COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 8.6.2005
SEC(2005) 747

COMMISSION STAFF WORKING PAPER

ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE TO THIRD COUNTRIES IN 2004

{COM(2005) 245 final

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
EC	European Community
EFF	Extended Fund Facility
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
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
FOREX	Foreign Exchange
FYROM	The 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 (formerly ESAF)
SAA	Stabilisation and Association Agreement
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SOE	State Owned Enterprise
USD	Dollar of the United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

TABLE OF CONTENTS

List of abbreviations 2
1. INTRODUCTION 5
2. ALBANIA 6
2.1. Executive summary 6
2.2. Macroeconomic performance 6
2.3. Structural reforms 7
2.4. Implementation of macro-financial assistance 7
3. ARMENIA 10
3.1. Executive summary 10
3.2. Macroeconomic performance 10
3.3. Structural reform 11
3.4. Implementation of exceptional financial assistance 12
4. BOSNIA AND HERZEGOVINA 15
4.1. Executive summary 15
4.2. Macroeconomic performance 15
4.3. Structural reforms 16
4.4. Implementation of macro-financial assistance 17
5. GEORGIA 20
5.1. Executive summary 20
5.2. Macroeconomic performance 20
5.3. Structural reform 21
5.4. Implementation of exceptional financial assistance 22
6. Moldova 25
6.1. Executive summary 25
6.2. Macroeconomic performance 25
6.3. Structural reform 26
6.4. Implementation of exceptional financial assistance 28
7. ROMANIA 30
7.1. Implementation of macro-financial assistance 30

8. SERBIA AND MONTENEGRO 31
8.1. Executive summary 31
8.2. Macroeconomic performance 31
8.3. Structural Reforms 32
8.4. Implementation of macro-financial assistance 33
9. TAJIKISTAN 36
9.1. Executive summary 36
9.2. Macroeconomic performance 36
9.3. Structural reforms 37
9.4. Implementation of macro-financial assistance 38
10. UKRAINE 40
10.1. Executive summary 40
10.2. Macroeconomic performance 40
10.3. Structural reforms 41
10.4. Implementation of macro-financial assistance 42

1. INTRODUCTION

This working document is released in parallel with the Communication from the Commission to the Council and the European Parliament on the implementation of macro-financial assistance to third countries in 2004 and is meant to complement it. It discusses the economic situation 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 or are still outstanding in 2004.

In line with the recommendations of the Court of Auditors in their special report of March 2002, particular attention is paid to the relevant aspects of the transition process and of the implementation of structural reforms in the beneficiary countries. Progress in this respect also reflects the degree to which the corresponding economic policy conditions attached to the EC macro-financial assistance have been met.

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 2004 appears in Annex, as well as well as statistical data of the related countries.

---

[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(1992)400 of 16 September 1992.
COM(1994)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.
COM(2002)352 of 11 July 2002.
COM(2003)444 of 24 July 2003.
COM(2004)523 of 28 July 2004.

2. ALBANIA

2.1. Executive summary

GDP growth accelerated to an estimated 6.2 % in 2004. The continuing appreciation of the lek together with modest inflationary pressure have provided scope for additional monetary policy easing in 2004. Large imbalances remain in the external sector. While the trade deficit is estimated to have remained above 20% of GDP for 2004, substantial private transfers from abroad have contributed to finance a current account deficit of an expected 7.5% of GDP. Foreign direct investment has been boosted in 2004 by the privatisation of the Savings Bank in spring. Progress has been achieved in financial sector restructuring and privatisation, but the privatisation of remaining large state-owned enterprises has been relatively slow, in particular with regard to telecommunication and energy utilities. Some progress was achieved in the management of public expenditures and revenues. In April 2004, the Council adopted a decision to provide macro-financial assistance to Albania for a maximum amount of EUR 25 million. The implementation of this assistance is expected to take place in 2005.

2.2. Macroeconomic performance

GDP growth accelerated to about 6.2 % in 2004. This was the combined result of a significant increase in domestic hydro power production, improved agricultural output and a steady upward trend of growth in services. Inflation developments remained subdued in 2004, helped by a good harvest and the continued appreciation of the lek. 12-month consumer price inflation stood at 2.2% in December 2004.

In 2004, fiscal consolidation continued. The government deficit is estimated to have reached 5.2% of GDP and is planned at 4.8% of GDP in 2005. During the first 9 months of 2004, the overall fiscal deficit registered a decline of 2.4% on a year-on-year basis. Since revenues had been below the government's target in 2003, the authorities implemented adjustment measures in the form of a lower revenue target for the 2004 budget, equivalent of 0.7% of GDP, to offset the shortfall. For 2004, tax revenues are estimated to have increased to 20.2% of GDP. However, continued efforts in this area are necessary as tax revenues still remain among the lowest in the region (as a percentage of GDP). Government expenditure declined to 26.5% of GDP in 2003 and remained 2 percentage points below target as contingency measures to offset the revenue shortfall were taken (mainly savings on subsidies for imported electricity facilitated by favourable conditions for hydropower which contributed to improved domestic supply, as well as delayed or smaller salary increases for personnel). For 2004, expenditures are estimated by the authorities to have reached 28.8%. Some tax measures, especially beneficial for businesses have been taken, inter alia: the reduction of the simplified small businesses profit tax and the corporate tax rates (from 4% to 3% and from 25% to 23%, respectively). Moreover, the introduction of a personal annual income declaration system is scheduled for 2006.

The absence of substantial inflationary pressure and the continuing nominal appreciation of the lek opened the scope for a relaxation of monetary policy. As a result, the Bank of Albania lowered its main policy rate by 100 basis points to 5.25% in 2004.

The current account deficit is expected to have marginally declined to 7.5% of GDP in 2004. as a smaller trade deficit was partly offset by a decline in private transfers. A substantial increase in foreign direct investment to EUR 309 million (about 6% of GDP) was expected for 2004 against EUR 158 million (about 3% of GDP) in 2003, partly as a result of the international sale of the Savings Bank for an amount of EUR 103 million.

2.3. Structural reforms

Progress in public administration reform has continued, but the strengthening of the tax administration remains a major challenge. In the field of financial control and audit, some significant progress has been made recently. Whereas privatisation of small- and medium-sized enterprises has been completed, large-scale privatisation has suffered delays over recent years. However, as far as the banking sector is concerned, the sale of Savings Bank, the largest bank of the country, to a strategic foreign investor was completed in 2004. As a result of this sale the banking sector is now almost completely in private hands.

Some progress was made in the area of public finance control, notably as a result of the entering into force of the Law on Internal Audit in April 2004. Nonetheless, an overall Public Internal Financial Control strategy, strengthened financial control structures and a better implementation of existing financial control-related legislation remain necessary. In addition, further measures to curb down the size of the informal sector would help to support fiscal consolidation.

A strengthening of the tax administration remains also at the core of the fiscal strategy, as well as the fight against tax evasion, fraud and corruption, and the improvement of the VAT system. The improvement of communication with tax payers, the simplification of tax-payment procedures and the development of a functioning system which guarantees the re-payment of taxes collected in excess would also contribute to increase tax collection and enhance confidence between tax payers and the tax administration, in particular in an country where over the 95% of the economy is composed of small- and medium-sized enterprises. On a positive note, in 2004 98.5% of the revenue target was achieved and 2,700 new taxpayers were recorded.

2.4. Implementation of macro-financial assistance

In April 2004, the Council decided to provide macro-financial assistance to Albania for a maximum amount of EUR 25 million, including EUR 16 million of grants and EUR 9 million of loans, to help support its external financing requirements. The release of this assistance was postponed to 2005, given the more favourable than anticipated balance-of-payments developments in 2004, provided it remains necessary to finance external account needs. Negotiations on a Memorandum of Understanding, which defines the conditionality applying to this assistance, were successfully concluded in October 2004. The focus of this conditionality is on the areas of public finance management, public administration and financial sector reform, as well as on improving the business environment and private sector development.

In March 2004, an operational assessment of the reliability of financial circuits and procedures at the Ministry of Finance and the Bank of Albania was carried out by an external consultant, on behalf of DG ECFIN. This assessment concluded that a framework for sound financial management at both authorities is effective. However, to further strengthen this framework, conclusions of the operational assessment are reflected in the conditionality of the agreed Memorandum of Understanding.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most price categories are liberalised except for some public services and utilities. Prices of electricity and oil have been increased towards cost recovery levels under the oversight of the Regulatory Authority. Electricity prices for poor families are however still subsidised. Pricing for telecommunication is fully liberalised, even for international calls. Railway transport prices remain subsidized.

2. Trade liberalisation

Albania is a WTO member since 2000 and has concluded Free Trade Agreements negotiations with its neighbouring countries and is implementing them. Negotiations with Turkey and Moldova on such agreements continued in 2004.

3. Exchange regime

Albania maintains a managed floating exchange rate regime. However, the Bank of Albania intervenes when necessary to smooth out strong fluctuations. In 2004, the lek appreciated by about 5.5% and 7.1% against the euro and the US dollar, respectively.

4. Foreign Direct Investment

For 2004, a substantial increase in foreign direct investment to EUR 309 million (about 6% of GDP) against EUR 158 million (about 3% of GDP) in 2003 was expected, partly as a result of the international sale of the Savings Bank. However, the number of administrative barriers to establish a business in Albania remains high.

5. Monetary policy

The Bank of Albania continued with its stability-oriented monetary policy in 2004 and maintained its 2-4% inflation target. Credit growth remained robust and at end-August 2004 credit to the economy constituted 12.6% of M3 and 7.3% of GDP (up from 6.8% of GDP in 2003). The base interest rate is at a historical minimum of 5.25%, after having been cut by 100 basis points during 2004.

6. Public Finance

The performance in terms of revenue collection has been improved compared to previous years, but still remained below needs given the country's weak tax revenue base. In 2004, 98.5% of the revenue target was achieved and 2,700 new taxpayers were recorded.

7. Privatisation and Enterprise Restructuring

Privatisation in Albania gained some momentum with the successful sale of the Savings Bank to Raiffeisen Bank in early 2004. The privatisation of Albtelekom and ARMO (fuel company) is underway and completion is expected by year-end 2005. A feasibility study on the privatization of KESH (electricity state company) is foreseen in 2005. However, progress in the process of restructuring and privatization of large insolvent companies has been slow.

8. Financial Sector Reform

The successful privatisation of the Savings Bank, together with steps taken to privatise the main Albanian insurance company, INSIG, represents considerable progress towards the completion of the privatisation of the financial sector. The banking sector is virtually to 100% in private hands. Confidence in the banking sector has increased with local and foreign deposits growing in the 12-months to July 2004 by 9.7% and 13.6%, respectively.

3. ARMENIA

3.1. Executive summary

The Armenian economy continued to grow fast in 2004 so that the pre-transition level of GDP will be recovered in 2005. Real GDP growth reached 10.1% while the sectoral composition of economic growth reversed from the previous year with a strong pick up in agricultural production (+14.5%) combined with a much more modest growth rate in industrial production (+2.1%). The Central Bank of Armenia refrained from intervening in the foreign exchange market, and as a result the appreciation of the Armenian dram contributed to a marked decrease in consumer price inflation (2% at end-2004 down from 8.6% at end-2003).

There has also been gradual progress in structural reforms, but the overall business environment is not yet conducive to more broadly based economic growth. The government continues to focus on stabilisation of energy supplies, and several new investment projects are in progress.

Armenia implemented satisfactorily the economic programme supported by the IMF. The final review under the PRGF-supported three-year arrangement was concluded in December 2004 and consequently, the total approved amount of the arrangement has been disbursed to the country. The EC disbursed a grant instalment of EUR 5.5 million to Armenia in July 2004 after the country made a principal repayment of EUR 7 million to the Community. Armenia's outstanding debt to the EC was thereby reduced to only EUR 2 million.

3.2. Macroeconomic performance

As expected, real GDP growth was slightly slower in 2004 at about 10% after two years of very strong economic performance (average growth of 13.5% in 2002/2003). Agriculture, services and construction were driving the economy while industrial production posted only modest growth at two% largely due to disruptions in the supply of uncut stones for the diamond polishing sector. Processing of diamonds accounted for about 40% of exports in 2004 (about 50% in 2003). New investments in metallurgy, minerals and machine building are likely to contribute to a gradual diversification of exports in coming years. Despite the strong growth performance, officially registered unemployment has declined relatively little (from 10.8% in 2002 to 9.4% in 2004) while the level of unemployment indicated by household surveys is even higher at well over 20%.

The overall fiscal balance is on a sound basis with an estimated deficit of about 1.5% of GDP. A deficit of 2.6% was originally projected in the 2004 budget but because of some delays in the implementation of planned capital spending, total expenditures were below the budgeted level. The tax revenues-to-GDP ratio is estimated at 14.4% (14% in 2003). Nevertheless, at around 16%, total revenues as a percentage of GDP are below their level in 2003 because of a reduction in external grants. The introduction of a minimum turnover tax (at a rate of 1%) boosted tax collection from the corporate sector which had previously avoided paying profit tax by reporting losses. On the other hand, VAT and excise collection lagged behind overall output growth. The nominal increase in current expenditure (+20%) was directed in particular to finance a rise in public sector wages, higher defence expenditure and higher social spending in line with priorities set in the Poverty Reduction Strategy Paper. Interest payment fell as a result of more concessional composition of public debt.

The 12-month inflation decelerated from a peak of 9.5% (July 2004) to 2.0% (December 2004). By allowing the dram to appreciate, the Central Bank of Armenia curbed inflationary expectations towards its target inflation rate of three%. Despite the real effective appreciation of the dram, the loss of competitiveness is still considered to be relatively minor given a real depreciation of around 25% in 2000-2003.

The recent appreciation of the dram is driven by a strong rise in workers' remittances and other private transfers. According to preliminary estimates, the current account deficit narrowed down to below 5% of GDP in 2004 (6.8% in 2003). The trade deficit widened to about 18% of GDP as imports growth (+5.6%) exceeded exports growth (+4.3%). Foreign direct investment accelerated from the previous year (food industry, communications, construction and transport being the prominent sectors). The gross international reserves of the Central Bank of Armenia are comfortably high covering nearly four months of imports. In nominal terms the public external debt is at about USD 1.1 billion, while as a ratio to GDP it is estimated at about 33% (down from about 39% in 2003).

Armenia implemented satisfactorily the economic programme supported by the IMF. The IMF Executive Board concluded in December 2004 the final review under the PRGF-supported three-year arrangement. The total available amount of disbursements under the PRGF-arrangement (SDR 69 million) had been disbursed when the arrangement expired at the end of 2004. Discussions on a possible successor arrangement are likely to start in early 2005. The World Bank approved in June 2004 a new Country Assistance Strategy for Armenia, which foresees IDA lending of USD 170 million over four years. The total amount could be increased up to USD 220 million if the improvements in public finance management accelerate in Armenia. The World Bank focuses on reducing non-income aspects of poverty (such as access to basic services) and making economic growth overall more beneficial to the poor.

3.3. Structural reform

There has also been gradual progress in structural reforms, but the overall business environment is not yet conducive to more broadly based economic growth. The business climate remains difficult for new small and medium sized enterprises in particular. The highly concentrated firm structure in the formal economy is dominated by vested interests. Some steps were taken in the implementation and monitoring of the Anti-Corruption Strategy (adopted at the end of 2003) but the government's commitment was perceived fairly weak.

Due to persistent weaknesses in tax and customs administration, the gap between actual and potential revenue collection remains large. The situation is unlikely to improve substantially until the administrative structures are consolidated under the remit of the Ministry of Finance and Economy. In 2004, a two-year programme was drafted to reform some problematic areas of the administration, including addressing outstanding tax arrears from companies and meeting VAT refund commitments in a timely manner. A number of VAT exemptions on imported goods were removed in 2004. The tax base was expanded to include large retail markets. Consistent with its WTO commitments, Armenia is expected to increase the use of declared transaction values for assessing customs duties and VAT. In more general terms,a major challenge, which cannot be delayed very long, is to consolidate a large number of often contradictory provisions in the tax legislation into a unified tax code.

The Central Bank of Armenia (CBA) continued to strengthen regulations in the banking sector. New anti-money laundering legislation was approved by the parliament in November 2004 and a Financial Intelligence Unit will be created at the Central Bank for its implementation. The CBA intervened in eight banks over the past few years, and the last one of these (Armcommunications Bank) avoided liquidation when it was recapitalised by new investors which also acquired its largest debtor, the Nairit chemical plant. Some of the 19 operating banks would still have difficulties in meeting the new minimum capital requirement of USD 5 million which becomes effective in mid-2005. The CBA is expected to pay more attention to corporate governance issues in the banks and in the non-bank financial sector. Transparency and efficiency need to be addressed seriously also in the judicial system to encourage deepening of the financial intermediation and new business development. Total bank assets are at a low level equivalent to about 19% of GDP.

The dispute involving the government and Armentel, the monopoly operator in telecommunications since the privatisation in 1997, was settled between the parties outside the court. The government subsequently issued a second licence to another operator. In mobile phone and internet services Armenia has lagged behind other countries in the region.

Despite having a liberal trade regime, Armenia has not been able to fully benefit from increased trade opportunities after it became a WTO member in February 2003 because of its isolated position, high transportation costs and shortcomings in customs procedures. In 2004 a temporary closure by Russia of a border crossing with Georgia affected also Armenia’s trade routes. In an attempt to diversify both exports and imports, Armenia has strengthened trade relations with Iran. The two governments decided in 2004 to construct a gas pipeline from Iran to Armenia. Armenia envisages exporting electricity to Iran.

The government continues to focus strongly on stabilisation of energy supplies, and several new investment projects are in progress in addition to the gas pipeline, such as the development of small and medium-sized hydropower plants. A liquidation process of Armenergo, a wholesale intermediary between energy generation and distribution, was initiated in November 2004. The subsequent direct contracting is expected to improve market mechanisms in the energy sector (regulated by the Public Services Regulatory Commission). Tariff collection for consumed energy reached nearly 100% in 2004.

3.4. Implementation of exceptional financial assistance

Armenia has benefited from EC’s exceptional financial assistance which consists of a loan of EUR 28 million (disbursed in December 1998) and a total grant amount of up to EUR 30 million. Altogether five grant instalments, in the total amount of EUR 28.5 million, were paid under the assistance during the period 1998-2004. Through early principal repayments, Armenia has reduced the outstanding amount of its debt to the Community to EUR 2 million. The fifth grant instalment of EUR 5.5 million was paid in July 2004 after Armenia had made an early principal repayment of EUR 7 million to the EC as had been agreed with the Armenian authorities in the Memorandum of Understanding.

In April 2004, before proceeding with the above mentioned disbursement, the Commission carried out an “operational assessment” with the assistance of an external consultant in order to assess the soundness of financial circuits and administrative controls. On the basis of the report, the existing administrative procedures could be considered reliable.

The Commission services also agreed with the authorities on the conditions for the release of the sixth (final) grant instalment of EUR 1.5 million under the assistance. The policy conditions focus mainly on short-term measures in the area of public finance management (treasury, internal and external audit reform) as well as on tax and customs administration Shortcomings in tax and customs administration are prominent among the difficulties faced by foreign investors in Armenia, and these problems have been frequently on the agenda in EU-Armenia meetings in the context of the Partnership and Cooperation Agreement (PCA). The Commission services are also monitoring the adoption of new anti-money laundering legislation. In addition to satisfactory implementation of the agreed policy measures, the payment of the grant will be conditional on repayment of Armenia of its outstanding debt of EUR 2 million to the EC.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

No administratively set prices other than for utilities exist. Administered prices account for 8% of CPI basket.

2. Trade liberalisation

Liberal trade policy. Simple and relatively open import regime with a low average tariff structure. No quantitative restrictions. Accession to the WTO effective in February 2003.

3. Foreign exchange regime

Floating exchange rate of the dram with limited official intervention by the Central Bank of Armenia. No restrictions on current international transfers in conformity with Article VIII of the IMF's Articles of Agreement.

4. Foreign direct investment

Liberal policy towards foreign direct investment. Absence of restrictions on repatriation of profits and capital. Net FDI inflows 5% of GDP (2003).

5. Monetary policy

Low inflation environment maintained through prudent monetary policies conducted by the Central Bank of Armenia.

6. Public finances

Total fiscal revenues incl. grants estimated at around 16% of GDP (2004), of which tax revenues about 14 ½ % of GDP. Total expenditure estimated at about 17% of GDP. Medium-term expenditure framework has been integrated to the annual budget process, and a second generation treasury reform is underway.

7. Privatisation and enterprise restructuring

Private sector accounts for about 75% of GDP and employment. Most of commercially viable state-owned enterprises have been privatised (approx. 7300 small enterprises and 2000 medium and large scale enterprises).

8. Financial sector reform

Minimum capital requirement will be increased to the equivalent of USD 5 million in 2005. A deposit insurance scheme will become operational in 2005.

4. BOSNIA AND HERZEGOVINA

4.1. Executive summary

During 2004, Bosnia and Herzegovina maintained a stable macroeconomic environment, with inflation close to zero and growth rebounding from 3.5% of GDP in 2003 to an estimated 5% of GDP in 2004. After several consecutive years of fiscal consolidation, the budget deficit was in 2004 contained at 0.1% of GDP. Public expenditure remains on a high level, at 46% of GDP in 2004, although a declining trend has been achieved over the last years. The external imbalances remain significant, with a current account around 18% of GDP in 2004 despite increasing exports and inflows of FDI.

The Feasibility Study, as adopted in November 2003 by the Commission, identified 16 priorities on which BiH needs to make significant progress before further steps can be taken on negotiations of a Stabilisation and Association Agreement (SAA). During 2004 the authorities have to a large degree focused on the related areas for their reform efforts.

The implementation of the November 2002 Council Decision providing Bosnia and Herzegovina with up to EUR 60 million of macro-financial assistance is in the final stage of implementation. The first two tranches were disbursed, in February 2002 and in December2003/January 2004 respectively, after sufficient compliance with the attached conditionality. The third tranche has not yet been released. The Council Decision, originally expiring on 9 November 2004, has been amended in December 2004 by the Council to move forward the expiry date until 30 June 2005.

4.2. Macroeconomic performance

After a dip in the GDP growth rate in 2003, growth picked up again during 2004 to around 5% of GDP. A rebound in agricultural production and a sizeable increase in industrial production contributed positively to the increased growth. Industrial production grew by 13.6% in the Federation of Bosnia and Herzegovina (Federation) and by 10.3% in the Republika Srpska (RS) during the first three quarters of 2004 compared with the same period in the previous year. In the Federation the increase was mainly attributed to the processing industry and the energy sector while in the RS increasing production in the mining industry as well as the energy sector contributed the most to the rise.

BiH inflation is expected to have been contained to around zero in 2004. In September it stood, on an annual basis, at 0.1%, with an inflation rate of 1.9% in the RS against a mild deflationary trend of 0.5% in the Federation. Inflation in the RS has traditionally been higher than in the Federation, but the rates are steadily converging in the two entities. Through the Currency Board arrangement the Convertible Mark (KM) has been pegged to the euro at an unchanged rate since the introduction of the euro in January 1999. The level of gross official reserves has remained comfortable and covered around 4 months of imports in September 2004.

The size of public expenditure has been reduced from 50% of GDP in 2002 to 46% of GDP in 2004. However, this remains still a relatively high level, in particular in view of declining aid flows. Nevertheless, a remarkable fiscal consolidation has taken place, with the budget deficit after grants being reduced from 2.2% of GDP in 2002 (7.3% before grants) to 0.4% in 2003 (3% before grants). For 2004 a slight deficit of 0.1% of GDP is expected.

The external imbalances continue to be large, mainly driven by a sizeable trade deficit. During 2004 a few large privatisation deals materialised, which had a positive impact on FDI inflows. An improved export performance was also noticed, with exports having increased by 24% on an annual basis in September 2004, however from a very low basis. Despite these positive developments, the current account deficit remained at around 18% of GDP. Imports continued to grow, a result of increasing consumer demand fuelled by the continued expansion of consumer loans. Credit expansion is expected to slow down in 2005 and thereby rein in import growth, and the current account deficit is projected to be slightly lower in 2005.

External debt has been on the decline over the last years and is estimated to have equalled 34% of GDP at end 2004. An agreement on how to restructure and repay outstanding domestic debt claims was reached between the IMF and the authorities under the previous IMF programme. The deal would, if implemented as agreed, increase domestic debt by around 10% of GDP.

4.3. Structural reforms

In November 2003 the Commission finalised a Feasibility Study concerning the opening of negotiations on a SAA. It identifies 16 priorities on which BiH needs to make significant progress before the Commission recommends to the Council to open negotiations. During 2004 the Authorities have focused on related areas for their reform efforts and a large number of legislative measures have been adopted. In the economic sphere, the priority areas ranges from customs and taxation reforms, reforms on budget practice and legislation to the creation of a single economic space and trade related reforms.

Reforms in the area of public finance have continued. At entity levels, the implementation of the Treasury system has been completed, which contributed to increase transparency and resulted in a better control over commitments and savings. Implementation has also been completed at cantonal level and is ongoing in the RS municipalities. A new public procurement law was adopted in July 2004 and is expected to improve the quality of financial management of BiH public institutions.

An important area of reform has been indirect taxation and the creation of an Indirect Tax Authority (the ITA). The ITA board, comprising the finance ministers at Entity and State levels and their respective experts, started functioning during the first half of 2004. The main goals of the ITA will be to collect indirect taxes at the state-level, establish a unified customs administration and prepare the introduction of a state level VAT, which are important tasks in the context of strengthening of the single economic space and efficient revenue collection. An agreement on a single VAT rate of 17% was reached in 2004.

Privatisation of public enterprises has in general progressed slowly. The most advanced is the privatisation of small-scale publicly owned enterprises, mostly sold to local buyers. Recent progress has been recorded as regards the privatisation of larger and more strategically important enterprises, including large companies in the fields of mining and metal industry and these sales are likely to have a positive impact on the BiH economy as a whole. However, most of the remaining publicly owned companies are expected to be more difficult to sell, some of the reasons for this being over-indebtedness and the conditions of staffs' eligibility for social benefits. Courts are not fully capable of handling bankruptcy procedures and the large number of employees also complicates restructuring or liquidation and makes it a politically sensitive issue. These loss-making companies are a source of inefficient use of public resources, which negatively affects savings and investment.

The banking system is one of the sectors in BiH were the most rapid reforms and structural transformation have taken place. By end 2003, 90% of total capital in the banking sector was in private hands and the sector is at present dominated by foreign-owned banks. The regulatory framework as well as the enforcement of rules by the supervisory authorities has continued to be strengthened in 2004 and most banks do now also participate in the Deposit Insurance scheme. The sector has grown significantly during the last years: total assets of the banking sector increased from 41% of GDP in 2001 to 58% of GDP in 2003. Lending increased by 37% in 2002 and 25% in 2003, but the increase has so far been directed towards households rather than towards the corporate sector.

4.4. Implementation of macro-financial assistance

In November 2002 the Council approved Community macro-financial assistance of up to EUR 60 million to BiH (Decision 2002/883/EC), comprising a loan element of up to EUR 20 million and a grant element of up to EUR 40 million. The first tranche was disbursed in February 2003 (€15 million grant), following the approval by the IMF board of a new stand-by arrangement and the signature by the Commission and the BiH authorities of a Memorandum of Understanding (MoU) laying out the conditionality attached to the first two tranches. The second tranche was released in December 2003 (EUR 10 million grant) and January 2004 (EUR 10 million loan).

In June 2003 a Supplemental Memorandum of understanding was signed, outlining the economic policy conditions attached to the release of the third and last tranche of up to EUR 25 million. The conditions cover the areas of public finance and administration reform, private sector and business environment, financial sector reform and the area of statistics. Some of the conditions were closely linked to reforms in the context of the 16 priorities in the Feasibility Study.

A Commission staff mission visited Sarajevo and Banja Luka in June 2004 and found that significant progress had been made as regards third tranche conditions, in particular concerning banking sector reform and public finance and administration reform. However, some conditions were not yet met and further actions from the side of the Authorities were required before disbursement could take place. In addition, in August 2004 Commission-appointed consultants performed an "operational assessment", assessing the soundness of BiH's financial circuits and administrative controls. Based on the operational assessment's conclusions the Commission requested two measures to be implemented by the authorities before the third tranche could be disbursed. By the end of 2004, the economic policy conditions had been satisfactorily fulfilled by the authorities but further information (and possibly actions) related to the two above-mentioned measures were still required.

In order to allow the full implementation of this assistance, and given the expiry of the initial Council Decision on 9 November 2004, the Commission proposed in September an extension of this assistance until 30 June 2005, which the Council approved on 7 December 2004 (Council Decision 2004/861/EC) [2].

2 OJ L 370/80

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 BiH has started its process of negotiation to join the World Trade Organisation and has signed all the FTAs foreseen by the Stability Pact's Memorandum of Understanding on trade.
3. Exchange regime Since June 1998 BiH has a Currency Board Arrangement under which the national currency, the Convertible Mark (KM), is pegged to the Euro at the fixed rate of 1.96 KM.
4. Foreign direct investment Inflows of FDI have been hampered by the weak business climate and inconsistent frameworks between the two entities. Efforts during the last years to reduce bureaucracy and improve the overall business environment have to some extent succeeded and FDI increased by 20% during the first half of 2004 compared to first half of 2003.
5. Monetary policy The Central Bank of BiH is responsible for operating the Currency Board Arrangement and this arrangement limits the scope of monetary policy. The CBBH and other banks are prohibited from lending money to the government.
6. Public finances The share of public spending in GDP has been on a declining trend over the last years but remains large at around 46% of GDP in 2004, and public expenditure is often associated with large inefficiencies. However, significant fiscal consolidation has been achieved over time, together with tax harmonisation between entities. An important customs and taxation reform is underway (including VAT introduction).
7. Privatisation and enterprise restructuring While the privatisation of small and medium enterprises is virtually complete in both Entities, progress on the sale of large-scale 'strategic' enterprises, which could attract foreign investors, has lagged behind. In 2004 a few large privatisations with foreign buyers materialised, but remaining public companies are expected to be difficult to sell and are a source of inefficient use of resources.
8. Financial sector reform Banking supervision has continued to be strengthened and regulation improved. A Deposit Insurance Scheme covers most banks. The banking sectors in the two entities are still partly fragmented and are under the supervision of two separate agencies. However, the two agencies are expected to be put under the umbrella of the Central Bank.

5. GEORGIA

5.1. Executive summary

The Georgian economy continued to perform well in 2004. The reduction in the real GDP growth from 11.1% (revised figure for 2003) to 8.4% in 2004 is mainly due to negative growth in the agricultural sector. The construction of oil and gas pipelines through Georgia brought an additional stimulus which had spill over effects in the services sector.

Inflation remained broadly unchanged at 7.5% although the market driven appreciation of the Georgian lari did help to contain further inflationary pressures originating from the legalisation of the economy. The current account deficit (around 7.5% of GDP) did not deteriorate as much as expected because workers' remittances and other current transfers compensated for the increased import demand (mainly related to the pipeline projects). The new Government reinvigorated structural reforms in several areas and progress was visible already in the short-term.

Georgia resumed borrowing from the IMF in June 2004. The first review under the three-year PRGF arrangement was completed in December. Under the EC's Exceptional Financial Assistance, a grant tranche of EUR 6.5 million was paid in December after the Commission services had assessed the soundness of the financial circuits related to the management of this assistance in Georgia. The grant tranche had been pending since early 2003 when the condition on satisfactory implementation of the IMF-supported program was breached.

In June 2004, the Commission co-chaired with the World Bank a donors' conference on Georgia at which a total of EUR 850 million was pledged, including EC's pledge of EUR 125 million.

5.2. Macroeconomic performance

According to preliminary estimates, real GDP growth remained robust in 2004 at 8.4% (11.1% in 2003) despite negative growth in the agricultural sector (-3.6%). Manufacturing and construction were driving growth. Industrial production is estimated to have increased by 17%. The large oil and gas pipeline projects had also spill over effects in the services sector. Recent estimates indicate that the share of informal economy in the total output started to decline in 2004 following the authorities' actions against tax evasion. The national accounts may therefore also reflect inclusion of previously unaccounted activities. Estimates on the share of the shadow economy range from 40 up to 60%.

The fiscal policy was on a sound basis in 2004 owing to strong performance in revenue collection as a result of effective measures taken against tax evasion by the new Government. Tax revenues as a percentage of GDP are estimated at about 18% (14.5% in 2003). On cash basis, the fiscal deficit is estimated at around 1.5% of GDP as the stock of expenditure arrears was reduced rapidly, whereas on commitments basis a small surplus is estimated given some delays in planned capital expenditures. The Government expects that it will be able to clear all outstanding domestic expenditure arrears in 2005. These arrears totalled approximately 5% of GDP at the end of 2003. Domestic public debt was equivalent to about 11% of GDP at the end of 2004 (15% the year before). Yields on treasury bills have declined from a peak of 77% (October 2003) to 16% in February 2005.

Supported by steady re-monetisation, the National Bank of Georgia (NBG) has maintained a consistently prudent monetary policy stance. In 2004 the NBG allowed a market driven appreciation of the lari in order to contain inflationary expectations. The 12-month consumer price inflation stood broadly unchanged at 7.5% in December 2004 (7% the year before). The NBG intervened, however, in the foreign exchange market to smooth the appreciation trend, beginning to sterilise its interventions towards the end of the year through the limited instruments at its disposal. Nevertheless, the lari appreciated about 15% in real effective terms during 2004. The demand for lari increased partly as a result of the Government's actions against tax evasion and smuggling. Dollarization has been persistent in Georgia, but in 2004 the share of foreign currency deposits started to decline to below 80% of all deposits for the first time in several years.

The increase in the current account deficit (due to high import demand for the construction of the Baku-Tbilisi-Ceyhan pipeline) was not as high as expected given the strong inflows of remittances and other current transfers. According to preliminary estimates, the current account deficit was about 7.5% of GDP (7.2% in 2003). The gross international reserves of the NBU increased substantially during 2004, but still covered only two months of imports at the end of the year.

Georgia's public external debt remained broadly unchanged in nominal terms at about USD 1.8 billion, while as a ratio to GDP the external debt decreased substantially from 46% in 2003 to about 37% at the end of 2004. During the second half of 2004, Georgia concluded agreements with most of its bilateral creditors (most importantly with Russia) in line with the July 2004 Paris Club agreement which is expected to reduce debt service due to Paris Club creditors from USD 169.2 million to USD 46.4 million (under "Houston terms") over three years. The Paris Club creditors also expressed their willingness to consider a debt treatment under the Evian Approach on terms tailored to Georgia's debt situation after the current agreement expires provided that Georgia has demonstrated a satisfactory track record by that time.

5.3. Structural reform

During the first year in office the new Government made progress in tackling tax evasion, smuggling and corruption. The civil service has been downsized dramatically while public sector wages are being increased. About 30,000 positions were cut (23% of the public workforce) the largest cuts being in the traffic police and internal security. Tax and customs offices were also restructured and the number of staff retrenched. Privatisation has been resumed, including new legislation on land privatisation which had effectively stalled some years ago (75% of land still remains in state ownership). A list of 372 non-strategic assets, including several from the Autonomous Republic of Adjara, was drawn for privatisation in the short-term. Most remaining state-owned SMEs are expected to be sold fairly quickly without major problems while in case of larger enterprises careful preparation and transparency of tender procedures would be important for successful privatisation.

A new liberal tax code became effective in January 2005 following the examples from several Eastern European countries. The number of taxes was reduced from 21 to 8. A flat-rate personal income tax (12%) replaced marginal rates between 12 and 20%, and the payroll tax was reduced from 33% to 20%. The VAT rate will be reduced from 20% to 18% in mid-2005. These revenue losses are compensated by raising excise taxes and by eliminating various exemptions. To boost the legalisation of the informal economy, fiscal amnesty is provided for undeclared income and property acquired before the end of 2003 (government officials are excluded). A revision of the customs code is also planned.

Under the new Budget System Law, significant steps were taken in public finance management reforms during 2004, including effective introduction of a single treasury revenue account, improvement of commitments control and consolidation of extra-budgetary funds in the budget system. The VAT refund mechanism has become fully operational. Preparations for the introduction of a Medium-Term Expenditure Framework (as of the 2006 state budget) were also launched, supported by the EC and other donors.

Progress is also expected in other key areas, such as the energy sector rehabilitation, which would however require substantial new investments over several years as only some very basic repairs have been made so far. The IMF has estimated that in 2004 the energy sector's quasi-fiscal losses were reduced somewhat to about 4.5% of GDP (4.9% in 2003) following a gradual increase in electricity cash collections from main customers. Measures were also taken to reduce the theft of electricity but technical losses remain large. The legacy debt of the energy sector still has to be dealt with (estimated to total at least the equivalent of EUR 400 million). Electricity generating companies are being prepared for privatisation, starting from 2005. A new Regulatory Commission has been appointed to oversee the energy sector and it enjoys independence in setting energy tariffs.

In May 2004 Georgia ratified the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime, and is currently considering how to further improve the anti-money laundering system in the country. The banking sector is being consolidated through increases in the minimum capital requirements for commercial banks from GEL 5 million to GEL 12 million (approx. EUR 5 million) by 2008. The NBG has also strengthened regulations on single party and connected lending. The ratio of non-performing loans to total commercial bank loans decreased from 7.5% to 5.5% during 2004. The development of the non-bank financial sector is still in its infancy.

5.4. Implementation of exceptional financial assistance

Following the regime change after the resignation of president Shevardnadze in November 2003, the new Government engaged quickly in discussions with the IMF staff on a successor arrangement under the Poverty Reduction and Growth Facility. The IMF Board approved a new three-year PRGF-supported program for Georgia on 4 June 2004 in the amount of SDR 98 million. Thereafter, the Commission services were in a position to resume the exceptional financial assistance to Georgia which had been effectively off track in parallel with the previous IMF-program since early 2003.

European Community's exceptional financial assistance had been made available to Georgia in the form of a loan of EUR 110 million (disbursed in July 1998) and a total grant amount of up to EUR 65 million foreseen to be paid in several annual instalments. Altogether four grant instalments, in the total amount of EUR 31.5 million, were paid under the assistance in the period 1998-2004. Through early principal repayments, Georgia has reduced the outstanding amount of its debt to the Community to EUR 85.5 million. Repayments of the debt are scheduled to start in 2009.

The conditions for the release of the fourth grant instalment had been agreed with the Georgian authorities in early 2002. One year later, in the light of the mixed progress in the implementation of the policy measures, the Commission services agreed with the Georgian authorities to set the amount of the grant instalment at EUR 6.5 million (instead of the maximum amount of EUR 11.5 million), conditional on an early debt repayment by Georgia to the EC. After Georgia had reached agreement with the IMF in June 2004, the EC agreed to limit the amount of the early debt repayment to EUR 6.5 million. Before proceeding with the payment of the grant in December 2004, the Commission conducted an Operational Assessment of the financial circuits and administrative procedures related to the management of the macro-financial assistance in Georgia. The Assessment showed that substantial progress had been made at the Ministry of Finance and the National Bank of Georgia in the relevant areas.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

No administratively set prices exist outside the utilities sector. Administered prices account for about 3% of the CPI basket.

2. Trade liberalisation

Liberal trade policy. Georgia has been member of the WTO since June 2002. Based on margins allowed during WTO accession Georgia raised the number of tariff bands and the maximum tariff which led to an increase in the weighted average tariff to about 11%. Non-tariff barriers allowed for environmental, security and health reasons only in line with the PCA.

3. Foreign exchange regime

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

4. Foreign direct investment

Adequate overall legislation. Unlimited repatriation of capital and profits. Net inflows of FDI 8% of GDP.

5. Monetary policy

Prudent monetary policy has contributed to the stabilisation of the inflation at a low level. Dollarisation of the economy remains high (slightly below 80% of total deposits are in foreign exchange).

6. Public finances

Total fiscal revenues (including grants) estimated at 21% of GDP (2004), of which tax revenues 18% of GDP. Total expenditure and net lending estimated at about 20% of GDP (2004). Under the new Budget System Law, which became effective on January 1, 2004, the treasury system is being reformed, including the introduction of a Single Treasury Account System. A new liberal tax code is effective as of January 1, 2005.

7. Privatisation and enterprise restructuring

The private sector accounts for about 65% of GDP. Small scale privatisation largely completed while large scale privatisation continued to face problems. A new privatisation programme of 372 non-strategic companies underway in 2004 and 2005. New legislation under discussion on accelerating land privatisation.

8. Financial sector reform

There are 24 operating banks (of which 6 foreign-owned). Further consolidation is expected as the minimum capital requirement will be increased to GEL 12 million (approx. EUR 4.6 million) by 2008.

6. MOLDOVA

6.1. Executive summary

The upswing that began in 2000 continued in 2004, as year-on-year GDP growth exceeded 7%. Growing exports and buoyant remittances from Moldavians working abroad continue to drive the economy's expansion. Domestic demand is strong and industrial production is continuing its recovery.

Although exports grew strongly, the dynamics of imports were even more pronounced, so that Moldova's large trade deficit rose further. As a result, the current account deficit rose too, reaching around 7% of GDP.

Inflation that had accelerated sharply on the back of sustained money supply growth in 2003 moderated gradually in 2004 but was still well above 10%: the consumer price index rose by 12.5%, compared to 4.4% in 2002.

Fiscal policy was loosened considerably in the run-up to parliamentary election in spring 2005; a financing gap in the general government account emerged, as increase in spending overshot significantly additional budget revenue. Thanks to debt restructuring agreements with several public and private creditors, the public debt-to-GDP ratio has dropped further significantly, to around 36%, the burden of servicing debts remains high (debt service due would absorb nearly one fifth of central government revenues). Hence, dependence on capital flows from multilateral and bilateral creditors is set to remain high in the medium term. Also, Moldova has reduced significantly its stock of arrears, while still accumulating some new arrears.

Despite progress in adopting some new legislation and introducing some deregulation, the overall situation in the area of structural reform remains disappointing. About half of the economy is still controlled by the State, the government interferes in the economic activity heavily and in a non-transparent way and corruption is pervasive. In May 2004 the government adopted the Economic Growth and Poverty Reduction Strategy Paper but serious questions remain on the authorities' commitment to implement it.

Moldova received no EC-macro-financial assistance in 2004. Disbursements under the grant of EUR 15 million approved in December 2002 could not start in the absence of a working financing arrangement with the IMF

6.2. Macroeconomic performance

Moldova's economic recovery continued in 2004, with real GDP growth accelerating from 6.3% the year-before to 7.3%. The upswing is driven by sustained growth in Moldova's main trading partners Russia and Ukraine and, more importantly, by a rising domestic demand resulting from booming workers' remittances. Both exports and imports grew strongly, by about 25% in current dollar terms. As a result, the trade deficit increased further in absolute terms but remained broadly unchanged as part of GDP (at about one third).

Inflation that had picked up in 2003 – the twelve-month consumer price index (CPI) had reached its highest point of 17% in October 2003 – moderated gradually in 2004 to an end-year figure of some 12.5%. Inflation has been fuelled by strong domestic spending accommodated by rapid money growth resulting from continued large inflows of remittances. Easing of inflationary pressures allowed the National Bank of Moldova (NBM) to step up its interventions on the foreign exchange market during 2004 in order to accumulate international reserves and contain the appreciation of leu, Moldova's currency. The build up of inflationary pressures in 2003-2004 (the CPI had increased less than 5% in 2002) raises the issue of the right balance between different, sometimes conflicting, policy objectives of the NBM. The National Bank is expected to switch to somewhat tighter monetary policy aimed at bringing down inflation while continuing building up reserves.

In the run-up to parliamentary election in spring 2005, the fiscal stance during 2004 was loosened considerably. While revenue performance exceeded the original budget projections (owing to aggressive tax collection and higher-than-expected inflation), primary expenditure overshot the budget plans by an estimated 2.5% of GDP. With limited non-tax financing (revenue from external grants and privatisation receipts was well below expectations), the government had to increasingly make recourse to bank financing and continued to run arrears on bilateral debt (at the same time it had resumed some payments to the Paris Club although arrears remain to be cleared). As a result, the central budget surplus was cut from USD 27.4 million to USD 5 million. The general government account in 2004 turned to a deficit of more than 1% of GDP, both on cash and commitment basis, from a surplus in 2003. It is expected to increase to 2.5% of GDP in 2005.

In the course of 2004, Moldova has managed to cut its public external debt to below USD 1 billion or 36% of GDP (down from 52% of GDP one year earlier). Non-publicly guaranteed external debt is of a comparable amount. The current level of Moldova's debt reflects a series of restructuring agreements that have reduced the value of the outstanding debt over time. The latest debt deals covered debt owed to the Russian gas supplier Gazprom (that reduced total debt by over $60 million), the U.S. firm Hewlett-Packard, Turkey's EXIM Bank and Romania. Debt arrears were also reduced by half (from USD 86 million at end-2003 to an estimated USD 41million at end-2004) through buybacks and rescheduling. Yet, arrears still represented more than 2% of GDP, out of which nearly half in new arrears accumulated in 2004. Servicing of the debt remains a difficult and challenging task: in 2004, payments falling due amounted to nearly 20% of central government revenue. Given low foreign exchange reserves (just two months of imports) and the substantial structural current account deficit, which has worsened over time and in 2003-2004 accounted for around 7% of GDP, the country is expected to remain dependent on additional support from the IFIs and bilateral donors. Indeed, the large official transfers, and a high level of remittances from abroad can only partly mitigate the chronically high merchandise trade deficit.

6.3. Structural reform

In the initial phases of transition, in the 1990s, when it implemented successfully the first generation of reforms, Moldova was considered as one of the most advanced reformers in the CIS. Reform momentum lapsed subsequently, not least as a result of political shifts. Although the government remains basically committed to free-market policies, implementation has generally been slow and hesitant. The most frequent complaints are that the administration tends to interfere heavily and in a non-transparent manner in the business activity; that there is widespread corruption; that the burden of complying with regulations even on minor issues is extremely heavy, and finally, that foreign investors are discriminated against or harassed. Two important foreign investors, France's Lafarge and Spain's Union Fenosa, were involved in high-profile disputes that lasted for years and were only recently sorted out (successfully).

There have been no fundamental changes in this respect in 2004 even if attempts were made to improve conditions for business activity and SME development and attract foreign investment. So, the authorities made real efforts to simplify licensing and business registration requirements and introduced new legislation on microfinance and investment (the new investment law unifies treatment of domestic and foreign investors). Also, they approved a new anti-corruption strategy and made some progress in the fiscal reform. Yet, at the same time, the government's interventions in the economy remained widespread, formal and informal trade restrictions are still in place and there has been virtually no progresses in privatisation – the government-owned enterprises still produce about half of the total output. The result is that Moldova's business environment is still considered to be among the most difficult in the region and investments are very low.

One more attempt to make a new start in structural reform in Moldova was the adoption by the government of the final version of the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) in May 2004. The EGPRSP covers the period from 2004 to 2006; it includes a poverty diagnosis, sectored programmes and an overall policy strategy addressing the issues of sustainable economic growth, human development and social protection and inclusion. The strategy identifies a sound business environment, prudent macroeconomic management and better infrastructure as key prerequisites for sustainable growth. The EGPRSP also includes the costing of the proposed programmes within a Medium-Term Expenditure Framework (MTEF).

In the IMF-World Bank Joint Staff Assessment (JSA) of the Moldova EGPRSP completed at end-2004, the two institutions, while giving it a cautious overall positive judgement, identified a number of weaknesses. These might be captured under two headings – weaknesses of the strategy itself and implementation risks.

Weaknesses of the strategy refer essentially to the financing of the EGPRSP. The existing MTEF is not considered realistically capable of bringing Moldova's public finance on a sustainable footing. The MTEF contains revenue projections that seem too optimistic; furthermore, it assumes large unidentified financing and a continued default on scheduled amortisation payments to some bilateral creditors. Also, the MTEF projects marked increases in public sector wages and, more generally, in public expenditure; the costing of many programmes is questionable. The implicit assumption, that Moldova would reach agreement on an IMF programme, thus unlocking financial support from IFIs and donors, also looks optimistic at this juncture. At the same time, a significant part of the spending envisaged under the EGPRSP has not been included in the MTEF, which calls into question the implementation of many of the measures foreseen in the strategy. The apparent lack of resources suggests that the EGPRSP does not at present prioritise sufficiently between different expenditure needs.

Coming to the implementation risks, a major issue appears to be ownership of the EGPRSP. There is indeed much scepticism about the political commitment the strategy enjoys, not least given that it departs markedly from the government's 2001 Economic Revival Programme. It has been noted by many observers that actions on the ground seem to contradict heavily the spirit of the EGPRSP.

6.4. Implementation of exceptional financial assistance

Between 1994 and 2000, the European Community provided to Moldova three macro-financial assistance packages in the form of medium-term loans. The first two packages worth EUR 45 million and EUR 15 million were disbursed. Moldova has so far serviced scrupulously its external financial obligations towards the Community. The last MFA loan package amounting to EUR 15 million, decided in 2000, was cancelled in December 2002 and replaced by a grant of an equivalent amount.

The implementation of the Community MFA grant to Moldova that could not start in 2003 in the absence of a working financing arrangement with the IMF was still on hold in 2004. The Council Decision on the grant assistance expires at the end of 2005.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices have been liberalised.

2. Trade liberalisation

Relatively liberal international trade policy on paper, but formal or informal restrictions on some key commodities exist (notably sunflower seed ad scrap metal). Moldova became a member of the WTO in June 2000.

3. Exchange regime

The leu is convertible for current account operations. Floating exchange rate.

4. Foreign direct investment

Unlimited repatriation of capital and profits and no limitations on holding foreign currency bank accounts. Adequate overall legislation, but implementation is often problematic, which weakens the business climate. A new investment law introducing equal treatment of domestic and foreign investors adopted in 2004. There had been a trend toward increasing administrative interference on foreign investors, notably in the energy sector. FDI has been declining.

5. Monetary policy

High money supply growth, due largely to un-sterilised forex accumulation, have led to a sharp acceleration of inflation. Some slowing of inflation achieved in the second half of 2004. The National Bank expected to pursue a tighter policy course aimed at curbing inflation further while still continuing to accumulate forex reserves.

6. Public finances

Fiscal stance loosened in 2004. While budget revenue increased as a result of strengthened fiscal discipline, expenditure grew more. The result was a return to a small deficit in the general government account. Widening of the deficit is expected in 2005. Public external debt was cut to about 36% of GDP following debt buybacks and re-scheduling. Foreign debt arrears were reduced by half to 2% of GDP but new arrears appeared. 2004 debt service absorbed over one fifth of central government revenue.

7. Privatisation and enterprise restructuring

Structural reforms have slowed. The transformation to a market economy is far from complete. Privatisation of the key economic sectors suffered delays and are currently made difficult by bad market sentiment. However, some limited simplification of rules for businesses was introduced in 2004. An EGPRSP was adopted in 2004 which identified necessary structural reforms.

8. Financial sector reform

The financial sector is in a relatively good shape, but further strengthening is crucial to mobilize savings and promote investment. Although the share of bad loans has been declining, given rapid credit growth, attention will have to be maintained to prevent vulnerabilities.

7. ROMANIA

7.1. Implementation of macro-financial assistance

Since 1991, the EU has supported Romania's transition process through four macro-financial assistance operations. The latest one was approved in November 1999 when the EU Council granted Romania a balance-of-payments loan of up to EUR 200 million (Council Decision 99/732/EC), within the framework of a SDR 400 million IMF Stand-By Arrangement (SBA). After the release of the first EUR 100 million tranche in June 2000, however, the IMF programme went off-track and eventually expired. No further disbursements of EC macro-financial assistance could therefore take place.

In January 2002, pursuant to Council decision 99/732/EC, the EU Council agreed in principle to make available to Romania EUR 100 million in two sub-tranches subject to the satisfactory implementation of a 18-month SBA agreed with the IMF and provided the country makes adequate progress in its structural adjustment process. A Supplemental Loan Agreement and a Supplemental Memorandum of Understanding (SMOU) were signed in November 2002. Conditions for the disbursement of the first sub-tranche of EUR 50 million were fulfilled in the first half of 2003, and disbursement took place on 17 July 2003.

In the context of a 24-month SBA agreed with the IMF on 7 July 2004, which in the absence of any immediate balance-of-payments financing needs is considered a precautionary arrangement only, i.e. without any foreseen disbursements by the IMF, it was decided on 16 July 2004 to deactivate the MFA operation with Romania. Council Decision 99/732/EC providing the legal framework for the operation will remain in force. Should the need arise in the future, this assistance could be reactivated.

8. SERBIA AND MONTENEGRO

8.1. Executive summary

The economic performance of Serbia and Montenegro has improved in 2004 due to strong domestic demand driven by real wage increases and rapid credit growth. GDP is estimated to have grown by 7.2%, reflecting a recovery in industrial output and a rebound in agricultural production. Inflation has accelerated and reached 13.4%. The external sector remains vulnerable given the country's weak export performance. Financing requirements continue to be high, resulting from rising debt service obligations, as well as investment needs and buoyant private and government consumption. In Serbia, reform momentum has partly been regained following the creation of a new government in March 2004. In particular, a large number of laws in the economic and financial sphere have been adopted by the Serbian Parliament since then. However, privatisation efforts slowed in the first part of 2004 and the restructuring of large socially owned enterprises and public utilities has not started yet. The payment of the third tranche under the current macro-financial assistance to the country was delayed due to insufficient progress in implementing structural reforms. However, reform momentum was regained in the second half of 2004 and the grant element of the third tranche of EUR 10 million was paid in December 2004, leaving the last disbursement of the loan element of EUR 15 million to be made in 2005.

8.2. Macroeconomic performance

In 2004, real GDP growth in Serbia and Montenegro reached 7.2%, reflecting a robust recovery in agricultural production and rising industrial output. Twelve-month inflation (end-period) accelerated in Serbia to 13.7% in 2004 (from 7.6% in 2003), driven by buoyant domestic demand, increases in administered prices and the rising cost of fuel imports. In Montenegro twelve-month inflation reached 3.4% in 2004.

In 2004, the consolidated general budget deficit of Serbia was reduced to 1.7% of GDP. Reflecting strong domestic demand and improved tax enforcement efforts, the revenue performance of the republican and local budgets was better than expected. In particular customs and excise revenues grew strongly. Expenditures were generally under tight control, although new social security arrears vis-à-vis the private sector was recorded. In Montenegro, the budget deficit reached 2.5% in 2004, better than projected.

In 2004, the National Bank of Serbia followed a policy to balance the objective of maintaining price stability with external competitiveness and continued to implement its flexible managed float" policy. As a result, the nominal effective exchange rate depreciated by over 15% and in real terms depreciated by 3-4%.

The current account deficit of Serbia increased further in 2004 and is estimated to have reached 13% of GDP, boosted by rising import. While export growth lagged behind, exports accelerated in the second half of 2004, partially as an effect of past privatisations. Private remittances continued to be high at 14% of GDP while FDI reached a mere 4% of GDP, reflecting a slowdown of privatisation in the first half of the year. Net foreign reserves rose to about EUR 3 billion (3.2 months of projected

2005 imports at end December 2004). In Montenegro, the current account deficit is estimated to have reached about 10% of GDP in 2004, with FDI inflows of about EUR 50 million, mainly in the form of investments in the tourism sector.

The completion of negotiations with the London Club of creditors contributed to reduce the level of external debt by 7% of GDP. However, an increasing share of the external deficit is financed by debt which has contributed in keeping the debt-to-GDP ratio at a projected 56% of GDP at end-2004. Therefore, external sustainability remains a major challenge for Serbia and Montenegro, since debt service obligations are projected to rise materially to about 4% of GDP and 16% of exports of goods and services in 2005.

8.3. Structural Reforms

With respect to structural reforms some new momentum has been gained following the creation of a new government in Serbia in March 2004. In particular, a substantial legislative agenda has been submitted to the Serbian Parliament. Around 50 new laws, mainly in the economic and financial sphere, have been adopted in the second half of 2004 or were by the end of the year in the process of being voted, notably on bankruptcy, investment promotion, company registration, foreign trade, insurance, indirect taxation, and energy and railway. Moreover, the process of privatisation seems to be on the way to regain momentum. Tenders for three banks have been opened by September and more were expected to follow in due course. However the restructuring of large socially owned enterprises and public utilities, which has not yet really started, still represents a major challenge for economic policies in the future.

With increasingly less marketable enterprises in the pipeline, privatisation receipts have declined in 2004. Following rapid privatisation of socially-owned enterprises through tenders, auctions, and share sales in 2003, the process slowed down considerably in early 2004, reflecting political developments and a legal challenge to the modalities of share sales. Despite the new government's renewed commitment to privatisation in the second half of 2004, successful sales of socially-owned enterprises have declined given the predominance of less attractive heavily indebted and overstaffed enterprises in the pipeline.

In Montenegro, the Niksic steel company was sold in May 2004, and tenders have been launched for large enterprises including major units of the Podgorica Aluminium Plant (KAP), the tobacco company and the state telecommunications monopoly. The government has offered 13 hotels for sale, of which nine have been sold.

Bank privatisation has gathered new pace in Serbia in 2004. By end-June, reporting and control mechanisms have been strengthened in all banks with majority state ownership to preserve their value prior to privatization/resolution, and essentially all London Club obligations will be converted into state equity, removing an impediment to privatization. Following the successful launch of the first bank privatization tender in spring 2004 for Jubanka, tenders for two additional banks (Novosadska and Continental Banka) were launched in the fall of 2004.

As of end 2003, in Montenegro 10 banks were active. Progress in bank privatisation and supervision continued in 2004. The government intended to launch international tenders by mid-2005 to sell one of the largest banks, and to prepare a strategy to divest all remaining state-minority holdings in banks. Efforts to collect assets carved out from the banking sector will be intensified. The Central Bank of Montenegro has implemented most of the Basel Core Principles, and is working on implementing the remaining ones. A Financial Investigation Unit was recently created as foreseen according to the Anti-Money Laundering Law.

8.4. Implementation of macro-financial assistance

Following a first EUR 345 million packages implemented in 2001/2002, the Council decided in early November 2002 to provide the country with Community macro-financial assistance of up to €130 million. The objective of this assistance is to underpin economic policies in the context of the three-year IMF Extended Arrangement (2002-2005) approved in May 2002 and in particular to support the balance of payments and strengthen the foreign exchange position of the country. A Memorandum of Understanding (MoU) was negotiated and agreed between the Commission Services and the authorities in December 2002. It specified the economic policy conditions and structural measures for the release of the second and the third tranche of this assistance. The authorities have agreed to allocate 90% of the proceeds under this assistance to Serbia and 10% to Montenegro.

The first and second tranches, respectively of EUR 40 million and EUR 65 million were released in 2002 and 2003. The implementation of the third, EUR 25 million, tranche was delayed until late 2004 due to lack of progress in the implementation of a number of structural reforms.

In addition, in July 2004, DG ECFIN commissioned an external consultant with the task to assess the administrative procedures and financial circuits of the Finance Ministries and Central Banks, and the processes involved in macro-financial assistance in order to ensure that the beneficiary countries of MFA maintain a sufficient control environment. These assessments concluded that for both Republics a framework for sound financial management of the Finance Ministry and Central Bank is effective regarding the formal internal control requirements. However, in the case of Serbia, additional measures were recommended to strengthen the framework of financial control at the Finance Ministry. In light of these findings, it was agreed with the authorities to implemented additional measures, before the third MFA tranche was paid.

Following further progress in the second half of 2004, compliance with the agreed conditionality and with the additional measures as regards strengthening financial control, was considered by the end of the year as satisfactory, enabling the release of the third tranche. The grant element of EUR 10 million was paid in December 2004, leaving the EUR 15 million loan element to be paid in 2005.

In November 2003, the Council also decided to increase the current macro-financial package by EUR 70 million to up to EUR 200 million the EC assistance, through a revision of the Council Decision of November 2002, in order to help addressing additional financing needs identified by the IMF in the context of the current stabilisation programme. Pending compliance with the third tranche conditions the modalities of this additional assistance, including the precise tranching and attached conditionality, still remained to be negotiated with the authorities, and, in preparation of that, a Commission services mission took place in February 2005.

In order to allow the full implementation of this assistance, and given the expiry of the initial Council Decision on 9 November 2004, the Commission proposed in September an extension of this assistance until 30 June 2006, which the Council approved on 7 December 2004 (Council Decision 2004/862/EC).

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most price categories are liberalised except for some public services and utilities. Energy prices are being gradually adjusted towards cost recovery levels in both Republics. In 2004, further adjustments in electricity prices took place to bring them close to cost recovery levels, contributing to a resumption of inflation.

2. Trade liberalisation

Further regional trade liberalisation is ensured by the ratification of a number of free trade agreements that SCG concluded with the neighbouring countries under the Stability Pact initiative. Substantial, but incomplete harmonisation of tariff rates of Serbia and Montenegro took place during 2003, with an attempt to create an internal market between the two republics. However, no agreement on the harmonisation of agricultural tariffs, alignment of import levies and a vast of non-tariff barriers has been reached. Consequently, two separate applications for WTO membership have been submitted.

3. Exchange regime

Managed floating system in Serbia under which the nominal exchange rate was kept rather stable in 2001 and 2002 leading to a substantial real appreciation of around 50% during that period, though from a supposedly undervalued level at end-2000. In 2004, the nominal effective exchange rate depreciated by 15% and in real terms by 3-4%. Following the unilateral introduction of the German mark in Montenegro in 1999, the euro is now the sole legal tender in the republic. Higher inflation in Montenegro compared to the euro-area implies a substantial real appreciation.

4. Foreign Direct Investment

Appropriate legislation as well as a foreign investment promotion agency is in place. FDI is largely related to large privatisation deals; greenfield and equity investments remain low. In 2004, FDI is expected to have declined to 4% of GDP. FDI inflows to Montenegro amounted to about € 50 million, consisting mainly of investment in the tourism sector.

5. Monetary policy

In Serbia, continuation of stability-oriented monetary policy in 2004; balancing the objective of price stability with the goal of preserving external competitiveness. Annual inflation accelerated in Serbia to 13.7% in 2004, from 7.6% in 2003, driven by buoyant domestic demand, increases in administered prices and the rising cost of fuel imports. In Montenegro, given the adoption of the euro as sole legal tender the scope for an independent monetary policy is very limited and annual inflation reached 3.4% in 2004.

6. Public Finance

Further progress with reforms aimed at improving expenditure control in both republics, but continued need for further fiscal consolidation and prioritisation of public spending. VAT was introduced in Montenegro in April; its introduction was postponed to January 2005 in Serbia. Major reform step in Serbia was the transfer of all direct spending units to the single Treasury account and the steps to establish a centralised payroll system under the Treasury.

7. Privatisation and Enterprise Restructuring

Privatisation efforts slowed in the first part of 2004, but recovered in the remainder of the year. However, the restructuring of large socially owned enterprises and public utilities has not started yet. In Montenegro, the privatisation of parts of the giant Aluminium factory and of the telecommunication company is well advanced.

8. Financial Sector Reform

Banking supervision has been strengthened in both republics. The process of bank restructuring and privatisation in Serbia has been accelerated in the second half of 2004 and three state-owned banks have been offered for tender sale. In Montenegro, the privatisation of the last state-owned bank Podgorica Banka is under preparation.

9. TAJIKISTAN

9.1. Executive summary

Tajikistan's economy has continued to grow strongly last year, despite dampening effects from the landslides and floods in July. Strong output growth was recorded in the industrial and in the agricultural sector, leading to a real GDP growth of an estimated 10.5% for 2004.

Mixed results are noted in the area of structural reforms. A new, simplified Tax and Customs Code has been adopted last November, which should enable a rise in tax collection. A new privatisation strategy for 2003-07 was approved in November 2003, stipulating that state-owned enterprises - with a few exceptions - will be privatised, restructured or liquidated. The restructuring and privatisation of farms is progressing, despite a number of remaining barriers. A Code of Ethics for civil servants was adopted by Presidential Decree on 14th June 2004, as part of a broader civil service reform.

The fourth (2003) grant instalment of the Exceptional Financial Assistance to Tajikistan - EUR 7 million – is expected to be disbursed as soon as the country has completed the early debt repayment of EUR 8 million. This would bring the outstanding debt of Tajikistan towards the EC to EUR 36 million and the grant disbursements would total EUR 28 million. The fifth (2004) instalment will be released depending on the findings of a review mission planned for the second quarter of 2005and following another early debt repayment of EUR 8 million.

9.2. Macroeconomic performance

Tajikistan's economy has continued to grow strongly last year, despite dampening effects from the landslides and floods in July. In the first eleven months of 2004, output in the industrial sector rose by 16% year on year and the agricultural sector posted year-on-year growth of 15,4%, boosted by an increase in the cotton harvest. Real GDP growth for 2004 as a whole is likely to reach a post-independence record at about 10.5%.

The government has been targeting a broadly feasible budget deficit of 0.5% of GDP for the full year, which incorporates a rise in spending in areas such as health and education. As for the 2005 budget, the government has claimed that 46% of total expenditure will be directed to the social sphere, in line with its commitment under the Poverty Reduction Strategy Paper (PRSP).

Floods in July affected the availability of food products and caused inflationary pressure. However, this was offset by the combination of a more favourable grain harvest and tighter monetary policy. Annual average inflation is estimated at 7.5%, compared to more than 16% in 2003.

At end-2003, total external debt amounted to USD 1 billion (73% of GDP), of which 30% was owed to the largest creditor Russia. In October 2004, a bilateral agreement was signed, writing off USD 242 million out of Tajikistan's bilateral debt towards Russia. Tajikistan would settle the remainder of the debt by 31 December 2008 through a debt-to-equity swap (by giving Russia a share in a major hydropower plant). This agreement implies that the Tajik external debt is expected to fall to USD 700 million or about 50% of GDP.

Aluminium and cotton continue to dominate exports, but revenue from electricity (hydropower) sales should increase in the coming years. Global prices for aluminium have reached record highs in 2004, boosted in particular by strong demand in China. Global cotton prices have been on a downward trend throughout 2004, but remain strong compared with previous years. However, high export revenues and significant migrants' remittances were more than offset by import increases associated with rapid growth. As a consequence, the current account deficit widened from 1.3% in 2003 to an estimated 1.9% in 2004. Import coverage of gross official reserves increased from 1.8 months in 2003 to 2.3 months by end-2004.

9.3. Structural reforms

On the revenue side, a modernisation office has been established charged with overseeing reforms to the tax and customs system. Tax revenue is supposed to be boosted by the new, simplified Tax and Customs Code adopted on 3 November 2004 by the Parliament. A two-tier income tax with a rate of 8% (previously 10%) for those who earn less than somoni 100/month (USD 33/month) and a 13% rate for those earning above this level has been introduced. Further, it foresees a single land tax for farmers, replacing the five different taxes applied before. The new Tax Code also contains tax provisions for foreign investors, exempting them from all taxes for up to five years, depending on the size of their investment. Weak enforcement of the new legislation is likely to remain a problem.

A new privatisation strategy for 2003-07 was approved in November 2003. State-owned enterprises, with a few exceptions, will be privatised, restructured (if direct privatisation is not feasible) or liquidated. Three groups of enterprises are distinguished. The small enterprises of the first group (422 in total) will be privatised through auctions; those in the second group (104 medium-sized companies) will be sold through competitive tender; the third group of 37 large and strategic enterprises will be dealt with individually, with specific privatisation and restructuring programmes to be developed for each. This group includes the aluminium smelter Tadaz, the electric power telecom and railways monopolies, the airline and the state television companies. A total of 71 enterprises have already been privatised in the first half of 2004. However, many could only be sold after several auctions and below the original minimum prices. Ninety percent of the assets went to domestic investors.

In September 2004, the State Land Committee completed the inspection of the land reform process in 59 cities and districts of the country. Altogether, by 1st of June 2004, 21.281 Dehkan farms (private farms) have been created on the basis of restructured farms. In general, progress in farm privatisation has been hindered by the indebtedness of state-owned farms. According to the government, state farms have accumulated USD 255 million in debt, of which 66% is owed to private foreign creditors. The private debt burden alone is equivalent to 130% of cotton exports. In January 2004, the government agreed to write off USD 80 million in state debt, but the issue of the private debt is unresolved. One option under consideration is to swap the existing external debt for temporary cotton marketing rights.

A Code of Ethics for civil servants was adopted by Presidential Decree on 14th June 2004. The Code applies to all levels of civil service (from Ministers to local civil servants) and requires them to perform in a professional, fair and independent way. The adoption of this text is supposed to be part of a broader civil service reform. Within the National Bank of Tajikistan (NBT), extensive reforms were already undertaken, following recommendations by the IMF. Staff was reduced by 20% and at the same time wages have increased considerably. Training programs were set up in order to improve competences of the officials. President Rahmonov signed a Decree on 4 November 2004 raising the minimum wage and salaries of government employees as of 1 January 2005. Salaries of civil servants in science, health care and social sectors would raise by 100%, while salaries of teachers in preschools and elementary schools would increase by 70%. The minimum wage unit will also increase from 7 somoni (2.5 USD) to 12 somoni (4.3 USD) in 2005.

9.4. Implementation of macro-financial assistance

Tajikistan has benefited from an assistance package which consists of a loan of EUR 60 million (disbursed in March 2001) and a total grant amount of up to EUR 35 million to be disbursed in successive annual instalments.

As Tajikistan has made satisfactory progress in macroeconomic policies and in structural reform, it has benefited from maximum annual grant tranches, EUR 21 million so far. On the other hand, the EC has not pushed for the maximum annual debt repayments which the MoU would have allowed. Both in 2001 and 2002, Tajikistan was asked to repay EUR 8 million only, whereas the MoU would have allowed requesting EUR 12 million. Tajikistan’s outstanding debt to the EC is now EUR 44 million. A fourth grant instalment of EUR 7 million is to be disbursed in April 2005 after Tajikistan has made a third early debt repayment of EUR 8 million. Prior to it, the Commission performed an operational assessment with the assistance of an external consultant in June 2004. The assessment concluded that, despite some weaknesses detected, a framework for sound financial management is effective. A further mission to Dushanbe is foreseen in the second quarter of 2005, to review the conditionality linked to the fifth (final) grant instalment.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices are liberalised (with the exception of public utilities).

2. Trade liberalisation

Relatively liberal trade system with persistent non-tariff barriers. Import tariffs were unified at 5% in May 2002. Tajikistan has applied for membership in the WTO (observer status since 2001). The Eurasian Economic Community (including Russia, Belarus, Kazakhstan, Kyrgyz Republic and Tajikistan) aims at promoting regional economic co-operation.

3. Exchange regime

Relatively liberal exchange regime. The official exchange rate was unified with the curb market rate in July 2000 when an interbank foreign exchange market began operating. The new currency, somoni, was introduced in October 2000. A managed floating regime of the somoni is in place.

4. Foreign direct investment

Modest foreign direct investment due to Tajikistan's small market, lack of regional integration, slow pace of privatisation, limited access to financing, weakness of public administration and corruption. FDI inflows were 3.0% of GDP in 2002 and around 2% in 2003 and 2004.

5. Monetary policy

A Monetary Policy Committee was set up in 2003, which should lead to a more effective monetary policy. A decree was issued the same year, withdrawing lending authority from all National Bank branch managers, department heads and deputy chairpersons. It should stop the practice of direct credits from the NBT to the cotton sector.

6. Public finances

Total tax collection of the general government increased from 15.5% in 2003 to an estimated 16.2% of GDP in 2004. This increase is mainly due to improved administration of the VAT, including completion of the transition to the destination principle.

7. Privatisation and enterprise restructuring

A new privatisation strategy for 2003-07 was approved in November 2003. State-owned enterprises, with a few exceptions, will be privatised, restructured (if direct privatisation is not feasible) or liquidated.

8. Financial sector reform

A reduction in transfer fees was decided and progress has been made in improving banking regulation and supervision. This has encouraged more Tajik workers to use the banking system to remit wages earned abroad.

10. UKRAINE

10.1. Executive summary

Economic growth accelerated to 12% in 2004 fuelled by strong external demand and high market prices for Ukraine's main exports, notably steel. The balance of payments strengthened as current account surplus reached 11% of GDP. Inflationary pressures were exacerbated by loose fiscal policies in the second half of the year in the run-up to the presidential elections. The new Government nominated after president Yuschchenko's victory will have to address these emerging macroeconomic imbalances in early 2005.

The new Government is also expected to tackle corruption and the backlog of structural reforms, including increasing transparency of privatisation procedures and improving tax and customs administration in order to improve the business climate. The new Government's programme already includes encouraging elements in several key areas.

The IMF approved in March 2004 a precautionary stand-by arrangement (SBA) for Ukraine. Ukraine did not request any disbursements, however, and the arrangement fell off track in the autumn due to slippages in fiscal policy. EC's macro-financial assistance to Ukraine could however be made available in case Ukraine's external financial situation deteriorates so that it decides to request access to IMF resources.

10.2. Macroeconomic performance

Ukraine's GDP reached the equivalent of about EUR 50 billion in 2004 which is still only slightly more than half of the GDP level before transition. Economic growth reached a record high rate of 12% in 2004 (real GDP growth was 9.4% in 2003). Growth continued to be driven by both strong external demand for Ukraine's main exports (steel, machinery, chemicals) and robust domestic consumption and investment. Industrial output grew by 12.5% as a whole but a declining trend in monthly growth rates had been visible already after spring. After a poor harvest in 2003, agricultural output recovered to its normal level (+19% in real terms in comparison to 2003). Construction also picked up strongly (+22%). Retail and wholesale trade also grew by nearly 20% in real terms.

While Ukraine's exports benefited from continued strong demand in its traditional export markets in EU 25 and Russia, Ukraine also began to trade more with the rest of the world, including with China. Exporters' profits then further fuelled an investment and construction boom. At the same time, domestic consumption demand was supported by several factors. The progressive income tax (on a scale of 10-40%) was replaced by a flat rate of 13% in the beginning of 2004. In the run-up to the presidential election, the government also increased pensions and other social transfers. These increases in benefits had not been budgeted for 2004 but the government managed to finance them out of privatisation proceeds which exceeded amounts originally projected in the budget.

As a result of previous Government's spending decisions before the presidential elections, inflationary pressures and fiscal imbalances emerged, which the new

Government has to address as a matter of priority in 2005. Consumer price inflation reached 12.3% in 2004 (8.2% in 2003). Inflation accelerated towards the end of the year so that the last quarter of the year saw a 6.2% increase in the index (+2.4% in December alone). Price regulations on meat and gasoline were put in place in 2004 but these are unlikely to persist. The producer price index increased by 24% in 2004 and the wide gap vis-à-vis the consumer price index maintains an upward pressure for the latter in 2005.

In order to contain inflationary expectations, the most important challenge is to reduce the fiscal deficit, which has been on an increasing trend since about mid-2004. The deficit for the consolidated government (incl. central government and local budgets) is estimated at up to 4.5% of GDP for 2004, whereas a deficit of below 2% had been projected in early 2004. The approved budget for 2005 does not fully reflect all spending decisions taken during the election campaign (concerning in particular finances of the extra-budgetary pension fund). Accordingly the projected deficit of 2.2% of GDP will be exceeded substantially unless the new Government takes corrective measures in early 2005.

Households' bank deposits declined in October-December 2004 when people converted their hryvnia balances to cash dollars. The National Bank of Ukraine (NBU) was able to manage the imminent liquidity crisis by drawing massively on its foreign exchange reserves. Restrictions on deposit withdrawals and foreign exchange transactions were put in place but these were lifted at the end of the year when the situation had stabilised.

Large current account surpluses (estimated to have reached 10-11% of GDP in 2004) and NBU's policy of de facto pegging the hryvnia/ USD exchange rate (at about UAH 5.33) led to sharp increases in international reserves during the first half of 2004. Meanwhile, the hryvnia depreciated against the euro from UAH 6.7 to UAH 7.2 during the year. Despite the political turmoil, the gross international reserves of the NBU (USD 9.5 billion at the end of December 2004) are still above their level one year before, covering comfortably more than three months of imports. In early 2005 the international reserves have began to increase again.

In the past, the NBU did not actively sterilise the built up of international reserves. Rising demand for the hryvnia (re-monetisation) and increases in government deposits did help to a large extent to match the additional supply of liquidity through the NBU. Faced with emerging inflationary pressures in the second half of 2004, the NBU adopted a more active sterilisation policy (e.g. through reverse repos and the issuance of certificates of deposits). A more flexible exchange rate policy would, however, be helpful for better inflation control and in managing risks of unchecked credit expansion. The real exchange rate is substantially undervalued according to estimates by the IMF but the NBU has wanted to avoid any drastic policy changes. Nevertheless, the NBU announced its readiness to consider switching to inflation targeting as a long term goal.

10.3. Structural reforms

Decisive action by the new Government to improve the business climate will no doubt have a significant impact on future economic growth also through foreign direct investment (FDI). Strengthening of corporate governance and dismantling of uncompetitive practices would mobilise more broadly based economic growth, involving also small and medium sized enterprises. New Civil Code and Commercial Code became effective in January 2004 clarifying basic property rights but some inconsistencies still remain in the legislation. Adoption of a new Joint Stock Company Law is still pending. Lack of transparency in dealing with the persistent problem of the arrears on VAT refunds to exporters is one example which inhibits improvements in the business climate.

In May 2004, the European Commission concluded that Ukraine did not yet meet the criteria for a market economy status in the context of anti-dumping investigations due to recent state interference in pricing in some industrial sectors and remaining shortcomings in the bankruptcy legislation. Ukraine has made progress with its accession to the WTO by signing bilateral protocols on market access with 25 WTO members (including the EU but not yet the United States). Ukraine is now aiming at joining the WTO by the end of 2005.

Revenues from privatisation reached in 2004 the highest annual amount during Ukraine’s independence, UAH 9.58 billion, equivalent to about EUR 1.45 billion. The main assets privatised were the Kryvorizhstal steel plant, the Pavlohradvuhillia coal mine and Azot (Severodonetsk) chemical company. Foreign investors were effectively excluded from the most attractive privatisations under non-transparent tender procedures. At least some of the most controversial asset sales will be reviewed by the new Government, and even renationalising cannot be excluded in some cases.

While the new Government addresses the imminent fiscal imbalances, further efforts should also be devoted to an overall strengthening of the public finances and to improvements in the accountability of budget entities. For instance the proposed amendments to the constitution concerning the Accounting Chamber (the supreme external audit body) would strengthen its functions considerably. Rationalisation of subsidies (whether direct or indirect) would be desirable. Better management of state enterprises would also benefit the budget. At the same time, a comprehensive Medium-Term Expenditure Framework should be developed to provide a valuable tool for prioritisation of public expenditures in future budgets.

The sudden deposit withdrawals during the last quarter of 2004 were merely a temporary setback after a period of very rapid growth. Business and household deposits grew by 42% and 29% respectively for the year as a whole. Banks increased their lending volumes also by about 30%. Credit quality is a concern in light of lending to related parties and weaknesses in banks’ risk assessment practises, which are exacerbated by weak accounting and reporting standards in the corporate sector. Ukraine’s credit-to-GDP ratio is still relatively low at around 30%. Although the on-going credit boom in Ukraine can be attributed to catching up from a low level of financial intermediation, the risks are significantly increased given that institutional and structural reforms in the financial sector have lagged behind during the strong economic recovery.

10.4. Implementation of macro-financial assistance

The ECOFIN Council adopted in July 2002 a decision granting a new loan to Ukraine under the EC’s macro-financial assistance in the amount of EUR 110 million while cancelling the non-disbursed part (EUR 92 million) of the 1998 loan facility. However, in view of the strong improvement of its balance of payments in 2002-2004, Ukraine did not have any residual financing needs, and therefore the new loan has not been disbursed by the EC. This improvement in the external situation was also reflected in Ukraine's decision to treat the IMF stand-by arrangement (SBA) as precautionary, and Ukraine has not drawn any funds under this arrangement, approved by the IMF Board in March 2004. The SBA arrangement expires at the end of March 2005.

The Commission adopted a similar precautionary approach vis-à-vis the macro-financial assistance to Ukraine. The EC loan would be kept on hold in case a balance of payments financing need emerges later and Ukraine decides to use IMF resources. The July 2002 Council decision providing the legal framework for this operation will remain in force and the Commission stands ready to reactivate this assistance should the need arise in the future. Ukraine's outstanding debt to the Community decreased by EUR 57 million in 2004 to a total of EUR175 million.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices have been liberalised. In 2004 meat and gasoline prices were administratively regulated. Communal service tariffs (such as gas, electricity, heating and rents) are subject administrative controls and tend to be below full-cost recovery levels.

2. Trade liberalisation

Import regimes free of quantitative restrictions wit a few exceptions for health and safety reasons. A relatively liberal Customs Code (2001). The trade-weighted effective average import tariff is about 7 %. A high degree of dispersion in tariffs remains between 0 and 70%. A few export restrictions remain, namely on sunflower seeds, live animals, cow hides and skins, and scrap metals. Agricultural quotas are one of the main outstanding issues in Ukraine's WTO accession negotiations.

3. Foreign exchange regime

The exchange rate regime is classified as a conventional pegged arrangement as the National Bank of Ukraine maintained a de facto peg vis-à-vis the USD at about 5.3 hryvnia. Full current account convertibility (Article VIII status at the IMF) since September 1996. There are restrictions on all capital account transactions, mainly taking the form of licensing and registering requirements.

4. Foreign direct investment

FDI inflows increased as a percentage of GDP from 2% (2002) to 3% (2003) but remained below the average for the CIS (5.3%).

5. Monetary policy

The National Bank of Ukraine relies mainly on indirect monetary instruments. Credit to commercial banks allocated mostly through the Lombard facility, credit auctions and repossessions.

6. Public finances

Consolidated government expenditure estimated at about 39% of GDP; revenues 36% of GDP of which tax revenues 31% (2004).

7. Privatisation and enterprise restructuring

The private sector accounts for 65% of GDP. Privatisation of large enterprises accelerated in 2004 albeit under controversial and non-transparent terms, including notably Ukraine's largest steel plant Kryvorizhstal (deal expected to be reviewed by the new Government in 2005).

8. Financial sector reform

Over 150 operating banks of which several weakly capitalised. State-owned banks account for about 10% of bank assets.

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 2004 (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**	Dec. 1994	**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**	Jul. 1996			**130**

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	22.07.97	97/472/EC	**250**	Feb. 1998	**125**	**250**	
(BOP loan)				Dec. 1998	**125**		
Armenia, Georgia and Tajikistan (2)	17.11.97	97/787/EC	**375**			**279**	**96**
(Structural adjustment loans and grants)	modified by						
of which	28.3.00	00/244/EC					
Armenia			**(58)**	Dec. 1998 (loan)	**28**	**56,5**	**1,5**
				Dec. 1998 (grant)	**8**		
				Dec. 1999 (grant)	**4**		
				Feb. 2002 (grant)	**5,5**		
				Dec. 2002 (grant)	**5,5**		
				June 2004 (grant)	**5,5**		
Georgia			**(175)**	Jul. 1998 (loan)	**110**	**141,5**	**33,5**
				Aug. 1998 (grant)	**10**		
				Sep. 1999 (grant)	**9**		
				Dec. 2001 (grant)	**6**		
				Dec 2004 (grant)	**6,5**		
Tajikistan			**(95)**	Mar. 2001 (loan)	**60**	**81**	**14**
				Mar. 2001 (grant)	**7**		
				Dec. 2001 (grant)	**7**		
				Feb. 2003 (grant)	**7**		

Ukraine III	15.10.98	98/592/EC	**150**	Jul. 1999	**58**	**58**	**92**
(BoP loan)	12.07.02	02/639/EC					**(Cancelled)**
Albania III	22.04.99	99/282/EC	**20**				**20**
(BOP loan)							
Bosnia I (3)	10.05.99	99/325/EC	**60**	Dec. 1999 (grant)	**15**	**60**	
(BOP loan and grant)	modified by			Dec. 1999 (loan)	**10**		
	10.12.01	01/899/EC		Dec. 2000 (grant)	**10**		
				Dec. 2000 (loan)	**10**		
				Dec. 2001 (grant)	**15**		
Bulgaria IV	08.11.99	99/731/EC	**100**	Dec. 1999	**40**	**100**	
(BOP loan)				Sep. 2000	**60**		
fYRoM II (4)	08.11.99	99/733/EC	**80**	Dec. 2000 (grant)	**20**	**98**	
(BOP loan and grant)	modified by		**18**	Dec. 2000 (loan)	**10**		
	10.12.01	01/900/EC		Dec. 2001 (loan)	**12**		
				Dec. 2001 (grant)	**10**		
				May 2003 (grant)	**10**		
				June 2003 (loan)	**10**		
				Dec. 2003 (loan)	**18**		
				Dec. 2003 (grant)	**8**		
Romania IV	08.11.99	99/732/EC	**200**	Jun. 2000	**100**	**150**	**50**
(BOP loan)				July 2003 (loan)	**50**		
Kosovo I (5)	19.02.00	00/140/EC	**35**	Mar. 2000	**20**	**35**	
(Grant budgetary support)				Aug. 2000	**15**		
Montenegro (5)	22.05.00	00/355/EC	**20**	Aug. 2000	**7**	**20**	
(Grant budgetary support)				Dec. 2000	**13**		
Moldova III	10.07.00	00/452/EC	**15**				**15**
(BOP loan)	19.12.02	02/1006/EC					**(Cancelled)**
Kosovo II (3)	27.06.01	01/511/EC	**30**	Sep. 2001	**15**	**30**	
(Grant budgetary support)				Dec. 2002	**15**		
Serbia and Montenegro (ex FRY) I (6)	16.07.01	01/549/EC	**345**	Oct. 2001	**225**	**345**	
(BOP loan and grant)	modified by			Oct. 2001	**35**		
	10.12.01	01/901/EC		Jan. 2002	**40**		
				Aug. 2002	**45**		
Ukraine IV	12.07.02	02/639/EC	**110**				**110**
(BOP loan)							
Serbia and Montenegro II (ex FRY) (7)	05.11.02	02/882/EC	**130 (7)**	Dec. 2002 (grant)	**30**	**105**	**25**
				Fev. 2003 (loan)	**10**		
				Aug. 2003 (grant)	**35**		
				Aug. 2003 (loan)	**30**		
	modified by						
	25.11.03	03/825/EC	**70**	Dec 2004 (grant)	**10**	**10**	**60**
	07.12.2004	04/862/EC					
Bosnia II (8)	05.11.02	02/883/EC	**60**	Fev. 2003 (grant)	**15**	**35**	**25**
	modified by			Dec. 2003 (grant)	**10**		
	7/12/2004	04/861/EC					
				Dec 2004 (loan)	**10**		
Moldova IV	19.12.02	02/1006/EC	**15**				**15**
Albania IV	29.04.04	04/580/EC	**25**				**25**
			-------			-------	-------
TOTAL			**6195,5**			**5062,5**	**1133**

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

TO THIRD COUNTRIES BY REGION

Status of effective disbursements as of end-December 2004 (in millions of euro)

Country	Authorisations			Disbursements			
	Date of Council Decision	Reference of Council Decision	**Maximum amount**	Dates of disbursements	**Amounts of disbursements**	**Totals**	**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	**150**	**50**
(BOP loan)				July 2003	50		
Slovakia	22.12.94	94/939/EC	**130**			**Cancelled**	**130**
(BOP loan)						(Jul. 1996)	**Cancelled**
			-------			-------	-------
TOTAL A			**3305**			**2780**	**525**

B. Western Balkans

Albania I	28.09.92	92/482/EC	**70**	Dec. 1992	35	**70**	
(BOP grant)				Aug. 1993	35		
Albania II	28.11.94	94/773/EC	**35**	Jun. 1995	15	**35**	
(BOP grant)				Oct. 1996	20		
Albania III	22.04.99	99/282/EC	**20**				**20**
(BOP loan)							**(Cancelled)**
Bosnia I (1)	10.05.99	99/325/EC	**60**	Dec. 1999 (grant)	15	**60**	
(BOP loan and grant)	modified by			Dec. 1999 (loan)	10		
	10.12.01	01/899/EC		Dec. 2000 (grant)	10		
				Dec. 2000 (loan)	10		
				Dec. 2001 (grant)	15		
fYRoM I	22.07.97	97/471/EC	**40**	Sep. 1997	25	**40**	
(BOP loan)				Feb. 1998	15		
fYRoM II (2)	08.11.99	99/733/EC	**80**	Dec. 2000 (grant)	20	**98**	
(BOP loan and grant)	modified by			Dec. 2000 (loan)	10		
	10.12.2001	01/900/EC	**18**	Dec. 2001 (loan)	12		
				Dec. 2001 (grant)	10		
				May 2003 (grant)	10		
				June 2003 (loan)	10		
				Dec. 2003 (loan)	18		
				Dec.) 2003 (grant)	8		
Kosovo I (3)	19.02.00	00/140/EC	**35**	Mar. 2000	20	**35**	
(Grant budgetary support)				Aug. 2000	15		

Kosovo II (3)	27.06.01	01/511/EC	**30**	Sep. 2001	15	**30**	
(Grant budgetary support)				Dec. 2002	15		
Montenegro (3)	22.05.00	00/355/EC	**20**	Aug. 2000	7	**20**	
(Grant budgetary support)				Dec. 2000	13		
Serbia and Montenegro I	16.07.01	01/549/EC	**345**	Oct. 2001 (grant)	35	**345**	
(ex FRY) (4)		modified by		Oct. 2001 (loan)	225		
	10.12.2001	01/901/EC		Jan. 2002 (grant)	40		
				Aug.2002 (grant)	45		
Serbia and Montenegro II	05.11.02	02/882/EC	**130**	Dec. 2002 (grant)	30	**105**	**25**
(ex FRY) (5)				Fev. 2003 (loan)	10		
(BOP loan and grant)				Aug. 2003 (grant)	35		
	modified by			Aug. 2003 (loan)	30		
	25.11.03	03/825/EC (7)	**70**	Dec 2004 (grant)	10	**10**	**60**
	07.12.04	04/862/EC					
Bosnia II (6)	05.11.02	02/883/EC	**60**	Fev. 2003 (grant)	15	**35**	**25**
(BOP loan and grant)				Dec. 2003 (grant)	10		
				Dec 2004 (loan)	10		
	modified by						
	07.12.04	04/861/EC					
Albania IV	29.04.04	04/580/EC	**25**				**25**
(loan and grant)							
TOTAL B			**1038**			**883**	**155**
			-------			**-------**	**-------**

(1) Includes a loan principal amount of € 20 million and grants of € 40 million.
(2) Includes a loan principal amount of up to € 50 million and grants of up to € 48 million.
(3) Exceptional financial assistance.
(4) Includes a loan principal amount of € 225 million and grants of € 120 million.
(5) Includes a loan principal amount of € 55 million and grants of € 75 million
(6) Includes a loan principal amount of € 20 million and grants of € 40 million
(7) Includes a loan principal amount of € 25 million and grants of € 45 million

C. New Independent States (NIS)

Armenia, Georgia and Tajikistan (8)	17.11.97	97/787/EC	**375**			**279**	**96**
(Structural adjustment loans and grants)	modified by						
of which	28.3.00	00/244/EC					
Armenia			**(58)**	Dec. 1998 (loan)	28	**(56,5)**	**(1,5)**
				Dec. 1998 (grant)	8		
				Dec. 1999 (grant)	4		
				Feb. 2002 (grant)	5,5		
				Dec. 2002 (grant)	5,5		
				Jun 2004(grant)	5,5		
Georgia			**(175)**	Jul. 1998 (loan)	110	**(141,5)**	**(33,5)**
				Aug. 1998 (grant)	10		
				Sep. 1999 (grant)	9		
				Dec. 2001 (grant)	6		
				DEc. 2004 (grant)	6,5		
Tajikistan			**(95)**	Mar. 2001 (loan)	60	**(74)**	**(21)**
				Mar. 2001 (grant)	7		
				Dec. 2001 (grant)	7		
Belarus	10.04.95	95/132/EC	**55**	Dec. 1995	30	**30**	**25**
(BOP loan)							**(Suspended)**
Moldova I	13.06.94	94/346/EC	**45**	déc-94	25	**45**	
(BOP loan)				Aug. 1995	20		
Moldova II	25.03.96	96/242/EC	**15**	Dec. 1996	15	**15**	
(BOP loan)							
Moldova III	10.07.00	00/452/EC	**15**				**15**
(BOP loan)	19.12.02	02/1006 EC					**(cancelled)**
Moldova IV	19.12.02	02/1006/EC	**15**				**15**
(BOP grant)			*(15)*				
Ukraine I	22.12.94	94/940/EC	**85**	Dec. 1995	85	**85**	
(BOP loan)							
Ukraine II	23.10.95	95/442/EC	**200**	Aug. 1996	50	**200**	
(BOP loan)				Oct. 1996	50		
				Sep. 1997	100		

Ukraine III (BoP loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	**150**	Jul. 1999	58	**58**	**92** **(cancelled)**
Ukraine IV (BOP loan)	12.07.02	02/639/EC	**110** *(15)*				**110**
			-------			-------	-------
TOTAL C			**1065 (9)**			**712**	**353**

D. Mediterranean countries

Israel (9) (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			**6195,5**			**5062,5**	**1133**

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

(9) Assistance to Israel includes a loan principal amount of ECU 160 million and grants of ECU 27,5 million in the form of interesr subsidies.

ANNEX 3: Selected economic indicators

		2001	2002	2003	2004 Programme (1)	2004 Estimates
GDP at constant prices	(Percent change)					
Albania		7,2	3,4	6,0	6,2	6,0
Armenia		9,6	13,2	13,9	7,0	10,1
Bosnia-Herzegovina		4,5	5,5	3,5	5,1	5,0
Bulgaria		4,1	4,9	4,3		5,7
FYROM		-4,5	0,9	3,2		2,2
Georgia		4,7	5,5	11,1	6,0	8,4
Kosovo		21,2	1,2	3,1		3,2
Moldova		6,1	7,8	6,3		7,3
Serbia & Montenegro		5,5	4,0	2,7	7,2	4,8
Romania		5,7	5,0	5,2		8,3
Tajikistan		10,2	9,1	10,3	6,0	10,5
Ukraine		9,2	5,2	9,4	6,0	12,0
Consumer price (end year)	(Percent change)					
Albania		3,1	5,2	2,4	6,4	3,0
Armenia		2,9	2,0	6,2	3,0	2,0
Bosnia-Herzegovina		*3,1*	*0,4*	*0,6*	0,9	
Bulgaria		7,4	5,8	2,3		6,2
FYROM		5,5	1,8	1,2		-0,4
Georgia		3,4	5,4	7,0	5,0	7,5
Kosovo		11,7	3,6	1,0		1,8
Moldova		6,4	4,4	15,7		12,5
Serbia & Montenegro		92,5	21,5	11,6	9,7	9,5
Romania		34,5	22,5	15,3		11,9
Tajikistan		12,5	14,5	13,7	7,0	8,5
Ukraine		6,1	-0,6	8,2	6,0	12,3
Fiscal balance	(Percent of GDP)					
Albania		-7,6	-6,1	-4,1	-6,1	-4,8
Armenia		-3,8	-0,4	-1,1	-1,9	-1,5
Bosnia-Herzegovina		-3,3	-2,2	-4,0	-0,1	-0,1
Bulgaria		0,2	-0,8	0,6		1,4
FYROM		-7,2	-5,7	-1,6		1,4
Georgia		-2,0	-2,0	-2,5	-1,6	0,7
Kosovo		7,2	6,2	2,5		-7,0
Moldova		-0,3	-0,9	0,2		-1,5
Serbia & Montenegro		-0,7	-3,4	-4,0	-1,7	0,5
Romania		-3,5	-2,0	-2,0		-1,4
Tajikistan		-0,1	-0,1	0,9	-0,5	-0,4
Ukraine		-1,5	0,2	0,1	-0,8	-4,5
Current account	(Percent of GDP)					
Albania		-3,2	-6,5	-5,1	-5,8	-5,6
Armenia		-9,5	-6,2	-6,8	-5,9	-5,0
Bosnia-Herzegovina		-16,2	-20,0	-18,0	-15,8	-18,5
Bulgaria		-7,3	-5,6	-8,6		-7,5
FYROM		-6,5	-9,5	-3,3		-6,0
Georgia		-6,4	-5,8	-7,2	-9,6	-7,5
Kosovo		-8,6	-11,6	-15,8		-18,0
Moldova		-2,5	-4,4	-6,8		-6,7
Serbia & Montenegro		-4,6	-8,8	-10,2	-11,6	-11,0
Romania		-5,0	-3,6	-6,1		-7,6
Tajikistan		-7,0	-2,7	-1,3	-2,9	-1,9
Ukraine		3,7	7,5	5,8	3,7	10,2

Official foreign exchange reserves (end year) (EUR in mln)

Albania	0,8	0,9	1,3	0,9	0,9
Armenia	3,6	3,7	4,0	3,7	3,7
Bosnia-Herzegovina	5,1	4,6	5,1	4,4	
Bulgaria	3,6	4,6	5,5		7,0
FYROM	0,8	0,5	0,8		0,7
Georgia	1,4	1,7	1,3	1,3	1,6
Kosovo	0,3	0,3	0,5		0,3
Moldova	2,1	1,9	1,7		2,0
Serbia & Montenegro	1,3	2,4	4,5	3,5	3,7
Romania	4,4	6,5	7,1		11,7
Tajikistan	1,9	1,8	1,9	2,7	2,3
Ukraine	1,7	1,9	2,4	3,0	3,8

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

Sources: National authorities and IMF