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**ACCOMPANYING THE REPORT FROM THE COMMISSION ON THE
IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE TO THIRD
COUNTRIES IN 2009**

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LIST OF ABBREVIATIONS

CEFTA	Central European Free Trade Agreement
CPI	Consumer Price Index
DPL	Development Policy Loan
EBRD	European Bank for Reconstruction and Development
EC	European Community
EFC	Economic and Financial Committee
EIB	European Investment Bank
EPCA	Emergency Post-Conflict Assistance
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FYROM	The former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession
MFA	Macro-Financial Assistance
SAA	Stabilisation and Association Agreement
SAF	Structural Adjustment Facility
SDR	Special Drawing Rights
SME	Small and Medium size Enterprises
USD	Dollar of the United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

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INTRODUCTION

This working document is published in parallel with the Report from the Commission to the Council and to the European Parliament on the implementation of macro-financial assistance (MFA) to third countries in 2009. It provides economic and financial information regarding the situation of the beneficiary countries as well as more detailed information on the implementation of MFA operations in those countries. Statistical data on the different macro-financial assistance decisions adopted since 1990, by date and by regions, are included in the annex.

WESTERN BALKANS

1. BOSNIA AND HERZEGOVINA

1.1. Executive summary

Bosnia and Herzegovina entered into a recession in 2009, with real GDP estimated to have declined by 3.2%, mainly due to a drop in private domestic consumption, investment and a contraction of external demand. The trade deficit fell by 28%, resulting in a halving of the current account deficit. Driven by international price developments, in particular in transport, energy and food, a slight deflation of 0.4% was recorded. Fiscal policy came increasingly under pressure in early 2009 due to falling revenues and high spending commitments. A three-year Stand-By Arrangement for Bosnia and Herzegovina was approved by the IMF Board on 8 July 2009, resulting in several revisions of the budget. Nevertheless, the consolidated budget deficit in 2009 is estimated at above 5% of GDP. A mild recovery is expected for 2010.

In order to complement IMF and World Bank support, the Council of the European Union adopted a decision to make available to Bosnia and Herzegovina MFA in the form of a loan facility of up to EUR 100 million on 30 November 2009 (Decision 2009/891/EC). The objective of this assistance is to help the authorities address residual external financing and budgetary needs that emerged as a consequence of the strong economic slowdown affecting the country. The disbursement is planned in two tranches, tentatively in the third and fourth quarter 2010, subject to satisfactory compliance with conditionality requirements.

1.2. Macroeconomic performance

Before the crisis, Bosnia and Herzegovina's growth model was characterised by high domestic demand, fed by rapid credit growth, external financing and expansionary fiscal policies that fuelled macroeconomic imbalances, not least a widening current account deficit. The global economic and financial crisis started to reveal its impact on Bosnia and Herzegovina in the last quarter 2008. Trade dynamics slowed drastically and unemployment picked up. The slowdown of economic activity continued in 2009 and Bosnia and Herzegovina fell into a recession with growth estimated at -3.2% in 2009 after +5.3% in 2008. The economic downturn was mainly caused by a drop in private domestic consumption, investments and a contraction of external demand. As regards the

industrial sector, manufacturing (-4.6%¹) and mining (-2.8%) were the most affected in 2009, while the energy sector remained relatively robust (+0.1%). Within the processing industry, the highest annual production drops were registered in metal (-17.2%), machinery (-22.3%) and wood (-16%) products which are all highly dependent on external demand. Overall, industrial production in Bosnia and Herzegovina decreased by 3.3% in 2009.

The effect of the crisis on the labour market could be felt throughout 2009 but particularly in the first half of the year. Overall, the traditionally very high rate of registered unemployment increased from 40.6% in December 2009 to 42.7% a year later. Job losses were concentrated in the private sector while the number of employees in the public sector increased by 2.9% year-on-year in December 2009. The sectors most affected by rising unemployment were the processing industry and construction.

The decline in trade recorded in the first three quarters of 2009 decelerated in the fourth quarter, to some extent due to a base effect as trade had fallen drastically in the fourth quarter 2008. Imports of goods fell by 18.1% year-on-year (compared to a 27.6% decrease in the third quarter) and exports by 5.1% (17.3% in the third quarter), resulting in an improvement of the trade deficit by 27.4%. This led to a remarkable improvement of the current account which posted an estimated deficit of 7.5% of GDP in 2009 after 14.9% of GDP in 2008. Falling surpluses in the services, income and current transfers balances did not offset this development.

Foreign direct investments halved in 2009, reaching only an estimated 2.5% of GDP. While this appears to be mainly a result of the global economic crisis and worsened investors' sentiment, the lack of reform efforts, the standstill in privatisation and the unstable fiscal situation may have also contributed. Official foreign exchange reserves fell by 2.8% in the first two months of 2010 compared to their end-2009 level. However, they still cover around six months of imports.

Annual inflation became negative in May 2009, down from its peak of nearly 10% a year earlier. The disinflationary trend was mainly driven by developments in transport, energy and food prices. The downward pressure on prices came to a halt in December 2009 when prices were unchanged compared to the December 2008 level, and was reversed in early 2010. Overall, in 2009 the average price level decreased by 0.4% compared to 2008.

The short-term fiscal measures agreed with the IMF in May 2009 amounted to 0.7% of GDP on the revenue side and 2.5% of GDP on the expenditure side, relieving the pressure on the budgets. Both the Federation of Bosnia and Herzegovina and the Republika Srpska revised their budgets several times during the course of 2009 (three times in the Federation and twice in the Republika Srpska). However, these measures were unevenly implemented and revenues collected turned out to be lower than foreseen so that the envisaged deficit target (-4.7% of GDP, already revised downwards from the initial 4.4%) could not be reached. Indirect taxes revenues showed a severe negative trend in 2009. During the first three quarters of the year they decreased by 12% annually, mainly caused by a fall in customs revenues due to the strong decline of imports, import

¹ This figure is, however, somewhat blurred by the effects of the reopening of an oil refinery in December 2008 which drove the annual growth rate in the subsection of coke and refined products to 499% (!) in 2009.

prices and the reduction of tariffs following the entry into force of the Stabilisation and Association Agreement with the EU in mid-2008. Preliminary data indicate that, on account of revenue shortfalls and despite lower than-programmed expenditures, the 2009 general government deficit reached 5.3% of GDP. Overruns on wages and transfers were offset by strict control over other current spending and by underperformance of the capital budget.

1.3. Structural reforms

The commitment to pursue structural reforms remained weak, particularly in the Federation, but gained momentum in the context of the financial support facilities agreed with the international community, which linked its support to certain reforms, especially in the area of social transfers. The legislation agreed with the World Bank (and adopted in February 2010) to reform the system of social benefits to privileged groups in the Federation was necessary in order to curb down social benefit expenditures to a sustainable level.

The privatisation process in both entities continued to proceed very slowly, being however much more advanced in the Republika Srpska. Bosnia and Herzegovina has undertaken some limited reforms in order to improve the business environment. Obtaining a construction permit was simplified by facilitating the registration of new buildings in the land and property registries, reducing from 296 to 255 days the average time needed to obtain a permit. Transferring property also became more efficient thanks to the computerisation of the land registry. Despite some improvements in court registration, the average time to start a business remained at 60 days. A new Law on Business Companies came into effect in the Republika Srpska on 1 July 2009, simplifying the business start-up process, whereby certain inspections are now conducted after the business has started its operations. Concerning the closure of businesses, professional requirements for trustees were tightened, reducing the time needed in bankruptcy procedures. The "Legislative Guillotine" project to reduce administrative burdens has been completed in the Republika Srpska. In the Federation, it was launched in mid-2009. Businesses continue to suffer from political instability, a high tax burden, and slow contract enforcement and business registration procedures. These factors, as well as the poor quality of public services, negatively affects the business climate and the attractiveness of Bosnia and Herzegovina for investors.

Even though the country managed to climb three places in the latest World Bank's Doing Business Report to 116th in the world (out of 183 countries), it still lags behind its neighbours, reflecting lengthy procedures for paying taxes and in registering property. In the Global Competitiveness Report of the World Economic Forum, Bosnia and Herzegovina slides two positions to 109th place among 133 countries. Government and policy instability, as well as inefficient administration and tax rates, are named as the most problematic factors for doing business in the country.

1.4. Implementation of macro-financial assistance

Faced with a deteriorating economic environment and the legacy of poor fiscal policies, public finances increasingly came under stress in early 2009 as a result of falling revenues and high spending commitments. Refinancing of the current account deficit and of the external debt roll-over also became more uncertain under unfavourable financial markets developments. The authorities of all government levels concluded in early May 2009 negotiations with the IMF on a Stand-By Arrangement that comprised

commitments to a number of structural reforms and fiscal adjustment measures. The Fund's Board approved a EUR 1.15 billion loan (13% of GDP; 600% of the quota) for a three-year period on 8 July 2009. The first instalment of about EUR 203 million was disbursed in July. The estimated total financing gap under the programme amounts to some EUR 1.5 billion.

The main policy condition under the programme is a reduction of current expenditure, especially wages and social transfers. The programme seeks to: (a) reduce the structural fiscal balance so as to limit the government's financing needs and bring public finances to a sustainable medium-term path; (b) re-establish public wage policy restraint; (c) support adequate liquidity and capitalisation of banks; and (d) secure enough external financing and improve confidence. The first IMF review mission was conducted in November 2009 but formal approval of the review was delayed. Only after the reform of untargeted social benefits in the Federation of Bosnia and Herzegovina had been approved in Parliament in late February 2010, the conditions for the conclusion of the first programme review were deemed fulfilled. The IMF Board approved the review on 25 March 2010, which resulted in the release of the second and third tranche of the Stand-By Arrangement in the amount of approximately EUR 110 million and EUR 30 million, respectively. Like the first disbursement, they were channelled to the budgets of the Federation of Bosnia and Herzegovina (60%) and the Republika Srpska (40%).

Under the IMF programme's assumptions, the strong fiscal adjustment will reduce the budget's financing needs in 2010. However, those needs still amount to an estimated 2.3% of GDP (almost EUR 300 million), before international support. With the current account continuing to adjust and debt roll-over rates and FDI improving due to enhanced confidence in economic policies and the projected recovery in the world economy, gross financing needs during 2011 and the first half of 2012 are projected to decline substantially. The total external financing gap under the programme would amount to EUR 1,488 million. The IMF will provide about EUR 1,145 million (600% of quota) during the programme period, while the World Bank has indicated commitments of EUR 189 million. The EU's macro-financial assistance would contribute to filling the remainder of the external financial gap in 2010, complementing IMF and World Bank support.

On 22 May 2009, the State Minister of Finance of Bosnia and Herzegovina addressed a letter to the European Commission, requesting MFA in the amount of EUR 100 million. The Commission subsequently proposed on 29 October 2009 MFA to Bosnia and Herzegovina in the form of a loan facility of up to EUR 100 million and the Parliament voted favourably on 24 November. On 30 November 2009, the Council adopted the decision (Decision 2009/891/EC; published in the Official Journal of the European Union, L 320, 05.12.2009, p. 6-8.).

In order to update the Operational Assessment carried out in 2004, the Commission assigned PriceWaterhouseCoopers to conduct a new Operational Assessment of administrative procedures and financial circuits of public organisations involved in the management of MFA in Bosnia and Herzegovina. The assessment was carried out by the consultants in November 2009. Their general opinion is that the framework for a sound financial management is effective, especially in Republika Srpska and, to a lesser level, at State level, although with the need for further strengthening and completion of the reforms. On the other hand, significant gaps have been noted in the Federation of Bosnia and Herzegovina.

The disbursement will be conditional upon a satisfactory track record in the implementation of the current Stand-By Arrangement with the IMF, as well as upon a positive evaluation by the European Commission of progress made with respect to a number of structural reforms. The disbursement is planned in two tranches, tentatively in the third and fourth quarter 2010.

In addition, the World Bank plans to negotiate three successive DPL which are meant to be disbursed in 2010, 2011 and 2012. Negotiations for the first DPL were concluded in March 2010. This DPL1 was approved by the World Bank Board on 8 April 2010. It amounts to about EUR 155 million, which are supposed to be transferred to the budgets of the Federation of Bosnia and Herzegovina (60%) and the Republika Srpska (40%).

BOSNIA AND HERZEGOVINA - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Regulated prices largely prevail for some utilities and infrastructure as well as in some other areas.

2. Trade liberalisation

Bosnia and Herzegovina started WTO accession negotiations in 1999. In July 2008, the Stabilisation and Association Agreement with the EU was signed and the Interim Agreement entered into force.

3. Exchange rate regime

In 1997, the Central Bank of Bosnia and Herzegovina established a currency board with the Deutsche Mark as the anchor currency, which has functioned smoothly since then. With the introduction of the euro the Bosnian Convertible Mark was pegged at 1.95583 to the euro and has remained unchanged since then.

4. Foreign direct investment

FDI inflows reached a peak in 2007 when the telecommunications company of the Republika Srpska was privatised, stabilised in 2008 and then halved in 2009, falling to around 2.5% of GDP. FDI has been mainly related to privatisation transactions, as green-field investment is still hampered by weaknesses in the business environment.

5. Monetary policy

The Central Bank of Bosnia and Herzegovina is responsible for operating the currency board arrangement, which limits the scope of monetary policy basically to minimum reserve requirement ratios.

6. Public finances

The additional fiscal space created by the introduction of VAT in 2006 was not used to consolidate public finances but rather spilled into unproductive spending on social transfers and the public sector wage bill. The high share of public spending to GDP remained at around 45%. When the economic crisis unfolded in the country, public finances came increasingly under pressure so that the authorities had to resort to several budget rebalancing exercises in 2009, and to international support. A new IMF Stand-By Arrangement programme was agreed in July 2009.

7. Privatisation and enterprise restructuring

The government of the Federation of Bosnia and Herzegovina requested the privatisation agency to develop a revised action plan for 2009-10, including the privatisation of the entire public share in eight companies. However, the main public enterprises in the Federation, including the two telecom operators, are not covered, and progress on the plan is very slow. In Republika Srpska, around 69% of the initial stock of State – owned enterprises capital intended for privatisation had been sold by May 2010.

8. Financial sector reform

Despite the repercussions of the global financial crisis on Bosnia and Herzegovina, the financial sector remained sound and well-capitalised and its liquidity position was not seriously undermined. However, financial intermediation is still relatively shallow.

2. Kosovo (UNSCR 1244)

2.1. Executive summary

Despite the global economic crisis, Kosovo's GDP is estimated to have grown by 4.0% in 2009. However, the general picture is that Kosovo lags behind its neighbours in terms of per capita income and its level of growth is too sluggish in order to meet the substantial development needs. In 2009, Kosovo became a member of the IMF and the World Bank.

In November 2006, the Council had decided to make available to Kosovo exceptional Community financial assistance in the form of budget support grants of up to EUR 50 million (Council Decision 2006/880/EC). However, the assistance was not disbursed as a number of key conditions, in particular an understanding with the IMF as well as the confirmation of budgetary financing needs, were not met. The availability of exceptional Community financial assistance to Kosovo was to expire two years after the signing of the Memorandum of Understanding laying down the conditions for the release of the assistance, i.e. on 11 December 2009. The European Commission adopted on 7 December 2009 a Decision (2009/918/EU) to extend the availability period of the EU exceptional financial assistance to Kosovo by one additional year, until 11 December 2010.

2.2. Macroeconomic performance

Despite the global economic crisis, Kosovo's economy is estimated to have grown by 4.1% in 2009. Public investment and private consumption were the main contributors to growth. Kosovo's limited integration into global markets and its sound but underdeveloped financial sector have limited the impact of the international crisis so far. The use of the euro as legal tender sheltered Kosovo from currency depreciation and contributed positively to the overall financial stability. An expenditure-driven fiscal expansion however worsened substantially Kosovo's fiscal position.

A weak external demand and continuously robust domestic demand resulted in almost unchanged foreign trade deficit of about 45.9% of GDP in 2009 compared to 45.6% of GDP in 2008. Overall, the value of exports of goods decreased by 18.1% in 2009 and imports of goods recorded a marginal decline of 1.5%. As a consequence of trade developments, the coverage ratio of exports as a percentage of imports (12-month moving average) has decreased since December 2008 (10.3%) and stood at 8.2% a year later, while the trade deficit increased. The European Union and the countries of CEFTA remain the main trading partners of Kosovo.

The monetary framework is anchored on the use of the euro as legal tender. The Central Bank of Kosovo, therefore, cannot implement an independent monetary or exchange rate policy. Its role lies in supervising the financial sector and monitoring liquidity in the banking sector and credit expansion, with liquidity ratios and reserve requirements as main policy tools. The banking system consists of eight banks which mainly engage in domestic deposit-taking and lending. The sector showed little signs of distress in 2009 and financial intermediation progressed, albeit at a lower pace compared to 2008. At the end of 2009, annual deposit growth stood at 20.8% and credit growth at 8.9%. The loans-to-deposit ratio decreased to 73.9%, well below the informal benchmark according to which this ratio should not exceed 80%. Banks' annual profits decreased by 30% and reached EUR 25.3 million by the end of 2009.

Throughout most of the year 2009, the twelve-month CPI inflation rates were negative, driven mainly by falling food and energy prices. Only in December 2009 did inflation turned again positive at 0.1%. Since then, it slightly accelerated and reached 1.1% in February 2010 when the goods and services with positive contribution to inflation had a total weight of close to 51% in the whole CPI basket. Average annual inflation in 2009 stood at -2.4%, after 9.4% in 2008 and 4.4% in 2007.

The Kosovo authorities estimate that workers remittances declined by about 8% in 2009 to EUR 356 million. Migrant remittances constitute a major source of income for Kosovo, which is channelled predominantly into current consumption and contributes to alleviating poverty. At the same time, remittances significantly influence labour market outcomes by decreasing participation rates and increasing the reservation wage for those receiving them.

Labour Force Survey data show that almost all basic labour market indicators worsened in 2008. The labour force, as a percent of the working age population, dropped from 46.8% in 2007 to 46.2% in 2008. The employment rate was only 24.3%, far from its peak of 29.0% in 2006. The sector of trade provided most of the jobs in 2008 (17.1%), followed by education (13.6%), administration (9.7%), production (8.7%), and construction (8.6%). The unemployment rate stood at 47.5% in 2008, marking a significant increase from the 2007 level of 43.6%. Most of the unemployment is long-term, pointing to very low dynamics in the labour market, even though a significant informal sector distorts the actual picture.

Budgetary developments in Kosovo have been quite volatile and hard to predict in recent years, turning from a high surplus in 2007 to a high deficit in 2009. According to preliminary data from the ministry of economy and finance the general government posted a deficit of 1.1% of GDP in 2009. The underlying deficit is much higher amounting to about 6.4% of GDP, if a one-off EUR 200 million dividend payment received from the incumbent telecom company (PTK) is taken into account. The underlying nominal growth in total revenue (corrected for the one-off revenue) was slightly positive at 0.5%. Tax revenue increased by 1.4%, while non-tax revenue (excluding the PTK dividend) underperformed and declined by 5.1%.

Total expenditure increased substantially (by 17.8%) in nominal terms in 2009. Spending on wages and salaries was up by 16.4%, subsidies and transfers increased by 22.5% from an already high base in 2008, spending on goods and services was up by 9.0%, and capital outlays rose by 15.4%. The current expenditure growth pattern continued in early 2010 as well. Despite the positive balance after the first two months of the year, the budget is facing growing risks as tax revenue performance remains moderate and pressures on the expenditure side are rising.

2.3. Structural reforms

There have been almost no changes in the enterprise structure in 2009, which remains dominated by micro-enterprises. The number of registered enterprises increased across all municipalities and rose in total by 9.5% to 74,436, with 45% of them working in the sector of trade and repair. By the end of 2009, enterprises employing 5 and more people represented only 5.6% of total and enterprises with foreign capital ownership only 0.5% of all enterprises in Kosovo.

The restructuring of publicly-owned enterprises remains one of the main policy challenges. Infrastructure is still insufficient and often of poor quality. The energy sector is crucial for Kosovo's economic development and the low reliability of energy supply continues to be a major obstacle impeding business activity in Kosovo. Despite some improvements in billing and collection, commercial and technical losses are estimated at about 51% of all energy flows entering into the system operated by the Kosovo Energy Corporation. In order to boost the performance of the company, the authorities announced plans to privatise its supply and distribution functions. In line with the Energy Strategy for 2009-2018, a construction of a new coal-fired power plant with a capacity of at least 1,000 MW is envisaged as well.

In March 2010, the government awarded to a Turkish-American joint venture a contract for building the Vermica–Merdare motorway, enhancing the country's transport links with Albania. The government intends to give high priority to the estimated EUR 700 million (about 20% of GDP) project, expected to be completed in three to four years. This project constitutes a deviation from the initial 2010 budget and will adversely affect fiscal performance.

Overall, institutional capacity remains weak and little progress has been made with the establishment of clear property rights.

2.4. Implementation of macro-financial assistance

In November 2006, the Council decided to make available to Kosovo exceptional financial assistance in the form of budget support grants of up to EUR 50 million (Council Decision 2006/880/EC). This assistance was made available with a view to alleviating the financial situation in Kosovo, supporting the development of a sound economic and fiscal framework, facilitating the continuation and strengthening of essential administrative functions, and addressing public investment needs. In December 2007, a Memorandum of Understanding laying down the conditions for the release of the assistance was signed between the European Commission and the Kosovo authorities. However, the assistance was not disbursed as key conditions, in particular an understanding with the IMF as well as the confirmation of budgetary financing needs, were not met.

An operational assessment has been carried out in October 2008 by the Commission services with the assistance of PricewaterhouseCoopers. The conclusion of the report was that "the framework for a sound financial management is effective" despite weaknesses detected at the level of the internal control within the budgetary process.

The availability of the exceptional Community financial assistance to Kosovo was to expire two years after the signing of the Memorandum of Understanding laying down the conditions for the release of the assistance, i.e. on 11 December 2009. Nevertheless, the Council Decision foresaw the possibility for the Commission, after consultation of the EFC, to extend the availability period by a maximum of one additional year.

Among the preconditions for such an extension were clear prospects of an understanding or agreement between the Kosovar authorities and the IMF as well as confirmation of budgetary financing needs in 2010. To evaluate whether these conditions could be met in 2010, the Commission requested an official IMF assessment letter.

Based on the results of their mission to Kosovo in late October 2009, on 13 November 2009 the IMF issued an assessment letter confirming that these conditions could be met in 2010. Thus, the IMF assessment supported the case for the extension of the availability period of this assistance by one additional year, until 11 December 2010.

Therefore, after duly consulting the Economic and Financial Committee and with no objections to the proposed action, on 7 December 2009 the European Commission adopted a Decision (2009/918/EU) to extend the availability period of exceptional Community financial assistance to Kosovo by one additional year, until 11 December 2010. In a follow-up step, Addenda to the Memorandum of Understanding and to the Grant Agreement have been signed by the Kosovo authorities and the Commission.

KOSOVO - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

The price setting mechanism is basically free. Current governance arrangements as regards publicly-owned enterprises ensure the absence of government interference in the price setting mechanism of their services.

2. Trade liberalisation

Regional trade integration and liberalisation continued to face some obstacles in 2009. Serbia is still blocking the exports from Kosovo and Bosnia and Herzegovina is refusing preferential treatment. Efforts to resolve this trade dispute are ongoing.

3. Exchange rate regime

Kosovo continued to use the euro as sole legal tender. The Central Bank of Kosovo is in charge of regulating foreign exchange operations, providing payments services and supervising banks and other financial institutions.

4. Foreign direct investment

Net FDI inflows are estimated to have reached EUR 271 million (7.2% of GDP) in 2009, down from EUR 341 million (9.0% of GDP) in 2008.

5. Monetary policy

The monetary framework remained anchored on the use of the euro as sole legal tender (see also section 3 above).

6. Public finance

The execution of the budget in 2009 was characterised by a stable revenue performance and a substantial increase in both, current and capital spending. Preliminary data point to an annual 2009 budget deficit of 1.2% of GDP in 2009. The budget is facing growing pressure as tax revenue performance remains moderate and expenditure continues to rise.

7. Privatisation and enterprise restructuring

The privatisation of socially-owned enterprises continues under the auspices of the Privatisation Agency of Kosovo. The restructuring of publicly-owned enterprises remains one of the main structural policy challenges.

8. Financial sector reform

The banking sector has shown little signs of distress in 2009 and financial intermediation progressed, albeit at a lower pace compared to 2008. By the end of 2009, the loans to deposit ratio decreased to 73.9%, pointing to a conservative banking model. Although banks' profits decreased by 30% in 2009, the banking system remains profitable and well capitalised.

3. SERBIA

3.1. Executive summary

GDP contracted by 3% in real terms in 2009 as domestic demand waned against the backdrop of the global economic crisis. The balance of payments position somewhat improved as it benefitted from the narrowing of the current account deficit, as well as from IMF funding and an agreement with foreign parent banks. The fiscal slippage was broadly contained as the authorities implemented a number of economic policy measures announced under the IMF Stand-By Arrangement. The latter, approved in January 2009, was originally designed as precautionary assistance for EUR 420 million over 15 months and in May converted into a full-fledged disbursing programme of almost EUR 3 billion for the period 2009–2011.

On 30 November 2009, the Council of the European Union adopted a decision to make available to Serbia MFA in the form of a loan facility of up to EUR 200 million. The objective of this assistance is to help the government address residual external financing and budgetary needs that emerged as a consequence of the strong economic slowdown. This assistance from the European Union is complementary to the resources provided by International Financial Institutions and bilateral donors. Moreover, the Commission was able to disburse EUR 50 million (out of a total 100 million) of budget support under the Instrument for Pre-Accession.

By the end of 2009, Serbia made some progress in its path towards the EU integration. The confirmation of a satisfactory cooperation with the International Criminal Tribunal for the former Yugoslavia paved the way to the unblocking of the Interim Agreement and visa liberalisation. On 22 December, Serbia formally applied for EU membership.

3.2. Macroeconomic performance

Severely strained by the impact of the global recession since the second half of 2008, Serbia's economy shrunk by 3% in real terms in 2009. Following a 4.1% year-on-year fall in the first half of the year, the decline of GDP started to ease in the third quarter (-2.3% year-on-year) and the fourth quarter of 2009 (-1.6% year-on-year). Economic growth turned negative as domestic demand, which was the driving force of the economy over the past years, faltered, with investment estimated by the authorities to have fallen by more than 20% and private consumption by over 5%. The sectors most heavily affected by the crisis were construction (-17.1%) and manufacturing (-15.3%). Modest growth was recorded in transport (7.2%) and financial intermediation (5.1%).

Trade was significantly affected but as imports fell faster than exports, the traditionally large current deficit narrowed more than expected, down to 5.7% of GDP from 17.1% of GDP in 2008. Nevertheless, the merchandise trade deficit, which worsened towards the end of the year remained relatively high at slightly over 15% of GDP (down from above 20% in 2008). The reduction in the current account deficit was also partly due to a record inflow of remittances in 2009 of EUR 2.6 billion, i.e. around 8% of GDP. At the end of 2009, capital inflows also started to pick up but remained for the year as a whole considerably lower than in 2008. Foreign direct investment dropped by almost 25%. The additional SDR holdings extended under the IMF Stand-By Arrangement programme boosted reserve assets of the central bank in 2009, following a fall in foreign currency reserves a year earlier.

In the beginning of 2009 and, again, by the end of the year, the foreign exchange market came under significant pressure, leading to a 25% nominal depreciation of the dinar against the euro compared to mid-2008. Having stabilised the exchange rate through a tightening of the monetary policy in early 2009, the National Bank of Serbia reversed course during the year and provided liquidity notably through the lowering of the reference rate and administrative and regulatory measures. At the end of the year, it intervened again in the foreign exchange market. By end-2009, it had sold a total of EUR 567 million and slashed the interest rate by 825 bps, from 17.75% to 9.5%, in order to boost up liquidity and smooth the exchange rate depreciation. Credit activity to households and enterprises was sustained also owing to the European Bank Coordination Initiative², whereby foreign parent banks committed in March 2009 to maintain their exposure in Serbia at its 2008 level.

The prime monetary policy concern, however, has remained price stability since the inflation rate has been relatively high compared to other countries in the region. After a hike in 2007 and early 2008, which propelled the average CPI inflation back to double digits at 12.4% for 2008, inflationary pressures eased somewhat during 2009 thanks to lower oil and food prices, in line with the general price developments in the global markets. By the end of 2009, CPI inflation declined to 6.6% year-on-year (8.6% in 2008) which was mainly due to lower aggregate demand while the pass-through of the exchange rate depreciation has been limited.

Given the poor economic growth performance the labour market remained very weak. The Labour Force Survey conducted in October 2009 registered an increase in unemployment rate to 17.4% compared to 14.7% a year ago. In line with this trend, employment is estimated to have declined by 4.6%, resulting in a lower employment rate than in 2008 (50% vs. 53.3%). The nominal freeze of public sector wages contributed to an overall wage moderation for the year as a whole: net wages decreased in 2009 by 3.7% year-on-year in real terms compared to an almost 5% rise in 2008.

The general government deficit is estimated to have reached in 2009 4.2% of GDP, which is slightly below the deficit of 4.5%, of GDP foreseen in September under the Stand-By Arrangement programme. In line with the IMF conditions, the government implemented a number of fiscal expenditure measures capping current expenditures through a nominal freeze of public sector wages and pensions as well as restricting hiring in the public sector. In addition, there was across-the-board trimming of discretionary expenditure. Compared to 2008, the expenditure ratio is estimated to have declined by 0.5 percentage points to 43% of GDP. The share of revenues as a percentage of GDP is also estimated to have dropped in 2009 by 2.4 percentage points compared to 2008, to 38.7% of GDP. The difficult economic situation, which also involved extensive lay-offs in the private sector and salary freezes in the public sector, translated into a shortfall in personal income tax revenue. Furthermore, indirect taxation (customs revenues and VAT) plunged following the drop in domestic demand and imports. Conversely, excise taxes increased as a consequence of the rise in excise duties on diesel and gasoline. The budget financing gap in 2009 spurred government borrowing on the domestic financial

² The European Bank Coordination or Vienna Initiative is a platform launched in early 2009 to address needs ensuing from the unfolding of the global crisis. It is co-ordinated by the IMF, the EBRD and the European Commission, together with a number of countries that agreed with the IMF programmes. The platform has facilitated (i) commitments by parent banks to finance the roll-over of external lending; and (ii) enhanced cooperation between supervisory agencies in home and host countries.

market as well as from international sources. By end-December, public debt reached EUR 9.85 billion (31.3% of GDP).

3.3. Structural reforms

While important steps have been taken to transform the economy over the past years there has been, however, a slowdown in reform efforts since the start of the crisis. Important challenges remain, especially related to the creation of a viable market economy and a business-friendly environment. Furthermore, high unemployment and a growing number of insolvencies³ weigh on the economic performance.

The sluggish privatisation of public enterprises has been the weakest aspect of the reforms in Serbia. The privatisation of *socially-owned* enterprises stalled during the recent recession due to unfavourable market conditions. Furthermore, the sale contracts have been repealed in some cases where the authorities concluded that the buyer was in breach of some or all of the standard requirements. While calls to review past privatisation cases have resurfaced on grounds of money laundering allegations, the official stance is that the process would be completed by the end of 2010, one year behind schedule. Likewise, the liberalisation of *state-owned* banks and infrastructure activities, such as the electricity, telecom, airport and pharmaceutical companies, is being delayed since the government has not yet reached an agreement on restructuring and privatisation strategies for most of the enterprises concerned. Similarly, no progress has been made as regards stepping up the processes of denationalisation and restitution.

On the other hand, the authorities have initiated further steps in establishing legal predictability, and removing excessive administrative requirements and barriers. During 2009, Serbia has launched reforms in a few key areas, including the judiciary. As regards the reform of governance and regulatory institutions, however, the process is slow compared to its transition peers. According to the latest *Doing Business 2010* report by the World Bank, Serbia continues to lag behind the more advanced countries in most standards.

The government's policy priority now is to advance structural reforms in the direction of developing industrial sectors in the high value-added part of the productive chain so as to bolster exports. An improved economic performance will further depend in the country's ability to attract foreign investment and to deal with important structural rigidities in the labour market, reflected in the persistently high unemployment and a low participation rate, particularly among older workers.

3.4. Implementation of macro-financial assistance

In December 2008, against the backdrop of the international financial crisis and in response to the mounting economic problems under tighter external financing conditions, Serbia requested financial assistance from the IMF. An initial precautionary Stand-By Arrangement for EUR 420 million over 15 months was revised following a further deterioration of the economic situation in the first half of 2009. The programme was

³ Although the new law adopted in December 2009 was a welcome step towards speeding-up bankruptcy procedures, the efficiency of courts in dealing with these procedures remains an issue of concern.

converted into a disbursing one, and almost EUR 3 billion were made available for the period 2009–2011.

Furthermore, in view of the fragile economic situation and outlook the World Bank approved in 2009 a package of Development Policy Instruments in the total amount of around EUR 0.5 billion, planned for disbursement over a three-year period. Additionally, the EU agreed to provide exceptional budget support of EUR 100 million under the Instrument for Pre-Accession (IPA) on a satisfactory fulfilment of the economic policy conditions. Following a positive assessment of the required conditions for IPA budget support by the Commission services, the first tranche of EUR 50 million was paid at the end of December 2009.

After consulting the EFC, the Commission also proposed to make available to Serbia MFA in the form of a loan facility of up to EUR 200 million on 8 October 2009 and the Parliament voted favourably on 24 November. On 30 November 2009, the Council of the European Union adopted the related decision (Decision 2009/892/EC, OJ L 320, 05.12.2009, p. 9-11). The objective of this assistance is to help the authorities address residual external financing and budgetary needs that emerged in the context of the unfolding of the global crisis in the country. It is meant to be complementary to the IMF and the World Bank programmes.

As a prior step in designing the MFA, the Commission assigned PriceWaterhouse Coopers with conducting an update of the Operational Assessment of administrative procedures and financial circuits of organisations involved in the management of MFA which was carried out by the consultants in the spring of 2009. The general conclusion of the report is that the financial management framework is broadly sound and effective, despite certain weaknesses detected during the operational assessment. In particular, certain areas such as the internal and external audit function require urgent improvement. Compared to the situation assessed in 2004, real improvement was observed in different sectors such as the treasury administration, the accounting and debt management or the IT department.

A Memorandum of Understanding detailing the economic policy conditions related to the disbursement of the assistance was negotiated with the authorities in March 2010. The assistance is to be made available in 2010, conditional upon a satisfactory track record in the implementation of the current Stand-By Arrangement with the IMF, as well as subject to fulfilment of conditionality requirements, to be evaluated by the Commission services. It is planned to be disbursed in two equal instalments of EUR 100 million each, tentatively in the third and the fourth quarter 2010.

SERBIA - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

The share of administered prices in the CPI has declined steadily to around 6% by 2009. The government regulates prices of state-owned utilities in the area of fuel, electricity, telecommunication, communal and other public services.

2. Trade liberalisation

In December 2009, the EU unblocked the Interim Agreement, which Serbia had been implementing unilaterally since January 2009. This has paved the way for the start of the ratification process of the Stabilisation and Association Agreement signed in April 2008 by the EU Member States.

3. Exchange rate regime

Serbia's exchange rate regime is a managed float of the dinar. The central bank intervenes in the interbank market to avoid extreme exchange rate volatility and defend the dinar against depreciation in the core of the crisis. In 2009, it sold a total of EUR 657 million over a number of FOREX operations.

4. Foreign direct investment

There are no controls on inward direct investment. Net FDI inflows are estimated to have reached almost EUR 1.4 billion (4.4% of GDP) in 2009, down from EUR just above 1.8 billion (5.5% of GDP) in 2008.

5. Monetary policy

Since 2006, the National Bank of Serbia conducts monetary policy under a formal inflation targeting regime. In 2009, it abandoned core inflation as its target and started setting a broad target band around the headline CPI inflation rate. The main policy instrument in achieving the target has been the two-week repo interest rate. By end-December, it had been slashed by 825 bps to 9.5%, from 17.75% in the beginning of the year.

6. Public finance

In 2009, the fiscal deficit increased from 2.5% to 4.2% of GDP. This budgetary outcome, however, was better than the 4.5% target set in September, reflecting the considerable revenue shortfall in the face of the crisis. In response, the government implemented a number of ad-hoc expenditure cuts, which helped to rein in current spending. A more long-run fiscal adjustment, however, will require full-fledged structural reforms, in particular in public administration and the pensions system.

7. Privatisation and enterprise restructuring

Privatisation of public enterprises remains the weakest point on the recent reform agenda. Privatisation of socially-owned enterprises stalled in 2009 due to the crisis while privatisation of state-owned companies is being delayed due to the lack of political consensus about restructuring and privatisation strategies.

8. Financial sector reform

The banking sector regained stability after the crisis of confidence at the end of 2008 partly reflecting administrative and regulatory measures adopted by the authorities, as well as the commitments made by commercial banks under the Vienna Initiative⁴. Throughout 2009, the banking system remained well capitalised and liquid and deemed resilient to further stress.

⁴ See footnote 2

EASTERN NEIGHBOURHOOD COUNTRIES

4. ARMENIA

4.1. Executive summary

The global economic downturn and particularly the rapid deterioration of the Russian economy had a deep impact on the Armenian economy in 2009. Economic activity, which had started to fall in the last quarter of 2008, contracted by around 14.4% in 2009, representing a marked turnaround compared to the strong growth rates of previous years. A recovery above 3% is foreseen for 2010 although it is likely to be fragile and will depend on the developments of the Russian economy.

Led by the steep economic slowdown, average inflation fell dramatically from 9% in 2008 to 3.5% in 2009 while the fiscal deficit rose markedly to 7.8% of GDP in 2009 from 1.2% of GDP in 2008. Similarly, public debt rose from 16% of GDP at the end of 2008 to 39.8% of GDP in 2009 with the external component reaching 34% of GDP. As the country will continue to rely on donors financing to cover its financing needs, public debt is expected to increase to 50.8% of GDP in 2010, with the external component reaching 43% of GDP.

Armenia's external position deteriorated in 2009, despite the significant weakening of the Armenian dram and the deep recession that led to a contraction in imports. In the wake of a steep decline in exports and remittances, the current account deficit failed to adjust and widen to 13.8% of GDP in 2009 from 11.8% of GDP in 2008.

At the outbreak of the crisis, the Armenian authorities acted rapidly, adopting appropriate measures to mitigate the effects of the sharp downfall in output. In March 2009, they reached an agreement with the IMF on a Stand-By Arrangement totalling about USD 810 million, while securing additional funding from other multilateral and bilateral donors (including a USD 500 million loan from Russia) to meet the increasing fiscal and external financing needs. The EU Council of Ministers also decided, in November 2009, to provide MFA to Armenia amounting to EUR 100 million, part of which (EUR 35 million) will be in grants.

Performance under the Stand-By Arrangement has been strong. Upon Armenia's request, the IMF Executive Board approved, on 28 June 2010, a new programme, under the Extended Fund Facility and the concessional Extended Credit Facility. Under the new programme, which replaced the Stand-By Arrangement, Armenia will have access to about USD 392 million (290% of quota) in a three year period. Armenia's access to the Fund's concessional lending window should help alleviate its future debt repayment needs.

4.2. Macroeconomic performance

The global economic downturn and particularly the rapid deterioration of the Russian economy had a deep impact on the Armenian economy in 2009. Economic activity, which had started to fall since the last quarter of 2008, contracted by around 14.4% in 2009, representing a marked turnaround compared to the strong growth rates of previous years. This reflected the slump in the construction sector, which shrank by around 38%, partly reflecting a 30% reduction in remittances, and the strong contraction of industrial output by around 10% following the drop in metals prices. A recovery above 3% is foreseen for 2010 although it will be fragile and will depend on the developments of the

Russian economy. Data from the first five months of 2010 confirm the upward trend in GDP, which rose by 7.2% year-on-year. The sectors leading the recovery are services and industry, the latter benefitting from rising metals prices and government support measures.

Unemployment increased modestly in 2009 (to 6.9%, from 6.3% in 2008). The poverty ratio rose from 21.7% in 2008 to 24.6% in the third quarter of 2009. To mitigate these effects, the authorities increased average pensions and family benefits over the past two years, while improving the targeting of social benefits. Going forward, in order to protect the poor, the authorities aim to maintain social spending in 2010 broadly at the nominal level of 2009.

At the outbreak of the crisis, the authorities acted rapidly, adopting appropriate measures to mitigate the effects of the sharp downfall in output. In March 2009, they reverted to a fully floating exchange rate regime, allowing a de facto devaluation of the Armenian dram by around 22% against the euro and the USD. This step helped to improve competitiveness without threatening financial stability as the negative effects of the devaluation were largely absorbed. At the same time, they channelled donors' funds to on-lending activities to SME's and to specific sectors of the economy.

Average inflation in 2009 remained relatively low at around 3.5 % on the back of weak demand. However, end-period inflation was already 6.5% in December 2009 and it remained worrisome in the first four months of 2010 (reaching 6.8% in April year-on-year) as a result of the rise in international prices of raw materials and food products, the oligopolistic structure of import trade, and the peak up in aggregate demand. The central bank raised the refinancing rate from 5% (the rate that has been in place since September 2009) to 7.25% in May 2010 in several steps. However, movements in the refinancing rate have only had a limited impact, as the domestic money market is not sufficiently developed and the dollarization rate is high (around 70%).

After the March 2009 devaluation, the central bank committed to a free floating exchange rate regime. However, the exchange rate market is small and highly volatile, and the central bank often undertakes foreign exchange interventions to limit exchange rate volatility. Even though the exchange reserves floor target set by the IMF programme was comfortably met in December 2009, the central bank lost around USD 435 million in foreign exchange operations between September 2009 and April 2010. Apart from reducing short-term exchange rate volatility, central bank's interventions were aimed also at countering emerging inflation pressures by avoiding exchange rate depreciation. Altogether, since the beginning of 2010 the Armenian dram has depreciated by 3.9% against USD and has appreciated by around 16.6% against the euro (data as of 03/06/2010). Although foreign reserves in March 2010 were at sufficient levels (around USD 1.8 billion), a need for reserve built-up cannot be excluded in the near future as the current account deficit is expected to remain high.

Fiscal revenues decreased by 15% in 2009 while current expenditure (made up mainly of social spending and public wages) increased despite cuts in non-essential expenditures. As a result, the fiscal deficit rose markedly to 7.8% of GDP in 2009 (from 1.2% of GDP in 2008). Since growth is unlikely to resume strongly in the next two years, the fiscal deficit is forecasted to reach 5% of GDP in 2010 and 4% of GDP in 2011. The bulk of the budget financing needs will continue to be covered by international donors. Already in 2009, foreign financing allowed capital spending (mainly badly needed infrastructure investments) to increase by 21%. As a result, public debt is expected to increase from

16% of GDP at the end of 2008 to 50.8% of GDP in 2010, with the external component reaching 43% of GDP. While this debt level is still considered to be manageable, the increase in foreign exchange-denominated public debt is increasing significantly the exposure of the budget to an exchange rate shock.

External trade turnover contracted in 2009 by 27% (in dollar terms). Export revenue contracted by 34%, influenced by the drop in prices of metallurgical products, while imports contracted to a lesser extent (by around 26%). Remittances dropped by 30%. As a result, despite the significant weakening of the Armenian dram and the deep recession, the trade deficit failed to adjust and widened from 22.3% of GDP in 2008 to 23.9% of GDP in 2009 while the current account deficit widened from 11.5% of GDP in 2008 to 13.8% of GDP in 2009. These developments were exacerbated by the lack of competitiveness of the Armenian economy. FDI fell to 5.5% of GDP in 2009 from 7.7% of GDP in 2008. The situation in the external sector was somewhat better in the first quarter of 2010: export value increased by 160% (compared with Q1/2009) mainly as a result of the upward movement in prices of metals and food products (which constitute key export products of the Armenian economy) while import value increased to a lesser extent by 123%. Remittances in Q1/2010 have been stabilised at the same levels as Q1/2009. Despite these positive trends, pressures in the balance of payments will remain as the current account deficit for 2010 is projected to reach around 13% of GDP and is expected to remain high over the medium term.

The banking sector in Armenia is relatively small (banking assets represent around 35% of GDP) but well capitalised and deposit-funded (the capital adequacy ratio was at 28% in March 2010). Despite some modest increase in non-performing loans, stress tests show that, under all scenarios except for extreme credit shocks, the capital adequacy ratio would decline by no more than 4% for the system as a whole. Nevertheless, there is, as noted, a high dollarization ratio (above 70%) and a large currency mismatch between assets (mainly foreign currency denominated) and liabilities. [Lending rates on credit in domestic currency continue to be high (about 18%).] In 2009 and in the first half of 2010, banks were reluctant to lend in local currency and borrowers were reluctant to borrow in USD as they considered another devaluation of the Armenian currency likely in the near future. Consequently, credit expansion decelerated to 15% in 2009 from 48% in 2008. This deceleration concerned mostly consumer credit and loans to construction companies. The authorities are in the process of taking additional measures to narrow the currency mismatch between assets and liabilities and to reduce high dollarization of deposits.

4.3. Structural reforms

Despite the progress achieved in recent years, Armenia will need to pursue its economic reform efforts. Particular focus should be put on the improvement of the business and investment environment in order to strengthen the competitiveness of the economy and on reversing the recent negative trends in poverty and unemployment. With respect to poverty, while the targeting of social assistance programs has improved, coverage remains limited. The authorities are in the process of updating the Poverty Reduction Strategy Paper, which will provide analytical underpinnings for the growth and poverty reduction strategy. In that context, the efficiency and targeting of education and health spending will also be important given the efforts for fiscal consolidation in the coming years.

Economic competition in the internal market needs strengthening as still large market segments are dominated by few market players. Although, the legislative and institutional framework in this area is well developed in Armenia (revised recently in 2007), the implementation of the relevant laws on competition issues remains weak largely due to weaknesses in enforcement powers and institutional capacity.

Despite some improvements in recent years, given the structural weakness in the current account and the high volatility in the balance of payments, business environment needs to be significantly improved to narrow external imbalances. Improvements in infrastructure, customs administration, standardisation and certification are important to strengthen competitiveness in a land-locked country with high transportation costs and limited transportation routes. Progress in many of the trade-related reforms will be also critical for the launching of negotiations for a Deep and Comprehensive Free Trade Agreement with the EU, which is expected to improve the access of the Armenian exports to the European markets.

Finally, improving internal audit and procurement systems, combating tax evasion and corruption, streamlining tax administration procedures and establishing a comprehensive debt management strategy are necessary reforms given the public debt accumulation and the fiscal consolidation challenges that Armenia will face in the coming years.

4.4. Implementation of macro-financial assistance

In March 2009, the Armenian authorities reached an agreement with the IMF on a Stand-By Arrangement totalling about USD 810 million, while securing additional funding from other multilateral and bilateral donors (including a USD 500 million loan from Russia) to meet the increasing fiscal and external financing needs. On 28 June 2010, the IMF Executive Board approved a new programme, under the Extended Fund Facility and the concessional Extended Credit Facility. Under the new programme, which replaced the Stand-By Arrangement, Armenia will have access to about USD 392 million (290% of quota) in a three year period.

In November 2009, the European Union Council of Ministers decided to provide MFA to Armenia amounting to EUR 100 million, part of which will be in grants (EUR 35 million). Additional EU funds are expected to be made available to Armenia in the form of budget support grants under the European Neighbourhood and Partnership Instrument (ENPI)⁵.

The Commission is currently discussing with the Armenian authorities the economic policy and financial conditions of the operation. The policy conditions proposed by the Commission would support the authorities' reform efforts and are intended to be implemented before the end of 2010. They will focus in principle on the areas of public finance management, taxation, debt management and pension reform. Depending on progress with the discussions and the developments of Armenia's financing needs, the full amount of the first tranche of the assistance (a grant of EUR 17.5 million and a loan of EUR 30 million) could be released to the budget in September 2010 while the second

⁵ In 2010, the ENPI budget support disbursements are in the order of EUR 10 million (under ENPI annual action programmes for 2007 and 2008. DG AIDCO is also preparing a new General Budget Support programme amounting to EUR 22 million (incl. EUR 1 million for technical assistance). The disbursements under this programme are likely to start in early 2011.

tranche of the assistance (a grant of EUR 17.5 million and a loan of EUR 35 million) is foreseen to be released early 2011 subject to the compliance to the economic conditions attached.

ARMENIA - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Prices are largely free but there are fixed unclear monopolistic conditions in a number of sectors of the economy.

2. Trade regime

Armenia is a WTO member since 2003. The tariff structure is simple, all tariffs are bound and the applied average tariff is 2.7%. Customs procedures have improved but customs clearance remains slow and sometimes non-transparent due to the use of 'reference' values in breach of WTO rules. Problems remain regarding technical barriers to trade and in the sanitary and phyto-sanitary areas. Taxation of tobacco and beverages is still in breach to WTO rules. In 2009, Armenia qualified for the EU GSP+. EU is committed to launching DCFTA negotiations with Armenia once Armenia satisfies a number of pre-conditions.

3. Exchange rate regime

After the March 2009 devaluation of the Armenian dram, the central bank announced the adoption of a free floating exchange rate regime. However, the exchange rate market is small and highly volatile, and the central bank often undertakes foreign exchange interventions to limit exchange rate volatility.

4. Foreign direct investment

Armenia has a liberal trade and investment regime and there have been a number of improvements in the business climate and regulations in recent years in areas such as access to credit, registration of enterprises and the inspection of goods. The representatives of the business community who met an EU delegation in June 2010 expressed overall satisfaction with the investment climate. However, for a small land-locked economy with structural external imbalances more efforts should be made in areas of customs clearance, tax administration and anti-monopoly policies. FDI fell to 5.5% of GDP in 2009 from 7.7% of GDP in 2008.

5. Monetary policy

The central bank of Armenia follows an inflation targeting regime to conduct the monetary policy. However, the impact of monetary policy decisions on the economy is limited because domestic money market is not sufficiently developed and the rate of dollarization of deposits is close to 70%.

6. Public finances and taxation

Before the economic crisis, Armenia had a good track record in preserving fiscal discipline. While public expenditure management is strong, there is considerable room for improve several areas of public financial management such as internal financial control. The authorities are moving to address this issue. They also reverted to the Medium-Term Expenditure framework abandoned during the economic crisis. Tax and customs administration also need to be strengthened to meet the fiscal consolidation challenges ahead.

7. Financial sector

The banking sector in Armenia is relatively small (banking assets represent around 35% of GDP) but well capitalised and deposit-funded (capital adequacy ratio was 28% in March 2010). It consists mainly of private banks. The dollarization ratio is high (above 70%) and there is an important currency mismatch between assets (mainly foreign currency denominated) and liabilities. The central bank of Armenia is taking measures to strengthen prudential regulation and address these and other issues.

8. Privatisation and enterprise restructuring

During the 1990's and early 2000's most of the small- and medium-sized enterprises were privatised. Also, the electric power distribution system was privatised in 2005. Plans to privatise some remaining smaller enterprises seem to have been delayed as a result of the economic crisis.

5. GEORGIA

5.1. Executive summary

The global financial and economic crisis strongly affected Georgia and thus further exacerbated the economic downturn caused by the military conflict with Russia that occurred in August 2008. In 2009, real GDP contracted by 3.9%. As a result of the economic slowdown average inflation fell dramatically from 10% in 2008 to 1.7% in 2009. The country's external imbalances were somewhat reduced in 2009. The large current account deficit decreased from around 23% of GDP in 2008 to 12% of GDP in 2009. The strong rebalancing was driven by the trade balance adjustment as imports declined faster than exports thus reducing the trade deficit from around 30% of GDP in 2008 to 23%. 2009 was also marked by a strong decline of capital inflows: in comparison to 2008, worker remittances declined by more than 20%, while FDI inflows more than halved.

Both the country's fiscal position and its public debt position deteriorated in 2009. The budget deficit reached 9.2% of GDP. The widening of the general government deficit was mainly due to a contraction in fiscal revenue caused by the recession. It was financed through the external financial assistance of the International Financial Institutions bilateral partners and by issuing domestic Treasury bills. External public debt increased to 32% of GDP in 2009. Higher external borrowing provided funding for public infrastructure rehabilitation and social spending projects.

In September 2008, the IMF approved an 18-month Stand-By Arrangement for Georgia, worth USD 750 million. In 2009, Georgia drew an amount equivalent to USD 410 million. During the third review, approved by the IMF Board in August 2009, the SBA was extended until June 2011 and the financing package increased by about USD 424 million, bringing the whole SBA programme to USD 1.17 billion.

The EU Council Decision of 30 November 2009 provided MFA to Georgia amounting to EUR 46 million, in grants. This assistance is part of a comprehensive EU package of up to EUR 500 million to support Georgia's economic recovery in the aftermath of the August 2008 armed conflict with Russia. This EU assistance was pledged at an international donors conference in November 2008, which raised commitments by the international community totalling USD 4.5 billion.

The Commission disbursed the first tranche of the MFA of EUR 23 million in two parts in December 2009 and in early January 2010.

5.2. Macroeconomic performance

The global financial and economic crisis strongly affected Georgia and thus further exacerbated the economic downturn caused by the military conflict with Russia that occurred in August 2008. In the first half of 2009, real GDP dropped by 8.5% continuing the contraction that started in the third quarter of 2008. The economic contraction was driven by the decline in domestic demand caused by a tightening of bank credit, a fall in remittances and in foreign direct investment inflows, which subsequently led to a decline in output and consumption. Economic sectors especially hit have been manufacturing and construction. The first signs of economic stabilisation appeared in the third quarter of 2009. In 2009, real GDP contracted by 3.9%. As a result of the economic slowdown and

the decline in international commodity prices, average inflation fell dramatically from 10% in 2008 to 1.7% in 2009.

The country's external imbalances declined somewhat in 2009. The large current account deficit decreased from around 23% of GDP in 2008 to 12% of GDP in 2009. This strong rebalancing was driven by the trade balance: exports and imports of goods and services declined by 16% and 30%, respectively, thus reducing the trade deficit from around 30% of GDP in 2008 to 23% of GDP. 2009 was also marked by a strong decline of capital inflows: in comparison to 2008, worker remittances declined by more than 20% to USD 0.5 billion, while FDI inflows more than halved going from USD 1.5 billion to USD 0.8 billion.

Both the country's fiscal position and its public debt position deteriorated in 2009. The budget deficit reached 9.2% of GDP. The widening of the general government deficit was mainly due to a contraction in fiscal revenue caused by the recession. It was financed through the external financial assistance of the International Financial Institutions and the bilateral partners and by issuing domestic Treasury bills. As far as public debt is concerned, several years of strong growth and prudent debt management in early 2000s had significantly reduced Georgia's public debt and thus the country's external vulnerability. Public and publicly guaranteed external debt fell from 50% of GDP in 2000 to about 18% of GDP in 2007. Yet, this declining trend stopped in 2008: external public debt increased to around 21% of GDP in 2008 and to 32% of GDP in 2009. Higher external borrowing and international donors provided funding for public infrastructure rehabilitation and social spending projects.

As regards monetary and exchange rate policy, central bank legislation was amended in spring 2008 to make price stability the core objective of the National Bank of Georgia. This was to be achieved by introducing an inflation-targeting regime. However, from August 2008 the central bank resumed its interventions on the foreign exchange market to limit the depreciation of the lari. In early November 2008, under pressure from the markets, the authorities allowed the exchange rate to depreciate against the US dollar by around 17%. Since March 2009, the authorities have allowed for greater exchange rate flexibility. The central bank held regular foreign currency auctions to prevent the exchange rate from fluctuating too much but the practice of almost daily interventions has been abandoned.

The global financial crisis had adverse repercussions on the country's financial intermediation. Before the crisis, Georgia's financial sector was growing at a fast pace: domestic credit expanded from around 27% to 31% between 2006 and 2008. However, since late 2008, household deposits and bank lending have fallen considerably. Trust in the lari declined in 2009 with the share of domestic deposits held in foreign currency increased to 83%, from 64% in 2008.

The central bank took a number of counter-cyclical measures to increase liquidity and restore confidence in the banking sector by lowering reserve requirements and reducing the refinancing rate. However, monetary policy instruments have only had a limited impact due to the central role of the foreign currency in domestic financial transactions: the Georgian banking sector is highly "dollarized". Thus, rather than the central bank's refinancing rate, it is the domestic interest rate on the USD that has influenced the economic activity. In 2009, the high domestic lending rate of 23% restrained domestic lending and thus hampered economic recovery. Key challenges for the national monetary authorities are to rebuild trust in the national currency, develop monetary policy tools

and revive credit lending to the private sector in order to stimulate economic activity, while keeping inflation in check.

Poverty is widespread in Georgia, with 30% of the population living on less than USD 2 a day and more than half of the population living below the national poverty line. According to the IMF Poverty Reduction Strategy Paper, 52% of the population lived in poverty and 15% in extreme poverty in 2003. As in all transition countries, economic inequality has increased. While the top quintile of the population accounts for 30.6% of overall consumption, the bottom quintile's share of consumption is only 1.9%. Several factors have contributed to the high poverty and increasing inequality. Among them are a high unemployment rate of around 16.5% of the labour force and low real wages. A targeted social assistance programme introduced in 2006 covers around 16% of the population, but the level of assistance is low. Regional inequality is also significant, rural areas being the most disadvantaged. Gender inequality is considered to be relatively low, but is rising due to a lack of appropriate child care provisions.

5.3. Structural reforms

Since the 2003 Rose Revolution, Georgia has made significant progress in a number of legal and regulatory reforms. The tax system has been simplified and public finance management brought closer into line with international practices. Customs regime has been liberalised, while important anti-corruption measures have been taken and the regulatory business environment has substantially improved. However, in several areas, notably trade-related areas like protection and enforcement of intellectual property rights, competition, food safety and technical barriers to trade, Georgia's progress in approximation with the EU and international laws and standards remained limited. The economic crisis that started with the August 2008 war and was further fuelled by the global economic slowdown meant that the pace of legislative and regulatory policy initiatives slowed down in late 2008 - early 2009 as more urgent issues, such as accommodating the immediate needs of internally displaced persons were high on the government's policy agenda. However reforms efforts revived in the second half of 2009, with a number of new initiatives being put on the table.

One policy field that has been at the heart of government's reform efforts has been public finance management. Among the important milestones of these reforms have been: changing the budget process and format to meet international standards; introduction of a Single Treasury Account in 2005; and the reform of accounting and budget classification rules in 2008. Recent initiatives include the new budget code that unifies all the existing legislation on the budget process, and the new public procurement law, which brings public procurement practice into line with international standards. Some progress has also been achieved in reforming internal and external audit.

In the area of the financial sector reform, policy initiatives put forward in 2009 included the new Organic Law on the National Bank of Georgia. The new Law merged the Financial Supervision Agency with the central bank of Georgia. This law, effective from 1 December 2009, allowed the central bank to improve its macro-prudential oversight by supervising the whole of the country's financial sector. It also established price stability over the medium term as a key responsibility of the central bank.

5.4. Implementation of macro-financial assistance

In September 2008, to improve the country's balance of payments position and to contribute to a more stable macroeconomic policy framework, the IMF approved an 18-month Stand-By Arrangement for Georgia worth USD 750 million. The programme was frontloaded and enabled Georgia to draw USD 250 million from the Fund in the first instalment. In 2009, Georgia drew an amount equivalent to USD 410 million. At the third review, approved by the IMF Board in August 2009, the Stand-By Arrangement was extended until June 2011 and the financing package increased by about USD 424 million bringing the whole SBA programme to USD 1.17 billion.

The EU Council Decision of 30 November 2009 approved the provision of MFA to Georgia amounting to EUR 46 million, in grants. This assistance is part of a comprehensive EU package of up to EUR 500 million to support Georgia's economic recovery in the aftermath of the August 2008 armed conflict with Russia. This EU assistance is in turn part of a larger support package pledged by the international donor community at the Donor Conference which 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 MFA supported the Stand-By Arrangement agreed by the Georgian government with the IMF.

The Union's MFA contributed to covering Georgia's external financing needs in 2009-2010. By providing the MFA, the EU, together with the International Financial Institutions and bilateral donors, supported the authorities' efforts to improve the balance of payments situation, improve debt sustainability and address social hardship caused by the military conflict and the global economic and financial crisis.

The Commission disbursed the first tranche of the assistance of EUR 23 million in December 2009 and January 2010. The MFA conditionality, which is consistent with the IMF programme conditionality, has two elements: (i) the IMF Stand-By Arrangement programme must remain on-track; (ii) satisfactory progress must be made within a number of reforms in the field of public finance management. Reforms leading to a more transparent, coherent and accountable public finance management system have been a high priority for the Government of Georgia and the EU has been supporting these reforms.

GEORGIA - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Prices are largely free.

2. Trade regime

Georgia has a liberal trade regime. Import tariffs have been abolished on around 90% of products. In September 2006, the number of tariff bands on imported goods was reduced from 16 to three (0%, 5%, and 12%). The maximum tariff of 12% is applied to those agricultural products and building materials which compete with domestic goods. The average weighted tariff is estimated to be 1.5%. Non-tariff barriers allowed for environmental, security and health reasons. There are no quantitative restrictions on imports and exports. However, in 2009, Georgia continued to have discriminatory excise taxation on certain imported tobacco products and its applied import tariffs on spirits were above the levels specified in Georgia's WTO schedules. Some of the excise taxes were equalised from January 2010. Georgia has been member of the WTO since 2000. EU-Georgia bilateral trade relations are regulated by the Partnership and Cooperation Agreement, in force since 1999. Since December 2005, Georgia has benefited from the tariff preferences under the GSP+. On 10 May 2010, the EU Council approved the mandate for the negotiations of the Association Agreement between the EU and Georgia, including the establishment of a DCFTA, once the necessary conditions are met.

3. Exchange regime

Floating exchange rate of the lari with limited official intervention by the National Bank of Georgia. There are no restrictions on current international transactions, in conformity with Article VIII of the IMF's Articles of Agreement.

4. Foreign Direct Investment

Virtually all FDI related flows, including the repatriation of capital and profits, have been liberalised. Net inflows of FDI amounted to around 7% of GDP in 2009.

5. Monetary policy

The central bank's main policy objective is the price stability, to be pursued through a formal inflation targeting regime.

6. Public Finances and taxation

General government expenditure made up 37.1% of GDP in 2008. A new liberal tax code came into force on 1 January 2005. Over the period of 2004-08, the number of taxes was reduced from 21 to 6. In 2008, the corporate profit tax was reduced from 20% to 15%, while the income and social taxes were merged into one income tax of 25%. The tax code was further amended in 2009 in order to further decrease the tax burden and facilitate economic development. Improvements were introduced in the VAT deduction system and the e-filing system for tax returns has been further implemented. Georgia has double taxation agreements with 26 countries, including 19 EU Member States. Three new double taxation treaties were signed in 2009.

7. Privatisation and enterprise restructuring

There has been significant progress in privatisation and enterprise restructuring. Private sector amounts to 75% of GDP, while cumulative privatisation revenues reached around 42% of GDP.

8. Financial Sector

The majority of Georgia's commercial banks are foreign owned. In the summer of 2009, the share of non-performing loans increased to more than 18%. Since the beginning of the global crisis, the EBRD had to step in to recapitalise two systemically important banks. The banking sector is highly 'dollarized'. In 2009, the share of domestic deposits held in foreign currency increased to 83%, from 64% in 2008.

6. UKRAINE

6.1. Executive summary

Ukraine entered into a severe recession in 2009, with real GDP contracting in excess of 15%. Although the trade deficit fell sharply in 2009, stemming from a strong contraction in imports, Ukraine's overall balance of payments was negative. To finance the shortfall, Ukraine depleted its international reserves and resorted to borrowing from the IMF. However, in October 2009 the IMF programme went off track in light of additional government spending plans in the context of the presidential election campaign.

An IMF Stand-By Arrangement amounting to USD 16.5 billion was approved by the IMF Board in early November 2008. After the disbursement of three tranches amounting overall to USD 10.6 billion, the IMF programme was put on hold in November 2009. After several rounds of negotiations interrupted by the presidential elections and the formation of the new government in spring 2010, a staff-level agreement on a new Stand-By Arrangement of USD 14.9 billion for 2.5 years was announced on 2 July 2010.

Against the backdrop of the severe contraction in the Ukrainian economy, foreign exchange reserve depletion, pressure on the currency and deteriorating public finances, the Ukrainian authorities requested crisis-related assistance from the EU of USD 5 billion in February 2009. The European Commission proposed to make available an additional EUR 500m in macro-financial assistance to Ukraine in October 2009. The Council adopted the Decision on 29 June and the Parliament signed the decision on 7 July 2010. This assistance is to be combined with the EUR 110 million that remain undisbursed from the MFA approved by the Council in 2002. The next round of negotiations on MFA policy conditionality is expected to take place in July 2010.

6.2. Macroeconomic performance

In the EU neighbourhood, Ukraine was among the countries worst hit by the international economic and financial crisis. In 2009, GDP contracted by 15.1% in real terms, with growth having already slowed to 1.9% in 2008 after an average increase of nearly 8% over the preceding five years.

On the production side, the sharp drop in GDP over 2009 was primarily driven by a real contraction of 25.6% in manufacturing, the most important sector in the Ukrainian economy, accounting for one-fifth of total production. Wholesale and retail trade, the second-largest sector (15.9% of total output), experienced a 15.6% drop, while construction and energy production also registered double-digit contractions.

These sectoral developments are mirrored on the demand side. Gross fixed capital formation shrank by 46.2% in real terms and detracted 12.2 percentage points from real GDP growth, reflecting companies' unwillingness to invest in the wake of a rapidly deteriorating demand outlook, poor order books and dwindling profitability. In addition, Ukrainian banks experienced a reduction in the availability of external financing; both state-owned and private commercial banks had to be recapitalised, at a cost to the government of around 2.8% of GDP, financed primarily through domestic bond issuance, which was one of several factors in the increase in public debt to 35% of GDP in 2009 (from 12% in 2007 and 20% in 2008). Banks passed the credit squeeze on to the real economy in the form of tighter lending conditions, which in turn contributed to the retrenchment in investment and in household consumption. The latter contracted by

14.2% in real terms in 2009, accounting for 8.7 percentage points of the recorded decline in real GDP.

In contrast to the pre-crisis years – when economic growth in Ukraine was domestic-demand-led, while net exports tended to detract from growth – 2009 saw a large positive contribution (9.2 percentage points) from the external sector. This stemmed from the 38.6% drop in imports, which outweighed the (also rapid) contraction in exports of 25.6%, a reaction to world recession.

This sharp adjustment in the real economy, with its sudden drop of imports, triggered an improvement in the current account, the deficit of which narrowed from 7.7% of GDP in 2008 to 1.5% in 2009. The driving factor in this correction was the trade balance (in the case of Ukraine, goods trade dwarfs the flows recorded in the services, income and current transfers balances).

However, the improvement in the current account over 2009 was more than offset by the deterioration in the financial and capital account. In particular, Ukrainian banks experienced difficulties in obtaining external financing and were faced with a situation in which loan repayments to foreign creditors exceeded drawings of fresh loans. Moreover, foreign residents sold more Ukrainian bonds than they bought. As a result of this capital flight and despite the improvement in the current account, Ukraine's overall balance of payments was negative. The country financed this shortfall in two main ways: through the use of the central bank's international reserves and through borrowing from the IMF.

The depletion of Ukraine's official reserves already started in the final quarter of 2008 when the international financial crisis escalated. They fell by over one-third from USD 36.8 billion at the end of September 2008 to just USD 23.7 billion at end-April 2010. Reserves recovered only mildly during the remainder of 2009, ending the year at USD 25.5 billion. This drop in foreign currency reserves weakened Ukraine's external liquidity position significantly and, in November 2008, prompted the National Bank of Ukraine to allow the hryvnia to depreciate from its long-standing exchange rate of close to UAH 5 per US dollar. Between November 2008 and December 2009, the hryvnia lost nearly 40% of its value in US dollar terms, which stabilised around UAH 8 per US dollar in the final quarter of 2009. The sharp depreciation of the domestic currency led to higher prices for imported goods and services, in particular gas (hydrocarbons make up approximately one-third of Ukraine's import bill). As a consequence, despite the deep recession, Ukraine's consumer price inflation remained high, at 15.9% in 2009 (annual average).

The second source of financing to cover the balance of payments shortfall was credit from the IMF. The Fund started its latest lending operation in Ukraine in November 2008, paying out around USD 4.5 billion to the NBU in the first tranche. The second tranche, worth around USD 3 billion, was disbursed in May 2009 in roughly equal parts to the central bank and, as direct budget support, to the government. The third tranche (USD 3.5 billion, paid out in August 2009) was exclusively used for budget support.

6.3. Structural reforms

Structural reform was hampered over 2009 by the deep economic crisis. In addition, the presidential election of January-February 2010 was looming over the political

environment in the latter part of 2009, giving additional incentives for expansionary fiscal measures and exacerbating rivalries at the highest political level. Indeed, the IMF suspended its programme before the disbursement of the fourth and final tranche, scheduled for November 2009, due in particular to the projected budgetary impact of the so-called social standards bill, which was adopted by the Ukrainian Parliament in October 2009 and signed into law by President Yushchenko the following month (contrary to IMF advice). The bill foresees gradual increases in the official minimum subsistence level (which is used to determine various social benefits) and the minimum wage (which is used, among others, to set public sector pay).

The beginning of the 2009 was overshadowed by a renewed gas dispute between Ukraine and Russia, which resulted in a significant increase in the price for Ukraine's gas imports from its eastern neighbour. Thus, while official figures for the consolidated government budget deficit show only a relatively modest widening from 1.2% of GDP in 2008 to 3.8% of GDP in 2009 (due not so much to active counter-cyclical policies as to a fall in government revenues), the 2009 budget balance including the deficit incurred by Naftogaz, the state-owned gas company, amounted to around 9% of GDP. This reflects a significant subsidisation of domestic gas prices in Ukraine to levels that frequently do not even cover the price at which Naftogaz itself buys the gas, not to mention its own operating costs and the investment needs of the transmission system. While in July 2009 the Ukrainian government committed to a comprehensive reform programme in the energy sector, notably in agreements with the EU and the international financial institutions, the politically sensitive issue of domestic gas price increases was not addressed in the subsequent implementation period.

Elsewhere, according to the World Bank's Doing Business study, which aims to measure business regulation, Ukraine's commercial environment improved only marginally over the course of 2009. The country now ranks 142nd in the world, compared with Rank 146 a year earlier. Particularly problematic areas include the bureaucratic burden on businesses associated with paying taxes and with obtaining construction permits.

6.4. Implementation of macro-financial assistance

An IMF Stand-By Arrangement amounting to USD 16.5 billion was approved by the IMF Board in early November 2008. After the disbursement of three tranches amounting overall to USD 10.6 billion, the IMF programme was put on hold in November 2009. After several rounds of negotiations interrupted by the presidential elections and the formation of the new government in spring 2010, a staff-level agreement on a new Stand-By Arrangement for a 2.5-year programme amounting to USD 14.9 billion was announced on 2 July 2010.

Against a backdrop of the severe contraction in the Ukrainian economy, foreign exchange reserve depletion, pressure on the currency and deteriorating public finances, Ukraine requested crisis-related assistance from the EU of USD 5bn in February 2009. In October 2009 the European Commission proposed to make available EUR 500 million in MFA to Ukraine. The Council adopted the Decision on 29 June while the Parliament is expected to sign it on 7 July 2010. Thus, together with the Council decision from 2002 on MFA amounting to up to EUR 110 million, which had not been disbursed in previous years, a total of up to EUR 610 million is made available for MFA to Ukraine in 2010-2011.

In parallel, efforts by the Commission to prepare the implementation of the MFA included the assignment of PriceWaterhouseCoopers to conduct a new Operational

Assessment of administrative procedures and financial circuits of public organisations involved in the management of MFA in Ukraine. The assessment was carried out in October 2009. The general conclusion of the consultants is that the framework for sound financial management is effective despite several weaknesses detected during this mission, namely the absence of an efficient external audit function, a lack of transparency in public procurement and difficulties in the financial management of state-owned enterprises. These shortcomings will be taken into account in the design of the conditionality of the approved EU MFA.

UKRAINE - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices are free. Regulated prices prevail for some utilities, notably gas, as well as in some other areas.

2. Trade liberalisation

Ukraine joined the WTO in May 2008. This has generally helped to limit crisis-related protectionist pressures, although the authorities resorted to temporary import duty surcharges on cars and refrigerators during 2009. Negotiations on a DCFTA with the EU are on-going.

3. Exchange rate regime

Ukraine's central bank manages the level of the hryvnia against the US dollar. In late 2008, due to the crisis, the official exchange rate of close to UAH5:USD was abandoned. Since late 2009, the hryvnia has been held close to UAH8:USD.

There are only few restrictions on current international transactions, in conformity with Article VIII of the IMF's Articles of Agreement. During the crisis, in response to pressures on the currency markets, the central bank introduced a number of foreign exchange controls.

4. Foreign direct investment

FDI related flows are largely liberalised but a registration of foreign investment is required. FDI inflows reached a peak of USD 10.9 billion or 6.0% of GDP in 2008 (due mainly to healthy inflows during the first three quarters). However, in 2009 they more than halved to USD 4.8 billion or 4.1% of GDP.

5. Monetary policy

The National Bank of Ukraine is responsible for controlling domestic inflation and managing the currency, with the latter effectively taking precedence.

6. Public finances

General government expenditure made up 47.3% of GDP in 2008 (last available data). Two thirds of Ukraine's government expenditure goes towards wages and social transfers. While consolidated government deficit stood at a relatively moderate 3.8% of GDP in 2009, the figure is much higher (around 9% of GDP) if the deficit incurred by Naftogaz, the state-owned gas company, is included.

7. Privatisation and enterprise restructuring

There has been substantial progress in privatisation and enterprise restructuring. Cumulative privatisation revenues constituted 15.5% of GDP. While in the mid-2000s, private sector represented 65% of GDP, this share somewhat decreased to 60% in 2009. The privatisation of strategic assets (notably the gas transmission system) is prohibited by law.

8. Financial sector reform

Before the crisis, Ukraine had two state-owned banks: Ochadbank, a savings bank, and Ukreximbank, a bank specialised in export-import financing. In July 2009, the number of state owned banks increased to five as the state became majority owner in Kiev Bank, Rodovit and Ukrgazbank. Out of 186 operating banks, a total of 51 financial institutions have foreign capital, including 17 with 100% foreign capital. Several banks from the EU countries are major players in Ukraine: Raiffeisen Bank Aval, BNP Paribas, Crédit Agricole, Swedbank, Unicredito, Commerzbank and Hungarian OTP. The overall foreign capital stake in the Ukrainian bank system has decreased from about 39% to 35%.

The share of non-performing loans rose from 3% in early 2008 to 10% in mid-2009.

MEDITERRANEAN COUNTRIES

7. LEBANON

7.1. Executive summary

Mediterranean Countries taking part in the European Neighbourhood Policy are eligible for MFA under the Genval Criteria. Lebanon is the first country of this group benefiting from MFA since the balance of payments loan granted in 1994 to Algeria (Decision 1994/933/EC).

In 2009 the Lebanese economy weathered the global crisis relatively well, aided by capital inflows and strong growth of foreign deposits in the banking sector. This helped underpin fairly strong real GDP growth and enabled the government to finance the deficit. The fiscal situation, however, remained very vulnerable. Implementation of the ambitious programme of structural reforms concluded in the aftermath of the Paris agreements stalled as a consequence of the political stalemate, which paralysed progress in legislative activity in many fields. With a new coalition government finally formed in November 2009, prospects for legislative progress have improved, but the political context remains difficult. The follow-up to the original IMF Emergency Post-Conflict Assistance (EPCA), equivalent to SDR 25.375 million, was successfully completed in June 2009, but no follow-up programme has been agreed with the authorities.

Since January 2007, Lebanon and the EU have been implementing a European Neighbourhood Policy Action Plan. The third progress report on the Action Plan implementation was issued by the Commission in May 2010 and concluded that little progress had been made in implementing the economic reform agenda.

In December 2007, the Council adopted a decision on a MFA to Lebanon amounting to EUR 80 million – a combination of medium-term loans (EUR 50 million) and grants (EUR 30 million), to be disbursed in two tranches. The first tranche of grants and loans were disbursed in December 2008 and June 2009 respectively. At the end of 2009, the availability period of the assistance was extended to 21 December 2010. The lack of progress with implementing the MFA conditions has thwarted disbursement of the second tranche under the assistance programme.

7.2. Macroeconomic developments

The latest economic indicators show a quite robust performance of the Lebanese economy in spite of the global financial crisis. Real GDP growth is estimated at 5.5% on average in 2009, from 8.5% in 2008. Leading indicators show ongoing expansion of economic activity. This partly reflects the fact that the financial sector proved remarkably resilient to the global crisis and to the politically uncertain environment, with a government of national unity only formed towards the end of 2009. The high number of visitors from abroad around the elections also boosted domestic expenditure. For several industries the negative impact of the global financial crisis was increasingly felt towards end-2008, via several transmission channels. Trade volumes decelerated from the beginning of 2009 onwards, mirroring the slowdown in major trading partners, notably Arab countries and the countries in the European Union, which account for around 50 and 17 percent of Lebanese exports respectively. Persistent high interest rate spreads to international benchmarks kept interest rates on domestic bank loans up. From the second half of 2008 onwards, remittance inflows fell back in view of the slowdown in countries where Lebanese expatriates had been working.

But several other factors acted in support of the economy. Inflationary pressures abated sharply from the latter part of 2008 onwards, as commodity and global trade prices fell. Consumer price inflation as measured by the CPI fell from more than 10% in 2008 to around 1% in 2009. In addition, despite a clear negative impact of the crisis on tradable industries (exports contracted by 18%) the Lebanese banking system has so far been quite resilient. Lebanese banks have long-standing experience in operating in a strained economic and political environment, have had high liquidity buffers, limited exposure to structured products under long-standing prudential directives by the central bank, and had not borrowed heavily on international markets – if only because of Lebanon's impaired investor status. Relatively high deposit interest rates helped attract funding inflows in the aftermath of the global financial crisis, partly reflecting regional portfolio shifts in a relative flight to yield and certainty. Share prices also recovered from the trough in spring 2009, in line with global trends. Moreover, remittances inflows picked up again on the back of the rebound in regional and global growth.

Thus, Lebanon registered substantial capital inflows. Deposit inflows were sustained despite a continued fall in domestic interest rates and were partly diverted into real estate but did not translate into an acceleration in domestic credit growth to the private sector. The surge in financial inflows helped push foreign currency reserves to record levels, further bolstering the credibility of the exchange rate peg. In 2009, foreign currency reserves increased by 50.3 percent. Deposit growth helped domestic banks (which are the largest creditor group to the government) absorb high-yielding government bonds, which partly compensated for the lack of lending opportunities. The government borrowed beyond its needs, as reflected by the growing gap between the gross and net public debts. Ample liquidity enabled extending state borrowing to longer maturities in the yield curve (5-year T-bills in Lebanese pounds and 5 and 15-year eurobond issues that were finally launched early December 2009, yielding 5.875 and 7% respectively).

On the back of moderating growth, the current account deficit broadly stabilised in 2009, at around 11% of GDP. The total external debt ratio further declined to 187% of GDP in 2009, continuing the moderate downward trend witnessed in previous years. The elevated external debt ratio goes hand in hand with a high public deficit and debt. Despite buoyant fiscal revenue (up by around 20%) backed by strong economic activity, the government budget deficit (including grants) is expected to have broadly stabilised at around 10% of GDP in 2009, partly reflecting substantial increases in pension outlays and other government expenses. Total public expenditure increased by around 15%, of which is a large part is going to service the public debt. The relatively high interest rate spread which helped support capital inflows, is thus weighing on the government budget. International support did help alleviate the pressure on public finances. This included the first tranche of grants and loans (EUR 15 and EUR 25 million respectively) under the EU MFA facility.

In 2010, real GDP growth is expected to slow down to slightly above 2%, in response to the fading out of several factors that supported growth in 2009, such as financial portfolio shifts and the strong surge in tourist receipts. Despite the overall resilience of the Lebanese economy to global headwinds in 2009, the economic situation remains vulnerable on several counts. Apart from political risks and the general uncertainty on the strength of the global upswing, these relate to the high public and external debt, the reliance on just a few sectors to provide the bulk of growth, uncertainty about the persistence of foreign inflows in a situation where banks continue to have maturity mismatches, and possible inflation risks also in view of rising commodity prices.

7.3. Structural reforms

Implementation of the reform agenda outlined in the Paris III donors' conference programme stalled against a background of deep political divisions and consequent paralysis of legislative activity in the run-up to the June 2009 parliamentary elections and during the protracted subsequent negotiations on forming a new government.

Still mainly as a reflection of the long-lasting political stalemate, no meaningful progress was made on key reforms such as changing the heavily subsidised electricity subsidy system and passing the draft laws on WTO-related issues, pension reform, capital market reform and public procurement. Large privatisation projects, notably for mobile telephony and electricity supply, have been put on ice, reflecting ongoing uncertainty about market conditions. A 25% stake in the national air carrier MEA, held by the central bank, was announced to be floated in 2010 thus delaying the time path for full privatisation.

More generally, many impediments to a conducive business climate remain unresolved. Hence, the ranking of Lebanon according to several business climate measures remained poor in comparison with regional peers, many of which made progress in recent years.

The central bank progressed in improving operating procedures in financial services and adopting International Financial Reporting Standards. In view of the large weight of the financial sector in the Lebanese economy, international agreements on actions to improve oversight and reduce systemic risk in the global financial sector will have an impact in the years to come. Against this background, the Banque du Liban and IMF agreed to have a new Financial Stability Assessment in 2010. This would be valuable to identify vulnerabilities in the Lebanese financial system and to benchmark against new standards of oversight that are being implemented internationally. The high interest rates charged by commercial banks on domestic loans reflect the high spreads against international interest rate benchmarks that support deposit and reserve inflows. Spreads are in part mirroring risk premia and heavy government borrowing. However, the ensuing high interest rates and conservative lending policies hinder lending to domestic industries, in particular small and medium-sized enterprises.

With respect to public finance management, progress with improving budgetary planning and control has been limited. This concerns measures aimed at improving budget formulation and execution as well as plans to improve cash management and implement a single treasury account. The 2010 budget that was approved in April 2010 includes some provisions on fiscal accountability, but this does not imply a multi-annual fiscal framework.

With the new government in place, it is crucial that the authorities proceed with reviving the stalled reform agenda. This with a view to make growth in the country less dependant on a few industries only, such as finance, and to develop growth potential in other sectors. Despite relatively favourable macroeconomic developments in the last year, the fiscal deficit and public debt remain high and progress with fiscal consolidation to reduce the hefty burden of public debt service remains a key priority to ensure sustainability.

7.4. Implementation of macro-financial assistance

In 2008, the Commission started the implementation of the Council Decision 2007/860/EC providing macro-financial assistance of EUR 80 million in the form of a combination of a medium-term loan and grant of EUR 50 and 30 million respectively.

The assistance complements support from the Bretton Woods institutions, bilateral donors (including EU Member States and Arab countries), and other EU assistance provided under the ENPI and in the form of EIB loans. MFA is conditional, in particular, on progress in the implementation of IMF arrangements.

The EU MFA aims primarily at supporting the authorities' effort of fiscal consolidation. Thus, the specific reform measures targeted by the programme focus on public finance management and on two specific sector policies of particular importance for fiscal adjustment and debt reduction, namely the power sector and the social sector. Agreement on the conditions to be attached to the disbursement of the assistance was reached in the course of 2008. Subsequently, the EUR 15 million first tranche of the grant was disbursed end-December 2008. The first tranche of a 5-year loan of EUR 25 million was disbursed on 4 June 2009.

Due to the difficult political situation in the run-up to elections, progress with fulfilling the conditions was very limited in 2009. Against this background, in December 2009, the Commission extended the availability period of the second tranche of the assistance programme by one year, which will now expire on 21 December 2010. Disbursement of the second tranche is subject to the fulfilment of the agreed policy conditionality. One important element of conditionality is the existence of an ongoing IMF programme. In November 2008, the IMF Board approved a second Emergency Post-Conflict Assistance (EPCA II) package of SDR 25.375 million. The EPCA II programme expired at the end of June 2009, with the quantitative targets (focusing on an increase in foreign currency reserves and on targeting a reduction in the primary fiscal balance) comfortably met. However, key non-quantitative targets were not met, notably the introduction of a single Treasury account; the reform of electricity tariffs; and the privatisation of mobile phone networks. No further IMF programmes have been launched.

LEBANON - SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices are free, but the government subsidises the price of wheat.

2. Trade liberalisation

Liberal international trade policy, but protectionist measures are occasionally introduced. Lebanon is a founding member of GATT but it withdrew in 1949. It is now negotiating the accession to WTO.

3. Exchange regime

Fixed exchange rate (peg to the USD). No restrictions on current international transactions in conformity with Article VIII of the IMF's Articles of Agreement. Lebanon has also achieved substantial capital account convertibility.

4. Foreign direct investment

Unlimited repatriation of capital and profits and no limitations on holding foreign currency bank accounts. Legislation is overall adequate and an investment development authority exists but enforcement of contracts is sometimes problematic in the absence of commercial courts and independent judiciary.

5. Monetary policy

The Banque du Liban uses a wide range of monetary policy instruments to maintain financial stability and provide liquidity to the banking sector. It also occasionally provides financing to the government (on a temporary basis). The exchange rate peg is regarded as a key factor in maintaining monetary stability

6. Public finance

The high public debt ratio and high interest rates at which the government is borrowing remain issues of concern, also given the quite shallow tax base, which is skewed towards indirect taxes and provides exemptions for the banking sector, notably as regards taxing foreign deposits. Public finance management reform focuses on budget formulation and execution and medium-term planning. There has been little progress in recent years. Key issues, such as the Treasury Single Account law, are still pending before Parliament.

7. Privatisation and enterprise restructuring

The structural reform programme focuses on privatisation, improvement of business climate, privatisations, and opening of markets, but progress has been stalled due to the political situation. Important privatisations, for instance of mobile telephony licenses and the electricity company, have been postponed.

8. Financial sector reform

Lebanon has a sophisticated and developed financial sector, based on domestic private banks, which proved resilient to shocks despite vulnerabilities.

**Annex 1A - COMMUNITY MACRO-FINANCIAL AND EXCEPTIONAL FINANCIAL ASSISTANCE
TO THIRD COUNTRIES BY DATES OF COUNCIL DECISIONS**

Status of effective disbursements as of end-December 2009 (in millions of euro)

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals disbursed</u>	
Hungary I (Loan)	22.02.90	90/83/EC	870	Apr. 1990 Feb. 1991	350 260	610	260 (Suspended)
Czech and Slovak Federal Republic	25.02.91	91/106/EC	375	Mar. 1991 Mar. 1992	185 190	375	
Hungary II (Loan)	24.06.91	91/310/EC	180	Aug. 1991 Jan. 1993	100 80	180	
Bulgaria I (Loan)	24.06.91	91/311/EC	290	Aug. 1991 Mar. 1992	150 140	290	
Romania I (Loan)	22.07.91	91/384/EC	375	Jan. 1992 Apr. 1992	190 185	375	
Israel (1) (Loan)	22.07.91	91/408/EC	187,5	Mar. 1992	187,5	187,5	
Algeria I (Loan)	23.09.91	91/510/EC	400	Jan. 1992 Aug. 1994	250 150	400	
Albania I (Grant)	28.09.92	92/482/EC	70	Dec. 1992 Aug. 1993	35 35	70	
Bulgaria II (Loan)	19.10.92	92/511/EC	110	Dec. 1994 Aug. 1996	70 40	110	
Baltics (Loans); of which:	23.11.92	92/542/EC	220			135	85 (Suspended)
Estonia			40	Mar. 1993	20	20	20
Latvia			80	Mar. 1993	40	40	40
Lithuania			100	Jul. 1993 Aug. 1995	50 25	75	25
Romania II (Loan)	27.11.92	92/551/EC	80	Feb. 1993	80	80	
Moldova I (Loan)	13.06.94	94/346/EC	45	Dec. 1994 Aug. 1995	25 20	45	
Romania III (Loan)	20.06.94	94/369/EC	125	Nov. 1995 Sep. 1997 Dec. 1997	55 40 30	125	
Albania II (Grant)	28.11.94	94/773/EC	35	Jun. 1995 Oct. 1996	15 20	35	
Algeria II (Loan)	22.12.94	94/938/EC	200	Nov. 1995	100	100	100 (Suspended)
Slovakia (Loan)	22.12.94	94/939/EC	130	Jul. 1996			130 (Cancelled)
Ukraine I (Loan)	22.12.94	94/940/EC	85	Dec. 1995	85	85	
Belarus (Loan)	10.04.95	95/132/EC	55	Dec. 1995	30	30	25 (Suspended)
Ukraine II (Loan)	23.10.95	95/442/EC	200	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	200	
Moldova II (Loan)	25.03.96	96/242/EC	15	Dec. 1996	15	15	
fYRoM I (Loan)	22.07.97	97/471/EC	40	Sep. 1997 Feb. 1998	25 15	40	
Bulgaria III (Loan)	22.07.97	97/472/EC	250	Feb. 1998 Dec. 1998	125 125	250	
Armenia, Georgia and Tajikistan (2) (Loan and grant); of which:	17.11.97 28.3.00	97/787/EC modified by 00/244/EC	375			294,5	80,5

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals disbursed</u>	
Armenia (Loan and grant)			58	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant) June 2004 (grant) Dec 2005 (grant)	28 8 4 5,5 5,5 5,5 1,5	58	0
Georgja (Loan and grant)			175	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant) Dec 2004 (grant)	110 10 9 6 6,5	141,5	33,5
Tajikistan (Loan and grant)			95	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant) Feb. 2003 (grant) May 2005 (grant) Oct 2007 (grant)	60 7 7 7 7 7	95	
Ukraine III (Loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	150	Jul. 1999	58	58	92 (Cancelled)
Albania III (Loan)	22.04.99	99/282/EC	20				20
Bosnia I (3) (Loan and grant)	10.05.99 10.12.01	99/325/EC modified by 01/899/EC	60	Dec. 1999 (grant) Dec. 1999 (loan) Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (grant)	15 10 10 10 15	60	
Bulgaria IV (Loan)	08.11.99	99/731/EC	100	Dec. 1999 Sep. 2000	40 60	100	
fYRoM II (4) (Loan and grant)	08.11.99 10.12.01	99/733/EC modified by 01/900/EC	80 18	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant) May 2003 (grant) June 2003 (loan) Dec. 2003 (loan) Dec. 2003 (grant)	20 10 12 10 10 10 18 8	98	
Romania IV (Loan)	08.11.99	99/732/EC	200	Jun. 2000 July 2003 (loan)	100 50	150	50
Kosovo I (5) (Grant)	19.02.00	00/140/EC	35	Mar. 2000 Aug. 2000	20 15	35	
Montenegro (5) (Grant)	22.05.00	00/355/EC	20	Aug. 2000 Dec. 2000	7 13	20	
Moldova III (Loan)	10.07.00 19.12.02	00/452/EC 02/1006/EC	15				15 (Cancelled)
Kosovo II (3) (Grant)	27.06.01	01/511/EC	30	Sep. 2001 Dec. 2002	15 15	30	
Serbia and Montenegro (ex FRY) I (6) (Loan and grant)	16.07.01 10.12.01	01/549/EC modified by 01/901/EC	345	Oct. 2001 Oct. 2001 Jan. 2002 Aug 2002	225 35 40 45	345	
Ukraine III Modification Decision 98/592/EC	12.07.02	02/639/EC					
Ukraine IV (Loan)	12.07.02	02/639/EC	110				110
Serbia and Montenegro (ex FRY) II (7) (Loan and grant)	05.11.02	02/882/EC	130	Dec. 2002 (grant) Fev. 2003 (loan) Aug. 2003 (grant) Aug. 2003 (loan)	30 10 35 30	105	25
Bosnia II (8) (Loan and grant)	05.11.02	02/883/EC	60	Fev. 2003 (grant) Dec. 2003 (grant)	15 10	25	

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals disbursed</u>	
Moldova IV (Grant)	19.12.02	02/1006/EC	15				15
Serbia and Montenegro (ex FRY) II (7) Modification Decision 02/882/EC (grant)	25.11.03	03/825/EC	70	Dec 2004 (grant)	10	10	20
Albania IV (9) (Loan and grant)	29.04.04	04/580/EC	25	Nov 2005 (grant) March 2006 (loan) July 2006 (grant)	3 9 13	25	
Bosnia II (8) Modification Decision 02/883/EC (grant and loan)	7/12/2004	04/861/EC		Dec 2004 (loan) Jun 2005 (grant) Feb 2006 (loan)	10 15 10	35	
Serbia and Montenegro (ex FRY) II (7) Modification Decision 02/882/EC (Grant and loan)	07.12.2004	04/862/EC		April 2005 (loan) Dec 2005 (grant)	15 25	40	
Georgia II (Grant)	24.01.06	06/41/EC	33,5	August 2006 (grant) Dec 2006 (grant)	11 11	22	11,5
Kosovo (Grant)	30.11.06	06/880/EC	50				50
Moldova (Grant)	16.04.07	07/259/EC	45	Oct 2007 (grant) Jun 2008 (grant) Dec 2008 (grant)	20 10 15	45	
Lebanon (10) (Loan and grant)	10.12.07	07/860/EC	80	Dec 2008 (grant) Jun 2009 (loan)	15 25	40	40
Georgia (Grant)	30.11.09	09/889/EC	46	Dec 2009 (grant)	15,3	15,3	30,7
Armenia (11) (Loan and grant)	30.11.09	09/890/EC	100				100
Bosnia-Herzegovina (Loan)	30.11.09	09/891/EC	100				100
Serbia (Loan)	30.11.09	09/892/EC	200				200
Ukraine (Loan)	29.06.10	10/ /EC	500				500
TOTAL			7350			5350,3	2144,7

- (1) Assistance to Israel includes a loan principal amount of €160 million and grants of €27.5 million in the form of interest subsidies
- (2) Exceptional financial assistance, which includes a ceiling of euro 245 million for the loans and a ceiling of euro 130 million for the grants
Out of the global amount of euro 375 million, maximum amounts of euro 58 million, euro 175 million and euro 95 million were actually agreed countries
- (3) Includes a loan principal amount of up to €20 million and grants of up to €40 million
- (4) Includes a loan principal amount of up to €50 million and grants of up to €48 million
- (5) Exceptional financial assistance
- (6) Includes a loan principal amount of €225 million and grants of €120 million
- (7) Includes a loan principal amount of €55 million and grants of €75 million
- (8) Includes a loan principal amount of €20 million and grants of €40 million
- (9) Includes a loan principal amount of €9million and grants of €16 million
- (10) Includes a loan principal amount of €50 million and grants of €30 million
- (11) Includes a loan principal amount of €65 million and grants of €35 million

**Annex 1B - COMMUNITY MACRO-FINANCIAL AND EXCEPTIONAL FINANCIAL ASSISTANCE
TO THIRD COUNTRIES BY REGION**

Status of effective disbursements as of end-December 2009 (in millions of euro)

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals</u>	
<u>A. EU Accession countries</u>							
Baltics (loans) of which :	23.11.92	92/542/EC	220			135	85 (Suspended)
Estonia			40	Mar. 1993	20	20	20
Latvia			80	Mar. 1993	40	40	40
Lithuania			100	Jul. 1993 Aug. 1995	50 25	75	25
Bulgaria I (loan)	24.06.91	91/311/EC	290	Aug. 1991 Mar. 1992	150 140	290	
Bulgaria II (loan)	19.10.92	92/511/EC	110	Dec. 1994 Aug. 1996	70 40	110	
Bulgaria III (loan)	22.07.97	97/472/EC	250	Feb. 1998 Dec. 1998	125 125	250	
Bulgaria IV (loan)	08.11.99	99/731/EC	100	Dec. 1999 Sep. 2000	40 60	100	
Czech and Slovak Federal Republic (loan)	25.02.91	91/106/EC	375	Mar. 1991 Mar. 1992	185 190	375	
Hungary I (Structural adjustment loan)	22.02.90	90/83/EC	870	Apr. 1990 Feb. 1991	350 260	610	260 (Suspended)
Hungary II (loan)	24.06.91	91/310/EC	180	Aug. 1991 Jan. 1993	100 80	180	
Romania I (loan)	22.07.91	91/384/EC	375	Jan. 1992 Apr. 1992	190 185	375	
Romania II (loan)	27.11.92	92/551/EC	80	Feb. 1993	80	80	
Romania III (loan)	20.06.94	94/369/EC	125	Nov. 1995 Sep. 1997 Dec. 1997	55 40 30	125	
Romania IV (loan)	08.11.99	99/732/EC	200	Jun. 2000 July 2003	100 50	150	50
Slovakia (loan)	22.12.94	94/939/EC	130			Cancelled (Jul. 1996)	130 Cancelled
TOTAL A			3305			2780	525

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>		<u>Totals</u>	<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>		
B. Western Balkans							
Albania I (grant)	28.09.92	92/482/EC	70	Dec. 1992 Aug. 1993	35 35	70	
Albania II (grant)	28.11.94	94/773/EC	35	Jun. 1995 Oct. 1996	15 20	35	
Albania III (loan)	22.04.99	99/282/EC	20				20 (Cancelled)
Bosnia I (1) (loan and grant)	10.05.99 10.12.01	99/325/EC modified by 01/899/EC	60	Dec. 1999 (grant) Dec. 1999 (loan) Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (grant)	15 10 10 10 15	60	
fYRoM I (loan)	22.07.97	97/471/EC	40	Sep. 1997 Feb. 1998	25 15	40	
fYRoM II (2) (loan and grant)	08.11.99 10.12.2001	99/733/EC modified by 01/900/EC	80 18	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant) May 2003 (grant) June 2003 (loan) Dec. 2003 (loan) Dec. 2003 (grant)	20 10 12 10 10 10 18 8	98	
Kosovo I (3) (Grant budgetary support)	19.02.00	00/140/EC	35	Mar. 2000 Aug. 2000	20 15	35	
Kosovo II (3) (Grant budgetary support)	27.06.01	01/511/EC	30	Sep. 2001 Dec. 2002	15 15	30	
Montenegro (3) (Grant budgetary support)	22.05.00	00/355/EC	20	Aug. 2000 Dec. 2000	7 13	20	
Serbia and Montenegro I (ex FRY) (4)	16.07.01 10.12.2001	01/549/EC modified by 01/901/EC	345	Oct. 2001 (grant) Oct. 2001 (loan) Jan. 2002 (grant) Aug.2002 (grant)	35 225 40 45	345	
Serbia and Montenegro II (ex FRY) (5) (loan and grant)	05.11.02	02/882/EC modified by	130	Dec. 2002 (grant) Fev. 2003 (loan) Aug. 2003 (grant) Aug. 2003 (loan)	30 10 35 30	105	25
	25.11.03	03/825/EC (7)	70	Dec 2004 (grant)	10	50	20
	07.12.04	04/862/EC		April 2005 (loan) Dec 2005 (grant)	15 25		
Bosnia II (6) (loan and grant)	05.11.02 07.12.04	02/883/EC modified by 04/861/EC	60	Fev. 2003 (grant) Dec. 2003 (grant) Dec 2004 (loan) June 2005 (grant) Feb 2006 (loan)	15 10 10 15 10	60	
Albania IV (8) (loan and grant)	29.04.04	04/580/EC	25	Nov 2005 (grant) Mar 2006 (loan) Jul 2006 (grant)	3 9 13	25	
Kosovo	30.11.06	06/880/EC	50				50
Bosnia-Herzegoviona (9)	30.11.09	09/891/EC	100				100
Serbia (9)	30.11.09	09/892/EC	200				200
TOTAL B			1388			973	415
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- (1) Includes a loan principal amount of €20 million and grants of €40 million.
(2) Includes a loan principal amount of up to €50 million and grants of up to €48 million.
(3) Exceptional financial assistance.
(4) Includes a loan principal amount of €225 million and grants of €120 million.
(5) Includes a loan principal amount of €55 million and grants of €75 million
(6) Includes a loan principal amount of €20 million and grants of €40 million
(7) Includes a loan principal amount of €25 million and grants of €45 million
(8) Includes a loan principal amount of €9 million and grants of €16 million
(9) Assistance includes only loans

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals</u>	<u>Undisbursed</u>
C. New Independent States (NIS)							
Armenia, Georgia and Tajikistan (9) (Structural adjustment loans and grants)	17.11.97	97/787/EC	375			294,5	80,5
of which	28.3.00	00/244/EC					
Armenia			(58)	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant) Jun 2004(grant) Dec 2005(grant)	28 8 4 5,5 5,5 5,5 1,5	(58)	0
Georgia			(175)	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant) Dec. 2004 (grant)	110 10 9 6 6,5	(141,5)	(33,5)
Tajikistan			(95)	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant) Feb 2003 (grant) May 2005 (grant) Oct 2006 (grant)	60 7 7 7 7 7	(95)	
Belarus (loan)	10.04.95	95/132/EC	55	Dec. 1995	30	30	25 (Suspended)
Moldova I (loan)	13.06.94	94/346/EC	45	déc-94 Aug. 1995	25 20	45	
Moldova II (loan)	25.03.96	96/242/EC	15	Dec. 1996	15	15	
Moldova III (loan)	10.07.00 19.12.02	00/452/EC 02/1006 EC	15				15 (cancelled)
Moldova IV (grant)	19.12.02	02/1006/EC	15 <i>(15)</i>				15
Ukraine I (loan)	22.12.94	94/940/EC	85	Dec. 1995	85	85	
Ukraine II (loan)	23.10.95	95/442/EC	200	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	200	
Ukraine III (loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	150	Jul. 1999	58	58	92 (cancelled)
Ukraine IV (loan)	12.07.02	02/639/EC	110 <i>(15)</i>				110
Georgia II	21.01.06	06/41/EC	33,5	Aug 2006 Dec 2006	11 11	22	11,5
Moldova	16.04.07	07/259/EC	45	Oct 2007 Jun 2008 Dec 2008	20 10 15	45	
Georgia	30.11.09	09/889/EC	46	Dec 2009	15.3	15,3	30,7
Armenia (11)	30.11.09	09/890/EC	100	Dec 2009			100
Ukraine	29.06.10	10/ /EC	500				500
TOTAL C			2289,5			809,8	1479,7

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals</u>	
<u>D. Mediterranean countries</u>							
Israel (10) (Structural adjustment soft loan)	22.07.91	91/408/EC	187,5	Mar. 1992	187,5	187,5	
Algeria I (loan)	23.09.91	91/510/EC	400	Jan. 1992 Aug. 1994	250 150	400	
Algeria II (loan)	22.12.94	94/938/EC	200	Nov. 1995	100	100	100 (Suspended)
Lebanon (12)	10.12.07	07/860/EC	80	Dec 2008 Dec 2009		15 25	40
TOTAL D			867,5			727,5	140
TOTAL A+B+C+D			7350			5290,3	2059,7

9) Exceptional financial assistance, which includes a ceiling of euro 245 million for the loans and a ceiling of euro 130 million for the grants
Out of the global amount of euro 375 million, maximum amounts of euro 58 million, euro 175 million and euro 95 million were actually agreed with the beneficiary countries

(10) Assistance to Israel includes a loan principal amount of ECU 160 million and grants of ECU 27.5 million in the form of interest subsidies.

(11) Includes a loan principal amount of €65 million and grants of €35 million

(12) Includes a loan principal amount of €50 million and grants of €30 million