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REPORT FROM THE COMMISSION
TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE TO THIRD COUNTRIES IN 2001

LIST OF ABBREVIATIONS

CAMEL	Capital, assets, management, earnings, liquidity (parameters used in international system for rating banks)
CBA	Currency Board Arrangement
CEECs	Central and East European Countries
CPI	Consumer Price Index
DEM	German Mark
EC	European Community
EFF	Extended Fund Facility
EIB	European Investment Bank
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FESAL	Financial and Enterprise Structural Adjustment Loan
FRY	Federal Republic of Yugoslavia
FYROM	Former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IMF	International Monetary Fund
MFA	Macro-Financial Assistance
NIS	New Independent States
PRGF	Poverty Reduction and Growth Facility (formally ESAF)
SAA	Stabilisation and Association Agreement
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
USD	Dollar of the United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

TABLE OF CONTENTS

I. INTRODUCTION

This report assesses the economic situation, the progress of reforms and the prospects of the countries that received macro-financial assistance in 2001, with particular reference to the implementation of the conditions attached to it.

Chapter II provides an overview of the EC macroeconomic assistance to third countries, with an historical background, a summary of the operations in 2001, and an analysis of the burden-sharing among the international donor community.

The following chapters discuss relevant aspects of the transition process in the countries for which either new macro-financial assistance operations have been decided by the Council or disbursements under previously decided operations have been made in 2001.

This report is submitted in accordance with the Council Decisions regarding Community macro-financial or exceptional financial assistance to third countries and follows on from the reports presented in previous years[1].

The complete list of macro-financial assistance operations decided by the Council with the corresponding disbursements up to the end of 2001 appears in Annex 1. Annex 2 summarises the macro-financial assistance provided by bilateral and multilateral donors to the countries that received EC macro-financial assistance. Finally, selected macroeconomic indicators are summarised in Annex 3.

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1 See the following Communications from the Commission to the Council and the European Parliament with the title 'Report on the implementation of macro-financial assistance to third countries':
COM(92)400 of 16 September 1992
COM(94)229 of 7 June 1994
COM(1995)572 of 27 November 1995
COM(1996)695 of 8 January 1997
COM(1998)3 of 13 January 1998
COM(1999)580 of 15 November 1999.
COM(2000)682 of 27 October 2000.
COM(2001)288 of 1 June 2001.

II. OVERVIEW

1. Background

MFA supports the political and economic reform efforts of the beneficiary countries and is implemented in association with support programmes from the IMF and the World Bank. It has continued to incorporate a set of principles which underline the exceptional character of this assistance, its complementarity to financing from the IFIs and its macroeconomic conditionality. In particular, Community MFA has supported efforts by recipient countries to bring about economic reforms and structural changes. In close co-ordination with the IMF and the World Bank, it has promoted policies that are tailored to specific country needs with the overall objective of stabilising the financial situation and establishing market-oriented economies. The Commission implements this type of assistance in consultation with the Economic and Financial Committee.

2. Macro-financial assistance in 2001

a) New decisions

The years 1999 and 2000 had already been years of enhanced MFA to the Balkan countries, when, as a result of increased balance-of-payments difficulties and of the Kosovo crisis, seven operations for a maximum amount of EUR 515 million had been decided by the Council for Romania, Bulgaria, Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia (FYROM), -Kosovo and Montenegro. In 2001, this increase in assistance to the Balkan region was confirmed by a substantial assistance package to the Federal Republic of Yugoslavia (Serbia and Montenegro). The Council decided in July 2001 to provide EUR 300 million in total of which a EUR 225 million loan and grants of EUR 75 million following democratic changes in this country. In December 2001, The Council approved a revision of this Decision by increasing the overall amount of this assistance to up to EUR 345 million of which EUR 120 million for the grant component. In June, further grant assistance to Kosovo was decided in an amount of EUR 30 million. This was followed in December with a EUR 18 million grant package to the Former Yugoslav Republic of Macedonia (FYROM).

b) Disbursements

Disbursements of macro-financial assistance amounted to a total of EUR 392 million in 2001, excluding grants of EUR 5.5 million for Armenia and of EUR 40 million for the Federal Republic of Yugoslavia (Serbia and Montenegro) disbursed on the basis of procedures initiated in 2001 but adopted in January 2002. The disbursements consisted of EUR 15 million for the Federal Republic of Yugoslavia (Kosovo), EUR 260 million for the Federal Republic of Yugoslavia (Serbia and Montenegro), EUR 15 million for Bosnia, EUR 22 million for the former Yugoslav Republic of Macedonia and EUR 6 million for Georgia. In March 2001 **Tajikistan** settled its remaining arrears of EUR 78.8 million towards the Community. It subsequently benefited from a new EUR 95 million assistance package consisting of a EUR 60 million loan and of grants to be disbursed over a five year period. Out of this assistance package adopted in March 2000, a grant amount of EUR 14 million and a loan of EUR 60 million were disbursed in 2001.

Out of the EUR 392 million disbursed, EUR 95 million took the form of grants. These were for the former Yugoslav Republic of Macedonia (EUR 10 million), the Federal Republic of Yugoslavia (Kosovo) (EUR 15 million), Bosnia (EUR 15 million), the Federal Republic of

Yugoslavia (Serbia and Montenegro) (EUR 35 million), Georgia (EUR 6 million) and Tajikistan (EUR 14 million). The rest of the assistance took the form of loans : for the Former Yugoslav Republic of Macedonia, (EUR 12 million), for the Federal Republic of Yugoslavia (Serbia and Montenegro) (EUR 225 million), and for Tajikistan (EUR 60 million).

c) Repayments and undisbursed operations

Some MFA operations decided in the first half of the 1990s have not been fully paid out as initially foreseen. This has been the result of either improved external financial conditions (Hungary, Baltics, Slovakia, Algeria), or of a difficult political climate (Belarus). In these cases, the disbursement of the remaining tranches is not programmed anymore. For more recently adopted operations, implementation, in some cases, has been delayed because of the slowing-down in the reform process (Romania, Georgia). In the case of Albania, Moldova and Ukraine, evolving circumstances have led the Commission to reconsidering the terms of the existing assistance operations. These might be reconsidered or replaced by new revised assistance packages, possibly in the course of the year 2002. The last column of Annex 1 provides details concerning the undisbursed amounts.

3. Trends and tendencies in macro-financial assistance

The Community's macro-financial assistance is intended to support macroeconomic stabilisation of the beneficiary countries and ease their balance of payments difficulties. It plays also a very useful role in promoting structural reform.. Over the years, the number of countries to which it was appropriate for the Community to extend such support expanded, as a growing number of countries neighbouring the EU faced balance of payments difficulties and committed themselves to rigorous programmes of economic reform. This led to a change in the geographic balance of assistance from the early years, when most beneficiary countries were countries in Central and Eastern Europe. As a result of the conflicts in the Western Balkans, in particular the Kosovo conflict of 1999 and of the political changes in the Federal Republic of Yugoslavia (Serbia and Montenegro), a clear tendency for a relative increase of MFA to the countries of the Balkans developed through the 1999-2001 Council Decisions.

Out of the three MFA decisions taken in 2001, two were for traditional balance of payment assistance operations, while the third one only was designed to support the budget of the beneficiary entity. This budget support operation was decided in favour of Kosovo, which could not benefit from an IMF-supported economic programme. A particularity of the decisions of the 2000-2001 period was the substantial share of grant support in the total amount decided : 43 % instead of 6 % over the 1990-1999 period. The new grant/loan proportions of the assistance packages reflects the assessment made by the EU bodies of the relative degree of poverty of the recipient countries and of their limited debt servicing capacity. As observed already in 1999 and 2000, MFA is aimed not only at promoting macroeconomic stabilisation and the balance of payments, but also plays a very useful role in supporting the government’s programme of structural reform. Consistently, MFA has been effectively combined with assistance from the Phare/Ispa, Tacis or Obnova/Cards programmes with a view to strengthening the institutional capacity that was essential to the success of the structural reform process.

Tables 1 and 2, and their accompanying Graphs 1a and 2a underline the exceptional character of the EC MFA. The highest volumes of MFA operations were decided and disbursed in the years immediately after the changes in the political and economic systems of the countries of Central and Eastern Europe. Since then, the fluctuations in the amounts of MFA reflect decisions taken on a case-by-case basis after an assessment of the macro-economic situation and financing needs of the potential beneficiary countries. Graph 1a for operations decided over the whole period from 1990 to 2001 (totalling up to EUR 5.8 billion) and Graph 2a for actual amounts disbursed (totalling up to EUR 4.7 billion) show the important concentration of the assistance in the CEECs that are candidates for EU accession (around 57% of total macro-financial assistance over the last decade). However, macro-financial assistance to these countries was progressively phased out in parallel with their progress in macroeconomic adjustment and reform. More recently, macro-financial assistance has been mainly provided to the Western Balkans (operations in 1999, 2000 and 2001) and some low income NIS. The relatively low amounts for the Mediterranean countries (14% of the overall amounts authorised, but no new authorisation since 1996) should be considered against the background of other forms of macroeconomic support made available to these countries (notably the MEDA Structural Adjustment Facilities).

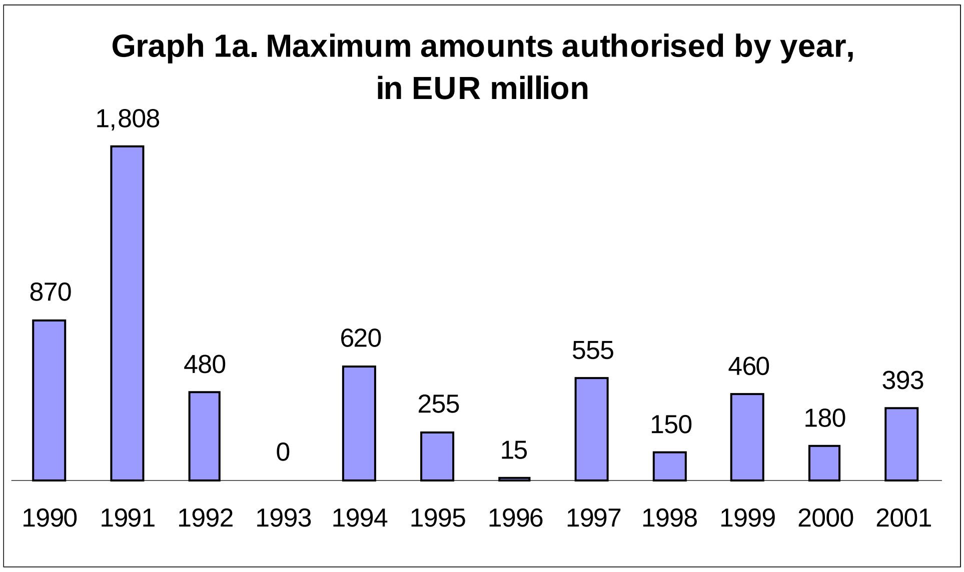
Table 1. Macro-financial assistance, 1990-2001
Maximum amounts authorised, millions euro

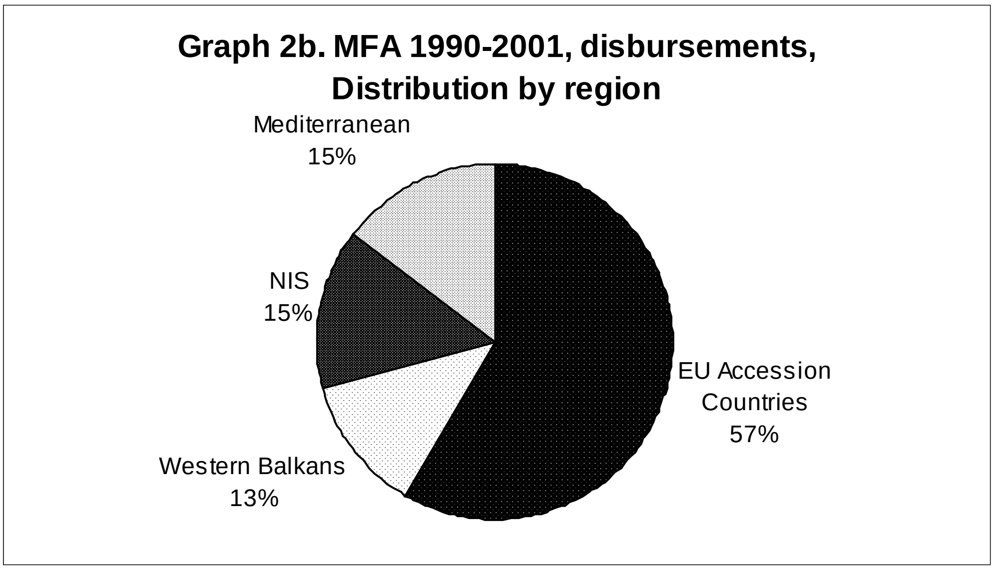
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Totals
By region													
EU Accession Countries	870	1.220	410		255			250		300			**3.305**
Western Balkans			70		35			40		160	55	393	**753**
NIS					130	255	15	265	150		125		**940**
Mediterranean		588			200								**788**
Total amounts authorised	**870**	**1.808**	**480**	**0**	**620**	**255**	**15**	**555**	**150**	**460**	**180**	**393**	**5.786**
out of which, straight grants		28	70		35			95		70	90	168	**556**
		Interest subsidies to Israel	Albania		Albania			Armenia and Georgia		Bosnia (40) FYROM (30)	Kosovo (35) Montenegro (20) Tajikistan (35)	FYROM (18) FRY (120) Kosovo (30)	

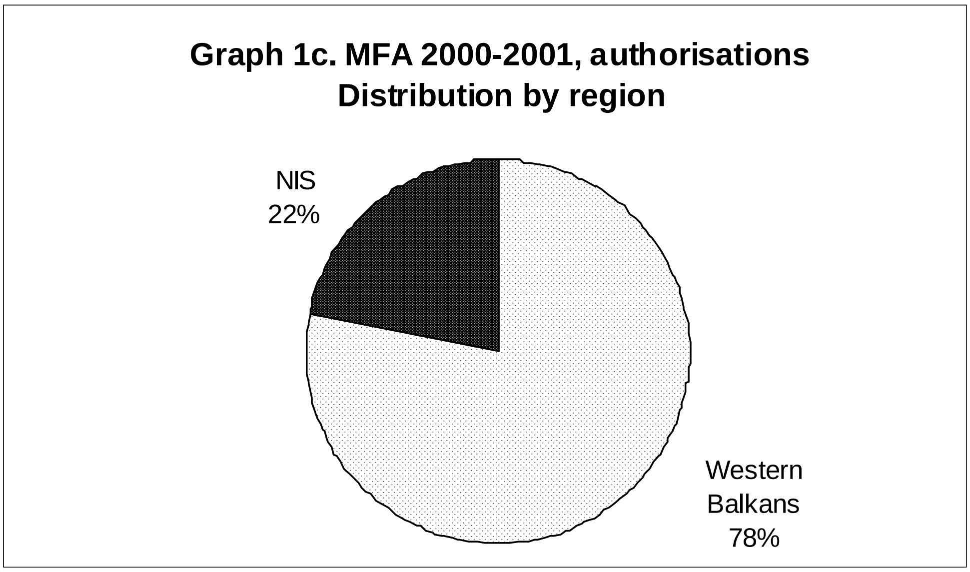
Disbursements, millions euro

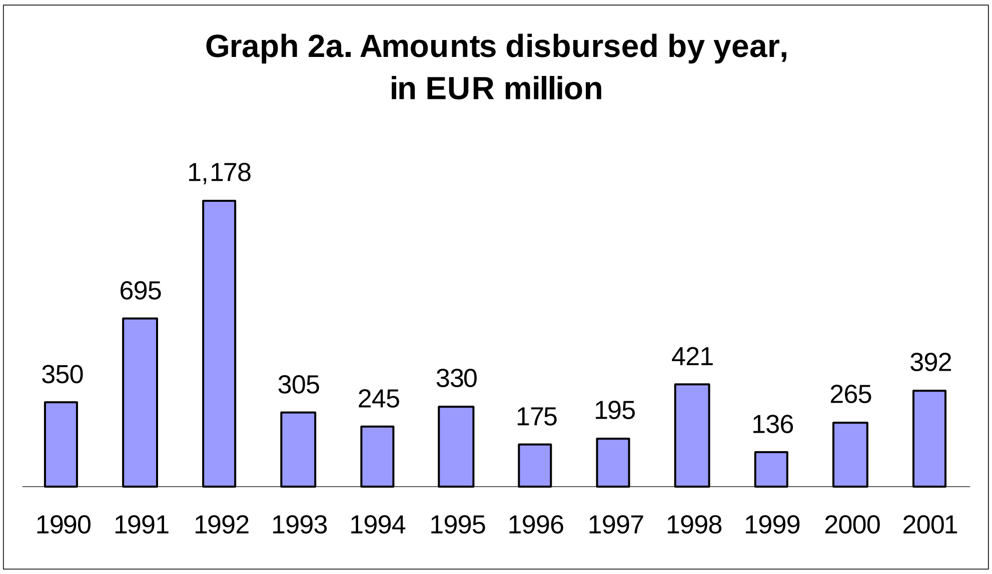
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	Totals
By region													
EU Accession Countries	350	695	705	270	70	80	40	70	250	40	160		**2.730**
Western Balkans			35	35		15	20	25	15	25	105	312	**587**
NIS					25	135	115	100	156	71		80	**682**
Mediterranean			438		150	100							**688**
Total amounts disbursed	**350**	**695**	**1.178**	**305**	**245**	**330**	**175**	**195**	**421**	**136**	**265**	**392**	**4.687**
out of which, straight grants			63	35		15	20		18	28	85	105	**369**
			Israel (28) Albania (35)	Albania		Albania	Albania		Armenia (8) Georgia (10)	Armenia (4), Georgia (9), Bosnia (15)	Bosnia (10) FYROM (20) Kosovo (35) Montenegro (20)	Bosnia (15) FYROM (10) Kosovo (15) FRY (35) Georgia (6) Tajikistan (14)	

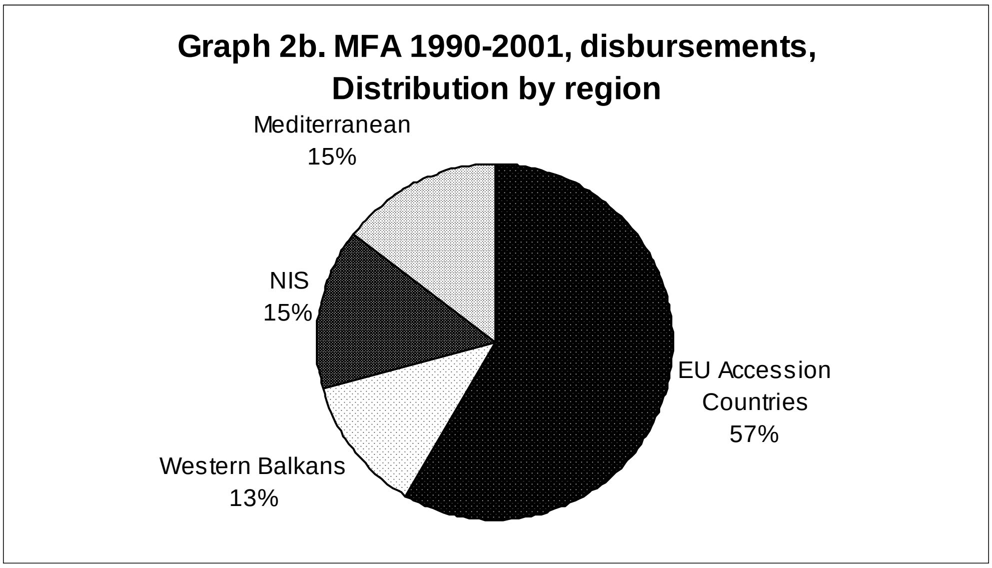
NB: 2000 figures include disbursements in favour of Bosnia, FYROM and Montenegro which, for technical reasons, took place in early January 2001.

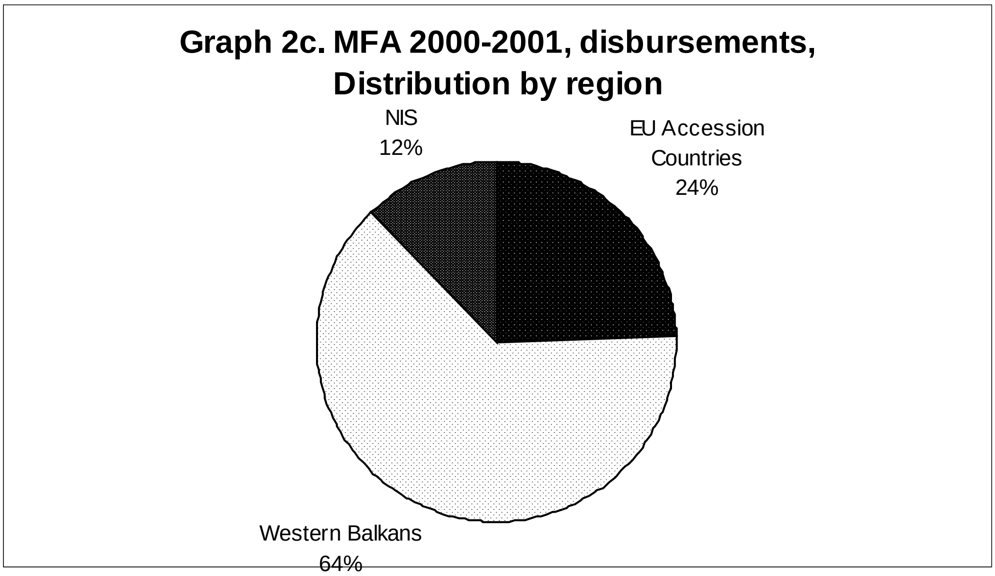

Graph 1a. Maximum amounts authorised by year, in EUR million
870
1,808
480
0
620
255
15
555
150
460
180
393
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001


Graph 2b. MFA 1990-2001, disbursements, Distribution by region
Mediterranean 15%
NIS 15%
EU Accession Countries 57%
Western Balkans 13%


Graph 1c. MFA 2000-2001, authorisations Distribution by region
NIS 22%
Western Balkans 78%


Graph 2a. Amounts disbursed by year, in EUR million
350
695
1,178
305
245
330
175
195
421
136
265
392
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001


Graph 2b. MFA 1990-2001, disbursements, Distribution by region
Mediterranean 15%
NIS 15%
EU Accession Countries 57%
Western Balkans 13%


Graph 2c. MFA 2000-2001, disbursements, Distribution by region
NIS 12%
EU Accession Countries 24%
Western Balkans 64%

4. Burden-sharing

In the context of the donor co-ordination process in support of CEECs and the Western Balkans, the European Commission in liaison with the World Bank has organised pledging conferences where the needs for external financing are assessed and potential contributions from the IFIs and bilateral donors -including the EC- are agreed in principle. A similar approach has been followed for other potential beneficiary countries through Consultative Group meetings convened at the initiative of the World Bank.

The resources provided by various donors to support the residual external financing needs of the countries that receive EC MFA are summarised in Annex 2. Details by recipient country for the year 2001 are provided in Annex 2.1.

Since the inception of MFA, the absolute amounts committed by the EC have fluctuated substantially, in parallel with the volume of financial support provided by the international community (see Annex 2 and similar tables in previous MFA reports).

Initially, Community assistance was substantial in comparison with funding provided by IFIs. The Community indeed played a key role, both as a major provider of these funds and as the co-ordinator of bilateral assistance for the CEECs through the G-24 process. However, as the IFIs were progressively able to mobilise more resources through new instruments, their share in the financing packages rose substantially until 1999..

At the same time, contributions from external creditors, both public and private, were mobilised in the form of debt-relief and debt-reduction operations which were particularly important in 1991, 1994, 1995 and 2001. Among the countries receiving EC MFA, those concerned by these debt-relief and similar operations were Algeria in 1991 and 1994; Bulgaria in 1991, 1994 and 1997; Moldova in 1996; Ukraine in 1994, 1995 and 1999, and the former Yugoslav Republic of Macedonia, Bosnia and Herzegovina and Albania in 1999. In 2000, no debt relief took place for any country receiving EC MFA. In 2001, the Federal Republic of Yugoslavia (Serbia and Montenegro) benefited from a substantial debt relief arrangement agreed in the context of the Paris Club.

III. ALBANIA

1. Executive summary

Under the 3-year IMF programme adopted in May 1998, the Albanian authorities managed to make further progress in macroeconomic stabilisation: GDP growth for 2001 reached 6.5%, a figure slightly below the average growth rate of 7-8% registered in the three previous years, the fiscal deficit was further reduced, the current account deficit slightly deteriorated partly because of strong imports of investment goods, the exchange rate of the Lek remained strong against the euro while slightly depreciating against the dollar, and annual inflation was maintained at a low level (some 3.5%).

On the structural reform side, some progress was registered. In the financial sector, further steps were taken for the privatisation of the remaining state-owned bank, which is expected to be privatised in 2002. A second GSM license was attributed in early 2001. Progress with the restructuring of the power sector is in line with the action plan agreed in December 2000. Significant progress was also registered in the fiscal area with the adoption of the second Medium Term Expenditure Framework covering the 2002-2004 period.

The macro-financial assistance of up to EUR 20 million decided by the Council in April 1999 was not implemented because of the reticence of the Albanian authorities to increase non-concessional borrowing under a relatively comfortable Net International Reserve (NIR) position. As a result, this assistance has now been deprogrammed.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Prices mostly market-determined, with the exception of a few selected public services.
2. Trade liberalisation No quantitative restrictions on imports. Few export bans remaining. Four different levels of tariff rates (0, 2, 10 and 15%). Member of WTO since September 2000.
3. Exchange regime Since July 1992 free floating exchange rate. Exchange system largely free of restrictions on current account transactions.
4. Foreign direct investment Liberal legislation. No restriction on profit repatriation. Although the sale of land to foreigners is permitted and despite progress in land registration, the land market is not yet functioning properly.
5. Monetary policy Central bank monetary policy entirely based on the use of indirect instruments, following the removal of minimum short-term deposit rates in July 2000. Treasury bill auctions (3, 6, 12 months).
6. Public finances VAT introduced in July 1996 and reformed in October 1997. Update in June 2001, for the period 2002-2004, of the Medium Term Expenditure Framework (MTEF) designed in December 2000.
7. Privatisation and enterprise restructuring Privatisation of arable land largely completed. 1997 SME's privatisation programme completed. First large state-owned strategic enterprise (AMC) privatised in 2000. Stock exchange set up in March 1996.
8. Financial sector reform Two-tier banking system dominated by the remaining large state-owned bank, the Savings Bank, to be privatised in 2002.

2. Macroeconomic performance

Since 1998, the Albanian authorities have implemented a comprehensive medium-term macroeconomic and structural adjustment programme supported by the IMF under a Poverty Reduction and Growth Facility (PRGF, formerly ESAF). The successful start of recovery in 1998 was maintained in 1999 and 2000 with GDP growth of respectively 7.3 and 7.7%. Annual inflation as of end-2000 remained under control, at 4.5%, the domestically financed budget deficit was further reduced, and the current account deficit decreased to 7% of GDP.

Owing to the weak agricultural growth and to the deteriorating electricity situation, real GDP growth in 2001 slowed down to 6.5%, from an average of 7-8% in the previous three years. Transport and services mainly contributed to this growth. Albania's growth performance also had a positive impact on the unemployment rate, which declined from about 17% in December 2000 to about 14.5% in December 2001 - possibly also because of increased controls on enterprises and the grey economy. A relatively restrictive monetary policy, coupled with significant increases in productivity, contributed to keeping inflation under control. In spite of inflationary pressures caused by the crisis in the neighbouring FYRoM, as well as by election-related public expenditure, inflation was limited to 3.5% in December (year-on-year).

Taking into account the amendments to the 2001 budget resulting from the energy crisis and involving additional subsidies for electricity imports, fiscal performance in 2001 has been broadly on track with expectations, however with lower than projected revenue and expenditure. The overall deficit is expected to have reached around 9% of GDP, in line with the 2000 figure. Foreign financing of the deficit, which predominantly took the form of grants or concessional borrowing, accounted for about 4% of GDP, domestic financing for about 3%, privatisation receipts accounting for the remaining 2%.

As usual since the beginning of the transition, strong inflows of remittances from Albanians living abroad – estimated at about USD 470 million in 2001 - partly compensated for the officially recorded trade deficit, which is however reported to have increased because of important imports of investment machinery and better customs control. Consequently, the current account balance is expected to have slightly deteriorated (7.4% of GDP, compared to 7% in 2000). Foreign direct investment accelerated in 2001, which contributed to a new increase in foreign exchange reserves (USD 737 million or 4.7 months of imports as of end-2001, compared to USD 608 million or 4.3 months of imports as of end-2000). The combination of low inflation and a fairly comfortable level of foreign exchange reserves contributed to the stability of the exchange rate of the national currency: over the last couple of years, the Lek has only slightly depreciated against the dollar, while remaining roughly stable vis-à-vis the euro. At the end of 2001, foreign debt, including arrears, reached a level of USD 1.19 billion, corresponding to about 29% of GDP, which is quite low compared to some other Western Balkan countries, and is expected to stabilise at this level in the years to come.

3. Structural reforms

Further progress was achieved in 2001 in enterprise privatisation and restructuring. Following the sale in July 2000 of the mobile phone company AMC, a second GSM license was attributed in August 2001 to a British-Greek consortium (thus contributing to FDI). In May 2001, the Albanian Parliament approved the law for the privatisation of the fixed-line telecom operator, Albtelekom, which is expected to be completed in late 2002. As of September 2001, progress with the implementation of the restructuring of the power sector, including the electricity company KESH, was broadly in line with the action plan agreed in December 2000. Steps were also made in the privatisation of the oil company Servcom.

The privatisation of the National Commercial Bank in October 2000 created the preconditions for the privatisation of the remaining state-owned – and largest - bank in the country, the Savings Bank (SB). Following the adoption by Parliament of the necessary privatisation law and other preparatory steps, the opening of the international tender for its privatisation was announced in June 2001. However, following the 11 September events and continuing unrest in the former Yugoslav Republic of Macedonia, the privatisation process has been delayed. The revised timetable includes a short list selection of interested banks by the end of March 2002 and the selection of the buyer by the end of June. Meanwhile, efforts have been made to reduce the SB's dominant position in the market, by transferring 70 pension payment offices to Albapost, and by contracting SB's fiscal functions in Elbasan district, via auctions, to the German FEFAD Bank.

Concerning trade liberalisation, there are no quantitative restrictions on imports and only very few remaining on exports (skins and hides and scrap metals, and some wood products). As from January 2001, the maximum tariff rate on imports has been reduced to 15%, which represents a significant reduction from that prevailing in 1999 (20%) and 2000 (18%).

Some steps have been carried out in order to improving the Albanian business environment and investment climate. A Bankruptcy Law, consistent with the Law on Securing Charges, has been adopted in 2001, as well as a Law on Deposit Insurance. The registry for movable property is now operational. Efforts are being made to further improve the legal framework and to stimulate domestic and foreign investments. The setting up of an agency that will provide "one-stop" facilities for investors and a credit information point is planned for 2002. The law for the execution of court decisions was approved in January 2001 and a law on mediation of business disputes was expected to be approved before the end of the year 2001. However, despite these initiatives, the current deficiencies of the Albanian judiciary and business-related administrations, as well as repeated corruption cases, prevent a serious boost of investments. Key legislation such as the commercial law remains to be improved in order to facilitate adequate implementation and enforcement.

In the fiscal area, the Medium Term Expenditure Framework (MTEF), designed for the first time in 2000, was updated and improved in June 2001 for the 2002-2004 period within the framework of the World Bank-sponsored Growth Poverty Reduction Strategy (GPRS). The MTEF and the GPRS provide a strong framework for the preparation of the 2002 budget with a clear prioritisation of expenditure.

4. Implementation of macro-financial assistance

In the context of the 3-year PRGF-supported programme approved by the IMF in May 1998, the Council decided on 22 April 1999 to provide to Albania a macro-financial assistance facility of up to EUR 20 million. Contrary to the previous two macro-financial assistance operations (EUR 70 million grant decided in 1992 and EUR 35 million grant decided in 1994), this assistance would take the form of a loan.

However, in 1999 and 2000, the Community also supported Albania's short- and medium-term adjustment and reform programme with targeted grant support to the budget: EUR 14.5 million through the PHARE Special Assistance and EUR 5 million under the EC Food Security Programmes. To help the country to cope with the costs linked to the presence of refugees during the Kosovo crisis, the Commission also provided to Albania exceptional grant budgetary support of some EUR 33 million.

In this context, and also in the light of the country's favourable hard currency reserves position, the Albanian authorities have indicated that they did not require the release of the Community macro-financial assistance in the form of a loan. As a result, the Commission has now deprogrammed this assistance operation.

IV. ARMENIA

1. Executive summary

The Armenian economy grew at a record high rate in 2001. Real GDP growth was 9.6 % (6.0 % in 2000). Growth was driven by agriculture, construction and services. Exports were up 14 % while imports remained unchanged from previous year. The current account deficit declined somewhat to about 11 % of GDP (14.5 % in 2000). Budget revenues increased as tax collection improved, but the tax/GDP ratio declined

The Parliament approved in July 2001 a list of over 900 enterprises to be privatised over the next three years, including mining, metallurgical and energy assets. Lack of interest from foreign investors in a difficult investment climate has however delayed bidding and negotiations.

The IMF Board approved a three-year arrangement for Armenia under the Poverty Reduction and Growth Facility in May 2001. Of the total PRGF loan amount of about USD 87 million, USD 13 million was disbursed in 2001.

The Commission concluded in June 2001 that Armenia had made substantial progress in satisfying the conditions for the disbursement of the grant tranche scheduled for 2001. The grant disbursement was made in February 2002.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation No administered prices exist outside the utilities sector.
2. Trade liberalisation Liberal trade policy. Simple and relatively open import regime with a low tariff structure. No quantitative restrictions. Negotiations on access to the WTO continued in 2001 (agricultural protection remains unresolved).
3. Exchange regime Floating exchange rate. Limited official intervention. Access to foreign exchange unrestricted. Interbank market dominant for foreign exchange.
4. Foreign direct investment Liberal policy towards foreign direct investment, absence of restrictions on repatriation of profits and capital.
Monetary policy Low inflation environment maintained through cautious monetary policies conducted by the Central Bank.
5. Public finances Budget revenue estimated at around 17 % of GDP in 2001; total expenditure estimated at about 22 % of GDP.
6. Privatisation and enterprise restructuring New privatisation programme approved in Parliament. The privatisation process has however slowed down due to lack of investor interest in a difficult business climate. New attempts to bring private management to the power distribution companies after the international tender failed.
7. Financial sector reform The fully state-owned Savings Bank has been sold to local investors in 2001. Minimum capital requirement for existing banks increased in 2001 and further increases scheduled for coming years.

2. Macroeconomic performance

Armenia has made progress in macroeconomic policies, but continues to run a high current account deficit and relies on transfers and remittances from the Armenian diaspora to finance this. The Armenian economy grows at record high speed: real GDP grew by 9.6 % in 2001 (the highest rate since independence). Because it is fairly isolated from world markets, the current economic slowdown has not affected Armenia. Growth is supported by both exports and domestic spending. There was a 13 % rise in retail sales in 2001. Exports rose by 14 % while imports remained virtually unchanged from the previous year. Continued growth in exports is important since the lack of trade relations has hindered export expansion to regional markets (due to regional isolation in relation to the unsolved Nagorno Karabakh conflict). The current account deficit (including official transfers) declined in 2001 somewhat to 11 % of GDP (from 14 % of GDP in 2000).

During 2001, budget revenues increased as tax collection improved, but the positive development was not maintained throughout the year and there were problems in budget implementation towards the end of 2001. Revenue increases allowed the government to reduce pension arrears. Nevertheless, the tax/GDP ratio declined to 14.3 % in 2001. No significant reduction in the general government deficit has been recorded in 2001, and the deficit is estimated to have remained at nearly 5 % of GDP.

Monetary policy was gradually loosened over 2001, and consumer price inflation rose from 0.4 % in 2000 to 2.9 % in 2001, which remains, however, below the projected 3.5 %. The Armenian dram was rather stable in 2001 at about 560 dram per USD. Foreign exchange reserves are still comfortable at more than 3 months of imports. External debt amounted to around USD 860 million (about 45 % of GDP) at the beginning of 2001, and there was no substantial change during 2001. Armenia has negotiated an agreement with Russia on a debt-equity swap for its USD 94 million debt. The agreement will become effective in 2002.

The IMF Board approved a three-year arrangement for Armenia under the Poverty Reduction and Growth Facility in May 2001. Of the total PRGF loan amount of about USD 87 million, USD 13 million was disbursed in 2001. Towards the end of the year Armenia encountered problems in meeting the agreed economic policy targets and further disbursements were postponed until early 2002.

3. Structural reforms

The pace of structural reforms started to recover in 2001 after a slowdown in 1999-2000. The Parliament approved in July 2001 a new privatisation programme which includes a list of over 900 enterprises to be privatised in three years. The list includes also mining, metallurgical and energy assets. At the same time, the emphasis has shifted from quick sales toward attraction of suitable strategic investors. The privatisation process has not been proceeding as expected, however. Of the 14 larger companies which were originally targeted for privatisation in 2001, seven were sold. A difficult investment and business climate has dampened interest from abroad. For instance, the international tenders to privatise four electricity distribution companies failed to attract bids in 2001. As an alternative, it has been decided to merge the four networks into one, and the government has started negotiations on leasing the distributors to a foreign operator for a three-year period. Privatisation of power generation assets is also under preparation.

Minimum capital requirements for existing banks have been increased to accelerate consolidation in the very fragmented banking sector. The last fully state-owned bank, the Savings Bank, was sold to a group of Armenian investors in 2001.

There has been progress in bringing competition policies in line with EU rules. A new law on competition policy has been enacted and an independent Competition Commission has been established. Enforcement of bankruptcy legislation still remains ineffective, however.

Also a new financial disclosure law for all highly placed public officials has been enacted. A government commission for anti-corruption policies has been created, but adoption and implementation of new measures has progressed slowly.

A new tax code was enacted in December 2000 to replace progressive corporate taxation with a flat rate of 20 % for large businesses. Measures to simplify the tax code for small businesses have also been taken.

The Government has declared the development of information technologies as its main priority in fostering the economy and creating new jobs. Armenia has specialists and expertise in the sector and it seeks to limit the brain drain which has become a serious problem.

4. Implementation of exceptional financial assistance

Armenia has benefited from a European Community assistance package which consists of a loan of EUR 28 million (disbursed in 1998) and a total grant amount of EUR 30 million (to be disbursed over the period 1998-2004). The structural conditionality for the 2001 grant tranche included i.a. conditions on improvement in tax collection rates, strengthening of prudential regulation in the banking sector, adoption of a new land code, clearing of arrears on salaries and pensions, clearing of arrears to energy suppliers and preparation of a vade-mecum for foreign investors. A Commission staff mission concluded in June 2001 that Armenia had made substantial progress in satisfying the macroeconomic and structural conditions for the disbursement of the 2001 grant tranche which amounts to EUR 5.5 million. The grant disbursement was made in 2002 on the basis of the procedure initiated in 2001, after Armenia’s reduction of its net debtor position towards the Community by EUR 7 million as agreed between the Commission and the Armenian authorities.

V. BOSNIA AND HERZEGOVINA

1. Executive summary

Under the IMF-supported Stand-By Arrangement (SBA), approved in May 1998, Bosnia and Herzegovina (BiH) has made significant progress towards macroeconomic stability thanks to adherence to the strict rules under the currency board arrangement as well as fiscal restraint. In 2001 growth remained sustained, although it was revised downwards to 5-6%, from an initially estimated 8%, and inflation subdued (at about 4.5% in 2001). The high current account deficit is estimated to have declined further in 2001, to 20.8% of GDP (22.2% in 2000). The IMF completed the sixth and final seventh reviews under the SBA on 10 May 2001 and a new arrangement is expected to be agreed in early 2002.

In the area of structural reforms, marked progress has been made in 2001 in small-scale privatisation, public expenditure management and reform, customs administration reform and recently also large-scale privatisation. However, progress was slower in the areas of tax harmonisation, privatisation of state-owned banks, and establishing a simplified investment environment.

Given the satisfactory progress with regard to structural conditions attached to Community macro-financial assistance, the Commission disbursed the third and final grant tranche amounting to EUR 15 million at the end of 2001.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Most prices have been liberalised with the exception of a few selected public services.
2. Trade liberalisation The Free Trade Agreement (FTA) with Croatia became effective on January 1, 2001, with tariffs on goods originating in BiH being reduced by 30 % and up to 100 % from 2004 onward. Similar FTAs are being negotiated with FYROM, Slovenia and FRY. Accession to the WTO is moving ahead and is expected in the first half of 2002.
3. Exchange regime The common currency, KM, is pegged to the DM/Euro at parity under the currency board arrangement since June 1998 and no revision of the parity in connection to the switchover to the Euro was foreseen.
4. Foreign direct investment Uncertain environment resulting from perceived high risks and non-transparent policies. The Federation has adopted in November 2001 a law on foreign investment, making its legislation compatible with the 1998 State law on foreign investment policy.
5. Monetary policy The Central Bank of BiH is responsible for operating the Currency Board Arrangement. The CBBH and other banks are prohibited from lending money to the government.
6. Public finances Bloated public sector wage bills, subsidies, and unsustainable social security schemes. State budget not secured by own resources and contingent upon entities contributions. Progress has been achieved though at the institutional level. Tax harmonisation between entities not yet attained.
7. Privatisation and enterprise restructuring While small-scale privatisation has advanced well in both Entities recently, the process of large-scale enterprise privatisation has been slow and has gained new momentum only recently thanks to external technical assistance for tender procedures.
8. Financial sector reform The regulatory framework for banking has been laid down in both Entities, but the process of privatisation or liquidation of state banks has been slower than expected. Reform of the payments system is well advanced with the official closure of the Payments Bureaux, the transfer of their functions to the banking sector and the establishment of a central clearing house.

2. Macroeconomic performance

General elections took place in November 2000; however, only after protracted negotiations and the intervention of the OHR could governments be formed in both Entities and the State. They were formed in January 2001 in Republika Srpska (RS), February in the State and March in the federation of BiH (FBiH). This delayed economic reform and led to an extended legislative paralysis. In the second half of the year, the new governments regained momentum in their progress with reforms.

Macroeconomic data for 2001 indicate that GDP growth continued to decelerate, and the authorities expect a growth rate of around 5-6% for the year 2001 as a whole, compared to higher rates in previous years and an initial 8% estimate. Tentative information points to some recovery of agricultural production, from the decline in 2000 which was mostly due to a severe drought. Unemployment is estimated at about 40% of the labour force, a rate which is particularly high if compared with the average rate in the Western Balkan region (17%) or in candidate countries (12%).

Inflation remains subdued (estimated at about 4.5% in 2001) and the exchange rate of the Konvertible Marka (KM) stable, supported by a strict adherence to the rules of the currency board introduced in mid-1998. Maintaining its credibility is the main monetary objective of the Central Bank. The KM was pegged on a 1:1 basis to the Deutsche Mark/Euro, and the monetary authorities have ruled out any revision of the parity in connection to the switchover to the euro. On the fiscal side, general government expenditure remained very high and was estimated at about 44% of GDP in 2001. Bloated public sector wage bills, subsidies, and unsustainable social security schemes are a cause for concern; larger than expected deficits as a result of increased spending on wages and pensions have forced the State to take action towards the end of the year to bring current expenditure into line with available resources.

The trend of export recovery initiated in 2000 (partly due to a reopening of the Yugoslav market), combined with a slight increase of imports (mainly due to reductions in donor finance for reconstruction) translated into an almost constant trade deficit of USD 1.6 billion. The current account deficit (excluding transfers) declined further in 2001. But with 20.8% of GDP (after 22.2% in 2000), it still is very high. Foreign debt remains at high levels (about 61% of GDP in 2001*)*, partly as a result of a substantial debt burden inherited from the former Yugoslavia. Debt service in percentage of export of goods is relatively low, though, reflecting the concessional nature of much of the debt and favourable debt rescheduling. Net foreign direct investment (FDI) per capita increased from USD 35 in 2000 to USD 38 in 2001 (projected), but remains one of the lowest of the region. Little progress has in fact been achieved in improving the legislative environment for FDI, which remains difficult and non-transparent, with differing rules across Entities.

3. Structural reforms

Progress has been made in 2001 with regard to public expenditure management and reform. At the State level, work is already under way to strengthen budgetary control of State functions in a Ministry of Treasury set up in October 2000. At the Entity level, Treasury departments have been established in the course of the year in the Finance Ministries of both Entities, and the creation of a Single Treasury Account is operational since 1st of January 2002. All government payment orders will pass through this account, hence ensuring greater fiscal transparency and control.

In the area of customs and tax reforms, both Entities have now adopted a Law on Tax Administration. While some steps in harmonising tax rates have been taken, especially for excise and sales tax rates, full harmonisation is not yet attained. As far as the reorganisation programme of the tax administration is concerned, much progress has been achieved in 2001 in the Federation, where the establishment of control and investigation units, as well as of a debt management service is progressing well. The RS has speeded up this process only recently, and adopted the relevant Law in October 2001. Discussions on the introduction of VAT are only in a preliminary stage, and raise a number of issues related to the difficult co-operation between the two Entities.

Small-scale enterprise privatisation has advanced well in both Entities; the Federation has privatised up to now 192 small-scale enterprises, while in the RS 169 have been sold. The deadline for the sale of the remaining public small enterprises has been extended and has now been set for 31 March 2003. For large-scale privatisation, progress has been slower, although the process was speeded up recently. In the Federation, 34 companies, out of 157 offered, were successfully privatised. In the RS, where it has been particularly difficult to attract foreign bidders, only three strategic companies, out of the original list of 86, have been privatised to date, while contract negotiations are ongoing for a fourth company. The impact of privatisation on corporate governance remains uneven and often delayed, in so far as citizens or the privatisation investment funds are not always in a position to assess the viability of the enterprises or impose industrial restructuring.

The payment bureaux were closed at the beginning of January 2001 and their functions transferred to the banking sector. Substantial progress has also been achieved in banking supervision and prudential regulations (e.g. through the increase of minimum capital requirements). On the other hand, privatisation of state-owned banks progressed at a slower pace than envisaged, in both Entities: no bank has been privatised in the Federation, even though two banks are in the final stage of negotiations, while only three banks have been sold in the RS. By the end of 2001, a draft law on deposit insurance was prepared, which envisages the creation of a State-level bank-deposit insurance agency. It is expected to cover depositors' assets up to KM 5,000 in member banks. At present separate agencies exists in each Entity, although in the RS no funds have been reserved to cover relevant interventions.

4. Implementation of macro-financial assistance

In May 1998, the authorities of BiH concluded a Stand-By Arrangement (SBA) with the IMF. In May 1999, the Council decided to provide BiH with a package of Community macro-financial assistance comprising a loan facility of up to EUR 20 million and a grant facility of up to EUR 40 million (Decision 1999/325/EC). Following the completion of the first review under the IMF programme and the full clearance by BiH of its outstanding obligations to the Community and the EIB, the Commission disbursed in December 1999 a first tranche totalling EUR 25 million (EUR 15 million grant and a EUR 10 million loan). Following satisfactory progress under the IMF programme, including the completion of the fourth and fifth reviews, and the satisfactory fulfilment of the specific conditions attached to the Community assistance (relating to structural reform), the second tranche, amounting to EUR 20 million, was disbursed at the end of 2000. Out of this amount, EUR 2 million of the EUR 10 million grant element was made available to the State budget, while the remainder was made available to the Entity budgets.

Following some delays in policy implementation, which required three extensions of the SBA (in May 1999, March 2000 and December 2000), the IMF completed its sixth and final seventh review and approved the disbursement of USD 18 million (SDR 14 million) in May 2001. Negotiations are still under way with the BiH authorities on a new SBA, which is expected to be signed in the early months of 2002.

The disbursement of the third tranche of EUR 15 million (all grant) had been linked to continued progress under the IMF programme as well as to a set of structural reform criteria including i.a. in the area of public expenditure management, customs and tax, privatisation and banking reforms. In mid-2001, a first review was carried out by Commission staff which acknowledged progress in several areas but encouraged the authorities to make further progress in other key areas, such as public expenditure management and reform or FDI legislation. Following a second review in November, and the broad fulfilment of structural conditions by the BiH authorities, the third and final tranche of Community assistance was disbursed at the end of 2001. Out of the total amount, EUR 2.5 million have been made available directly to the State budget, while the remainder was made available to the Entity budgets.

VI. FEDERAL REPUBLIC OF YUGOSLAVIA (Kosovo)

1. Executive summary

Economic activity in Kosovo has resumed with considerable speed after the conflict and living conditions continued to improve: growth of real GDP is estimated to have been in the order of 10% in 2001, albeit coming from a low level and driven by donor supported reconstruction. GDP inflation is estimated at 13%. However, manufacturing and export activities remain subdued and unemployment is high.

UNMIK, and particularly its EU-led Pillar IV, responsible for economic reconstruction and development, has further progressed in important economic areas. It has enhanced unexpectedly well revenue collection and tax compliance. The number of banks as well as bank deposits and lending have developed favourably. In the absence of an acknowledged privatisation body, UNMIK also carried out commercialisation tenders for state-owned enterprises so as to pave the ground for investment.

In continuation of its support, the Council decided in June 2001, following a Commission proposal, to provide further exceptional Community financial assistance to Kosovo of up to EUR 30 million in the form of a grant (2001/511/EC). The disbursement of the first tranche took place in September upon the signature of a Memorandum of Understanding between UNMIK and the Community.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Prices are liberalised with the exception of a few public services.
2. Trade liberalisation UNMIK applies an amended FRY customs code, charging a 10% customs rate, varying excise duties, and sales tax (15%), replaced by the VAT in July 2001, on imported goods. It does not charge customs on goods originating in the rest of FRY. UNMIK has maintained the preferential trading arrangements of FRY with the former Yugoslav Republic of Macedonia.
3. Exchange regime The use of the euro/D-Mark (and other currencies) has been legalised, albeit the Yugoslav Dinar remains the legal tender.
4. Foreign direct investment The establishment of the commercial law framework has advanced. However, the business environment remains unfavourable resulting from political situation and legal uncertainties.
5. Monetary policy Given its status, Kosovo does not have a Central Bank nor a monetary policy. The Banking and Payments Authority of Kosovo (BPK) exercises a number of functions usually attributed to a central bank including the preparation of the changeover to the euro from January 2002 onwards.
6. Public finances Domestic revenues exceeded original estimates in 2001. Further expansion of taxes and measures to enhance revenue collection are planned. The control of the public wage bill remains a challenge. For the time being, there is no comprehensive social protection system.
7. Privatisation and enterprise restructuring Privatisation of public enterprises is hampered by legal uncertainties. UNMIK continued to commercialise enterprises through management contracts.
8. Financial sector reform Within the regulatory and supervisory framework of BPK, the number of licensed banks has increased to seven. The number of accounts and deposits are developing positively. The payments system is advancing with increasing number of non-cash transactions. Based on a regulation passed in October, a regulatory and supervisory framework for the insurance sector is being set up.

2. Macroeconomic performance

Economic activity has resumed with considerable speed after the conflict and living conditions continue to improve: growth of real GDP is estimated to have been in the order of 10% in 2001, albeit coming from a low level. Reconstruction is evident, agriculture is rebounding and there is a vibrant private service sector. Winery, one of the few export sectors, seems to develop positively: a production of 10 million litres is expected for 2001. The number of registered businesses as of October 2001 has increased by 44% compared to end of 2000. There are indications of a shift from trade to other economic activities including manufacturing. However, the economy continues to be characterised by the donor supported reconstruction programmes and the significant foreign presence resulting in unusually high imports and problematic imbalances in salary and taxation. Unemployment remains high (in the order of 50%). GDP inflation in 2001 is estimated at some 13%. The availability of macro-economic data remains poor: there are no official figures for GDP, GDP growth, inflation, consumption, private investment or population from the Statistical Office of Kosovo. Despite progress and considerable efforts to refine the estimates, the calculation still bear a significant level of arbitrariness due to the weak database.

The Central Fiscal Authority (CFA) managed well the implementation of the Kosovo budget 2001 although a number of budget expenditure items were revised upwards during the year from original DM 500 million to DM 566.5 million. Preliminary data suggest that actual expenditure for 2001 will turn out in the order of DM 537 million whereas domestic revenue collection performed significantly better than originally budgeted (DM 572 million compared to DM 338 million). Depending on the final outcome of the budget and including donor support for the budget, the CFA will be able to carry forward a certain accumulated cash balance, which will be needed temporarily to provide collateral for the euro conversion and for contingency purposes. The balance will allow the budget to mature, i.e. to address a number of long-term obligations and to initiate capital investment expenditure under the budget, notably for maintenance of donor investments. This is also important since donors support is expected to decrease.

According to the European Agency for Reconstruction (EAR), the provision of public services has improved but its sustainability remains a major concern of the reconstruction efforts. The public utilities, notably the energy sector, still suffer from unreliable supply and very low cost recovery. The de-facto low price provides incentives for increasing consumption (e.g. car-wash facilities, electric heater). In the area of telecommunication, the progress in the fixed line network is still limited and province-wide telecommunications largely rely on the mobile network. In the area of rail, some lines are running; a master plan on the network is being worked on including the establishment of facilities for spare parts and basic rehabilitation.

3. Structural reforms

UNMIK has progressed unexpectedly well in enhancing revenue collection and tax compliance. This is due to the opening of Tax Collection Offices at the Administrative Boundary Line (ABL) with Serbia, the successful implementation of the VAT from 1 July onwards, effective control measures and improved capacity ensuing from on-going recruitment and training.

UNMIK prepared the introduction of a two-pillar pension system comprising a pay-as-you-go-system financed from contributions (including a universal benefit scheme for those who did not contribute to the past pension system) and a mandatory fully funded system.

In 2001, the Banking and Payments Authority of Kosovo (BPK) fully licensed an additional six commercial banks thus totalling seven banks which operate 22 branch offices. So as to ensure stability and to avoid overbanking, the BPK will raise the capital requirements with effect from January 2002. The BPK is carrying out regular supervision inspections, which have not brought up any grave misconduct. In addition, BPK has granted licenses to 15 micro-finance and non-bank financial institutions, (seven in 2001), that provide credit to individuals and SMEs. The growth in deposits reflects both the growing number of banks and confidence in the system. Loan activity however is more constrained and limited to a maturity below 12 months. The lack of access to debt finance for capital investment is one of the major obstacles to the further development of productive activities. In particular, the lack of collateral for bank lending is identified as one of the major factors hampering such an access.

On 5 October 2001, UNMIK adopted the regulation on Insurance Licensing, Supervision and Regulation, which assigns the BPK with the licensing and supervising of insurance companies. Existing insurance companies are required to apply for licensing under the new regulation.

The BPK has continued to improve its payment system to offer payment services to UNMIK, the Kosovo civil administration and NGOs. According to the BPK, it currently provides UNMIK with payments services through seven branches throughout the region and makes over 80,000 individual payments monthly for public salaries and stipends. The BPK aims to restrict its services to banks; it has closed down the accounts of public enterprises. The inter-bank clearing system inaugurated in May is operating smoothly and more than doubled the monthly transactions until October compared to June.

The number of non-cash payments is increasing. Starting with some 75 non-cash transactions in July, the department of public services has paid in October some 1,300 salaries upon accounts and almost 2,900 payments in December. Until the end of the year, UNMIK was subsidising the charges linked to opening and holding an account with a bank. Some departments started to require the holding of an account as a pre-condition for recruitment.

UNMIK has closed further the missing elements in the commercial law framework. Through its regional offices, it provides business information and contacts; it organises seminars and management training. It is also carrying out substantial training of Kosovars to work in the ministry. However, UNMIK continues to suffer from the lack in political support to progress in the area of privatisation. In the absence of an acknowledged privatisation body, UNMIK also carried out commercialisation tenders and has signed, as of 15 November, 11 deals committing an investment volume of DM 108 million over the contract period. It remains a major challenge to improve the quality of the judicial system and law enforcement so as not to deter investors.

Concerning the changeover to the Euro, UNMIK follows the model of the EU area with only two months of dual circulation so as to limit money laundering. The BPK has estimated cash needs at about DM 15-20m of coins in total, compared to DM 500m for notes. A public information campaign was organised in the course of 2001. The BPK has been in contact with the ECB, Deutsche Bundesbank, Österreichische Nationalbank and the banks it holds account with (Commerzbank, Raiffeisenbank). The ECB approved a frontloading also in the case of Kosovo; commercial banks have provided for the cash shipments.

4. Implementation of exceptional financial assistance

Following the provision of a first exceptional financial assistance grant of EUR 35 million in 2000 as part of a broader Community assistance package of EUR 360 million, another grant of up to EUR 30 million has been approved in June 2001 (2001/511/EC) with a view to alleviating the financial situation in Kosovo, facilitating the establishment and continuation of essential administrative functions and supporting the development of a sound economic framework. These funds add to the EUR 320 million pledged under CARDS assistance in 2001.

A first tranche of EUR 15 million was disbursed in mid-September following the signature of a Memorandum of Understanding (MoU) between UNMIK and the Community. The release of the second tranche is subject to satisfactory compliance with economic policy conditions as laid down in the MoU. These include measures to promote the financial and private sector development, to produce macro-economic data, and, most importantly, to develop the revenue base further so as to pursue prudent budgetary policies. The funds were to be made available to UNMIK through its CFA. A first review by the Commission in November showed that considerable progress has been made in these areas.

In the course of the implementation of its exceptional financial assistance, the Commission has been maintaining close contacts with the International Financial Institutions, notably the IMF and the World Bank, both at working level as well as via the regular meetings of the Working Level Steering Group monitoring the economic and financial developments in Kosovo.

VII. FEDERAL REPUBLIC OF YUGOSLAVIA (SERBIA AND MONTENEGRO)

1. Executive summary

Overall it appears that one year after the political changes occurred in the FRY in late 2000, the authorities have accomplished substantial progress toward restoring macro-economic stability, liberalising the exchange, price and trade regimes and improving market confidence. In 2001, real output grew by 5.5 %; inflation has declined considerably from 115 to 40%, the exchange rate has been kept stable while foreign exchange reserves increased substantially, and budget performance was good with a much lower than expected cash deficit before grants. However, economic difficulties persist and further important decisions on the restructuring of the FRY economy will be on the political agenda soon. They will most likely lead to the eventual closure of a number of big and non-viable enterprises and banks. At the same time the authorities will be facing the challenge of sustaining general public support for reforms.

In October 2001, the second review under the IMF stand-by arrangement that covers the period until end-March 2002 was started and successfully completed in mid-January 2002. It enabled the FRY to draw on the third tranche of USD 62.5 million out of the total amount of USD250 million.

In July, the Council decided to provide a macro-financial assistance to FRY of up to EUR 300 million. Following the clearance of all arrears of the FRY towards the European Investment Bank and the Community, the first tranche of EUR 260 million was released in October 2001. Following a satisfactory review of economic policy conditions, the second tranche of EUR 40 million was disbursed in January 2002. On 10 December 2001, the Council approved a revision of its July decision designed to increase the overall amount of this assistance to up to EUR 345 million.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Most administrative price controls have been removed with the exception of some public services where considerable price increases have been implemented.
2. Trade liberalisation A new 2001 federal law simplified procedures, abolished most licences and quotas, reduced the number of duties and lowered the average tariff rate ; separate trade law in Montenegro with lower tariffs than on the federal level.
3. Exchange regime Managed float regime under which the exchange rate of the Dinar has been kept stable; Montenegro introduced the Euro as the sole legal tender in November 2000.
4. Foreign Direct Investment FDI is still relatively low, Serbian foreign investment law in preparation; Montenegro adopted a law on FDI already in 2000.
5. Monetary policy Strict monetary policy of the National Bank of Yugoslavia; creation of base money almost exclusively on the basis of foreign exchange increases and limited credits to general government; no sovereign monetary policy in Montenegro.
6. Public finance Comprehensive fiscal reforms, including the implementation of a major tax reform in Serbia and the preparation of a Tax Action Plan in Montenegro; initial steps to improve fiscal management; improved revenue collection and expenditure control, Treasury system being set up.
7. Privatisation and enterprise restructuring Adoption of a new privatisation framework in Serbia in June 2001, enterprise and anti-trust law in preparation, restructuring plans for two large loss makers adopted, continuation of Mass Privatisation programme in Montenegro.
8. Financial sector reform Progress in bank rehabilitation in Serbia, Bank Rehabilitation Agency was set up, all banks have been screened and either closed, merged or put under enhanced supervision. Four largest non-viable Serbian banks to be closed. In Montenegro, the largest bank, Montenegro Banka, was put under temporary administration.

2. Macroeconomic performance

Real GDP growth in 2001 (5.5%, incl. some 3.5% in Montenegro) was mainly driven by a strong recovery in agricultural output (20-25%) from the previous year's severe drought, and increased activity in services, including tourism in Montenegro, and transportation. However, industrial production continued to perform poorly and in Jan-Nov 2001 it was 0.6% lower than during the same period in 2000.

As a result of tight monetary policies, inflation in Serbia came down considerably from 115% at end-2000 to around 40% at end-2001, despite several major increases in electricity prices by a cumulative 120% since the start of 2001. In Montenegro, annual inflation increased slightly to 25% from 22.5%, mainly due to accelerated liberalisation of prices for electricity, municipal services, transport and milk and bread in the course of the year**.**

The consolidated general government accounts in the FRY recorded a cash deficit before grants of some 2.4% of GDP in 2001 (around USD 240 million), compared to the originally budgeted of 6.1% of GDP. The lower deficit was mainly due to improved tax revenue performance, but also reflected action taken to compress public spending (by 1.8% of GDP) in the light of a shortfall in foreign budgetary financing and delays in obtaining privatisation receipts in Serbia.

Following the adoption of a managed float in Serbia at the beginning of 2001, the Dinar remained broadly stable at the level fixed in October 2000 (YuD 30 per Deutsche Mark). Gross reserves of the National Bank of Yugoslavia reached around USD 1,300 million by end-January 2002 (compared to USD 605 million at the beginning of 2001), equivalent to almost 2.9 months of projected imports in 2002. In Montenegro, the unilateral adoption of the Deutsche Mark/Euro as the sole legal tender in late 2000 contributed to macro-economic stabilisation as it excludes the possibility of base money creation.

The balance of payments of the FRY recorded a widening trade deficit in 2001, which could be close to USD 2,800 million, and large inflows of remittances and service receipts. The latter helped containing the current account deficit to around USD 1,075 million before grants. Foreign Direct Investments are still low and were expected to reach USD 120 million in 2001.

A huge outstanding debt of some USD12.2 billion at end-2001, or 140% of GDP, is a major constraint on the external front. In that respect, the agreement between the Paris Club and the FRY authorities on a phased 66% reduction in the net present value of obligations towards Paris Club creditors (some USD4.5 billion) and a rescheduling of the remaining stock over 22 years with a 6 year grace period must be seen as an important element to foster the sustainability of the country's external position.

3. Structural reforms

In both Serbia and Montenegro, the liberalisation of prices continued through 2001 with the abolition of price controls for almost all good categories and the gradual adjustment of prices to more market-oriented levels, in particular for energy in Serbia and for public utilities and essential goods (e.g. milk and bread) in Montenegro.

Significant progress was made in Serbia with the adoption of a new privatisation framework in June 2001 that sets the basis for the privatisation of 150 state and socially owned enterprises through tenders and some 5,000 other companies through auctions on the basis of transparent procedures. According to the new law, foreign investors can obtain up to 70% of shares through public tenders. At end-2001, 35 companies had been put under tendering procedures. The authorities had received bids for the privatisation of three large cement companies, which were expected to be sold in January 2002, somewhat later than initially envisaged. Enterprise restructuring plans for two large loss makers (the car holding Zastava and a big copper producer BOR) were elaborated and a plan concerning the Zastava Company was eventually agreed among the government, the management and unions. A new Serbian law on the Agency for SME development was adopted in November 2001. In Montenegro, the mass privatisation programme that encompasses 450.000 citizens and 221 companies was completed in early December 2001. Moreover, for some 20 companies tendering procedures were initiated (out of 110 enterprises that are going to be privatised through batch sales, tenders or auctions, or to be liquidated). 51% of Montenegro's telecom company was offered for sale in mid-2001 and three investors expressed interest. In 2002, the Montenegrin authorities intend to tender Yugopetrol.

The first fundamental steps to liberalise foreign trade were taken in May 2001, with the adoption at federal level of the Foreign Trade Act, the Customs Tariff and the Tariff Act, which simplified procedures, abolished most licences and quotas, reduced the number of duties and lowered the average tariff rate. In Montenegro, progress was made with regard to trade liberalisation as the number of items subject to restrictions was reduced. Since 2000, Custom tariffs have been reduced substantially from 25% to below 3% on average and are currently lower than in Serbia.

Bank restructuring in Serbia progressed rapidly in line with the Bank Restructuring Strategy that was adopted by the National Bank of Yugoslavia (NBY) in May 2001. After all 82 banks in Serbia had been reviewed, 19 banks were closed and another 15 banks were merged. Licences for five new banks were issued from May to December 2001. A decision to close the four largest banks was announced in early 2002. Although the whole banking system in Serbia has remained extremely fragile, there have been signs of renewed public confidence as evidenced by a substantial revival of savings. In Montenegro, further steps were taken to restructure the banking system. Diagnostic reports for 10 banks were prepared with the support of international advisors. Four banks were re-licensed on the basis of these reports. Moreover, the authorities elaborated and endorsed in principle a plan to restructure the largest bank, Montenegro Banka.

4. Implementation of macrofinancial assistance

On 11 June 2001 an IMF stand-by arrangement covering the period until end-March 2002 was approved and successfully reviewed in October 2001 and January 2002. On 16 July 2001, the Council approved a Community macro-financial assistance of up to EUR 300 million in favour of the FRY, comprising a loan facility of up to EUR 225 million and a grant facility of up to EUR 75 million. Following the clearance of all arrears of the FRY towards the European Investment Bank and the Community, the first tranche of the assistance amounting to EUR 260 million (comprising EUR 225 million loan and EUR 35 million grant) was released in October 2001. A review mission in December 2001 found that the conditions attached to the disbursement of the second tranche (EUR 40 million) had been broadly fulfilled in the following areas: Public expenditure management and control, tax administration and tax policy reform, private sector development, bank restructuring and management of external debt. Following this satisfactory review the second tranche was disbursed in January 2002. On 10 December 2001, the Council approved a revision of its July decision increasing the grant element of the assistance to up to EUR 120 million, thereby augmenting the overall amount of this assistance to up to EUR 345 million.

VIII. THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

1. Executive summary

The year 2001 was marked by the eruption of ethnic fighting which dramatically affected the population and economy. After several years of positive growth, GDP decreased markedly in 2001 by almost 5%. As a result of the security crisis, the situation of public finances was affected by some slippage in public expenditure, notably military expenditure, and an important reduction of VAT collected. The public finances deficit for the year 2001 was about 6.7% of GDP. Inflation (5.3 %) remained subdued.

Significant progress was recorded in 2001 in implementing structural reforms in a number of areas, notably tax reform, strengthening budget controls, trade policy and public administration. Owing to the spring crisis the fYRoM Government was not able to achieve the objectives of the three-year PRGF/EFF-supported program, approved by IMF in autumn 2000, which was discontinued. As a bridge to a new arrangement, the fYRoM authorities agreed in December with the IMF on a Staff Monitored Programme (SMP) for a period of six months (starting on 1 January 2002).

Following the broad progress recorded in 2001 in the areas of structural reform, against the background of the political and economic crisis in Spring, the disbursement of the second tranche (EUR 10 million grant and EUR 12 million loan) of macro-financial assistance (totalling EUR 80 million) was launched in December 2001 (payment made in early January 2002 on the basis of the SMP). On 10 December 2001, the Council approved an additional macro-financial assistance in the form of a EUR 18 million grant in favour of the fYRoM.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Price liberalisation has been essentially completed, except for most utilities and various items such as oil and oil by-products, postal services.
2. Trade liberalisation A small number of tariff and non-tariff barriers remain in place. The recently completed SAA and the Interim agreement will imply more liberal market access for EU products and gradual reduction of tariffs on most important products.
3. Exchange regime From early 1994, de facto peg of the denar to the DM, and now to the Euro; since the devaluation of July 1997 it stands at some 60.5 denar to one Euro.
4. Foreign direct investment (FDI) The environment for FDI has improved. However, approval from the government is still requested to carry out some types of foreign direct investments, while the absence of a properly functioning market for land is also hampering the FDI inflows. FDI inflows have been erratic in recent years and largely dependent on a few large transactions.
5. Monetary policy Monetary policy is conservative and essentially based on the exchange-rate anchor.
6. Public finances In April 2000, the Government introduced VAT and lowered taxation on labour from January 2001 onwards. The Public Revenue Office increased controls in the second half of the year 2001. The Government has launched in 2001 public investment programme focuses on public infrastructure (water supply, road maintenance), the rehabilitation of schools and health centres.
7. Privatisation and enterprise restructuring The privatisation programme begun in 1993; by the end of December 2001, some 1646 enterprises had already been privatised. Privatisation in the agricultural sector is nearly complete. In the second semester 2001, three large industrial enterprises were privatised. The liquidation of a number of loss making companies has been delayed and is expected to take place in 2002.
8. Financial sector reform New banking law of 2000 establishing the legal framework for modernised and strengthened banking sector. The banking sector is already predominantly privately owned. The sector is highly concentrated: the two largest banks, Stopanska Banka (sold in April 2000 to a Greek bank) and Komercijalna Banka, hold about two thirds of total deposits in the banking system.

2. Macroeconomic performance

2001 was an exceptional year for the fYRoM owing to the eruption of ethnic fighting in Spring, which lasted until the political settlement of the crisis in August. The crisis dramatically affected the population and the economy. GDP, which had previously been expected to grow at a rate of about 6%, decreased instead by 4.6%, thus causing a negative swing of about 10 GDP percentage points. In addition, the cost of repairs of damaged housing and infrastructure, according to a recent study[2], is estimated at around 1.8% of GDP. The contraction of output affected most sectors of the economy. The level of unemployment, with 29.5% of the labour force by the end of the year 2001 (compared to 32.2% in 2000), reflects the low level of production.

In spite of the crisis, conservative monetary policies based on the external exchange anchor vis-à-vis the DM/EUR have prevented the country from falling into the spiral of high inflation. To stem losses of reserves in the context of the security crisis, the Central Bank in May-June increased reserve requirements and more than doubled its short term interest rates. Consumer prices overall increased by 5.3% in 2001, against 5.8% in the year 2000.

In Spring increased military expenditure in the context of internal fighting put a particular strain on the Government's budget, especially the hiring of new military and police personnel and increases of salaries for special units in the police and the army. Expenditure peaked at 41% of GDP, i.e. 7 percentage points of GDP higher than in 2000. Against this increase in expenditure, revenue decreased markedly. Overall, in 2001 the fiscal revenue decreased by 7% in nominal terms and the overall fiscal deficit reached 6.7% over the year as a whole, against a surplus of 2.5% of GDP in the previous year.

On the external side, a sharp drop of imports, down to about USD 1527 million from a level of USD 1875 million in 2000, allowed for a reduction of the trade deficit to USD 370 million. The current account deficit increased sharply to a level of about 11% of GDP. This high deficit was however to some extent compensated by long term capital inflows from privatisation proceeds in the amount of USD 310 million (about 9% of GDP), following the sale of the national telecom operator in January 2001. Therefore, hard currency reserves, in spite of significant losses over the year, remained significant, in the amount of about USD 779 million at the end of the year, equivalent to 4.9 months of imports. At the end of 2001 the fYRoM was on track with its debt servicing obligations.

The Poverty Reduction and Growth Facility (PRGF) and Extended Fund Facility (EFF) programme agreed with the IMF in late 2000 was discontinued in Spring. In late 2001 the authorities reached an agreement with the IMF on a 6-month Staff Monitored Programme (which started on 1 January 2002), committing to tighter fiscal discipline, with reduced government expenditure at 36.8% of GDP in 2002, down from 41% of GDP in 2001, and which is to be replaced in the course of 2002 by a new upper credit tranche arrangement.

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[2] IMG report on damage assessment in the fYRoM, November 2001.

Overall, the situation remains fragile and further consolidation of the civilian peace process is essential in order to re-establish the ground for sustained stabilisation and reform policies as well as economic growth.

3. Structural reforms

Following the liberalisation of bread and flour prices in October 2000, price liberalisation is now essentially completed, except for most utilities, public transport and various items such as oil and postal services.

In spite of the successful sale in January 2001 of 51% of the national telecom company to Matav, the Hungarian operator, privatisation overall slowed down over the year 2001. In the second semester three large industrial enterprises were privatised: Sletovo Battery, Gazella (shoe manufacturer) and Godel (leather work). The privatisation of the state electricity company, ESM, is being prepared with the aim to sell the company by the end of 2002.

Some 40 large loss making enterprises were expected to be either sold or liquidated in 2001: while the crisis delayed the process in the first semester, the authorities have taken action in the last quarter by liquidating one company and commissioning expertise from international consultants on 17 enterprises, the bulk of which are expected to be closed in the course of 2002.

The EU is the main trade partner of the fYRoM and accounts for 48.5% of exports and 41.8% of imports. Following the signature of a Stabilisation and Association Agreement (SAA) between fYRoM and the EC in the year 2000, the first of the kind, the Interim Agreement came into effect in June 2001. Quotas on agricultural and fishery products were abolished. In agriculture, reciprocal trade concessions were agreed (with the exception of wine). The fYRoM concluded Free Trade Agreements (FTAs) with a number of neighbouring countries (including Croatia which is the second country after the fYRoM to have signed an SAA with the EC), EFTA countries and Ukraine. The fYRoM is an observer in the WTO and negotiations which were delayed by the crisis of last year resumed at the end of the year, with a view to achieving full membership in the year 2002.

As of July 2001 the payments functions from the old Payments Office (ZPP) inherited from the socialist era were progressively phased out and transferred to the banking system. In 2001, the authorities reinforced the surveillance of the financial sector, in particular of eight identified problem banks. The rating of three of those banks was upgraded to the necessary minimum. Actions on the five remaining banks were initiated such as the appointment of an administrator, or the merging of two of the problem banks with other banks to improve their financial strength. The sector however continues to suffer from a high level of non performing loans (about 35% were classified doubtful or non performing) and low efficiency, and its development is impeded by the low degree of financial intermediation.

4. Implementation of macro-financial assistance

On 8 November 1999, the Council decided to provide the former Yugoslav Republic of Macedonia with a second macro-financial assistance of up to EUR 80 million (loan up to EUR 50 million and grant up to EUR 30 million).

Following the approval of a PRGF/EFF-supported program by the IMF Executive Board which was delayed until 29 November 2000, a first tranche of the Community assistance amounting to EUR 20 million grant and EUR 10 million loan was disbursed in December 2000/January 2001.

The set of conditions to be fulfilled for the release of the second tranche, included tax reform, strengthening budget controls, trade policy and public administration. Following a review showing broad progress, also taking into account the difficult political and economic situation in the country, the Commission launched the disbursement of the second tranche (EUR 10 million grants and EUR 12 million loans) in December 2001 (disbursed in January 2002 on the basis of a Staff Monitored Programme providing a macro-economic framework).

Moreover, the original Council decision was revised on 10 December 2001, allowing for the extension of the assistance until the end of 2003 and increasing the grant element by EUR 18 million (to a grant total of EUR 48 million out of a total EUR 98 million). This additional macro-financial assistance as well as the outstanding assistance under the original decision will be implemented in the framework of an new IMF arrangement and is subject to specific economic policy conditions still to be negotiated.

IX. GEORGIA

1. Executive summary

Economic growth accelerated in 2001 and is estimated at 4.5% (1.9% in 2000). Inflation remained moderate at 3.4% (4.6% in 2000). The current account position deteriorated somewhat from previous year.

In March 2001 Georgia reached an agreement with the Paris Club following which debt repayments are rescheduled over 20 years with a three-year grace period. Bilateral discussions have not been concluded with all creditors, most importantly with the largest non-Paris Club creditor, Turkmenistan. There are still some concerns around remaining debt service obligations in 2003 and 2004.

The structural reform process slowed down in 2001. There was less interest from foreign investors and announced privatisations in telecommunications and in the energy sector were not finalised. The dismissal of the government in November 2001 created further delays in reform efforts towards the end of the year.

Georgia's three-year arrangement under the PRGF was approved by the IMF Board in January 2001 and Georgia was able to draw a total SDR 27 million by the end of the year from the IMF.

Georgia benefited in December 2001 from a grant tranche of EUR 6 million under the Community's exceptional financial assistance.

Summary Status of Economic Reform
1. Price liberalisation Most prices have been liberalised.
2. Trade liberalisation Liberal international trade policy. Georgia became a member of the WTO in June 2000. Most import and export restrictions have been eliminated, but the parliament has introduced an export ban on non-ferrous scrap metal (Georgia's biggest export item) from Feb. 2002 as a measure against illegal activities. There have been restrictions on timber exports also.
3. **Exchange regime** The lari is not subject to exchange restrictions. Floating exchange rate.
4. Foreign direct investment Adequate overall legislation. Unlimited repatriation of capital and profits and no limitations on holding foreign currency bank accounts. Foreign investors are not allowed to own agricultural land, only to lease it. Progressive privatisation establishing title and registering of urban and industrial land.
5. Monetary policy The prudent monetary policy has contributed to the stabilisation of the inflation rate at a low level. Dollarisation of the economy remains high (about 80 percent of deposits are in foreign currencies).
6. Public finances Budgetary revenue (including grants) estimated at 16.5 % of GDP; total expenditure and net lending estimated at 18 % of GDP. An anti-corruption strategy is being implemented. A new budget system law is under preparation.
7. Privatisation and enterprise restructuring Small and medium size privatisation has been largely completed. Currently the focus is on main utilities (telecommunications and the power sector) where the government aims at finding strategic investors or bringing companies under private management, if suitable investors not found. There has been a marked decline in foreign investor interest (due to poor business climate) and progress has been made slowly.
8. Financial sector reform Several measures have been taken to strengthen bank regulation and supervision. Legislation has been amended to establish the authority of the National Bank of Georgia to revoke bank licences. In 2001 the National Bank revoked licences from six failing bank. The minimum capital requirement has been increased. IAS reporting standards and new asset classification and provisioning regulations have been adopted for commercial banks. Public confidence in the banking sector still remains low, however.

2. Macroeconomic performance

The macroeconomic situation of Georgia improved in 2001, with an estimated real GDP growth of 4.5 %. This resulted mainly from agricultural production which recovered from the previous year's severe drought. On the other hand, industrial production fell by 1 %.

The general government deficit has been reduced clearly (-7 % of GDP in 1999; -4 % in 2000; -2 % in the first half of 2001) reflecting primarily expenditure cuts but only to a very modest extent improvements in revenues. Georgia has still one of the lowest tax-to-GDP ratios in the region (about 14.5 % in 2001). Revenue collection by the general government was disappointing also in 2001, although total revenues increased slightly in relation to the GDP from the previous year. Weak administration, corruption and smuggling have not been tackled in a way that would bring significant improvements in collection rates. Consequently, the government was not able to reduce the stock of accumulated social expenditure arrears as planned.

The monetary authorities reaffirmed their commitment to maintain low inflation. In 2001 consumer price inflation slowed down to 3.4 % (year-end) from 4.6 % in 2000 (year-end). The lari depreciated about 7 % against the US dollar during 2001, first in the beginning of the year and then at the time of the government crisis in November 2001 (the exchange rate was at about 2,15 lari/USD at the end of the year). Public confidence in the lari remains low, and it has not acquired a savings function yet (foreign currency deposits are at about 80 % of all deposits).

Georgia's current account deficit is estimated to have further deteriorated in 2001 from the previous year when it was at 5.4 % of the GDP, transfers included. Foreign exchange reserves increased at the end of the year but were still low in terms of imports coverage at below 1 ½ months of imports. External debt at end-2001 amounted to around USD 1.7 billion or about 52 % of GDP (53 % of GDP in 2000).

Georgia reached an agreement with the Paris Club in March 2001, following which debt repayments are rescheduled over 20 years with a three-year grace period. Bilateral discussions were not concluded with all creditors by the end of 2001. Most importantly, Georgia continues discussions with its largest non-Paris Club creditor, Turkmenistan. Despite the Paris Club agreement, there are still some concerns around remaining debt service obligations in 2003 and 2004.

Georgia's three-year arrangement under the PRGF was approved by the IMF Board in January 2001 and Georgia was able to draw a total SDR 27 million by the end of the year from the IMF.

3. Structural reforms

Georgia has a relatively liberal international trade regime, but recently there have been increasing political pressures to impose export bans in order to attack illegal activities in the country. The parliament imposed an export ban on timber until the end of 2001, and a ban on non-ferrous metal waste and scrap exports (Georgia's largest export good) which is to become effective in 2002.

Several privatisation initiatives failed to bring results in 2001. The focus has shifted from the remaining large state-owned industrial enterprises (where restructuring is ongoing albeit slowly) to main utilities, especially in the telecommunication and the power sectors. There has been a decline in foreign investor interest, due to an unfavourable investment climate, and since it has become more difficult to find suitable strategic investors, the government now attempts to bring the companies under private management as a first step. For instance, in the case of remaining state-owned electricity distribution companies, it is necessary to bring private management which would enforce non-payment cases in order to raise total collection rates.

The National Bank of Georgia (NBG) continued to take steps in strengthening bank regulation and supervision. Licences were revoked from six banks in 2001 but in two cases banks were still able to retain their licences through a Supreme court ruling. The parliament passed amendments to the banking and central bank legislation in October 2001 to establish fully the authority of the NBG in resolution of the problem of insolvent banks. Since February 2001, commercial banks are required to submit monthly reports in line with IAS. The NBG has also issued new asset classification and provisioning regulations in 2001.

Following an anti-corruption strategy which was published in 2000, two Presidential Decrees were issued in 2001 focusing on short-term measures to increase transparency through a broadening of financial disclosure, clarifying the role of government regulatory agencies, carrying out internal audits of government agencies and publication of their expenditures. The implementation of these Decrees started slowly, but after the reshuffling of the government at the end of the year, there has been a renewed intention to focus measures on tax and customs administration.

4. Implementation of exceptional financial assistance

The structural conditionality for the 2001 grant included i.a. conditions on improvement in tax collection rates, reduction of arrears on salaries, pensions and social expenditure, privatisation of the remaining electricity distribution and generation companies and of the telecommunications, and review of bankruptcy legislation. Although substantial progress was made in most of these areas during 2001, in a number of areas progress is lagging, in particular in customs revenue collection, energy sector reform, and privatisation. The Commission decided therefore in December 2001 to disburse a reduced amount of EUR 6 million grant under the Community’s exceptional financial assistance to Georgia, after an early principal repayment of EUR 8 million was made by this country on its outstanding debts towards the Community.

X. MOLDOVA

1. Executive summary

Real GDP grew by 6.1% year on year in 2001, according to preliminary data. Despite slow reforms and a relatively weak external environment, the economy is still expected to grow at an annual rate of around 4-5% in 2002-03. This reflects an extremely low base period, following years of steep economic decline, as well as the accumulated effects of gradual reform progress. Moldova's economy will also benefit from relative macroeconomic stability and generally solid import demand in Russia.

Inflation continued to fall dramatically, to 6.4% by the end of 2001, down from 18.4% in 2000 and 43.8% in 1999. The average monthly rise in prices equalled a record low 0.5%, despite a moderate increase in monthly inflation towards the latter part of the year.

Political developments prompted again a standstill in reforms in 2001, in particular in the field of privatisation and enterprise reform.

The government signed a three-year memorandum of understanding in the context of a PRGF with the IMF on 1 December 2000. However, since a new government took office in February 2001, the IMF-programme was continuously off track and no external financing was received.

Given that the release of the first tranche of a EUR 15 million macro-financial assistance loan to Moldova (approved by the Council of the European Union in July 2000), was conditional upon a satisfactory implementation of Moldova’s arrangement with the IMF, no disbursements have been made so far under the Community’s assistance package.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation The vast majority of prices were liberalised in an early stage of transition. Only very few administered prices are left.
2. Trade liberalisation Moldova maintains a very liberal trade regime. The tariff structure features three bands (5,10 and 15%) and the simple average tariff is only 7%. Moldova joined the WTO in 2001.
3. Exchange regime Freely floating exchange rate, full current account convertibility.
4. Foreign Direct Investment The FDI regime is open and non-discriminatory.
5. Monetary policy Conservative policies, aiming at price stability by the use of monetary aggregates as nominal anchors.
6. Public finance An impressive, and necessary reduction in the budget deficit was made in 1999 and 2000, mainly by reductions in health care, education and public sector expenditure. No further progress was made in 2001; foreign debt sustainability is critical.
7. Privatisation and enterprise restructuring Structural reforms accelerated markedly in 2000. Substantial progress was recorded in the energy sector, land reform was on schedule, whereas the main bottleneck, the privatisation of the economically very important winery and tobacco sectors was finally approved in October 2000. In 2001, no further progress was achieved, and proposals were even made to turn back reforms.
8. Financial sector reform The central bank has been successful in implementing banking sector consolidation, and the banking system is sound. Markets remain undercapitalised.

2. Macroeconomic performance

The relatively strong performance seen in 2001 is mainly the result of the industrial sector's strong recovery, in combination with the halt in the agricultural sector's decline. Disaggregated GDP data are available only for the first half of 2001. This confirms the dominant role played by the manufacturing sector, which accounted for almost 20% of GDP over the period and was growing at a double-digit rate by the second quarter. Industrial production data for the third quarter show continued, albeit more moderate, double-digit industrial growth. By contrast, the much larger services sector, which is now responsible for more than half of total GDP, grew only marginally over the first half and contributed negligibly to growth over this period. From the expenditure side, domestic demand, particularly by households, accounted for most of the GDP growth seen during the first half of 2001, particularly during the first quarter.

Consumer price inflation fell to 6.4% by the end of 2001, down from 18.4% in 2000 and 43.8% in 1999. The average monthly rise in prices equalled a record low 0.5%, despite a moderate increase in monthly inflation towards the latter part of the year. This increase was primarily attributable to seasonal factors, which drove up the price of food (food prices grew by 3% in December). Monthly inflation in December, at 1.9%, was the highest recorded in almost two years. High inflation and sluggish nominal wage growth prompted a steady decline in real wages throughout 1999 and the first half of 2000. An economic turnaround and sharp disinflation since then have prompted a renewed rise in real wages throughout 2001, particularly as the government has moved aggressively to raise minimum wage levels, according to Economic Trends, by September 2001.

The government has eased fears that it would preside over a considerable fiscal loosening. In late November 2001, it won parliamentary approval for an IMF-supported budget for 2002, and it is unlikely to reverse the fiscal improvements achieved under the previous two cabinets. The IMF requires that the country's budget has to be balanced and if the new administrative-territorial reform, for instance, needs some additional expenses it is necessary to determine their source, whether they will be effected by increase of budget returns or by reduction of other expenditure.

The 2002 budget passed by parliament in late November includes a consolidated deficit of Lei 320 million (USD 24m), or around 1.4% of target GDP. During the final budget debate, parliamentary deputies rejected calls for a further boost to projections for both revenue and expenditure.

The government financed its budget deficit in 2001 through new central bank loans, which totalled approximately Lei145m between January and September, and sales of government securities, which reached Lei119m over the same period. When first formulating its budget for 2001, the government had planned to finance its deficit from privatisation receipts and multilateral inflows, neither of which proved forthcoming.

The current-account deficit for the third quarter of 2001 increased to USD 49 million, compared with USD 35 million in the third quarter of 2000. This resulted from the rise in the merchandise trade deficit sparked by a slowdown in export sector growth over the course of 2001, and continued high levels of import expenditure. The rising current-account deficit also represents a drop in the transfers surplus, owing to low levels of grants, and an increase in the services deficit, which was brought on by a decline in exports of travel and transportation services. These considerations more than outweighed the sharp increase in the income surplus brought on by increased remittances from Moldovans working outside the CIS (the NBM counts remittances as income). Owing to the sharp fall in the second-quarter deficit, the cumulative deficit in January-September is still somewhat narrower than that recorded during the year-earlier period.

Official foreign exchange reserves were roughly constant during the last two years, at just over USD 200 million, or between 2.5 and 3 months of imports.

3. Structural reforms

Privatisation of the wineries, tobacco plants and utilities were earlier conditions set by both the IMF and World Bank. The Communist Party consistently voted against the sales when in opposition, but after coming to power was forced to support the sales as the restoration of relations with the multilaterals grew more urgent.

Moldova has failed to complete any major privatisations since February 2000, such that the government earned a meagre Lei 32.6 million (USD 2.5 million) from small-scale privatisations in 2001. It already abandoned the sales of two of its major wineries, Vismos and Nis- Struguras, at the end of 2001 because the offers, from Russian and local companies, were too low.

The government has more ambitious plans for 2002, with around 350 companies up for sale. These includes plans to sell majority stakes in two of the country's five electricity distributors this year after two previous failed attempts. Union Fenosa (Spain) bought the other three distributors for USD 25.2 m in 2000 and promised to invest a further USD 67 million .

In the case of the planned sale of 51% of the state telephone operator, MoldTelecom, the Austrian bank acting as advisor on the sale, Raifeissen Investments, is due to prepare tender documents by March 2002. The government views this as the flagship sale of the year, and the key to any chance of meeting its 2002 debt-servicing obligations. In 1997 the government had turned down a USD 46 million offer from OTE of Greece for 40% of the company. This time around it will face difficulties in generating even this degree of interest, given the poor investor sentiment towards new telecommunications acquisitions. Moldova faces the dilemma that the most serious interest in Moldovan assets will come from Russian or Ukrainian investors, who are less likely to carry through with the investment and corporate governance improvements hoped for from Western strategic investors. The IMF-Memorandum stipulates that the government is to take some concrete steps as to the privatization of the "Moldtelecom", not necessarily to privatize but to reach a certain progress in the process.

4. Implementation of macro-financial assistance

On 10 July 2000, the Council decided to provide Moldova with a macro-financial assistance package of up to EUR 15 million. However, given that the IMF-programme was off track since the installation of the new government in early 2001, the Commission suspended preparations for implementation of Community’s assistance.

XI. ROMANIA

1. Executive summary

The macroeconomic environment improved but the situation remained fragile with a widening current account deficit and high, albeit declining, inflation. On the back of looser fiscal and income policies, economic growth accelerated strongly in the first half of 2001. The accompanying sharp deterioration in the external balance prompted the authorities to adopt a tighter policy stance in the second half of the year when international conditions also became less favourable.

Progress in structural reforms remained patchy. Some important divestitures were concluded but the underlying pace of privatisation remained very slow. In the second half of the year, the authorities began to aggressively adjust energy prices but mounting public enterprises' arrears and losses during most of the year pointed to the endurance of soft budget constraints.

Much will depend on the effective implementation of the comprehensive economic programme agreed with the IMF in late October that is to be supported by a new 18-month SBA for SDR 300 million. No new disbursement of EU macro-financial assistance took place during the year.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation In 2001, the number of regulated prices (essentially public utilities and energy), represented about 18% of the CPI basket.
2. Trade liberalisation In 2001, the average applied MFN rate was 19.4% on all products, 15.6% on industrial ones and 33.2% for agricultural goods. Romania has signed a Europe Agreement with the EU and free trade agreements with CEFTA, EFTA, Israel, Moldova and Turkey. In 2001, negotiations were finalised with Lithuania and opened with Croatia. In violation of its obligations under both the EA and the WTO, Romania introduced export restrictions on strategic raw materials.
3. Exchange regime The leu freely floats, but the central bank intervenes frequently in an effort to maintain external competitiveness. There is full current account convertibility.
4. Foreign direct investment The FDI regime is open and non-discriminatory; profit may be freely repatriated. Since early 1997, foreign investors can own land necessary to carry out their activities. Laws regulating and promoting FDI and portfolio investment have been repeatedly modified, creating legal uncertainty.
5. Monetary policy The National Bank of Romania enjoys a high degree of independence . The Law on the statute of the central bank defines its main objective as ensuring the stability of the national currency in order to contribute to price stability. It also allows for a limited amount of direct financing to the government.
6. Public finances Basic tax reform has been completed, but major steps to consolidate public finances remain to be implemented, including pension and health reforms, abolishing widespread tax exemptions, improving collection, and developing better budgeting and expenditure control procedures.
7. Privatisation and enterprise restructuring By the end of 2001, the majority of small and medium-sized companies had been privatised, but most large-scale companies remained public and subject to poor corporate governance and financial discipline. The authorities have privatised 5 of the 64 large state-owned enterprises identified for divestiture in agreement with the World Bank.
8. Financial sector reform Reform of the banking sector was slow at first, leading to serious difficulties in 1997 and 1999. Subsequently, however, the authorities took major steps to strengthen the regulatory framework while closing or restructuring and privatising the most problematic banks. At end-2001, public-owned institutions still accounted for nearly half of all banking sector assets. Capital markets remained small and underdeveloped.

2. Macroeconomic performance

After a three-year recession, positive growth resumed in 2000 and accelerated strongly in 2001, reaching 5.1% in the nine months to September. The recovery was initially kick-started by the strong performance of exports which followed the sharp real exchange rate depreciation of 1999. Since mid-2000, however, growth has become increasingly domestic-based on the back of a loosening fiscal and quasi-fiscal stance. In the first three quarters of 2001, in particular, the recovery was driven by stock accumulation and, above all, a sharp rise in household consumption which grew by 6.8% on the back of real increases in social transfers and wages.

Inflation declined considerably but remains very high. During 2001, its average rate fell to 34.5%. By December, the year-on-year rate had dropped more than 10 percentage points to 30.3% despite the sharp increases in energy prices mandated in the second half of the year. Inflation was, nevertheless, higher than targeted and monetary policy continued to give a greater weight to the objective of external viability within the framework of the managed float regime introduced in 1999. After accelerating in the first half of the year on the back of a substantial rise in the minimum wage and strong growth in the public sector pay, the pace of real wage increases declined in the latter part of the year. In November 2001, the average real wage increased 1.5% year-on-year.

Following the loosening of the fiscal and quasi-fiscal stance in the run up to last year's elections, policies were tightened but only in the second half of 2001. In 2000, the general government deficit increased to 4% of GDP from 3.8% in 1999. Despite stronger growth in tax revenue bases and substantial savings on interest payments, the 2001 cumulative deficit had already reached 2% of projected GDP in June when the authorities began tightening expenditure control. By November, the cumulative deficit had only increased to 2.7% of projected GDP and appeared in line with a new end-year deficit target (revised downwards to 3.5% of GDP from 3.7%). The quasi-fiscal stance was also initially expansionary. Large state-owned enterprises financed strong increases in wage and investment spending through arrears which rose 38% in real terms over the first seven months of the year. At the same time, losses in the energy sector mounted unchecked until the summer when tariffs were adjusted sharply and collection efforts strengthened.

Against the background of this initially expansionary policy stance, the deterioration of the trade and current account deficit which had begun in the second half of 2000 accelerated sharply. In the first half of 2001, the cumulative current account deficit more than doubled relative to the same period of 2000 and reached 3.4% of projected GDP (against 3.7% of GDP for the all of 2000). This sharp worsening was largely driven by the rise in imports caused by stronger domestic demand and various one-off factors, such as the impact of last year's drought and the provision of time-bound fiscal incentives for capital investment. However, as the impact of these measures waned and the tightening policy stance began to take hold, the pace of external deterioration slowed down with the current account rising to 4.3% of projected GDP by October 2001. Export growth, however, declined sharply and turned negative on a year-on-year basis in late 2001, showing that the slow down in EU growth could pose a serious challenge to Romania's external adjustment.

Improved access to the international financial markets allowed Romania to easily finance its widening current account imbalance while increasing gross official reserves. After regaining access to the international capital market towards end-2000, Romania launched a EUR 600 million Eurobond on improved terms in June 2001 when Standard and Poor's raised its rating on Romanian long-term foreign currency debt (FITCH IBCA and MOODY's followed suit later in the year). Although external indebtedness has risen from USD 10.5 billion at end-2000 to USD 11.4 billion at end-October, Romania's debt-to-GDP ratio remains moderate by international standards at 30.2 percent of projected GDP.

3. Structural reforms

After stalling in the months prior to the end-2000 elections and in the early days of the incoming administration, structural reforms were re-launched, most notably in the run up to a new IMF programme agreed in late October.

Prior to the agreement, in fact, significant progress was recorded in the area of energy price adjustment and privatisation. Over the summer, sharp hikes in energy tariffs ended a long freeze which had undermined previous efforts to strengthen enterprise sector financial discipline and led to the renewed accumulation of inter-enterprises arrears. By the end of the 2001, energy prices had increased 56% on a year-on-year basis.

The privatisation process also re-started with the sale of Banca Agricola in spring, the finalisation of a complex deal for the sale of SIDEX, an integrated steel plant responsible for a large part of total losses in the state-owned enterprise sector, and the agreement with the World Bank on the tendering procedures concerning two profitable aluminium smelters. Little progress was, however, recorded in selling the large majority of the 64 state-owned commercial enterprises prepared for privatisation under the previous World Bank PSAL operation.

Despite these advances, the pace of structural reform remained relatively slow The economic programme supported by the 18-month SBA approved by the IMF board at end-October, however, sets an ambitious structural policy agenda aiming to advance restructuring in the energy sector (most notably by raising energy tariffs to cost-recovery levels and improving energy companies' collection rates), accelerate privatisation (through the sale of the largest public bank, two gas and two electricity distribution companies) and strengthen the regulatory and supervisory regime in the financial sector (including through the introduction of the International Accounting Standards and of tighter norms on loan classification and foreign exchange exposure).

4. Implementation of macro-financial assistance

Since 1991, the EU has supported Romania's transition process through four macro-financial assistance operations, the latest of which was approved in November 1999 when the EU Council granted Romania a balance-of-payments loan, of up to EUR 200 million, within the framework of a SDR 400 million SBA (Council Decision 99/732/EC). After the release of the first EUR 100 million tranche in June 2000, however, the IMF programme went off track in the run up to the parliamentary and presidential elections of end-2000 as the government's commitment to wage discipline in public enterprise waned and fiscal policy was loosened. No further disbursements of EU macro-financial assistance could therefore take place and the IMF SBA eventually expired in February 2001.

However, bolstered by a strengthening economic recovery, the incoming administration adopted an increasingly pro-reform attitude in the course of 2001. Following the implementation of several prior actions, this renewed commitment to economic stabilisation and reforms led to the approval by the IMF Board of an 18-month SBA for SDR 300 million (approximately USD 383 million) on October 31, 2001. Negotiations with the World Bank for a second Private Sector Adjustment Loan (PSAL) of USD 300 million are also at a very advanced stage.

Against this background, in early 2002, the Commission secured the agreement in principle of the ECOFIN Council to make available to Romania EUR 100 million, pursuant to Council Decision 99/732/EC, in two sub-tranches, subject to the satisfactory implementation of the SBA and adequate progress in the country' structural adjustment process.

XII. TAJIKISTAN

1. Executive summary

In 2000 a real GDP growth rate of 8.3 % was achieved. In 2001 the GDP is estimated to have grown with about 10 %. Aluminium production continued on its increasing trend and also the cotton harvest was good, but declining world prices in both sectors dampened the results. It is a positive development that growth has spread to other sectors such as food processing, forestry and construction materials.

As small-scale privatisation is coming to close, the focus is moving to larger enterprises where the privatisation process has had a much slower start. The government has begun to reorganise the public infrastructure with a view to separate regulatory and operational functions in the transport, telecommunications and power sectors. Fiscal reforms and the restructuring of the banking sector continued in 2001.

The IMF Board concluded favourably the most recent review of Tajikistan's third annual arrangement under the PRGF in July 2001, and Tajikistan was able to draw a total of USD 16 million under the PRGF in 2001. The final two reviews of the arrangement were not completed, however, because of delays in implementing structural reforms.

Tajikistan settled its remaining arrears of EUR 78.8 million towards the Community in March 2001. Subsequently, Tajikistan benefited from a new macro-financial assistance package consisting of a new loan of EUR 60 million and a total grant amount of up to EUR 35 million. The Community loan and the first grant tranche of EUR 7 million were disbursed in March 2001. The second grant tranche of EUR 7 million was disbursed in December 2001.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Most prices liberalised (with the exception of public utilities).
2. Trade liberalisation Relatively liberal trade system with an average tariff rate of 8 % and no significant non-tariff barriers. Applied for membership in the WTO (observer status since July 2001). Customs union with Russia, Belarus, Kazakhstan and Kyrgyz Republic.
3. Foreign exchange regime Relatively liberal exchange regime. Official exchange rate unified with curb market rate in July 2000 when an interbank foreign exchange market began operating. The new currency, somoni, introduced in October 2000. Managed floating of the somoni.
4. Foreign direct investment Modest foreign direct investment due to high perceived country risk, despite a relatively liberal legal regime. No legal obstacles to foreign direct investment or to foreign ownership of shares, no restrictions on the repatriation of profit and capital (a transfer tax of 15 %).
5. Monetary policy Independence of the National Bank reasonably assured under the Law. In practice, until mid-2000, the NBT performed quasi-fiscal functions dictated by broader economic and political considerations. Poor liquidity management by the National Bank has been an additional source of inflation.
6. Public finances Overall revenues estimated at 15 % of GDP; total expenditure estimated at 15 % of GDP. A new Treasury system has been set up including regional treasuries in all administrative districts. A unit for major taxpayers was also set up. A public audit office was established in 2001, but it is not fully independent.
7. Privatisation and enterprise restructuring The privatisation of small enterprises is largely completed. Successful privatisation of all cotton ginneries. 55 % of total agricultural land is in private hands. Land reform slowed down in 2000 because of interference from local governments. Officials continue to intervene in the operations of new private farms and firms. The largest industrial companies and utilities remain in state hands.
8. Financial sector reform Significant progress in improving banking regulation and supervision. Restructuring agreements between the NBT and the four main banks. Lending to insiders and non-collection of loans remain widespread. Confidence in the system is still low and ability to mobilise savings remains limited (bank deposits below three percent of GDP).

2. Macroeconomic performance

Real GDP is estimated to have grown by about 10 % in 2001 (8.3 % in 2000). Economic growth has spread to several sectors of the economy outside the dominating cotton and aluminium sectors (such as food processing, forestry and construction materials). The severe drought which has affected the region in 2000 and 2001 is not completely overcome and last year's grain harvest also suffered from the drought. Hydroelectric plants have operated at less than half of their capacity because of the low water levels, which necessitated an increase in net electricity imports. The current account deficit is estimated to have increased to about 7 % of the GDP in 2001 (deficit of 6.3 % in 2000, transfers included). Cross-border trade has been affected by increased difficulties at the borders. Aluminium and cotton continue to provide up to 65 % of all export revenues, and the trade balance is therefore very vulnerable to fluctuations in world commodity prices.

The fiscal stance remained largely unchanged compared to the previous year. The general government deficit is estimated at 0.1 % of GDP for 2001 (0.6 % in 2000).

Following the monetary tightening, the rate of inflation slowed down rapidly during 2001 (from an average of 33 % in 2000) to about 11 % year-end 2001). The Tajik currency, somoni, stabilised during 2001, having depreciated initially after its introduction in October 2000.

Tajikistan's external debt of USD 1,231 million represented 129 % of GDP at the end of 2000 and 297 % in relation to exports. External debt remained roughly constant over 2001. The ratio of the net present value of the external debt to fiscal revenues was at about 400 percent for 2001. The imports coverage of gross international reserves of the National Bank is at about 2 ½ months. Net foreign direct investment has been modest at an annual level of about USD 20 millions over the last few years. The IMF Board concluded favourably the most recent review of Tajikistan's third annual arrangement under the PRGF in July 2001, and Tajikistan was able to draw a total of USD 16 million under the PRGF in 2001. There were however delays in the implementation of the agreed structural reforms in the second half of the year, and the final two reviews under the arrangement were not completed as planned.

3. Structural reforms

Significant progress has been made in fiscal reforms. The sales taxes on cotton and aluminium have been gradually phased out and are to be abolished fully in 2002-2003. The treasury has been reinforced and regional treasuries were set up. A new unit for major taxpayers has been created. A public audit office has been established but it does not function fully independently. Areas where it is necessary to take further measures to improve transparency and accountability include in particular quasi-fiscal operations and financial relations between the Ministry of Finance and the Central Bank.

As small-scale privatisation is close to completion, the focus is shifted to larger enterprises where privatisation has been dragging so far. By August 2001, 349 large and medium-sized companies had been sold out of the total 955 enterprises which are subject to privatisation. Poor transparency remains a major concern in the privatisation process. It has been estimated that around 70 % of privatised large and medium sized companies are insider-owned and controlled. The government has announced its intention to restructure the two largest state-owned companies (the electricity monopoly Barki Tajik and the aluminium smelter Tadaz). Tadaz alone accounts for over half of industrial output.

The land reform process has been slowed down by local governments which have been reluctant to cede their control over the old collective farms. In agreement with the World Bank, Tajikistan is committed to increase significantly the issuance of private land certificates by May 2002. Responsibilities of the Land Reform Committee have been enhanced to speed up the process.

The government has begun to restructure the public infrastructure with a view to separate regulatory and operational functions in the transport, telecommunications and power sectors. For instance, legislative changes are planned for Tajiktelecom to be incorporated and for establishing an independent regulator in the telecommunications sector.

The authorities continued to make progress in improving banking regulation and supervision. A further increase in the minimum capital requirement is planned in order to increase consolidation in the banking sector. Overall confidence in the banking system remains low and banks' ability to mobilise savings is limited (bank deposits amount to below 3 % of GDP). The National Bank of Tajikistan has concluded restructuring agreements with the four major privatised commercial banks which has produced some results i.a. in the area of loan recovery and credit assessment. Because of non-compliance with the IAS, financial information is still unreliable.

4. Implementation of macro-financial assistance

In March 2000, the Council adopted a decision to extend to Tajikistan the exceptional financial assistance already agreed for Armenia and Georgia. Tajikistan settled its remaining arrears of EUR 78.8 million towards the Community in March 2001. Subsequently, Tajikistan benefited from a new assistance package which consists of a new loan of EUR 60 million and a total grant amount of up to EUR 35 million to be disbursed in successive annual tranches over the period extending to 2004. The new loan and the first grant tranche of EUR 7 million were disbursed in March 2001. Given that Tajikistan made satisfactory progress in structural reforms (notably with the improvement of the taxation system, with the privatisation process, and with measures related to restructuring of the banking sector) while also the macroeconomic performance of Tajikistan has been satisfactory despite the difficult external conditions, the second tranche of EUR 7 million was disbursed in December 2001 after Tajikistan had reduced its net debtor position towards the Community by EUR 8 million.

XIII. UKRAINE

1. Executive summary

After a decade of negative growth, the Ukrainian economy grew by 5.8 percent in 2000 and the rate of growth accelerated in 2001. Other macroeconomic trends have also been positive. Inflation has declined markedly and the consolidated budget deficit was kept at about 1½ % of GDP in 2000 and 2001.

The current account remains in surplus, although the surplus is shrinking reflecting strong domestic demand driven import growth and an appreciating real exchange rate. Following a sharp depreciation in the second half of 1999, the hryvnia has been relatively stable in nominal terms since Spring 2000. In July 2001, the Paris Club decided to reschedule Ukraine's debts.

However, the balance of payments remains vulnerable. Debt service obligations are still important and the country has yet to regain access to the international capital markets. FDI inflows remain disappointing and, although official reserves are increasing, they still represent less than 2 months of imports.

In the structural area, positive steps have been taken in areas such as privatisation, banking regulation, land reform and energy sector reform, but much remains to be done. Progress in gas sector reform has been elusive and significant weaknesses remain in some large banks. Also, Ukraine continues to impose trade restrictions that violate the PCA rules.

The IMF reactivated its EFF in late 2001 but disagreements over the budget have delayed the completion of the 7th review of the programme, scheduled for early 2002. In early 2002, the Commission submitted to the Council a proposal to cancel the 1998 macro-financial assistance and disburse its remaining funds under a new macro-financial assistance operation. This new assistance would amount to EUR 110 million (including EUR 92 million from the 1998 operation).

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation Most prices have been liberalised. Communal services tariffs (such as gas, electricity, heating, and rents) are subject to administrative control and tend to be below full-cost recovery levels.
2. Trade liberalisation Import regime free of quantitative restrictions, with a few exceptions for health and safety reasons. Trade-weighted average import tariff was 7.5% in mid-1999. A uniform 2% import surcharge was imposed in July 1999 for six months. A few export restrictions (such as export duties on sunflower seeds and scrap) remain. PCA with EU entered into force on 1 March 1998. Ukraine has introduced several trade restrictions that were incompatible with the PCA.
3. Foreign exchange regime Full current account convertibility (Article VIII status at the IMF) since September 1996. Certain foreign exchange restrictions on current transactions were reintroduced between September 1998 and August 1999 to defend the currency.
4. Foreign direct investment Tax relief granted to some investments constituting at least 20% of an enterprise's capital and to investments in the automobile industry above USD 100 million. FDI inflows have remained very low on a per capita basis (they reached only USD 587 million, or USD 12 per capita, in 1998).
5. Monetary policy Increasing reliance on indirect monetary instruments. Central bank credit to commercial banks allocated mostly through the Lombard facility, credit auctions and repos.
6. Public finances General government expenditure reduced from about 70% of GDP in 1992 to some 36% of GDP in 2000. Public employment cut by 1 million (to 4.7 million) between 1994 and 1998. Consolidated government deficit reduced from 5.2% of GDP in 1997 to 1.5% of GDP in 2001. Social security contributions, the VAT and the profit tax are the main sources of revenue, accounting together for about 70% of consolidated government tax revenues.
7. Privatisation and enterprise restructuring Small-scale privatisation virtually completed. Over 9,500 enterprises privatised through a mass (voucher) privatisation scheme launched in early 1995. Privatisation programme is now focusing on the large enterprises, including those in the energy and telecommunications sectors. Limited involvement of foreign or strategic investors. According to the government, private sector accounted for about 60% of industrial output in 1998.
8. Financial sector reform Significant efforts made since 1997 to strengthen banking supervision and regulation, including the adoption of laws on the central bank and on banking activities in 1999-2000, the introduction of the International Accounting Standards, and the establishment of a new reporting system for banks. Most banks are privately owned. The banking system, however, remains weak, with some of the largest banks in poor condition. Banking licence of one such bank was withdrawn in 2001. Capital markets remain underdeveloped.

2. Macroeconomic performance

After expanding by 5.8 percent in 2000, the first positive yearly rate since Ukraine's independence, *real GDP* grew by 9 percent in the first 11 months of 2001. On the supply side, growth was fuelled by both industrial and agricultural production, with the latter benefiting from another exceptional grain harvest. On the demand side, the main driving forces were consumer spending and investment. Economic activity has shown, however, signs of deceleration in the second half of 2001, reflecting weaker demand in Russia and other trading partners and the impact of an appreciating real exchange rate on net exports. Growth is expected to continue slowing down in 2002 (to 5-6 percent).

Despite the strengthening of economic activity, *inflation* has been on a downward trend. In November 2001, year-on-year consumer price inflation reached a post-independence low of 4.5 percent, down from a recent peak of 32 percent in July 2000. The decline in inflation reflects a combination of factors, including a moderate nominal appreciation of the hryvnia, a prudent fiscal policy, the good harvests of 2000 and 2001, and lower oil prices. There are, however, some concerns that the surge in real wages and pensions (a reflection of the precipitous drop in inflation and, in the case of wages, fast productivity growth, but also of political decisions), the decline in wage and pension arrears and the fast rate of expansion of the monetary aggregates may increase again inflation in 2002. In December 2001, monetary policy was loosened further when the central bank cut its refinancing rate from 15 percent to 12.5 percent, the sixth reduction in 2001 (this rate had stood at 27 percent at end-2000). The central bank also eased reserve requirements for commercial banks during 2001.

The *deficit of the consolidated government* (on a cash basis and showing privatisation revenues as a financing item) reached 1.5 percent of GDP in 2001, the same level as in 2000. The deficit would be significantly higher, however, if the roughly 1.9 billion hryvnias (about 0.8 percent of GDP) of estimated arrears on VAT refunds were also taken into account.[3] The budget for 2002 foresees a deficit of 1.8 percent of GDP, in line with IMF demands, but it does not properly take into account either the need to clear the arrears on VAT refunds or the cost of the parliament's decision to reintroduce privileges for certain categories of the population (including the military and judges) for housing, transportation and communal services.

Following a depreciation of about 20 percent between July 1999 and January 2000, *the hryvnia* has been relatively stable. Given Ukraine's large inflation differential against its main trading partners, this has resulted in a considerable real exchange rate appreciation since February 2000. Although this real appreciation is beginning to affect export performance, it is so far largely a correction to the over-depreciation suffered in late 1999 and early 2000. The exchange rate is therefore thought to remain at a relatively competitive level.

With domestic demand keeping import growth strong and export growth decelerating due to weaker foreign demand and the appreciation of the real exchange rate, the surplus in *the current account* is narrowing. The surplus is estimated to have shrunk from 4.7 percent of GDP in 2000 to about 3 percent of GDP last year and is projected to

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3 The total stock of unpaid VAT refunds is estimated by the government at about 6 billion hryvnias.

fall further to about 1½ percent of GDP this year. Despite this comfortable current account, however, the balance of payments remains vulnerable. Access to the international bond markets was lost in the wake of the Russian crisis of 1998 and FDI inflows have continued to be disappointing. In this context, official *foreign exchange reserves* are still low (about USD 2.9 billion, or 7.5 weeks of imports, at end-October 2001), although they have shown an upward trend since the spring of 2000.

Ukraine's *external debt stock* stood at the equivalent of about 30 percent of GDP at end-2001. In July 2001, the Paris Club agreed on a rescheduling of Ukraine's debts in July 2001.[4] The agreement consolidates approximately USD 580 million due on loans contracted by Ukraine before 31 December 1998. This amount consists of principal arrears and maturities due from 19 December 2000 through 3 September 2002. This debt is to be repaid over 12 years in 18 equal successive semi-annual instalments, with a 3-year grace period. In addition, the Paris Club has granted deferrals on the interest payments, which effectively means that much of the interest payments burden for 2001 has been shifted to 2002.

The rescheduling agreement has reduced Ukraine's debt service due to Paris Club creditors during 2001 and 2002 from an initial amount of USD 805 million to USD 286 million, which consists mainly of payments of interest and payments of principal falling due in 2002 after the end of the consolidation period. This should make a significant contribution to strengthening Ukraine's balance of payments position (the reduction in debt service in 2001-02 is equivalent to about 1.4 percent of projected 2001 GDP). The normalisation of Ukraine's relations with the Paris Club could also pave the way for an eventual return of the country to the international capital markets.

3. Structural reforms

Progress with *structural reforms* slowed down significantly in 2001, partly reflecting the political stalemate around the resignation of Prime Minister Yushchenko and the formation of a new government in May 2001. There have been, however, certain encouraging steps, such as the withdrawal of the operating licence from Banka Ukraina (an insolvent state-owned bank), the adoption of a new land code, and the improvement in cash collection rates in the power sector.

In the *agricultural area*, the parliament passed a new Land Code in October 2001 that lays the ground for the development of a private land market. The new Code, which came into effect on 1 January 2002, was approved after a tense debate in which the communists expressed their strong opposition. The code however imposes a moratorium on sales of land until 2005. President Kuchma signed the new Code into law in November 2001 but called for the abolition of the 5-year moratorium. Although the new Code is a welcome step, to be really effective it will require a package of accompanying laws, including laws on the Land Cadastre and Land Evaluation. The authorities are also considering establishing an agrarian bank with the possible support of the World Bank.

On the *privatisation* front, the parliament adopted in early 2000 a programme for 2000-2002 foreseeing the sale of large companies. At over 2 billion hryvnias,

[4] Ukraine had stopped servicing its debts to the Paris Club in January 2000. In April 2000, some USD 2.6 billion of foreign debt, mostly eurobonds held by private investors but also part of Ukraine's debt to the Russian gas company Gazprom, were swapped into 7-year bonds denominated in euros or dollars.

privatisation revenues more than doubled in 2000. Some sales, however, were not conducted in a transparent manner, with some companies having been excluded in some cases from the bidding process without a clear justification. The budget for 2001 foresaw a substantial increase in privatisation revenues (to 5.9 billion hryvnias), reflecting the sale of large companies. However, this target was not met: privatisation revenues were only about one third of the programmed number, reflecting delays in the privatisation of the electricity distribution companies and Ukrtelecom, the state-owned telecommunications monopoly.

Banking regulation and supervision have been considerably strengthened in recent years with technical assistance from foreign donors. Significant weaknesses remain, however, in some of the largest banks. Restructuring programmes for those banks were adopted in 1999 and their implementation is a key aspect of the conditionality of the World Bank, the IMF and of our macro-financial assistance. In mid-July the authorities withdrew the operating licence from Banka Ukraina and the bank is being liquidated. Another bank that is a delicate financial position is the State Savings Bank. Progress with the restructuring of this bank has so far been rather limited.

In the *energy area,* Chernobyl was finally closed down on 15 December 2000. In the same month, the Commission and the EBRD approved the loans for *the K2R4 project* but the effectiveness of these loans was subject to a number of prior conditions, including the reactivation of the IMF programme, the existence of an appropriate regulatory authority in the nuclear sector, and confirmation of the financial commitment of the different institutions involved. Although these conditions have been met, the signing of the loan contracts has been delayed following the government’s request to revise some of parameters and conditions of the project.

There has been some progress with *power sector reform*. Cash collection rates have improved and the privatisation of a first batch of regional electricity distribution companies was completed in May 2001. However, on 31 May 2001, President Kuchma ordered a temporary suspension of the privatisation of additional electricity distribution companies. While the authorities have later declared that this moratorium is over, some uncertainties remain about the timing and the number of companies that will be privatised in the next round. One key pending area of structural reform in the energy area concerns the *gas sector*, where little progress has been made so far.

In the area of *trade liberalisation,* Ukraine has made some progress since the spring of 2000 towards removing a number of trade restrictions that were incompatible with the PCA. However, overall progress in this area, particularly with respect to certain export restrictions and the elimination of discriminatory measures in the automobile sector, has been insufficient.

4. Implementation of macro-financial assistance

In October 1998, the Council granted to Ukraine a third macro-financial loan in the amount of up to EUR 150 million.[5] The first tranche (EUR 58 million) was disbursed in July 1999. Discussions on the policy conditions for the release of the second tranche,

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5 The first and second macro-financial assistance operations, in the amount of EUR 85 million and EUR 200 million, respectively, were approved by the Council in December 1994 and October 1995.

however, were interrupted when the IMF’s EFF ran off-track in the autumn of 1999. In December 2000, when the IMF reactivated the EFF, the Commission resumed discussions on the second tranche conditions.

In September 2001, an agreement ad referendum was reached on the conditions related to the release of the second tranche of the 1998 loan facility. At the end of 2001, however, the EFF went again off-track. Moreover, Ukraine seemed unlikely to meet some of the conditions agreed with the Commission, notably those regarding the elimination of discriminatory regulations in the automobile sector. In this context and taking into account the debt rescheduling agreement reached between Ukraine and its Paris Club creditors in July 2001, the Commission submitted to the Council in January 2002 a proposal to cancel the 1998 facility and disburse its remaining funds under a new macro-financial assistance operation.[6] This new assistance would amount to EUR 110 million (including the EUR 92 million from the 1998 operation) and would have a longer maturity than the 1998 operation (15 years instead of 10) and a longer grace period (10 years instead of 7).

[6] COM (2002) 12 final, 17.01.2002.

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 2001 (in millions of euro)

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

Bulgaria III (BOP loan)	22.07.97	97/472/EC	**250**	Feb. 1998 Dec. 1998	125 125	**250**	
Armenia, Georgia and Tajikistan (2) (Structural adjustment loans and grants) of which	17.11.97 modified by 28.3.00	97/787/EC 00/244/EC	**375**			**254,5**	**120,5**
Armenia			**(58)**	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant)	28 8 4 5,5	**(45.5)**	**(12.5)**
Georgia			**(175)**	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant)	110 10 9 6	**(135)**	**(40)**
Tajikistan			**(95)**	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant)	60 7 7	**(74)**	**(21)**
Ukraine III (BoP loan)	15.10.98	98/592/EC	**150**	Jul. 1999	58	**58**	**92**
Albania III (BOP loan)	22.04.99	99/282/EC	**20**				**20**
Bosnia I (3) (BOP loan and grant)	10.05.99 modified by 10.12.01	99/325/EC 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 (BOP loan)	08.11.99	99/731/EC	**100**	Dec. 1999 Sep. 2000	40 60	**100**	
FYROM II (4) (BOP loan and grant)	08.11.99 modified by 10.12.01	99/733/EC 01/900/EC	**80** **18**	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant)	20 10 12 10	**52**	
Romania IV (BOP loan)	08.11.99	99/732/EC	**200**	Jun. 2000	100	**100**	
Kosovo I (5) (Grant budgetary support)	19.02.00	00/140/EC	**35**	Mar. 2000 Aug. 2000	20 15	**20** **15**	
Montenegro (5) (Grant budgetary support)	22.05.00	00/355/EC	**20**	Aug. 2000 Dec. 2000	7 13	**20**	
Moldova III (BOP loan)	10.07.00	00/452/EC	**15**				**15**
Kosovo II (3) (Grant budgetary support)	27.06.01	01/511/EC	**30**	15 - Sep. 2001	15	**15**	**15**
FRY I (4) (BOP loan and grant)	16.07.01 modified by 10.12.01	01/549/EC 01/901/EC	**345**	Oct. 2001 Oct. 2001 Jan. 2002	225 35 40	**300**	**45**
			-------			**-------**	**-------**
TOTAL			**5786**			**4732**	**1053,5**

(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 loans for a maximum amount of € 225 million and grants for a maximum amount of € 120 million.
(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.

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

Status of effective disbursements as of end-December 2001 (in millions of euro)

Country	Authorisations: Date of Council Decision	Authorisations: Reference of Council Decision	Authorisations: Maximum amount	Disbursements: Dates of disbursements	Disbursements: Amounts of disbursements	Disbursements: Totals	Disbursements: Undisbursed
A. EU Accession countries							
Baltics	23.11.92	92/542/EC	**220**			**135**	**85**
(BOP loans)							**(Suspended)**
of which :							
Estonia			**(40)**	Mar. 1993	20	**(20)**	**(20)**
Latvia			**(80)**	Mar. 1993	40	**(40)**	**(40)**
Lithuania			**(100)**	Jul. 1993	50	**(75)**	**(25)**
				Aug. 1995	25		
Bulgaria I	24.06.91	91/311/EC	**290**	Aug. 1991	150	**290**	
(BOP loan)				Mar. 1992	140		
Bulgaria II	19.10.92	92/511/EC	**110**	Dec. 1994	70	**110**	
(BOP loan)				Aug .1996	40		
Bulgaria III	22.07.97	97/472/EC	**250**	Feb. 1998	125	**250**	
(BOP loan)				Dec. 1998	125		
Bulgaria IV	08.11.99	99/731/EC	**100**	Dec. 1999	40	**100**	
(BOP loan)				Sep. 2000	60		
Czech and Slovak Federal Republic	25.02.91	91/106/EC	**375**	Mar. 1991	185	**375**	
(BOP loan)				Mar. 1992	190		
Hungary I	22.02.90	90/83/EC	**870**	Apr. 1990	350	**610**	**260**
(Structural adjustment loan)				Feb. 1991	260		**(Suspended)**
Hungary II	24.06.91	91/310/EC	**180**	Aug. 1991	100	**180**	
(BOP loan)				Jan. 1993	80		
Romania I	22.07.91	91/384/EC	**375**	Jan. 1992	190	**375**	
(BOP loan)				Apr. 1992	185		
Romania II	27.11.92	92/551/EC	**80**	Feb. 1993	80	**80**	
(BOP loan)							
Romania III	20.06.94	94/369/EC	**125**	Nov. 1995	55	**125**	
(BOP loan)				Sep. 1997	40		
				Dec. 1997	30		
Romania IV	08.11.99	99/732/EC	**200**	Jun. 2000	100	**100**	**100**
(BOP loan)							
Slovakia	22.12.94	94/939/EC	**130**			**Cancelled**	**130**
(BOP loan)						(Jul. 1996)	**Cancelled**
			-------			-------	-------
TOTAL A			**3305**			**2730**	**575**

B. Western Balkans

Albania I (BOP grant)	28.09.92	92/482/EC	**70**	Dec. 1992 Aug. 1993	35 35	**70**	
Albania II (BOP grant)	28.11.94	94/773/EC	**35**	Jun. 1995 Oct. 1996	15 20	**35**	
Albania III (BOP loan)	22.04.99	99/282/EC	**20**				**20** **(Suspended)**
Bosnia I (1) (BOP loan and grant)	10.05.99 modified by 10.12.01	99/325/EC 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 (BOP loan)	22.07.97	97/471/EC	**40**	Sep. 1997 Feb. 1998	25 15	**40**	
FYROM II (2) (BOP loan and grant)	08.11.99 modified by 10.12.2001	99/733/EC 01/900/EC	**80** **18**	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant)	20 10 12 10	**52**	**28** **18**
Kosovo I (3) (Grant budgetary support)	19.02.00	00/140/EC	**35**	Mar. 2000 Aug. 2000	20 15	**20** **15**	
Kosovo II (3) (Grant budgetary support)	27.06.01	01/511/EC	**30**	Sep. 2001	15	**15**	**15**
Montenegro (3) (Grant budgetary support)	22.05.00	00/355/EC	**20**	Aug. 2000 Dec. 2000	7 13	**20**	
FRY I (4) (BOP loan and grant)	16.07.01 modified by 10.12.2001	01/549/EC 01/901/EC	**345**	Oct. 2001 (grant) Oct. 2001 (loan) Jan. 2002 (grant)	35 225 40	**300**	**45**
			-------			-------	-------
TOTAL B			**753**			**627**	**126**

C. New Independent States (NIS)

Armenia, Georgia and Tajikistan (4) (Structural adjustment loans and grants) of which	17.11.97 modified by 28.3.00	97/787/EC 00/244/EC	**375**			**254,5**	**120,5**
Armenia			**(58)**	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant)	28 8 4 5,5	**(45.5)**	**(12.5)**
Georgia			**(175)**	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant)	110 10 9 6	**(135)**	**(40)**
Tajikistan			**(95)**	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant)	60 7 7	**(74)**	**(21)**
Belarus (BOP loan)	10.04.95	95/132/EC	**55**	Dec. 1995	30	**30**	**25** **(Suspended)**
Moldova I (BOP loan)	13.06.94	94/346/EC	**45**	déc-94 Aug. 1995	25 20	**45**	
Moldova II (BOP loan)	25.03.96	96/242/EC	**15**	Dec. 1996	15	**15**	
Moldova III (BOP loan)	10.07.00	00/452/EC	**15**				**15**
Ukraine I (BOP loan)	22.12.94	94/940/EC	**85**	Dec. 1995	85	**85**	
Ukraine II (BOP loan)	23.10.95	95/442/EC	**200**	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	**200**	
Ukraine III (BoP loan)	15.10.98	98/592/EC	**150**	Jul. 1999	58	**58**	**92** **(Suspended)**
			-------			-------	-------
TOTAL C			**940**			**687,5**	**252,5**

D. Mediterranean countries

Israel (5) (Structural adjustment soft loan)	22.07.91	91/408/EC	**187,5**	Mar. 1992	187,5	**187,5**	
Algeria I (BOP loan)	23.09.91	91/510/EC	**400**	Jan. 1992 Aug. 1994	250 150	**400**	
Algeria II (BOP loan)	22.12.94	94/938/EC	**200**	Nov. 1995	100	**100**	**100** **(Suspended)**
			-------			-------	-------
TOTAL D			**787,5**			**687,5**	**100**
TOTAL A+B+C+D			**5786**			**4732**	**1054**

(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) Exceptional financial assistance, which includes loans for a maximum amount of € 225 million and grants for a maximum amount of € 120 million.
(5) 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.

Annex 2: Balance of payments support to recipients of EU macro-financial assistance by contributor, 1990-2001 (1)

2a. In millions US$

	1990	1991	1992	1994	1995	1996	1997	1998	1999	2000	2001
IFI's	**419**	**5607**	**1564**	**4086**	**1877**	**250**	**732**	**2800**	**1751**	**36**	**530**
IMF	219	4177	909	3206	1477	195	584	2200	1009	12	250
World Bank	200	1430	655	880	400	55	148	600	742	24	155
Bilaterals	**1618**	**5600**	**708**	**11202**	**3885**	**67**	**582**	**336**	**872**	**238**	**3421**
EU (2)	1108	2190	423	855	330	19	329	168	556	189	359
Other bilaterals (3)	511	1406	285	702	150	10	73		264	49	92
of which											
USA		35		100		10	15		75	13	22
Japan	200	850	120	350	150		54		22	7	
Debt relief		2004		9645	3405	38	180		52		2970
Paris Club		554		4920					52		2970
London Club				4380							
Other (4)		1450		345	3405	38	180				

2.b In percent of total commitments, including debt relief

	1990	1991	1992	1994	1995	1996	1997	1998	1999	2000	2001
IFI's	**21**	**50**	**69**	**27**	**33**	**79**	**56**	**94**	**67**	**13**	**14**
IMF	11	37	40	21	26	62	44	74	38	4	7
World Bank	10	13	29	6	7	17	11	20	28	9	4
Bilaterals	**79**	**50**	**31**	**73**	**67**	**21**	**44**	**6**	**33**	**87**	**89**
EU (2)	54	20	19	6	6	6	25	6	21	69	9
Other bilaterals (3)	25	13	13	5	3	3	5		10	18	2
of which											
USA		0		1		3	1		3	5	1
Japan	10	8	5	2	3		4		1	3	
Debt relief		18		63	59	12	14		2		78
Paris Club		5		32					2		78
London Club				29							
Other (4)		13		2	59	12	14				

2c. In percent of total commitments, excluding debt relief

	1990	1991	1992	1994	1995	1996	1997	1998	1999	2000	2001
IFI's	**21**	**61**	**69**	**72**	**80**	**90**	**65**	**92**	**68**	**13**	**47**
IMF	11	45	40	57	63	70	52	59	39	4	29
World Bank	10	16	29	16	17	20	13	33	29	9	18
Bilaterals	**79**	**39**	**31**	**28**	**20**	**10**	**35**	**8**	**32**	**87**	**53**
EU (2)	54	24	19	15	14	7	29	8	21	69	42
Other bilaterals (3)	25	15	13	12	6	4	7		10	18	11
of which											
USA		0		2		4	1		3	5	3
Japan	10	9	5	6	6		5		1	3	

(1) Based on Council Decisions for EU operations.
No operation was decided in 1993.

(2) EU macro-financial assistance.

(3) Including EU Member States.

(4) Syndicated commercial banks loan in favour of Algeria in 1991, debt relief in favour of Ukraine by Russia and Turkmenistan in 1994 and 1995, debt rescheduling in favour of Moldova by Russia in 1996 and debt rescheduling in favour of Bulgaria and FYROM in 1997.

Annex 2.1.: Balance of payments support to recipients of EU macro-financial assistance by contributor, 2000-2001 a) (in millions of US$ and in percent of total commitments and disbursements)

Balance of payments support 2000

	Total				Kosovo				Moldova			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%
IFI's	**36**	**13**	**36**	**13**	**5**	**6**	**5**	**6**	**31**	**57**	**31**	**76**
IMF	12	4	12	4					12	22	12	29
WB (policy based)	24	9	24	9	5	6	5	6	19	35	19	47
Bilaterals	**238**	**87**	**120**	**44**	**81**	**94**	**78**	**94**	**24**	**43**	**10**	**24**
EU	189	69	74	27	42	49	42	50	14	25		
USA	13	5	13	5	13	15	13	16				
Japan	7	3	7	3	7	8	7	8				
Other bilaterals	29	11	26	9	19	22	16	19	10	18	10	24
Debt relief												
London Club												
Paris Club												
Other												
Total	**275**	**100**	**156**	**57**	**86**	**100**	**83**	**100**	**55**	**100**	**41**	**100**

	Montenegro				Tajikistan			
	Commitments		Disbursements		Commitments		Disbursements	
	mio US$	%	mio US$	%	mio US$	%	mio US$	%
IFI's								
IMF								
WB (policy based)								
Bilaterals	**32**	**100**	**32**	**100**	**102**	**100**		
EU	32	100	32	100	102	100		
USA								
Japan								
Other bilaterals								
Debt relief								
London Club								
Paris Club								
Other								
Total	**32**	**100**	**32**	**100**	**102**	**100**		

Balance of payments support 2001

	Total				Kosovo				Federal Republic of Yugoslavia			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%
IFI's	**530**	**14**	**137**	**30**	**15**	**18**	**12**	**20**	**390**	**10**	**125**	**31**
IMF	250	7	125	27					250	7	125	31
WB (policy based)	155	4	12	3	15	18	12	20	140	4		
Bilaterals	**3421**	**89**	**325**	**70**	**70**	**82**	**47**	**80**	**3350**	**90**	**278**	**69**
EU	359	9	269	58	49	57	35	60	310	8	234	58
USA	22	1	20	4	10	12	10	17	12	0	10	2
Japan												
Other bilaterals	70	2	36	8	12	14	2	3	59	2	34	8
Debt relief	2970	78							2970	79		
London Club												
Paris Club	2970	78							2970	79		
Other												
Total	**3826**	**103**	**462**	**100**	**85**	**100**	**59**	**100**	**3740**	**100**	**403**	**100**

	FYROM			
	Commitments		Disbursements	
	mio US$	%	mio US$	%
IFI's	**34**	**36**	**2**	**100**
IMF	34	36	2	100
WB (policy based)				
Bilaterals	**61**	**64**		
EU	16	17		
USA				
Japan				
Other bilaterals				
Debt relief	45	47		
London Club				
Paris Club	45	47		
Other				
Total	**95**	**100**	**2**	**100**

a) Disbursements are shown under the year of corresponding commitments.

ANNEX 3: Selected economic indicators

	1998	1999	2000	2001 Programme (1)	2001 Estimates
GDP at constant prices	(Percent change)				
Albania	8,0	7,3	7,8	7,3	6,5
Armenia	7,2	3,3	6,0	6,5	9,6
Bosnia-Herzegovina	10,0	10,0	5,0	8,0	5,5
FRY	2,5	-15,7	6,7	5,0	5,5
FYROM	2,9	2,7	4,6	6,0	-4,6
Georgia	2,9	2,9	1,9	3,9	4,5
Kosovo	-	-	-	-	10,0
Moldova	-6,5	-3,4	1,9	5,0	6,1
Romania	-4,8	-1,2	1,8	4,5	5,3
Tajikistan	5,3	3,7	8,3	5,0	10,3
Ukraine	-1,9	-0,4	4,5	4,0	7,0
Consumer price (end year)	(Percent change)				
Albania	8,7	-1,0	4,2	3,0	3,5
Armenia	-1,3	2,0	0,4	3,5	2,9
Bosnia-Herzegovina					
Federation	5,0	-1,0	2,0	4,0	2,0
Republika Srpska	14,0	14,0	15,0	9,0	7,0
FRY	44,0	50,0	115,0	35,0	40,0
FYROM	-2,4	2,6	4,9	1,2	5,3
Georgia	10,7	10,9	4,6	4,9	3,4
Kosovo	-	-	-	-	7,9
Moldova	18,2	43,8	18,4	10,0	6,4
Romania	40,6	57,8	40,7	29,0	30,3
Tajikistan	2,7	31,3	61,0	13,6	11,5
Ukraine	22,0	19,1	27,0	13,2	6,1
Fiscal balance	(Percent of GDP)				
Albania	-10,4	-11,4	-9,1	-9,2	-9,0
Armenia *	-4,8	-5,5	-4,0	-4,0	-4,8
Bosnia-Herzegovina					
Federation	-1,8	-1,3	-2,3	-1,7	n.a.
Republika Srpska	-5,1	-5,2	-2,9	-3,2	n.a.
FRY	n.a.	n.a.	-0,9	-6,1	-2,4
FYROM	-1,7	0,0	2,2	-1,2	-6,7
Georgia *	-4,9	-5,0	-2,6	-1,4	-2,0
Kosovo	-	-	-7,3	-4,9	1,0
Moldova	-8,6	-2,6	-1,5	-1,5	-1,1
Romania	-5,4	-3,6	-4,0	-3,5	-3,3
Tajikistan	-3,8	-3,1	0,2	-0,5	-0,1
Ukraine	-3,5	-2,4	-1,5	-3,0	-1,5
Current account	(Percent of GDP)				
Albania	-6,1	-7,3	-7,0	-7,5	-7,4
Armenia **	-27,3	-25,0	-19,8	-18,9	-16,0
Bosnia-Herzegovina	-18,9	-21,4	-20,9	-20,4	-17,2
FRY	-5,5	-7,5	-7,6	14,6	10,7
FYROM	-9,6	-5,9	-8,5	-8,2	-10,6
Georgia **	-17,2	-14,9	-13,7	-9,7	-9,5
Kosovo	-	-	-	-	-
Moldova	-16,7	-2,6	-10,1	-7,9	-5,7
Romania	-7,0	-4,1	-3,7	-6,0	-5,9
Tajikistan	-9,3	-3,4	-3,9	-6,7	-7,2

Ukraine	-3,1	2,7	4,0	2,1	3,0
Official foreign exchange reserves (end year)	(Months of imports)				
Albania	3,7	3,8	4,3	4,5	4,7
Armenia	3,6	3,7	3,5	3,7	3,5
Bosnia-Herzegovina	0,8	2,2	2,5	2,5	3,6
FRY	n.a.	1,1	1,3	1,5	2,4
FYROM	2,0	3,0	3,5	3,6	6,0
Georgia	1,0	1,3	1,0	1,2	1,2
Kosovo	-	-	-	-	-
Moldova	1,4	2,9	2,7	3,1	2,6
Romania	2,2	2,6	2,9	3,0	3,5
Tajikistan	1,5	1,7	1,9	2,5	2,2
Ukraine	0,6	0,8	0,8	1,0	2,0

(1) Programme targets set in IMF programmes, if any.

* On a cash basis.
** Excluding official transfers.

Sources: National authorities and IMF