorandum of Understanding referred to in Article 2(1).

Article 2

1. The Commission, acting in accordance with the advisory procedure referred to in Article 6(2), shall be empowered to agree with the authorities of Georgia on the economic policy and financial conditions attached to the European Union macro-financial assistance, to be laid down in a Memorandum of Understanding which shall include a timeframe for their fulfilment (hereafter the 'Memorandum of Understanding'). The conditions shall be consistent with the agreements or understandings referred to in Article 1(3). These conditions will aim, in particular, at strengthening the efficiency, transparency and accountability of the assistance,

5 OJ L 184, 17.7.1999, p. 23.

including public finance management systems in Georgia. Progress in attaining these objectives shall be regularly monitored by the Commission. The detailed financial terms of the assistance shall be laid down in the Grant Agreement and the Loan Agreement to be agreed between the Commission and the authorities of Georgia.

2. During the implementation of the European Union financial assistance, the Commission shall monitor the soundness of Georgia's financial arrangements, the administrative procedures and the internal and external control mechanisms which are relevant to such assistance and the adherence to the agreed timeframe.

3. The Commission shall verify at regular intervals that Georgia's economic policies are in accordance with the objectives of the European Union macro-financial assistance and that the agreed economic policy conditions are being satisfactorily fulfilled. In doing so, the Commission shall coordinate closely with the International Monetary Fund and the World Bank, and, when required, with the Economic and Financial Committee.

Article 3

1. Subject to the conditions of paragraph 2, the European Union financial assistance shall be made available by the Commission to Georgia in two instalments, each of them consisting of a grant and a loan element. The size of each instalment shall be laid down in the Memorandum of Understanding.

2. The Commission shall decide on the release of the instalments subject to satisfactory implementation of the economic policy conditions agreed in the Memorandum of Understanding. The disbursement of the second instalment shall not take place earlier than three months after the release of the first instalment.

3. The European Union funds shall be paid to the National Bank of Georgia. Subject to provisions to be agreed in the Memorandum of Understanding, including a confirmation of residual budgetary financing needs, the Union funds may be transferred to the Treasury of Georgia as the final beneficiary.

Article 4

1. The borrowing and the lending operations related to the loan component of the European Union assistance shall be carried out in euro using the same value date and shall not involve the European Union in the transformation of maturities, in any exchange or interest rate risks, or in any other commercial risk.

2. The Commission shall take the necessary steps, if Georgia so requests, to ensure that an early repayment clause is included in the loan terms and conditions and that it is matched by a corresponding clause in the terms and conditions of the borrowing operations.

3. At the request of Georgia and where circumstances permit an improvement of the interest rate of the loan, the Commission may refinance all or part of its initial borrowings or restructure the corresponding financial conditions. Refinancing or restructuring operations shall be carried out in accordance with the conditions set out

in paragraph 1 and shall not have the effect of extending the average maturity of the borrowing concerned or increasing the amount of capital outstanding at the date of the refinancing or restructuring.

4. All costs incurred by the European Union which are related to the borrowing and lending operations under this Decision shall be borne by Georgia.

5. The European Parliament and the Economic and Financial Committee shall be kept informed of developments in the operations referred to in paragraphs 2 and 3.

Article 5

The European Union financial assistance shall be implemented in accordance with the provisions of Council Regulation (EC, Euratom) No 1605/2002 of 25 June 2002 on the Financial Regulation applicable to the general budget of the European Communities[6] and its implementing rules. In particular, the Memorandum of Understanding, the Loan Agreement and the Grant Agreement to be agreed with the authorities of Georgia shall provide for appropriate measures in relation to the prevention of, and the fight against, fraud, corruption and other irregularities affecting the assistance. In order to ensure greater transparency in the management and disbursement of funds, the Memorandum of Understanding, the Loan Agreement and the Grant Agreement shall also provide for controls, including on-the-spot checks and inspections, to be carried out by the Commission, including the European Anti-Fraud Office. They shall in addition provide for audits, including where appropriate on-the-spot audits, by the Court of Auditors.

Article 6

1. The Commission shall be assisted by a committee.

2. Where reference is made to this paragraph, Articles 3 and 7 of Decision 1999/468/EC shall apply, having regard to the provisions of Article 8 thereof.

Article 7

1. By 30 June of each year, the Commission shall submit to the European Parliament and to the Council a report on the implementation of this Decision in the preceding year, including an evaluation thereof. The report shall indicate the connection between the policy conditions as laid down in the Memorandum of Understanding, Georgia's on-going economic and fiscal performance and the Commission's decisions to release the instalments of the assistance.

2. No later than two years after the expiry of the availability period referred to in Article 1(4), the Commission shall submit to the European Parliament and to the Council an *ex post* evaluation report.

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6 OJ L 248, 16.9.2002, p. 1. Regulation as amended by Regulation (EC, Euratom) No: 1995/2006 (OJ L 390, 30.12.2006, p. 1)

Article 8

This Decision shall take effect on the day of its publication in the *Official Journal of the European Union*.

Done at Brussels, […]

For the European Parliament
The President
[…]

For the Council
The President
[…]

Annex 3: LEGISLATIVE FINANCIAL STATEMENT FOR PROPOSALS

1. FRAMEWORK OF THE PROPOSAL/INITIATIVE

1.1. Title of the proposal/initiative

Macro-financial assistance to Georgia

1.2. Policy area(s) concerned in the ABM/ABB structure[7]

Policy area: Title 01 – Economic and Financial Affairs **Activity: 03 – International economic and financial affairs**

1.3. Nature of the proposal/initiative

X The proposal/initiative relates to **a new action**

☐ The proposal/initiative relates to **a new action following a pilot project/preparatory action**[8]

☐ The proposal/initiative relates to **the extension of an existing action**

☐ The proposal/initiative relates to **an action redirected towards a new action**

1.4. Objectives

1.4.1. The Commission's multiannual strategic objective(s) targeted by the proposal/initiative:

"To promote prosperity beyond the EU"

The major areas of DG ECFIN related activity pertain to:

1. Fostering the implementation of the European Neighbourhood Policy by deepening economic analysis and strengthening policy dialogue and advice on the economic aspects of the Action Plans.

2. Developing, monitoring and implementing macro-financial assistance for partner third countries, in co-operation with the relevant international financial institutions.

1.4.2. Specific objective(s) and ABM/ABB activity(ies) concerned

Specific objective No 3: "Providing macro-financial assistance to third countries in resolving their balance of payment crises and restoring external debt sustainability"

ABM/ABB activity concerned: International Economic and Financial Relations, global governance.

[7] ABM: Activity-Based Management – ABB: Activity-Based Budgeting.

[8] As referred to in Article 49(6)(a) or (b) of the Financial Regulation.

1.4.3. *Expected result(s) and impact*

The proposed assistance consists of an EU loan of EUR 23 million and a grant of up to EUR 23 million to Georgia (the grant to be financed from the General Budget), with a view to contributing to a more sustainable balance of payments situation. The assistance will help the country overcome the economic and social hardships endured as a result of the military conflict in August 2008 and the consequences of the global financial crisis. It will also promote structural reforms aimed at raising sustainable economic growth, improving public finance management and strengthening economic integration and regulatory approximation with the EU.

An ex-ante evaluation (see the Staff Working Document accompanying the Commission proposal) was carried out by Commission services in September-October 2010 (by Unit D2 of the Economic and Financial Affairs Directorate-General). It concluded that the EU macro-financial assistance was warranted.

1.4.4. *Indicators of results and impact*

The authorities, notably the Ministry of Finance, will be required to report on a set of indicators to the Commission services on a regular basis. They will also provide a comprehensive report on the compliance with the agreed policy conditions ahead of the disbursement of the second instalment of the assistance.

The Commission services will continue to monitor public finance management, following the operational assessment of the financial circuits and administrative procedures that is being carried out in Georgia in preparation of this operation. The Delegation of the European Union to Georgia will also provide regular reporting on issues that are relevant for the monitoring of the assistance. The Commission services will remain in close contact with the IMF and the World Bank to benefit from their insights from their on-going activities in Georgia.

An independent ex-post evaluation of the EU macro-financial assistance provided to Georgia 2006-2008 was finalised in January 2010. The MFA operation implemented between late 2009 and mid-2010 will be subject to ex-post evaluation in 2011. The present operation will be subject to ex-post evaluation within two years after the expiry of its implementation period.

An annual report to the Council and European Parliament is foreseen in the proposed decision of the European Parliament and the Council, comprising an assessment of the implementation of this assistance operation.

1.5. Grounds for the proposal/initiative

1.5.1. *Requirement(s) to be met in the short or long term*

The disbursement of the assistance will be conditional upon a satisfactory track record in the implementation of the present three-year arrangement agreed between Georgia and the IMF under the Stand-By Arrangement (SBA). In addition, the Commission shall agree with the Georgian authorities on a number of specific policy conditions which have to be met before the second instalment is released by the Commission. These policy measures shall be consistent with agreements reached by Georgia with the IMF. Before the release of the second instalment of the assistance, the Commission services, in co-operation with the national authorities, shall verify that the policy conditions have been fulfilled.

1.5.2. *Added value of EU involvement*

By helping the country overcome the economic shock caused by the conflict with Russia and the global crisis, the proposed EU MFA will contribute to promote macroeconomic and political stability in the Eastern neighbourhood / Eastern Partnership region and closer economic and political ties between Georgia and the EU. By complementing the resources made available by the international financial institutions and other donors, it contributes to the overall effectiveness of the package of financial support agreed by the international donor community in the aftermath of the crisis.

In addition to the financial impact of the MFA, the proposed programme will strengthen the government's reform commitment and its aspiration towards closer relations with the EU. In a wider context, the proposed action fits well into the EU's general approach towards Georgia, which is one of a stronger engagement, as reflected in the opening of negotiations on an Association Agreement, a key component of which will be the conclusion of the Deep and Comprehensive Free Trade Area.

The MFA operation adds value to the EU involvement in Georgia as it is mobilized to help Georgia in dealing with serious short-term balance-of-payments difficulties. It is expected to help create a stable macroeconomic framework, including by promoting a sustainable balance of payments and budgetary situation. The assistance underpins the implementation of strong adjustment and structural reform measures to remedy these difficulties. The general budget support assistance, as provided under the ENPI, has more long-term oriented development objectives and would not be appropriate as a short-term balance of payments support instrument.

1.5.3. *Lessons learned from similar experiences in the past*

A recent external evaluation of a similar assistance provided to Georgia in the past indicates that the practice of selecting a limited number of key structural reforms has been successful and suggests continuing this practice with adequate monitoring and close policy dialogue being maintained throughout the implementation period of the assistance. Furthermore, good results in the overall reform agenda during the previous MFA operation allows the Commission to follow the same orientation for the proposed operation.

1.5.4. *Coherence and possible synergy with other relevant instruments*

Regarding the coherence and possible synergy with other EU instruments, the EU package of assistance to Georgia includes programmed funds under the ENPI envelope and crisis instruments (the Instrument for Stability, Humanitarian Aid and the MFA). The package also includes the costs for the EU Civilian Monitoring Mission in Georgia. Through the programmed sectoral budget support, the ENPI envelope has so far supported reforms in the area of public finance management, criminal justice sector, vocational education and training and regional development. For the period of 2011-2013 a new ENPI package of EUR 180 million has been allocated. The key value added of the MFA in comparison to other EU instruments would be to help create a stable macroeconomic framework, including by promoting a sustainable balance of payments and budgetary situation, and an appropriate framework for structural reforms.

MFA does not provide a regular financial support nor is meant to support the economic and social development of the recipient countries. The MFA is to be discontinued as soon as the country's external financial situation has been brought back into a sustainable path. Afterwards, regular EU cooperation assistance instruments are meant to take over, notably the direct budget support provided under the ENPI Regulation.

MFA is also meant to be complementary to interventions by the international financial institutions; in particular the IMF supported adjustment and reform programmes. The assistance of macroeconomic nature is released only if economic and financial policy conditions are fulfilled.

1.6. Duration and financial impact

X Proposal/initiative of **limited duration**

– X Proposal/initiative in effect: for 2.5 years from the entry into force of the Memorandum of Understanding, as stated in the Art 2(1) of the proposed Decision.

– ☐ Financial impact from YYYY to YYYY

☐ Proposal/initiative of **unlimited duration**

– Implementation with a start-up period from YYYY to YYYY,

– followed by full-scale operation.

1.7. Management mode(s) envisaged[9]

X Centralised direct management by the Commission

☐ Centralised indirect management with the delegation of implementation tasks to:

– ☐ executive agencies

– ☐ bodies set up by the Union[10]

– ☐ national public-sector bodies/bodies with public-service mission

– ☐ persons entrusted with the implementation of specific actions pursuant to Title V of the Treaty on European Union and identified in the relevant basic act within the meaning of Article 49 of the Financial Regulation

☐ **Shared management** with the Member States

9 Details of management modes and references to the Financial Regulation may be found on the BudgWeb site: http://www.cc.cec/budg/man/budgmanag/budgmanag_en.html

10 As referred to in Article 185 of the Financial Regulation.

☐ **Decentralised management** with third countries

☐ **Joint management** with international organisations

If more than one management mode is indicated, please provide details in the "Comments" section.

Comments :

Active cooperation will be sought from the EU Delegations in the monitoring of the assistance.

2. MANAGEMENT MEASURES

2.1. Monitoring and reporting rules

This assistance is of macroeconomic nature and its design is consistent with the IMF-supported economic programme. The monitoring of the action by the Commission services will take place on the basis of progress in the implementation of the SBA arrangement and specific reform measures to be agreed with the Georgian authorities in a Memorandum of Understanding. The authorities, notably the Ministry of Finance, will be required to report on a set of indicators to the Commission services on a quarterly basis and will provide a comprehensive compliance report ahead of the disbursement of the second instalment of the operation.

The Commission services will continue to monitor public finance management, following the operational assessment of the financial circuits and administrative procedures that will be carried out in Georgia in December 2010 in preparation of this operation. The Delegation of the European Union to Georgia will also provide regular reporting on issues that are relevant for the monitoring of the assistance. The Commission services will remain in close contact with the IMF and the World Bank to benefit from their on-going activities in Georgia.

An annual report to the Council and to the European Parliament is foreseen in the proposed decision of the European Parliament and the Council and, comprising an assessment of the implementation of this assistance operation. Furthermore, an independent ex-post evaluation of the assistance is planned to be carried out by the Commission or its duly authorised representatives within two years after the expiry of the implementation period.

2.2. Management and control system

2.2.1. Risks identified

There are fiduciary, policy and political risks related to this macro-financial assistance operation.

There is a risk that the macro-financial assistance, which is not dedicated to specific expenses (contrary to project financing, for example), could be used in a fraudulent way. In general terms, this risk is related to factors such as central bank independence, quality of management systems and administrative procedures, control and oversight functions in the financial circuits, security of IT systems, and adequate internal and external audit capabilities.

As regards policy risks, the main assumption is that the Government of Georgia will remain committed to fiscal adjustment and compliance with its agreement with the IMF. This will be validated on the basis of IMF's regular monitoring of performance indicators and structural benchmarks. There is a risk that the Government of Georgia will not comply with the IMF programme conditions, as the programme targets may turn out more difficult to reach than assumed and as political conditions in the country may change. However, the authorities have shown strong commitment to work with international institutions to implement the reform agenda.

Consolidation of the democratic reforms and institutions is at the core of the EU's relations with Georgia. There are some shortcomings in the independence of the judiciary and there is a need to strengthen a pluralistic media landscape. The ongoing process of Constitutional reform is encouraging but there are uncertainties concerning the final direction that it will take. National parliamentary elections are scheduled for 2012, while presidential elections are due in 2013. Overall, risks of political instability or backtracking of democratic reforms remain manageable.

Finally, a failure to find a peaceful resolution of the military conflict with Russia represents a significant political risk.

2.2.2. Control methods envisaged

The macro-financial assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and by the European Court of Auditors.

2.3. Measures to prevent fraud and irregularities

The Commission services have put in place an on-going programme of Operational Assessments of the financial circuits and administrative procedures in all third countries benefiting from the European Union macro-financial assistance in order to fulfil requirements implied by the Financial Regulation applicable to the General Budget of the European Communities. The conclusions of available IMF Safeguard Assessments and of other relevant reports of the IMF and the World Bank are also taken into consideration.

In Georgia, the Commission services, with the support of duly mandated external experts, will carry out in early December 2010 an operational assessment of the financial circuits and administrative procedures at the Ministry of Finance and the National Bank of Georgia. This review will cover areas such as management structure and organisation, management and control of funds, security of IT systems, internal and external audit capacity as well as the independence of the central bank. It will verify the validity of the last operational assessment conducted in 2005 that concluded that the framework for sound financial management is largely effective. In particular, it concluded that the Ministry of Finance is effective with regard to budgetary control, but needs to be strengthened and developed with regard to internal control within budget organisations and internal and external audit. It also concluded that the framework for sound financial management within the National Bank of Georgia was effective.

The proposed legal basis for macro-financial assistance to Georgia includes a provision on fraud prevention measures. These measures will be elaborated further in a Memorandum of

Understanding. It is envisaged that a number of specific policy conditions will be attached to the assistance, mainly in the area of public finance management, with a view to strengthening efficiency, transparency and accountability.

In addition, the Commission intends to emphasise public finance management reforms in the policy conditionality attached to this operation.

3. ESTIMATED FINANCIAL IMPACT OF THE PROPOSAL/INITIATIVE

3.1. Heading(s) of the multiannual financial framework and expenditure budget line(s) affected

- Existing expenditure budget lines:

01 03 02: Macroeconomic assistance

Heading of multiannual financial framework	Budget line	Type of expenditure	Contribution			
	Number [Description………………………...……….]	DA/NDA (11)	from EFTA[12] countries	From candidate countries[13]	from third countries	within the meaning of Article 18(1)(aa) of the Financial Regulation
4	01 03 02 01 Macroeconomic assistance	DA	NO	NO	NO	NO

01 04 01 14 – Provisioning of the Guarantee Fund

Heading of multiannual financial framework	Budget line	Type of expenditure	Contribution			
	Number [Heading……………………………………..]	Diff./non-diff.	from EFTA countries	From candidate countries	from third countries	within the meaning of Article 18(1)(a) of the Financial Regulation
4	01 04 01 14 Provisioning of the Guarantee Fund	DA	NO	NO	NO	NO

The Guarantee Fund for external actions has to be provisioned according to the Fund Regulation, as amended. In line with this Regulation, loans are based on the outstanding amount at the end of a year. The provisioning amount is calculated at the beginning of the year "n" as the difference between the target amount and the Fund's net assets at the end of the year "n-1". This provisioning amount is introduced in the year "n" to the "n+1" preliminary budget and effectively paid in one transaction at the beginning of the year "n+1" from "the provisioning of the Guarantee Fund" (budget line 01 04 01 14). As a result, 9% (maximum of EUR 2.1 million) of the effectively disbursed amount will be considered in the target amount at the end of the year "n-1" for the calculation of the provisioning of the Fund.

11 DA= Differentiated appropriations / DNA= Non-Differentiated Appropriations
12 EFTA: European Free Trade Association.
13 Candidate countries and, where applicable, potential candidate countries from the Western Balkans.

01 04 01 04 – European Union guarantee for EU loans raised for macro-financial assistance to third countries.

The budget entry ("p.m.") reflecting the budget guarantee for the loan (EUR 23 million) will be activated only in the case of an effective call on the guarantee. It is not expected that the budget guarantee be called.

- New budget lines requested: not applicable.

3.2. Estimated impact on expenditure

3.2.1. Summary of estimated impact on expenditure

EUR million (to 3 decimal places)

Heading of multiannual financial framework:	4	01 03 02 Macro-economic assistance

DG: ECFIN			Year **N**[14]	Year **N+1**	Year **N+2**	Year **N+4**	Year **N+5**	**TOTAL**
• Operational appropriations								
Number of budget line: 01 03 02	Commitments	(1)		23				**23**
	Payments	(2)		23				**23**
•Appropriations of an administrative nature financed from the envelop of specific programs[15] : operational assessment and ex-post evaluation								
Number of budget line: 01 03 02	Commitments	(3)	0.03			0.15		**0.18**
	Payments	(4)		0.03		0.05	0.1	**0.18**
TOTAL appropriations for DG ECFIN	Commitments	=1+3	0.03	23		0.15		**23.18**
	Payments	=2+4		23.03		0.05	0.1	**23.18**

14 Year N is the year in which the proposal is expected to be adopted (2010).

15 Technical and/or administrative assistance and expenditure in support of the implementation of EU programmes and/or actions (former "BA" lines), indirect research, direct research.

Heading of multiannual financial framework:	5	" Administrative expenditure "

EUR

		Year N	Year N+1	Year N+2	Year N+3	… enter as many years as necessary to show the duration of the impact (see point 1.6)			TOTAL
DG: ECFIN									
• Human resources		36,600	36,600	36,600					
• Other administrative expenditure : missions		6,000	15,000	10,000					
TOTAL DG ECFIN	Appropriations	**48,600**	**46,600**	**48,600**					

TOTAL appropriations under HEADING 5 of the multiannual financial framework	(Total commitments = Total payments)	**48,600**	**46,600**	**48,600**					

EUR)

		Year N[16]	Year N+1	Year N+2	Year N+3	… enter as many years as necessary to show the duration of the impact (see point 1.6)			TOTAL
TOTAL appropriations under HEADINGS 1 to 5 of the multiannual financial framework	Commitments	**48,600**	**46,600**	**48,600**					
	Payments	**48,600**	**46,600**	**48,600**					

[16] Year N is the year in which the proposal is expected to be adopted (2010).

3.2.2. *Estimated impact on operational appropriations*

– ☐ The proposal/initiative does not require the use of operational appropriations

– x The proposal/initiative requires the use of operational appropriations, as explained below:

Commitment appropriations in EUR million (to 3 decimal places)

Indicative objectives and outputs ⇩		Year **N**		Year **N+1**		Year **N+2**		Year **N+3**		Year **N+4**		**TOTAL**	
	Type of output[17]	Number of outputs	Cost	Number of outputs	Cost	Number of outputs	Cost	Number of outputs	Cost	Number of outputs	Cost	Number of outputs	Cost
- Output	Providing assistance in the form of grants through a number of instalments			2	23							2	23
- Output	Performing operational assessment of financial circuits and controls	1	0.03									1	0.03
	Completing ex-post evaluation of the assistance									1	0.15	1	0.15
TOTAL COST													23.18

[17] Outputs are products and services to be supplied (e.g.: number of student exchanges financed, number of km of roads built, etc.).

3.2.2.1. Estimated requirements of human resources

– ☐ The proposal/initiative does not require the use of human resources

– X The proposal/initiative requires the use of human resources, as explained below:

Estimate to be expressed in full amounts (or at most to one decimal place)

	Year **N**	Year **N+1**	Year **N+2**	Year **N+3**	… enter as many years as necessary to show the duration of the impact (see point 1.6)		
• Establishment plan posts (officials and temporary agents)							
Economic and Financial Affairs 01 01 01 (Headquarters and Commission's Representation Offices)	0.33	0.33	0.33				
XX 01 01 02 (Delegations)	-	-	-				
XX 01 05 01 (Indirect research)	-	-	-				
10 01 05 01 (Direct research)	-	-	-				
• External personnel (in Full Time Equivalent unit: FTE)[18]							
XX 01 02 01 (CA, INT, SNE from the "global envelope")	-	-	-				
XX 01 02 02 (CA, INT, JED, LA and SNE in the delegations)							
XX 01 04 ***yy*** [19] - at Headquarters[20]							
XX 01 04 ***yy*** [19] - in delegations							
XX 01 05 02 (CA, INT, SNE – Indirect research)							
10 01 05 02 (CA, INT, SNE - Direct research)							
Other budget lines (specify)							
TOTAL	**0.33**	**0.33**	**0.33**				

XX is the policy area or budget title concerned.

The human resources required will be met by staff from the DG who are already assigned to management of the action and/or have been redeployed within the DG, together if necessary with any additional allocation which may be granted to the managing DG under the annual allocation procedure and in the light of budgetary constraints. Cost of the staff needed is estimated on the basis of 30% of the annual expenditure for an AD5 – AD12 grade official

Description of tasks to be carried out:

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[18] CA= Contract Agent; INT= agency staff ("Intérimaire"); JED= "Jeune Expert en Délégation" (Young Experts in Delegations); LA= Local Agent; SNE= Seconded National Expert.

[19] Under the ceiling for external personnel from operational appropriations (former "BA" lines).

[20] Essentially for Structural Funds, European Agricultural Fund for Rural Development (EAFRD) and European Fisheries Fund (EFF).

Officials and temporary agents	E.g. prepare memoranda of understanding and grant agreements, liaise with the authorities and the IFIs, liaise with external experts for the operational assessments, conduct review missions and prepare Commission staff reports, prepare Commission pro0cedures related to the management of the assistance
External personnel	N.A.

3.2.3. Compatibility with the current multiannual financial framework

– X Proposal/initiative is compatible the current multiannual financial framework.

– ☐ Proposal/initiative will entail reprogramming of the relevant heading in the multiannual financial framework.

– ☐ Proposal/initiative requires application of the flexibility instrument or revision of the multiannual financial framework[21].

3.2.4. Third-party contributions

– The proposal/initiative does not provide for co-financing by third parties

3.3. Estimated impact on revenue

– X Proposal/initiative has no financial impact on revenue.

– ☐ Proposal/initiative has the following financial impact:

  – ☐ on own resources

  – ☐ on miscellaneous revenue

[21] See points 19 and 24 of the Interinstitutional Agreement.