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**Annex to the**

**REPORT FROM THE COMMISSION TO THE COUNCIL AND  
THE EUROPEAN PARLIAMENT**

**ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE TO THIRD  
COUNTRIES IN 2005**

{COM(2006) 391 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

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## 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 2005 and is meant to complement it. It discusses the economic situation in the countries for which disbursements under previously decided operations have been made or are still outstanding in 2005.

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<sup>1</sup>.

The complete list of macro-financial assistance operations decided by the Council with the corresponding disbursements up to the end of 2005 appears in Annex, as well as well as statistical data of the related countries.

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<sup>1</sup> 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.  
COM(2005)245 of 8 June 2005

## **2. ALBANIA**

### **2.1. Executive summary**

GDP growth remained high at 5.5% in 2005. After the last cut of the main policy rate by 25 basis points to the current 5.0% in March 2005, the central bank continued to follow a neutral course of monetary policy, aiming at stable interest rates. The appreciation pressures of the Albanian lek against the euro eased towards the end of 2005. Over the whole year, the lek appreciated against the euro in nominal terms by approximately 2.7%. It depreciated vis-à-vis the USD by around 12.5% over the same period. Large imbalances remain in the external sector. While the trade deficit is estimated to have remained above 23% of GDP in 2005, substantial private transfers from abroad have contributed to finance a current account deficit of an estimated 7.0% of GDP. Foreign direct investment dropped somewhat to 2.9% of GDP in 2005 in comparison to 4.6% of GDP in 2004 when boosted by the privatisation of the Savings Bank. The privatisation and restructuring of remaining large state-owned enterprises have been delayed, in particular with regard to telecommunication and energy utilities. Some progress was achieved in the management of public expenditures and revenues; nevertheless the strengthening of the tax administration and public sector governance remain ones of the key challenges for the new Government.

### **2.2. Macroeconomic performance**

Albania's stable macroeconomic environment, characterised by strong GDP growth and subdued inflation, has been maintained in 2005. However, at the end of the year the country suffered from frequent power supply shortages for almost four months, mainly as a result of the strong dependence on hydro sources for generating electricity and the failure of tenders for purchasing sufficient electricity from abroad. Power supply cuts hit especially small businesses. The IMF estimated the repercussions of the crisis on economic growth at 0.5% of GDP in 2005 and at 1% in 2006. Thus, the estimate of GDP growth has been revised to 5.5% in 2005 and is expected to further decline to 5.0% in 2006.

The labour market continued to slightly improve throughout 2005. The unemployment rate (based on registered data) fell slightly from 14.4% at the end of 2004 to 14.3% in June 2005 and further to estimated 14.2% in September 2005. This indicator provides however only limited information due to a significant informal sector and hidden unemployment in particular in agriculture, while some jobless fail to register.

The 2005 budget execution has been better than planned and the overall budget deficit in 2005 is estimated at 3.8% of GDP. In October 2005, the IMF staff mission reached an agreement with the authorities on key parameters for the remainder of 2005 and for the 2006 budget and the underlying macroeconomic and fiscal policy assumptions. It agreed on a two-step reduction of the tax burden: cuts in the small business tax from 3% to 1.5%, with implementation starting as of November 2005, to be followed by a reduction of the corporate profit tax from 23% to 20%, to be implemented as of January 2006. The 2006 budget, adopted by Parliament in December 2005, is based on conservative revenue projections and does not include

possible gains from the tax administration reform measures. Furthermore, the 2006 budget contains a contingency of 0.75% of GDP to be released only in the second half of the year, provided budget performance is favourable for the first half of the year. The overall budget deficit for 2006 is foreseen at 4.1% of GDP.

Inflation continued to follow an upwards trend since July 2005, when CPI inflation reached a low of 1.8% (y-o-y). It gradually increased to 3.0% (y-o-y) in November 2005 due to persistent pressure from rising oil prices. The latter was somewhat moderated by the continuing appreciation of the Albanian lek vis-à-vis the euro, in particular in the first semester of 2005. Annual inflation stood at 2.2% in 2005, remaining at the lower end of the Bank of Albania's informal 2-4% inflation target range. The Bank of Albania currently examines prerequisites for a gradually move to a formal inflation targeting regime with the aim of enhancing the transparency and credibility of its monetary policies.

The IMF foresees a widening of the trade deficit to about 23% of GDP in 2005 and 2006. The current account deficit is estimated at 7% of GDP in 2005 and is expected to widen to 8.1% of GDP in 2006. Financing of the trade deficit still largely depends on significant remittances and other current transfers, estimated at 14% of GDP in 2005. Less than half of the current account deficit is covered by foreign direct investment, estimated at 2.9% of GDP in 2005 and 3.2% of GDP in 2006. Based on the last IMF estimates, residual balance-of-payments needs are estimated at EUR 24 million (0.4% of GDP) in 2005 and at EUR 38 million (0.5% of GDP) in 2006, over and above financing provided by IFIs. Balance-of-payments projections will be further monitored by the IMF, and may hence be updated again.

### **2.3. Structural reforms**

Progress in public administration reform has continued, the administrative capacity of the tax administration has further improved and several crucial reforms have been put in place throughout 2005. In the field of financial control and audit, some significant progress has been achieved. However revenue collection and public expenditure management remained weak, revealing significant inefficiencies particularly in some of the social and infrastructure sectors. 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.

Whereas privatisation of small- and medium-sized enterprises has been completed, large-scale privatisation has suffered delays. The ratification of the sale agreement that would complete the privatisation of Albtelecom was rejected by the Albanian Parliament in October 2005, calling for a review of the sale contract and the whole tender procedure. The attempt to sell a majority stake in ARMO to a strategic investor in May 2005 failed due to a lack of any market interest.

### **2.4. Implementation of macro-financial assistance**

In April 2004, the Council decided to provide Albania with macro-financial assistance of up to EUR 25 million, including EUR 16 million of grants and EUR 9 million of loans. The aim of this assistance is to ease Albania's external financing constraints, to support its balance of payments and to strengthen its foreign exchange position. 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 MoU was signed in May 2005). 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 the Commission assisted by an external consultant. This assessment concluded that despite some administrative weaknesses in the Ministry of Finance, a framework for sound financial management at both authorities is effective. In order to further strengthening this framework, the main related recommendations of the operational assessment were reflected in the conditionality of the Memorandum of Understanding. Upon the fulfilment of the corresponding conditions, the grant component of the first tranche of EUR 3 million was disbursed in November 2005. The disbursement of the loan component of the first tranche of EUR 9 million is expected to be completed in the first quarter 2006.

In November 2005, Commission services carried out a mission to review the conditionality attached to the EUR 13 million second tranche of this assistance. The mission found that good progress had been achieved or was ongoing in several areas. However, more action was still needed to fully meet a number of the conditions and further monitoring will be carried out in the first half of 2006.



## 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 the former Yugoslav Republic of Macedonia, Croatia, Bulgaria, Kosovo (under UNSCR 1244), Romania, Serbia and Montenegro, Moldova, and Bosnia and Herzegovina.

### 3. Exchange regime

Albania maintains a managed floating exchange rate regime. However, the Bank of Albania intervenes when necessary to smooth out strong fluctuations. The appreciation pressures of the Albanian lek against the euro eased towards the end of the year. Over the whole year, the lek appreciated against the euro in nominal terms by approximately 2.7%. It depreciated vis-à-vis the USD by around 12.5% over the same period.

### 4. Foreign Direct Investment

In 2005, foreign direct investment decreased somewhat to EUR 197 million (about 2.9% of GDP) against EUR 277 million (about 4.6% of GDP) in 2004. The number of administrative barriers to establish a business in Albania remains high and together with uninviting general business environment continue to represent major impediments for a substantial inflow of foreign investment.

### 5. Monetary policy

The Bank of Albania continued with its stability-oriented monetary policy in 2005 and maintained its 2-4% inflation target. After the last cut of the main policy rate by 25 basis points to the current 5.0% in March 2005, the central bank continued to follow a neutral course of monetary policy, aiming at stable interest rates.

### 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 October 2005, the IMF staff mission reached an agreement with the authorities on key parameters of the remainder of 2005 and 2006 budget and the underlying macroeconomic and fiscal policy assumptions, including a set of tax administration reform measures.

### 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. Nevertheless the process of restructuring and privatisation of large companies such as of Albtelekom and ARMO (fuel company) has been delayed.

### 8. Financial Sector Reform

The successful privatisation of the Savings Bank, together with steps taken to privatise the main Albanian insurance company, INSIG, represented considerable progress towards the completion of the privatisation of the financial sector. The banking sector is now close to 100% in private hands.

### **3. ARMENIA**

#### **3.1. Executive summary**

The Armenian economy continued recent years strong growth in 2005 and surpassed the pre-transition level of GDP. Real GDP growth reached 10.5% while the sector composition of economic growth shifted slightly with a strong boom in construction (+31.2%) continued growth in agricultural production (+11.8%) and renewed growth in industrial production (+6.2%). The appreciation of the Armenian dram has contributed to a marked decrease in consumer price inflation (0.6% in 2005 down from 7.0% in 2004).

There has been gradual progress in structural reforms, but although Armenia is in front among CIS countries on most dimensions of structural reforms, the overall business environment is not yet fully conducive to more broadly based economic growth.

Armenia implemented satisfactorily the economic programme supported by the IMF. The IMF in May 2005 approved a three year arrangement under the Poverty Reduction and Growth Facility (PRGF) to support the government's economic program through 2008. The EC disbursed a grant instalment of EUR 1.5 million to Armenia in December 2005 after the country made a principal repayment of EUR 2 million to the Community. Armenia has no further outstanding debt to the EC.

#### **3.2. Macroeconomic performance**

Real GDP growth increased slightly in 2005 to about 10.5% following several years of strong economic performance (10.0% in 2004). Construction, agriculture and services were driving the economy while industrial production posted more modest growth at 6.2%. Processing of diamonds accounted for about 39% of exports in 2005 (about 42% in 2004). New investments are likely to contribute to a gradual diversification of exports in coming years. Despite the strong growth performance, officially registered unemployment continued to decline quite slowly (from 9.4% in 2004 to 8.9% in 2005) while the ILO-compatible unemployment level indicated by household surveys is much higher.

The overall fiscal balance is on a sound basis with an estimated deficit of about 2.4% of GDP. The tax revenues-to-GDP ratio is estimated at 14.5% (14.1% in 2004). A corporate tax rate of 1% of company turnover was introduced in January 2005 and a list naming the 300 top tax payers was published in April 2005 (aimed at embarrassing the wealthiest tax evaders), with the aim to boost taxes. Nevertheless, at about 15.6%, total revenues and grants as a percentage of GDP are almost unchanged since 2004 and still below their 2003 level because of a reduction in grants. The nominal increase in current expenditure (+15%) was directed in particular to finance a rise in social spending in line with priorities set in the Poverty Reduction Strategy Paper. The 2006 budget likewise foresees a significant increase in social spending and defence spending.

The 12-month inflation decelerated from 4.9% in January to -0.2% in December 2005. By allowing the dram to appreciate, the Central Bank of Armenia curbed inflationary expectations and reduced inflation below its target inflation rate of 3%. Despite the real effective appreciation of the dram, the loss of competitiveness is still considered to be relatively moderate given a real depreciation of around 25% in 2000-2003.

The recent appreciation of the dram is driven by a rise in FDI, workers' remittances and other private transfers. According to preliminary estimates, the current account deficit narrowed to 3.9% of GDP in 2005 (4.6% in 2004). The trade deficit narrowed slightly to about 12% of GDP. Goods and services imports growth (+20.2%) slightly exceeded exports growth (+19.8%). Foreign direct investment increased to about USD 255 million (food industry, communications, construction and transport being the prominent sectors) from USD 217 million in 2004. The gross international reserves of the Central Bank of Armenia are comfortably high covering four months of imports. In nominal terms the public external debt increased to about USD 1.2 billion, while as a ratio to GDP it is estimated at about 29% (down from about 31% in 2004).

Armenia implemented satisfactorily the economic programme supported by the IMF. The IMF Executive Board concluded in December 2004 the final review under the first PRGF-supported three-year arrangement. A second three year arrangement under the PRGF was approved in May 2005 to support the government's economic program through 2008. The total available amount of disbursements under this PRGF-arrangement is SDR 23 million with SDR 3.28 million disbursed after the first review in November 2005. The World Bank Country Assistance Strategy for Armenia approved in 2004 provide for 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 been gradual progress in structural reforms, but the overall business environment is not yet fully conducive to more broadly based economic growth, though Armenia is in front among CIS countries on most dimensions of structural reforms. Bureaucracy, corruption and limited access to finance is still perceived to weight on the business climate. This is confirmed by the World Bank's governance indicators that show continued problems with rule of law, government effectiveness, corruption and political stability. 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. Steps were taken in the implementation and monitoring of the Anti-Corruption Strategy 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. A risk-based customs clearance programme was introduced in November 2005. This follows an increased use of transaction prices instead of reference prices for assessment of import declarations.

These steps should help to push forward a more efficient and transparent customs clearance.

The Central Bank of Armenia (CBA) continued to strengthen supervision and regulations in the banking sector. The minimum capital requirement was raised to the equivalent of USD 5 million from USD 2 million in July 2005, and this seems to have advanced some consolidation in the sector. A deposit insurance scheme was also launched in July 2005. Supervision of banks will be upgraded significantly in 2006 in line with FSAP recommendations. Financial depth is increasing, but access to finance is still limited. The efficiency of financial intermediation needs to be improved, as indicated by the still high interest rate spread, which fell from 13.7% in 2004 to 12.2% in 2005. 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 (2005 figure not available yet).

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 an attempt to diversify both exports and imports, Armenia has strengthened trade relations with Iran. A gas pipeline from Iran to Armenia is under construction and is expected to be completed in early 2007.

#### **3.4. Implementation of exceptional financial assistance**

The EC's exceptional financial assistance programme was completed in 2005 with the disbursement of the final grant instalment of EUR 1.5 million in December. The payment followed Armenia's repayment in November 2005 of all outstanding debt of EUR 2 million to the Community. Upon clearing all arrears vis-à-vis the Community in 1998, Armenia had benefited from a loan of EUR 28 million which the country has now fully repaid through early principal repayments. The total available amount of the grant element, EUR 30 million, was disbursed in altogether 6 instalments over the period 1998-2005. Satisfactory progress was made in structural reforms also in 2005 so that the Commission could release the final grant instalment without any waivers.

The structural policy conditionality for this final grant instalment was largely based on an operational assessment on the soundness of Armenia's public finance management that was carried out in April 2004. In April 2005, the Commission, assisted by external experts, carried out a follow-up assessment which concluded that significant progress had been made in several areas. An internal audit development unit has been established in the Ministry of Finance and Economy to oversee the implementation of the Government Strategy for Development of Internal Audit System in 2005-2008. The positions of chief auditors, created in 2004, have been filled for the most part in line ministries and a training and certification programme is in place supported by donor-assistance. The adoption of amendments to the Constitution in a national referendum in November 2005 paves the way for the modernisation of the legal framework for independent external audits by Armenia's supreme audit institution, the Chamber of Control. Other areas of progress include putting in place a regular reporting mechanism for government-owned non-

commercial organisations (former budget organisations) on their revenues and expenditure.

In the context of the exceptional financial assistance, the Commission continued to monitor tax and customs issues which have been raised by the EU side on a number of occasions in meetings under the Partnership and Cooperation Agreement (PCA). The government adopted an action plan for tax and customs reforms (2005-2006) aiming at increasing tax buoyancy. The authorities' decision to publish a list of the 300 largest taxpayers in April 2005 was a commendable initiative to improve tax compliance. In customs administration, progress albeit rather slowly has been made to comply with Armenia's WTO undertakings in customs valuation and in post clearance verification. Significant progress was made by the Central Bank of Armenia over 2005 in the implementation of the new anti-money laundering law adopted at the end of 2004.

## Summary Status of Economic Reform

### 1. Price liberalisation

No administratively set prices other than for utilities exist.

### 2. Trade liberalisation

Liberal trade policy. Simple and relatively open import regime with a low average (about 3%) 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 about 6% of GDP (2004).

### 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 15.6% of GDP (2005), of which tax revenues about 14.5% of GDP. Total expenditure estimated at about 18% 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

The minimum capital requirement was raised to the equivalent of USD 5 million and a deposit insurance scheme became operational in July 2005.

## **4. BOSNIA AND HERZEGOVINA**

### **4.1. Executive summary**

Bosnia and Herzegovina maintained a stable macroeconomic environment in 2005, with the economy growing at around 5% as in 2004. Inflation picked up from previous low levels, mainly as a result of higher energy prices and changes in administered prices. Despite the improving exports performance, external imbalances continue to be very large, mainly a result of high imports and limited export capacity of the country. Exports growth was driven by increased prices and volumes for metal and mineral products while the overall dynamism of the economy remained rather weak. Structural reforms continued to be rather slow, although some achievements were noted in the fields of indirect taxation and privatisation.

In the course of 2005 the November 2002 Council Decision, as amended in December 2004 to extend its expiry date until 2005, and providing Bosnia and Herzegovina with up to EUR 60 million of macro-financial assistance, came to its final stage of implementation. The first two tranches had been disbursed in February 2002 and in December 2003/January 2004 respectively, after satisfactory compliance with the attached conditionality. The grant part of the third tranche, amounting to EUR 15 million, was released in June 2005. The release of the corresponding loan part of EUR 10 million was delayed pending ratification of the loan by the BiH State Parliament and foreseen to take place in the beginning of 2006.

### **4.2. Macroeconomic performance**

After a dip in the GDP growth rate in 2003, growth picked up during 2004 to around 5% of GDP and is estimated to have stayed at a similar level in 2005. Industrial production continued to grow rather strongly in 2005, although at a slightly lower pace than in 2004, by around 10%. The increase in industrial production was mainly driven by output growth in the mining and processing industries, in particular in the Republika Srpska.

After three years of annual inflation rates below 1%, inflation surged in 2005 to 3.1% in September (y-o-y). The increase was mainly due to higher energy prices and price hikes for certain regulated prices. Inflation is expected to have continued to increase in the beginning of 2006 due to the introduction of VAT by first of January 2006 and related price increases. 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. Despite some degree of fiscal consolidation and expenditure reduction which took place during the past years, the size of public spending remains comparatively high at around 50% of GDP.

The external imbalances continue to be large, mainly driven by a sizeable trade deficit. Imports amounted to over 80% of GDP in 2004. Exports have been growing strongly, although from a relatively low basis, and increased by 22% in September 2005 year-on-year. Import growth also accelerated, although less rapidly, from 7.6% in 2004 to 11% in September 2005 (y-o-y). Export growth was largely attributed to volume and price increases for metal and mineral products, which accounted for over 40% of total exports during the period January to September

2005, while dynamism in other sectors remained rather weak. The current account deficit remained very large and according to Central Bank data stood at around 23% of GDP in March 2005, but is likely to have decreased somewhat during the remainder of 2005. BiH experienced strong FDI inflows in 2004 of over 7% of GDP, mainly due to a few large privatisation deals. During the first three quarters of 2005, inflows continued to be rather strong and roughly equalled the same amount in nominal Euro-terms as for the same period the year before.

External debt has been on the decline over the last years and is estimated to have equalled 30.7% of GDP at end 2005, down from 32.7% the year before. However, an agreement on how to restructure and repay outstanding domestic debt claims still remains to be reached. After the courts struck down a previous proposal to restructure the debt at a net present value of 10% of GDP, any future deal is likely to be highly costly and increase the debt burden significantly.

#### **4.3. Structural reforms**

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 and was responsible for the introduction on 1<sup>st</sup> of January 2006 of a single VAT rate of 17%. The introduction went rather smoothly and is an important step to harmonise indirect taxation between the entities and to improve revenue collection.

Privatisation process remained slow in 2005, although some progress was achieved in particular in the Republika Srpska. Complicated organisational structures as regards the responsibilities for privatisation, vested interests and the financial status of companies have slowed down the process. Loss-making public companies are a source of inefficient use of public resources, which negatively affects savings and investment. Improved bankruptcy legislation has been adopted but its application remains limited.

The banking system is one of the sectors in BiH where 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 and most banks now participate in the Deposit Insurance Scheme.

#### **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. 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)<sup>2</sup>.

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<sup>2</sup> OJ L 370/80



The first tranche was disbursed in February 2003 (EUR 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 covered the areas of public finance and administration reform, private sector and business environment, financial sector reform and the area of statistics. After the performance of an “operational assessment”, assessing the soundness of BiH’s financial circuits and administrative controls, in August 2004 the Commission requested actions prior to the disbursement of the third tranche. In May 2005 conditions and additional prior actions related to the release of the third tranche were considered as fulfilled and the grant part of this last tranche was disbursed in mid 2005. The disbursement of the loan component of the third tranche required the adoption of the loan agreement in the BiH Parliament which has delayed its disbursement until February 2006.

The operation has thereby come to an end.

## Summary Status of Economic Reform

### **1. Price liberalisation**

Regulated prices largely prevail for utilities and infrastructure as well as in some other areas. Price regulations are decided upon separately in the two entities and are also in certain areas handled on municipality and cantonal level.

### **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**

FDI inflows have increased significantly over the last years and amounted to around 7% of GDP in 2004. However, FDI in 2004 and 2005 has largely been related to a rather small number of privatisation transactions and the investment climate is still hampered by the weak business climate and partly inconsistent frameworks between the two entities.

### **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 50% of GDP (not taking the informal economy into account) and public expenditure is often associated with large inefficiencies. However, significant fiscal consolidation has been achieved over time, together with tax harmonisation between entities. Important customs and taxation reforms, including VAT introduction, has been introduced.

### **7. Privatisation and enterprise restructuring**

The privatisation process has been slow, although some successful sales in particular the metal and mining sectors were achieved in 2004 and some further progress was made, in particular in the Republika Srpska, during 2005. Complicated organisational structures as regards the responsibilities for privatisation, vested interests and the weak financial standing of many companies have impeded the process..

### **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 supervision in the two entities is not fully integrated.

## **5. GEORGIA**

### **5.1. Executive summary**

Economic growth accelerated somewhat in 2005 to around 8% (6.2% in 2004) owing to strong performance of both industry and agriculture. The BTC oil pipeline was completed and a parallel gas pipeline from the Caspian Sea through Georgia to the Mediterranean is due to become operational in 2007. The privatisation process took off last year, bringing revenues equivalent to approximately 3% of GDP (0.9% in 2004).

As a result of better coordination of fiscal and monetary policies, inflation decelerated towards the end of the year, with annual inflation of 6.2% in December (7.5% in December 2004). The current account deficit widened to an estimated 12% of GDP (7.6% in 2004) owing to large inflows of capital goods for pipeline and other infrastructure investment. The deficit was covered by inflows of foreign direct investment.

The Government's reform programme continues to receive strong financial and technical support from the international community. Georgia resumed borrowing from the IMF in June 2004. The second review under the three-year PRGF arrangement was completed in July 2005. The World Bank approved in August 2005 a new Country Partnership Strategy for Georgia. In November 2005, the EU started consultations with Georgia on an Action Plan for the European Neighbourhood Policy.

In January 2006, the Council decided to provide macro-financial assistance to Georgia in a total amount of EUR 33.5 million in grants over a two-year period. As part of the preparations for the assistance, the Commission carried out in 2005 a follow-up assessment on Georgia's public finance management reforms.

### **5.2. Macroeconomic performance**

According to preliminary estimates, real GDP growth accelerated to about 8% in 2005 (compared to a revised real GDP growth rate of 6.2% for 2004). Industrial production performed particularly strongly (+18% year-on-year in January-September 2005) while the agricultural sector (accounting for about 16% of GDP) recovered after harsh weather conditions of 2004 (+5.2% year-on-year in January-September). The large oil and gas pipeline projects continued to have spill over effects in the services sector which nevertheless remains a relatively small sector. The strong economic growth of recent years has not reduced unemployment, however, because of on-going large-scale restructuring and retrenchment in the public sector which has not been matched by private sector job creation. In 2005, the unemployment rate was approaching 14%.

The authorities eased the fiscal stance in 2005 against a backdrop of continued strong performance in tax revenue collection and the projected windfall of privatisation revenues. Because of inflationary pressures (consumer price inflation reaching 9.4% year-on-year in the first half of 2005), the government decided however to delay the payment of remaining domestic expenditure arrears till 2006. Tax revenues as a

percentage of GDP remained broadly unchanged at about 18% of GDP despite lower tax rates of the new tax code which became effective in January 2005. Revenue growth outperforming the realised expenditure growth, the initially projected fiscal deficit of 4.8% of GDP on cash basis was reduced to below 1%.

Domestic public debt was reduced to about 8% of GDP (10.6% the year before) as the government had access to concessional external financing, notably from the World Bank. Yields on treasury bills were at around 14% in December 2005. The Ministry of Finance and the National Bank of Georgia (NBG) look for ways to develop a government bond market, starting with a conversion of existing government debt to the central bank into marketable securities. This would also help develop the central bank's monetary policy instruments.

Supported by re-monetisation, the NBG has maintained a prudent monetary policy stance. In 2005 the Georgian lari remained broadly stable in nominal and real terms after a sharp appreciation in 2004. The 12-month consumer price inflation peaked at 10.3% in April 2005 but decelerated then to 6.2% in December 2005 (7.5% in December 2004). Following increases in oil and food prices, the authorities became concerned with the inflationary risks in mid-2005 and earlier fiscal easing and accommodating monetary policy were readjusted accordingly in the second half of the year. Typical for many transition economies, dollarisation is persistent also in Georgia, but on a declining trend at about 70% at end-2005 (86% in 2003).

The increase in the current account deficit in 2005 was expected given the high import demand for the construction of the oil and gas pipelines as well as other infrastructure investments. The increase in the trade deficit was however balanced to some extent by strong growth in workers' remittances (+60% in 2005), most of which originates from Russia. According to preliminary estimates, the current account deficit was about 10% of GDP (7.6% in 2004). The gross international reserves of the NBU increased substantially during 2005, but still covered only about two months of imports at the end of the year.

Georgia's external debt decreased in nominal terms to USD 1.65 billion at the end of 2005, while as a ratio to GDP the external debt is estimated to have decreased further from 33.6% (2004) to about 27% (2005). Georgia has concluded agreements with nearly all bilateral official creditors in line with the July 2004 Paris Club agreement which reduced significantly Georgia's debt service 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. Given its present access to concessional loans on IDA terms, the government has refrained from all commercial borrowing.

In preparation for Georgia's future access to international capital markets, the authorities deemed appropriate to seek a sovereign credit rating. In December 2005, the Standard & Poor's rating agency assigned its B+ long-term rating to the government of Georgia with a positive outlook. The S&P stated that Georgia's rating is supported by the government's strong political commitment to prudent financial policies and market-oriented structural changes. The present rating is constrained by the short track record of political and economic stability, "together with uncertainties

connected with regional conflicts that may endanger the pace of reform or decrease investor interest in the region”.

### **5.3. Structural reform**

During the second year in office the new post-Rose Revolution government continued to make progress in structural reforms, presenting a growing legislative agenda to the parliament. A new licensing law was passed in July 2005 reducing drastically the number of licensed business operations from 900 to 150. The law on entrepreneurship was amended to streamline registration requirements for new businesses and eliminating the interference by courts in the process. The import tariff structure was simplified in line with WTO accession commitments in January 2005 and a further reduction in the number of tariff bands and maximum tariff rates is planned for 2007/2008. A new Customs Code was submitted to the parliament in September 2005, but not yet adopted, while work on secondary legislation on customs administration continued. The new Customs Code is expected to reduce hurdles in transit trade which is an important service sector in Georgia. Corruption and smuggling in customs and tax administration have been tackled by the authorities. Now the initial progress in enforcement needs to be consolidated through a comprehensive reform process so that a significant reduction in the shadow economy is achieved. According to official estimates some 30% of economic activities remain in the shadow.

Initial rehabilitation projects helped to achieve to a more reliable electricity supply in 2005, but substantial new investments over several years is required to secure the situation and to meet a growing demand. Quasi-fiscal deficit of the energy remains at around 4% of GDP. The authorities have been working on a new energy tariff structure. Privatisation of regional distribution companies and power generation companies is also an important part of the government’s strategy. Technical and financial viability of gas distribution is a particular concern. Some improvements could be expected after the bankruptcy proceedings of Tbilisi’s gas distribution company and its subsequent acquisition by a Kazakh state-owned company decided in December 2005. The gas pipeline for imports from Russia will be rehabilitated with assistance from the United States and the construction of the South Caucasus Pipeline from Azerbaijan is also progressing. Following the recent drastic price increase on imported gas, the government decided to subsidise households’ consumption in 2006 while more viable solutions to improve the overall energy security and viability are being sought.

In July 2005 the parliament adopted a law on the privatisation of agricultural land. As a next step, a functioning land market is needed to help farmers increase the size of their land holdings which is now one of the major obstacles in addition to access to financing. Privatisation of large state-owned enterprises accelerated so that total privatisation proceeds reached approximately 3% of GDP in 2005 (0.9% in 2004). Hasty privatisation procedures were however criticized for lack of transparency and coherent management. The controversies were partly due to the weaknesses of the privatisation law. Foreign direct investment was still dominated by the oil and gas pipelines, but the banking sector also started to attract some foreign investment in 2005.

A national anti-corruption strategy was prepared in 2005 focusing on reforms in civil service, procurement, internal and external audit, tax administration and regulatory barriers faced by businesses as well as the functioning of law enforcement bodies. According to the Transparency International's 2005 Corruption Perception Index Georgia's score improved slightly from 2.0 to 2.3 (in comparison to a score of 9.5-9.7 for the best performing countries).

#### **5.4. Implementation of macro-financial assistance**

When the European Community's exceptional financial assistance to Georgia expired at the end of 2004, the Commission launched preparations for a new Council Decision to provide further grant assistance to Georgia with a view to supporting the government's economic reforms and helping the country improve debt sustainability. Under the exceptional financial assistance, only EUR 31.5 million out of the total available grant amount of EUR 65 million was disbursed because of non-compliance with the conditionality, notably the IMF-supported economic program being off-track. The Commission proposed to the Council to make available the remaining uncommitted amount of EUR 33.5 million, linked to early principal repayments by Georgia. Georgia's outstanding debt to the Community totalled EUR 85.5 million at the end of 2005.

The Commission intends to focus on public finance management reforms in the policy conditionality attached to this assistance. In December 2005, the Commission (with external experts) conducted a follow-up mission to Tbilisi to update the 2004 Operational Assessment on financial circuits and administrative processes at the Ministry of Finance. Good progress had been made with Treasury reforms so that the single treasury account became fully operational in January 2006. A medium-term expenditure framework is in early stages of development, requiring strong support and commitment from all participants. An accounting reform strategy is being finalised and other second-generation treasury reforms are also underway. External and internal audit functions are not clearly defined yet, however. New legislation in this area is under consideration. Overall, the pace of the reforms has been commendable in the period following the Rose Revolution. The findings of the mission will inform the Commission in the design of the structural reform criteria for disbursements of the new macro-financial assistance.

On 24 January 2006 the EU Council decided to provide macro-assistance to Georgia up to EUR 33.5 million over a two-year period (Decision 2006/41/EC, published in the Official Journal of 28 January 2006). The first grant instalment will be conditional on the completion of the third review under the IMF-supported economic programme (foreseen in spring 2006) and an early debt repayment by Georgia to the Community.

Summary Status of Economic Reform	
<b>1.</b>	<p><b>Price liberalisation</b></p> <p>No administratively set prices exist outside the utilities sector. Administered prices account for about 5% of the CPI basket.</p>
<b>2.</b>	<p><b>Trade liberalisation</b></p> <p>Liberal trade policy. Georgia has been member of the WTO since June 2002. Based on margins allowed at WTO accession Georgia initially raised the number of tariff bands and the maximum tariff but then reversed its trade policy in 2005, and further reductions in tariffs are planned as of 2007. Non-tariff barriers allowed for environmental, security and health reasons only in line with the PCA.</p>
<b>3.</b>	<p><b>Foreign exchange regime</b></p> <p>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.</p>
<b>4.</b>	<p><b>Foreign direct investment</b></p> <p>Adequate overall legislation. Unlimited repatriation of capital and profits. Net inflows of FDI 10% of GDP (2004).</p>
<b>5.</b>	<p><b>Monetary policy</b></p> <p>Prudent monetary policy has contributed to the stabilisation of the inflation at a low level. Dollarisation of the economy decreased recently but remains at around 70% of total deposits.</p>
<b>6.</b>	<p><b>Public finances</b></p> <p>Total fiscal revenues (including grants) estimated at 22% of GDP (2005), of which tax revenues 18% of GDP. Total expenditure and net lending estimated at about 24% of GDP). Under the new Budget System Law, which became effective on January 1, 2004, the treasury system is being reformed, including a full functioning Single Treasury Account as of January 2006. A medium-term expenditure framework is being developed. A new liberal tax code is effective as of January 1, 2005.</p>
<b>7.</b>	<p><b>Privatisation and enterprise restructuring</b></p> <p>The private sector accounts for about 65% of GDP. Small scale privatisation largely completed while large scale privatisation accelerated in 2004-2005 after a standstill. New legislation adopted in 2005 on land privatisation.</p>
<b>8.</b>	<p><b>Financial sector reform</b></p> <p>There are 21 operating banks (of which 8 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.</p>

## **6. MOLDOVA**

### **6.1. Executive summary**

The upswing that began in 2000 continued in 2005, as year-on-year GDP growth exceeded 7%. Domestic demand fuelled by buoyant remittances from Moldovans working abroad continues to drive the economy's expansion.

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 2004-early 2005 moderated gradually to about 10%, reflecting mainly increased sterilisation efforts by the National Bank.

Fiscal policy was loosened in the run-up to parliamentary election in spring 2005; however, as at the same time fiscal revenue increased substantially, the surplus of the general government account was not put in threat and even widened. This allowed the government to set aside some funds in view of a future debt settlement with official creditors (Moldova is still in arrears with the Paris Club members). Reflecting the rise in the GDP and higher debt repayments than new disbursements, the public debt-to-GDP ratio has dropped further significantly, to around 26%.

The implementation of structural reforms accelerated in 2005 following the adoption of the Economic Growth and Poverty Reduction Strategy and of the EU-Moldova Action Plan under the Union's European Neighbourhood Policy. New legislation was adopted in the areas of business environment and enterprise reform and the financial sector, an ambitious public administration reform was launched and some progress was achieved in reforming the social protection system. At the same time, privatisation process has not advanced and very little was done to reform the energy sector and the municipal services. Also, corruption remains a matter of concern.

Moldova received no EC-macro-financial assistance in 2005. 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. The Council Decision providing the legal framework for this operation is no longer valid since December 2005.

### **6.2. Macroeconomic performance**

Moldova's economic recovery continued in 2005, with real GDP growth remaining slightly above 7%, which is also the average growth rate in the last five years. Since the resumption of growth in 2000, the country's GDP increased by more than 40%. Moldova's strong growth performance is driven primarily by domestic household consumption and construction fuelled by booming workers' remittances – officially recorded to 30% of GDP. Exports continued growing albeit at a slower pace than in 2004 (an estimated 12.6%, in current dollar terms, against more than 23% in 2004). At the same time, imports increased by nearly 30% (again, in value terms), reflecting growing imports of consumer goods and higher energy prices. The result of these



trends was a substantial widening of the trade deficit, to nearly 38% of GDP (up from about 30% in 2003-2004), and of the current account deficit, to more than 7% of GDP (from less than 3% in 2004). The strong increase of the remittances – by more than one quarter – was clearly not enough to compensate for the worsening of the trade balance.

Inflation accelerated in the last months of 2004 and the first months of 2005 in run-up to the parliamentary election in spring 2005, reflecting continued large inflows of remittances. The twelve-month consumer price index (CPI) increased from below 11% in October 2004 to 14.2% in April 2005. Later in the year, inflation moderated gradually to an end-year figure of some 10%. This was largely the result of a sharp increase in the sterilisation efforts by the National Bank of Moldova, supported by restrictive fiscal policy (see below). The gradual easing of inflationary pressures allowed a moderate depreciation of the nominal exchange rate of the leu (by a little less than 3%, against the US dollar); yet the real effective exchange rate appreciated by about 2.5%. The National Bank of Moldova continued accumulating international reserves but their level is still well below three months of imports, the medium-term target of reserve accumulation in Moldova. For 2006, the National Bank intends to put more emphasis on controlling inflation while continuing building up reserves and maintaining a competitive exchange rate of the national currency.

In 2004 the fiscal stance was loosened considerably with primary expenditure overshooting considerably the budget plans. Yet, as revenue performance also exceeded the original budget projections, the budget remained in surplus (of about 0.7% of GDP). In 2005, fiscal revenue increased further reflecting a sharp rise in the revenue from taxation of consumption, primarily of VAT on imported goods. As a result, and despite further increase in public spending, the general government surplus widened further, to an estimated 1.5% of GDP. Yet, despite a seemingly comfortable fiscal position, Moldova's public finances situation remains extremely fragile given that the country is not servicing in full its external debt obligations. While Moldova continued servicing current interest on its debt to the Paris Club (it had resumed interest payments to the official creditors in July 2004), arrears on principal repayments continued to build up. The stock of arrears to the Paris Club at the end of 2005 was estimated to about USD 55 million, or more than 2% of GDP. The settlement of arrears remains a precondition for restoring Moldova's relations with the international financial community after the default of 2002. Since the resumption of interest payments to the official creditors, the authorities have been pursuing a policy aimed at normalising their relations with the creditors. It is in this context that they established in 2005 an escrow account in the budget, to be used for a future settlement of arrears in the event of a Paris Club agreement. In view of the results of the recent talks with the IMF on a new financing arrangement (see below), such an agreement seems now within reach.

Pending a possible Paris Club debt consolidation agreement, Moldova continued reducing gradually its external indebtedness. While in the course of 2004, Moldova had managed to conclude a number of bilateral debt reduction deals (both with non-Paris Club official and private creditors), in 2005 the reduction of the stock of the external debt was the result of regular principal repayments, not matched by new disbursements. It is estimated that at the end of 2005 Moldova's public and publicly guaranteed external debt was below USD 800 million or 26% of GDP (down from 34% one year earlier and still about 60% in 2002). Non-publicly guaranteed external

debt is substantially higher – between USD 1.1 and 1.2 billion. A large part of this debt – probably over 50% – is the debt, including arrears, for natural gas deliveries from Russia. Given the still low level of foreign exchange reserves and the large current account deficit, Moldova remains dependent on additional support from the IFIs and bilateral donors. Also, the burden on the economy of servicing debts remains high – about 20% of exports of goods and services.

### 6.3. Structural reform

The resumption of economic growth in Moldova in the beginning of the millennium coincided with a virtual standstill in structural reforms. During this period, the government's failure to achieve any significant progress in privatisations and enterprise restructuring and its excessive administrative interference in the economy led to a marked deterioration of the business climate. Starting from 2004, however, structural reforms re-appeared on the government's agenda. Already in 2004, attempts were made to improve conditions for business activity and SME development and attract foreign investment. One important step in this direction was the adoption of the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) in May 2004 setting medium-term priorities for government action and identifying, among the key prerequisites for sustainable growth, a sound business environment. The Government's renewed commitment to economic reforms has been reinforced by its stated European aspirations culminating in the adoption in early 2005 of the EU-Moldova Action Plan in the context of the European Neighbourhood Policy. This Plan aiming at establishing an increasingly close relationship between the EU and Moldova seems to be a very powerful driver for reforms.

Among particular structural policies implemented in 2005, the following should be singled out. In the area of *business environment and enterprise reform*, the main effort was in streamlining business regulation under the so-called Guillotine Law. The Guillotine Law aims at reviewing more than 1000 business regulations with the aim of cancelling most of them and streamlining the rest. Licensing and inspection costs have already been reduced substantially and are expected to be cut further when the review of the regulatory framework will be completed. In addition, the Parliament adopted amendments to the company law streamlining the ownership and corporate governance regulations. In the area of public enterprise management, the only noticeable development was the completion by the government of the inventory of the state asset holdings.

At the same time, the government launched a major *public administration reform*. The reform prepared with donor support consists in streamlining the public administration and reforming the civil service and aims at improving the government's capacity for decision making. It goes in parallel with the continuous improvement of the Medium-term Financing Framework (MTFF) aiming at a better use of government financial resources, an issue of particular importance in the context of the financing of the policies spelled out in the EGPRSP.

In the area of *social protection*, the government pursued the implementation of the pension reform programme. The reform aims at replacing the system based on the level of wages by the one based on actual contributions, while refraining from introducing new pension privileges. Also, the government initiated the reform of the

system of social assistance benefits with the aim of switching from the current targeting of specific categories of population to the one based on actual income.

The *financial sector reform* and consolidation progressed further, building on the recommendations of the Financial Sector Stability Assessment (FSAP) completed by the IMF in January 2005. The FSAP concluded that the banking sector is fundamentally sound but identified a number of structural shortcomings, including weaknesses in governance related to the government interference and the lack of transparency in the ownership of banks and their clients. The recently adopted amendments to the Law on Financial Institutions aim at correcting some of these weaknesses but much still needs to be done to improve the efficiency of the banking sector and open it up to competition from reputable foreign banks. One of the main issues that the authorities will need to tackle in the future is the restructuring and privatisation of the country's largest financial institution, the Savings Bank (Banca de Economii).

In several other areas progress has been more modest. While the *trade regime* remains fundamentally liberal, there are still formal and mostly informal restrictions on exports of some key commodities. The reforms of the *energy sector* and *municipal infrastructure* have hardly started. The weaknesses of Moldova's energy and municipal services regulation were highlighted in late 2005-early 2006 when Moldova faced a substantial rise in the price of imports of natural gas from Russia. The corruption remains a serious concern, despite a perceived improvement (Moldova's position in Transparency International's global Corruption Perception Index has improved).

#### **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 and is expected to have repaid the loans in full in 2006. The third 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. However, no disbursements were made under the latter in the absence of a working financing arrangement with the IMF. The Council Decision providing the legal framework for this operation remained valid until December 2005 but has now expired.

In the beginning of 2006, the Moldova's authorities reached an agreement with the IMF on the parameters of a new financing arrangement under the Fund's Poverty Reduction and Growth Facility (PRGF). The PRGF programme is to be approved by the Fund Executive Board in the first half of 2006.

<b>Summary Status of Economic Reform</b>	
<b>1. Price liberalisation</b>	Most prices have been liberalised.
<b>2. Trade liberalisation</b>	Relatively liberal international trade policy on paper, but formal or, mostly, informal restrictions on some key commodities exist (notably wheat and sunflower seed). Moldova became a member of the WTO in June 2000.
<b>3. Exchange regime</b>	The leu is convertible for current account operations. Floating exchange rate.
<b>4. Foreign direct investment</b>	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, after having declined in 2002-2003, is now growing but is still very modest.
<b>5. Monetary policy</b>	After acceleration in inflation in early 2005 reflecting continued large inflow of remittances, the National Bank stepped up sterilisation. As a result, inflation moderated gradually. The National Bank expected to pursue a tighter policy course aimed at controlling inflation while still continuing to accumulate forex reserves.
<b>6. Public finances</b>	Fiscal stance improved in 2005. Budget revenue increased reflecting sharp rise in taxation of consumption. As expenditure increase was smaller, the general government surplus widened to 1.5% of GDP. No further widening of the surplus is expected in 2006 given that Moldova is expected to need all possible fiscal resources to settle its debt arrears to the Paris Club (about 2% of GDP). Public external debt was cut to about 26% of GDP as a result of repayments not matched by new lending. Medium-term Financial Framework was further improved.
<b>7. Privatisation and enterprise restructuring</b>	Structural reforms have accelerated in several key areas boosted by the start of the implementation of the EGPRSP and the adoption of EU-Moldova ENP Action Plan. The simplification and streamlining of the regulatory environment of the enterprises has advanced through the implementation of the "Guillotine Law". Company law was amended. Yet virtually no progress was achieved in privatisation. Other key areas of structural reforms – public administration and social protection reforms – progressed. Yet business environment suffers from state intervention and formal and informal business restrictions.
<b>8. Financial sector reform</b>	The financial sector is in a relatively good shape, but further strengthening is crucial to mobilize savings and promote investment. Amendments to the banking legislation adopted in 2005 to improve governance through better transparency in ownership.

## **7. SERBIA AND MONTENEGRO**

### **7.1. Executive summary**

The economic performance of Serbia and Montenegro has been robust in 2005 driven by strong gains in trade, transportation, financial services and construction. GDP in Serbia is estimated to have grown by 6.5% year-on-year for the whole year and in Montenegro by 3.8% in the first nine months of 2005. Inflation in Serbia accelerated and reached 17.5%, while it stood at 2.4% in Montenegro. Fiscal policy has again been tightened in Serbia, and the consolidated general budget is projected to have reached a surplus of 1.1% of GDP. The external sector remains vulnerable given the country's weak export performance. However, strong FDI inflows have somewhat eased financing requirements. In both Republics, the reform momentum has again been strong in 2005 and in Serbia, the share of the private sector is estimated to have increased to 55% of GDP as privatisation and restructuring of the enterprise sector has been progressing. A Supplemental Memorandum of Understanding, laying out the economic policy conditions attached to an EUR 70 million additional macro-financial assistance, was signed on 29 November 2005 and the first tranche grant component of EUR 25 million was paid in late December 2005. The payment of the first tranche loan component of EUR 15 million was delayed pending ratification of the Loan Agreement by the Federal Parliament.

### **7.2. Macroeconomic performance**

#### **Serbia**

In 2005, Serbian GDP is estimated to have grown by 6.5% year-on-year driven by strong gains in trade, transportation, financial services and construction, more than offsetting a drop in agricultural output. Industrial production grew at a modest 1.3% for the whole year, while showing a robust recovery in the second half of the year. Inflation remained at double digits throughout the year and stood at 17.5% year-on-year in December, mainly driven by strong domestic demand, increases in administered prices, the rising cost of fuel imports and the one-off effect of VAT introduced in January 2005, but was also aggravated by the exchange rate indexation of prices.

Fiscal policy has been further tightened in 2005 and the consolidated general budget is projected to have reached a surplus of 1.1% of GDP, reflecting prudent budget execution amid lower than expected revenues, and measures to curb down subsidies and transfers. Monetary policy has been challenged to stem the rapid expansion of broad money and robust credit growth, as substantial capital inflows created appreciation pressure. Foreign exchange market interventions by the NBS have boosted money market liquidity, which was only insufficiently sterilised.

The current account deficit of Serbia has narrowed to 10.2%, based on strong export growth in the first half of the year and subdued import growth despite rising world oil prices. Nevertheless, exports remained at about half of imports in absolute terms. The financial account substantially improved on surging foreign direct investment

(FDI) and increased access to foreign loans. FDI surged to 7.7% of GDP, and foreign borrowing, mostly by the private sector, has increased to 7.6% of GDP. Foreign exchange reserves have risen to USD 5.9 billion or 5.2 months of imports. External debt-to-GDP remained high at about 61%. Debt service increased to 6.6% of GDP and is projected to rise further in coming years.

### **Montenegro**

In Montenegro, real GDP rose by 3.8% in the first nine months of 2005, reflecting upwards trends by 1.3% in industrial output (mining and processing industry). Retail sales turnover went up by 11.7%, while the construction sector recorded an increase of 11%. In 2005 the budget deficit was 2.8% of GDP.

The current account deficit widened in the third quarter of 2005 to EUR 42.3 million (3.6% of GDP for the period). The major factor for the gap widening was the strong expansion of the trade deficit, which increased for the same period by 34% (EUR 355.4 million). The reasons were the low competitiveness of domestic products, the higher prices and strong imports of crude oil derivatives (58% of total imports for the period January-September), and the decrease of the prices of the main exports items of the country (aluminium and steel). Moreover, surpluses in the services account (21.2%) and the current transfers balance (9.7%), due to growing tourism activity and rising workers remittances, were not sufficient to alleviate the current account deficit. Net foreign direct investment reached EUR 360.4 million by November 2005, a size which is not expected to recur, reflecting the privatisation in 2005 of the state most attractive assets (Telekom Montenegro, Podgorica Aluminium Plant, and Podgorica Banka).

By September 2005, external debt had decreased to 30.6% of GDP (EUR 503.4 million), from a level of 31.8% in end 2004.

## **7.3. Structural Reforms**

### **Serbia**

Reform momentum has again been strong in 2005. The share of private sector is estimated to have increased by 5 percentage points to 55% of GDP. However, a large share of resources is still held in uncompetitive activities in the public and socially owned sectors, lowering the growth potential. Privatisation of the socially owned companies progressed. Over 100 companies have also been declared insolvent under the new bankruptcy law which entered into force in February 2005. Restructuring of the public enterprises progressed with the spin-off of about 100 non-core companies and assets as well as the reduction in overstaffing. The restructuring of network industries, such as the energy, telecommunications and transport sector is still in its initial phase. There was some progress in the creation of a necessary regulatory framework and establishment of well-equipped regulatory agencies for these sectors. Bank privatisation proceeded successfully and supervision improved, but the increase in non-performing loans is of concern. The privatisation of four state banks helped raise the share of foreign bank ownership to 63% by end-September. The capital adequacy ratio was increased from 10 to 12% and a new banking law aligning current practises towards Basel Core Principles was adopted.

## **Montenegro**

The government launched an ambitious project for the restructuring of 97 companies to be either privatised or liquidated, and their assets sold. Major privatisation deals took place in 2005 with the sale of Telekom Montenegro, the aluminium producer KAP and Podgoricka Banka. The share of foreign capital in the banking sector increased in 2005 with several majority or minority shares purchases. A bank merger between NLB Montenegrobanka and Euromarket Bank was the first operation of this type in the republic. The volume of trade on the two Montenegrin stock exchanges increased sharply in 2005, reaching EUR 198.5 million, more than four times the total volume in 2004 (EUR 43 million).

### **7.4. Implementation of macro-financial assistance**

Following a first EUR 345 million assistance package implemented in 2001/2002, the Council adopted on 5 November 2002 a Decision (Council Decision 2002/882/EC) to provide further EC macro-financial assistance to the Federal Republic of Yugoslavia in an amount of up to EUR 130 million to underpin economic policies in the context of the three-year IMF Extended Arrangement (2002-2005) approved in May 2002 and to support the balance of payments. Of this assistance, EUR 55 million were in the form of a loan and EUR 75 million in grant. A Memorandum of Understanding (MoU) was signed in December 2002 which specified the economic policy conditions and structural measures for the release of the second and the third tranche of this assistance. The first tranche, comprising of EUR 10 million in loan and EUR 30 million in grant, and the second tranche, comprising of EUR 30 million in loan and EUR 35 million in grant, were paid in spring and fall 2003, respectively. The disbursement of the third and last tranche was delayed due to lack of progress in the implementation of structural reforms. After additional reform progress in 2004, the third tranche was released and the grant element of EUR 10 million was paid in December 2004. The payment of the loan element of EUR 15 million was completed in March 2005.

In June 2004, the Commission has carried out operational assessments of the financial circuits and procedures in the Ministries of Finance and the central Banks of Serbia and Montenegro with the assistance of an external consultant. These assessments concluded that despite some weaknesses of the administrative procedures in the Ministries of Finance, a framework for sound financial management at both authorities is effective.

On 25 November 2003, the Council further decided (Council Decision 2003/825/EC) to increase the current macro-financial assistance to up to EUR 200 million to address additional external financing needs identified by the IMF. In December 2004 the Council extended the legal basis of this assistance until 30 June 2006 (Council Decision 2004/862/EC). This additional assistance of EUR 70 million comprises a EUR 25 million loan and a EUR 45 million grant. It is available in two tranches of EUR 40 million and EUR 30 million, respectively. A Supplemental Memorandum of Understanding (SMoU) laying out the economic policy conditions attached to this additional assistance was signed on 29 November. The first grant tranche of EUR 25 million was released in December 2005 upon satisfactory compliance with conditionality requirements as defined in the SMoU. The payment of the loan tranche

of EUR 15 million was delayed beyond the end of the year, pending ratification of the Loan Agreement by the Federal Parliament.



## 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 2005, 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, 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

Serbia applies a managed floating exchange rate regime under which the nominal exchange rate was kept stable in 2001 and 2002 resulting in a substantial real appreciation during that period, though from a probably undervalued level at end-2000. In 2004, the National Bank of Serbia allowed for a stronger nominal depreciation to preserve the economy's competitiveness. In 2005, the degree of nominal depreciation was slowed despite pressures towards appreciation from large capital inflows, reflecting a trade-off between inflation and current account objectives. In Montenegro, following the unilateral introduction of the German mark in 1999, the euro is now the sole legal tender in the republic.

### 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 portfolio investments remain low. In 2005, FDI is expected to have increased to 7.7% of GDP, consisting mainly of privatisation revenues and amounting to EUR 1,255 million and EUR 630 million to Serbia and Montenegro, respectively.

### 5. Monetary policy

In Serbia, the execution of a stability-oriented monetary policy in 2005 was hindered by the high euroisation of the economy and strong capital inflows. Annual inflation accelerated to 17.5% in 2005, mainly driven by strong domestic demand, increases in administered prices, rising cost of fuel imports and the one-off effect of the VAT introduced in January 2005. In Montenegro, given the adoption of the euro as sole legal tender, the scope for an independent monetary policy is limited and annual inflation reached 3.4% in 2005.

### 6. Public Finance

In Serbia, fiscal policy was contractionary in 2005, also in cyclically-adjusted terms. This has helped to contain domestic demand and contributed to an improvement of external accounts. VAT was introduced in January 2005 and has helped to bolster revenues.

### 7. Privatisation and Enterprise Restructuring

Privatisation efforts in Serbia remained high in 2005. However, the restructuring of large socially owned enterprises and public utilities is still at an early stage. In Montenegro, the privatisation of the giant aluminium factory and of the telecommunication company was completed in 2005 and boosted Foreign Direct Investment.

### 8. Financial Sector Reform

Banking supervision has been strengthened in both republics. The process of bank restructuring and privatisation in Serbia continued in 2005. Six previously state-owned banks have been offered for tender sale and four of those have been sold by year end 2005. In Montenegro, the privatisation of the last state-owned bank (Podgorica Banka) was completed in 2005.

## **8. TAJIKISTAN**

### **8.1. Executive summary**

Tajikistan's economy has continued to grow strongly last year, recording 7.5% real GDP growth. The government budget surplus has been estimated at 0.1% in 2005 (a surplus has been recorded for the third consecutive year) and Tajik external debt has fallen to less than 40% of GDP. Annual average inflation in 2005 is estimated to have remained at about 7%. The current account deficit in 2005 is estimated to have narrowed from 4% of GDP in 2004 to 3.6% in 2005.

Satisfactory results are noted in the area of structural reforms. Implementation of the new simplified Tax and Customs Code, an improved VAT administration and the increase in VAT collection on imports - following a switch to the destination principle in intra-CIS trade - have contributed to a rise in tax collection. In the framework of the privatisation strategy 2003-2007, an external audit of the gas distribution company (Tajikgaz) was completed in February 2005 by a Russian external audit company acceptable to the World Bank and the IMF. Progress was made in the issuance of land use certificates. In addition, an agricultural debt strategy has been worked out by the Tajik authorities and the donor community, complemented by an action plan for implementation. The minimum capital requirement for banks has been raised from USD 1.5 million to USD 5 million. Non-complying banks are closed down or merged with other banks.

A final (fifth) grant instalment of EUR 7 million under the Exceptional Financial Assistance (EFA) to Tajikistan will be disbursed if the related conditionality is met and after Tajikistan has made a fourth early debt repayment of EUR 8 million. The review process is ongoing.

### **8.2. Macroeconomic performance**

Tajikistan's economy has continued to grow strongly in 2005. Continued robust inflows of workers' remittances have boosted retail trade, but growth in agriculture and industry has decelerated. Real GDP growth of 7.5% is estimated for the full year, compared to 10.6% in 2004.

Tax collection as a ratio to GDP has increased from 14.9% in 2003 to 15.2% in 2004 and to an estimated 16% in 2005. A key factor contributing to this upward trend is an improved VAT administration and the increase in VAT collection on imports following a switch to the destination principle in intra-CIS trade. Nevertheless, the government budget surplus has narrowed from 0.9% of GDP in 2003 to 0.7% in 2004 and to an estimated 0.1% in 2005. Increased revenue has been more than offset by a rise in spending in areas such as health and education.

The National Bank of Tajikistan (NBT) has maintained a relatively tight monetary policy in 2005 to keep inflation under control. However, weak institutional capacity, the expected fiscal loosening and the undeveloped nature of Tajikistan's financial sector have continued to constrain the NBT's conduct of monetary policy. Inflation has been pushed up by rises in domestic utility tariffs, increases in public sector salaries, pensions and the minimum wage, ongoing robust inflows of workers'

remittances contributing to growth in domestic demand and high fuel prices. Annual average inflation in 2005 is therefore estimated to have remained at about 7%.

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 \$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 under construction). This agreement implies that the Tajik external debt has fallen to USD 700 million or less than 40% of GDP.

Tajikistan's trade deficit has increased from 7% of GDP in 2004 to about 12% in 2005. This is due to deterioration in the country's terms of trade reflecting higher import prices for oil/gas and weaker export cotton prices, coupled with a rapid growth in consumer imports and a lower volume of cotton exports. Nevertheless, the current account deficit in 2005 is estimated to have narrowed from 4% of GDP in 2004 to 3.6% in 2005. This is mainly a result of the rapid growth in foreign remittances, having increased by almost 50% from their 2004 level.

### **8.3. Structural reforms**

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. A group of 37 large and strategic enterprises will be dealt with individually, with specific privatisation and restructuring programmes to be developed for each. This list includes the aluminium smelter Tadaz, the electric power company BarkiTajik, the state telecom company Tajiktelecom, the state railway monopoly Tajikrail and the national airline carrier Tajikair. In the framework of the strategy, an external audit of the gas distribution company (Tajikgaz) was completed in February 2005. It has been conducted by a Russian external audit company, acceptable to the World Bank and the IMF, who identified major accounting deficiencies that need to be addressed.

Progress was made in the issuance of land use certificates. In 2004, 35,000 certificates - representing 75,000 ha of land - have been issued and distributed to 280,000 farmers. During the first half of 2005, 70,000 certificates have been issued, of which 36,000 were actually distributed. However, progress in farm privatisation has been hindered by the indebtedness of state-owned farms. State farms - mainly in the cotton sector - have accumulated about USD 220 million in debt (close to 10% of GDP), mostly 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. In addition, an agricultural debt strategy has been worked out last year by the Tajik authorities and the donor community, complemented by an action plan for implementation. A first pillar of the action plan considers urgent measures to address the debt issue, while a second part deals with long term development of the agricultural sector.

The minimum capital requirement for large banks has been raised from USD 1.5 million in 2004 to USD 5 million as from 1st January 2005. Small banks have to meet the requirement since end-2005. The National Bank of Tajikistan (NBT) has become stricter on banks that do not comply with regulations. They are closed down

or merged with other banks. Commercial bank's compliance with International Accounting Standards (IAS) is considered to be satisfactory.

#### **8.4. 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.

In June 2004, an operational assessment of the reliability of financial circuits and procedures has been carried out with the assistance of an external consultant; the main weaknesses detected concern mainly the organisation of the Ministry of Finance and the independence of the control bodies. Nevertheless this assessment concluded that a framework for sound financial management is effective.

As Tajikistan has made satisfactory progress in macroeconomic policies and in structural reform, it has benefited from maximum annual grant instalments totalling EUR 28 million so far. On the other hand, the EC has not pushed for the maximum annual debt repayments which the MoU would have allowed. In 2001, 2002 and 2005, 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 36 million. A final (fifth) grant instalment of EUR 7 million will be disbursed if the related conditionality is met and after Tajikistan has made a fourth early debt repayment of EUR 8 million. The review process is ongoing.

## 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 around 2% of GDP in 2003 and 1.5% in 2005. In 2004, FDI/GDP was exceptionally high at 13% because of the debt-for-equity swap with Russia.

### 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 directed credits from the NBT to the cotton sector.

### 6. Public Finance

Total tax collection of the general government has increased from 14.9% of GDP in 2003 to 15.2% in 2004 and further to an estimated 16% in 2005. 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. In the framework of the strategy, an external audit of the gas distribution company (Tajikgas) was completed in February 2005 by an audit company acceptable to the IMF and the World Bank.

### 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. The minimum capital requirement for commercial banks has been raised from US\$ 1.5 million to US\$ 5 million. Non-complying banks are closed down or merged with other banks. Compliance with IAS is considered to be satisfactory.

## **9. UKRAINE**

### **9.1. Executive summary**

Real GDP growth was modest at 2.6% in 2005 (12.1% in 2004) mainly because of weaker external demand for Ukraine's steel exports and sluggish investment activity under an uncertain government policy environment. The trade balance turned negative and the current account surplus of 10.5% (2004) was halved. Although the fiscal deficit was contained at below 3% of GDP (4.4% in 2004), inflation continued to be fuelled by increases in public expenditure on pensions, wages and social transfers, in particular as the supply side response was constrained. Average consumer price inflation for 2005 reached 13.5% (9.0% for 2004).

Notwithstanding its overall reform orientation, the new Government nominated after president Yushenko's election victory was marred by internal disputes and lacked coherence in economic policy-making. The government pursued WTO accession actively but the parliament continued to oppose key economic legislation. In December 2005, the EU granted Ukraine a market economy status for anti-dumping purposes.

Ukraine's precautionary stand-by arrangement (SBA) with the IMF expired at the end of March 2005 (in fact off-track since the autumn 2005 due to slippages in fiscal policy), and the country did not pursue active discussions with the Fund on any successor arrangement. Accordingly, the EC's macro-financial assistance (decided in 2002) continued to be on hold in case Ukraine's external financial situation deteriorates so that it decides to request access to IMF resources.

### **9.2. Macroeconomic performance**

A negative terms-of-trade shock (import prices of energy increasing while world market prices on metal exports tumbled), combined with sluggish investment under an uncertain government policy environment, led to a hard landing with a real GDP growth rate of 2.6% in 2005. This is the lowest growth rate registered since 2000 when economic recovery started in Ukraine, resulting in an average real GDP growth rate of 8.4% in 2000-2004. On production side, the deceleration of growth last year derived from a reduction in value added in construction and trade (respectively -6.7% and -8.5%) and a modest growth in manufacturing (3.0%) and agriculture (0.4%). The recorded negative growth in trade is attributed to the elimination of artificial wholesale schemes while retail trade continued to grow, boosted by a strong increase in real incomes (about 20% year-on-year). Metal production and machine building were most badly affected by the slowdown, while food and chemical industries enjoyed more stable growth. Private consumption was driving the growth as net exports turned negative in 2005. Investment/GDP ratio declined to 19%, exacerbated by cuts in planned public investments.

Average consumer price inflation was 13.5% in 2005 (9.0% in 2004). The 12-month inflation decelerated somewhat towards the end of the year, reaching 10.3% in December (14.4% in mid-2005). The CPI has a large share of food products; neither domestic supply nor imports did meet increase in demand following the government's expansionary fiscal policy, under which increases pensions, wages and

social benefits continued. Increases in utility and transportation tariffs added to inflation.

The trade balance turned negative last year and the current account surplus of 10.5% (2004) is estimated to have narrowed to below 5% of GDP. Exports of goods increased by 5% (37% in 2004), and imports by 25% (26% in 2004). As China became a net exporter of steel last year, world market prices for Ukraine's most important export commodity declined. Other factors contributing to the negative trade balance were higher oil prices, appreciation of hryvnia (in nominal and real terms), liberalisation of imports of consumer goods and robust growth in households' disposable incomes.

The central government's fiscal deficit was somewhat below 2% of GDP (below 3% for the general government according to preliminary estimates) as revenue collection met the budgeted target and expenditures were executed below the budgeted plan. Strong tax revenue collection (tax revenues increasing from 30% of GDP in 2004 to around 34% of GDP last year) helped to reverse the widening of the deficit (from a deficit of -4.4% in 2004). On the other hand, the increased tax burden risks maintaining economic activities in the shadow. The Pension Fund's expenditures doubled in 2005 following increases in minimum pensions so that pension outlays as a percentage of GDP are among the highest in the world at nearly 16%. Transfers from the state budget covered the Pension Fund's deficit of around 4% of GDP. The Pension Fund's imbalance is also effectively constraining efforts to reduce payroll taxes.

Ukraine's public external debt of USD 13 billion is, however, at a sustainable level of about 16 percent of GDP. The gross international reserves of the National Bank of Ukraine (NBU) doubled in 2005 (USD 19.4 billion as of December 2005) mainly as result of privatisation-related capital inflows in the last quarter of 2005. The international reserves cover about 5 months of imports. The NBU continued interventions in the interbank market to maintain the de facto peg of the hryvnia to the US dollar (at 5.05 hryvnia per dollar) following the 5-percent nominal revaluation in April 2005.

In September President Yushchenko dismissed the first post-Orange Revolution government led by Tymochenko, which was marred by internal divisions. The political situation remained uncertain in anticipation of the March 2006 parliamentary elections and the parliament's no-confidence vote on the Yekhanurov's government in the beginning of 2006 added to the pre-election tensions. The rating agencies, however, maintained Ukraine's sovereign rating at BB (with stable outlook) supported by low government debt and good external liquidity.

The short-term macroeconomic challenges to be addressed immediately after the March elections include bringing inflation to single digits and putting in place a sustainable fiscal framework. The external balance is vulnerable to a further fall in metal and other export prices in addition the impact of higher gas prices on imports.

### **9.3. Structural reforms**

The stated intentions of new Government to improve the business climate were effectively undermined by questions such as the extent of "re-privatisation"

(reacquisition and resale of privatised assets which had been sold under non-transparent deals to insiders) while adoption of key economic legislation such as Joint Stock Company Law was pending in the parliament. The persistent problems with the VAT refunds to exporters were tackled and the outstanding stock of arrears was reduced while a more transparent management of the VAT refund system needs to be put in place.

In December 2005, the European Commission concluded that Ukraine had met the technical criteria for a market economy status in the context of anti-dumping investigations. This decision followed commitments by the government on non-interference in pricing mechanisms and clarifications on the application of bankruptcy legislation. Ukraine has made progress with its accession to the WTO by signing bilateral protocols on market access with some 40 WTO members (including the EU and also the United States in early 2006). Ukraine is now aiming at joining the WTO in 2006. The parliament approved several important pieces of new legislation to meet WTO accession requirements (such as on protection of intellectual property rights) while some significant bills were blocked by vested interest so that the legislative programme for WTO accession remains to be completed by the new parliament after the March 2006 elections.

The acquisitions of the Kryvorizstahl steel plant and the Aval Bank by foreign investors boosted foreign direct investment in 2005, which reached a record total of USD 7.3 billion. The cumulative FDI inflows (1989-2005) in per capita terms increased from USD168 to USD 349 in one year. Pre-occupied by the review of past privatisations, the government made only modest progress with new privatisation deals in particular as the parliament barred potential deals.

In 2005 the NBU took steps to liberalise foreign currency regulations. In April the mandatory sale of 50% of export proceeds was dismantled. In September inter-bank foreign currency trading was further liberalised and a forward market was established. Nevertheless, a duty of 1.5% on non-cash currency exchange operations (collected for the pension fund) impinged on the market's further development. New legislation was proposed to allow branches of foreign banks to operate more freely in Ukraine. The interest among EU banks to enter the Ukrainian market is increasing.

Fight against corruption and a public administration reform were important priorities for the authorities in 2005, starting with the customs administration. According to the Transparency International's 2005 Corruption Perception Index Ukraine's score increased from 2.2 in 2004 to 2.6 (in comparison to a score of 9.5-9.7 for the best performing countries) which improved its ranking from 122 to 107 (among 159 countries surveyed in total). Businesses report that tax administration and the regulatory burden are main obstacles for doing business in Ukraine.

#### **9.4. 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 thereafter, 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 which expired at the end of March 2005. Ukraine's external liquidity remained good in 2005, and the country did not pursue discussions with the IMF on a successor programme.

The Commission has adopted a 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 2005 to a total of EUR 118 million.

<b>Summary Status of Economic Reform</b>	
<b>1. Price liberalisation</b>	Most prices have been liberalised. Communal service tariffs (such as gas, electricity, heating and rents) are subject administrative controls and tend to be below full-cost recovery levels.
<b>2. Trade liberalisation</b>	Import regimes free of quantitative restrictions with 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 between 0 and 70%. A few export restrictions remain, namely on sunflower seeds, live animals, cow hides and skins, and scrap metals but these will be reviewed upon Ukraine's WTO accession.
<b>3. Foreign exchange regime</b>	The exchange rate regime is classified as a conventional pegged arrangement as the National Bank of Ukraine maintains a de facto peg vis-à-vis the USD (at about 5.05 hryvnia after a nominal five-percent revaluation in April 2005). 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.
<b>4. Foreign direct investment</b>	FDI inflows increased in 2005 by USD 7.3 billion to a total of USD 16.3 billion since independence which amounts to USD 349 in per capita terms.
<b>5. Monetary policy</b>	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. The NBU's discount rate was increased to 9.5% in August 2005.
<b>6. Public finances</b>	Consolidated government expenditure at about 42.5% of GDP; revenues 39% of GDP of which tax revenues 34% (2005). Pension outlays are increasing rapidly, reaching nearly 16% of GDP.
<b>7. Privatisation and enterprise restructuring</b>	The private sector accounts for 65% of GDP. Privatisation of large enterprises accelerated in 2004 albeit under controversial and non-transparent terms. In October 2005 Ukraine's largest steel plant Kryvorizhstal was re-auctioned after a court ruling determined its privatisation illegal. Overall lack of policy cohesion delayed planned new privatisations.
<b>8. Financial sector reform</b>	Over 150 operating banks of which several weakly capitalised. State-owned banks account for about 8% of bank assets and foreign-owned banks for some 12%. New legislation to liberalise operations of foreign bank branches underway.

**10. ANNEXES**

**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 2005 (in millions of euro)

<u>Country</u>	<u>Authorisations</u>			<u>Disbursements</u>			<u>Undisbursed</u>
	<u>Date of Council Decision</u>	<u>Reference of Council Decision</u>	<u>Maximum amount</u>	<u>Dates of disbursements</u>	<u>Amounts of disbursements</u>	<u>Totals</u>	
<b>Hungary I</b> (Structural adjustment loan)	22.02.90	90/83/EC	<b>870</b>	Apr. 1990 Feb. 1991	<b>350</b> <b>260</b>	<b>610</b>	<b>260</b> <b>(Suspended)</b>
<b>Czech and Slovak Federal Republic</b> (BOP loan)	25.02.91	91/106/EC	<b>375</b>	Mar. 1991 Mar. 1992	<b>185</b> <b>190</b>	<b>375</b>	
<b>Hungary II</b> (BOP loan)	24.06.91	91/310/EC	<b>180</b>	Aug. 1991 Jan. 1993	<b>100</b> <b>80</b>	<b>180</b>	
<b>Bulgaria I</b> (BOP loan)	24.06.91	91/311/EC	<b>290</b>	Aug. 1991 Mar. 1992	<b>150</b> <b>140</b>	<b>290</b>	
<b>Romania I</b> (BOP loan)	22.07.91	91/384/EC	<b>375</b>	Jan. 1992 Apr. 1992	<b>190</b> <b>185</b>	<b>375</b>	
<b>Israel (1)</b> (Structural adjustment soft loan)	22.07.91	91/408/EC	<b>187,5</b>	Mar. 1992	<b>187,5</b>	<b>187,5</b>	
<b>Algeria I</b> (BOP loan)	23.09.91	91/510/EC	<b>400</b>	Jan. 1992 Aug. 1994	<b>250</b> <b>150</b>	<b>400</b>	
<b>Albania I</b> (BOP grant)	28.09.92	92/482/EC	<b>70</b>	Dec. 1992 Aug. 1993	<b>35</b> <b>35</b>	<b>70</b>	
<b>Bulgaria II</b> (BOP loan)	19.10.92	92/511/EC	<b>110</b>	Dec. 1994 Aug. 1996	<b>70</b> <b>40</b>	<b>110</b>	
<b>Baltics</b> (BOP loans) of which :	23.11.92	92/542/EC	<b>220</b>			<b>135</b>	<b>85</b> <b>(Suspended)</b>
<b>Estonia</b>			<b>(40)</b>	Mar. 1993	<b>20</b>	<b>(20)</b>	<b>(20)</b>
<b>Latvia</b>			<b>(80)</b>	Mar. 1993	<b>40</b>	<b>(40)</b>	<b>(40)</b>
<b>Lithuania</b>			<b>(100)</b>	Jul. 1993 Aug. 1995	<b>50</b> <b>25</b>	<b>(75)</b>	<b>(25)</b>
<b>Romania II</b> (BOP loan)	27.11.92	92/551/EC	<b>80</b>	Feb. 1993	<b>80</b>	<b>80</b>	
<b>Moldova I</b> (BOP loan)	13.06.94	94/346/EC	<b>45</b>	Dec. 1994 Aug. 1995	<b>25</b> <b>20</b>	<b>45</b>	
<b>Romania III</b> (BOP loan)	20.06.94	94/369/EC	<b>125</b>	Nov. 1995 Sep. 1997 Dec. 1997	<b>55</b> <b>40</b> <b>30</b>	<b>125</b>	
<b>Albania II</b> (BOP grant)	28.11.94	94/773/EC	<b>35</b>	Jun. 1995 Oct. 1996	<b>15</b> <b>20</b>	<b>35</b>	
<b>Algeria II</b> (BOP loan)	22.12.94	94/938/EC	<b>200</b>	Nov. 1995	<b>100</b>	<b>100</b>	<b>100</b> <b>(Suspended)</b>
<b>Slovakia</b> (BOP loan)	22.12.94	94/939/EC	<b>130</b>	Jul. 1996			<b>130</b> <b>(Cancelled)</b>
<b>Ukraine I</b> (BOP loan)	22.12.94	94/940/EC	<b>85</b>	Dec. 1995	<b>85</b>	<b>85</b>	
<b>Belarus</b> (BOP loan)	10.04.95	95/132/EC	<b>55</b>	Dec. 1995	<b>30</b>	<b>30</b>	<b>25</b> <b>(Suspended)</b>
<b>Ukraine II</b> (BOP loan)	23.10.95	95/442/EC	<b>200</b>	Aug. 1996 Oct. 1996 Sep. 1997	<b>50</b> <b>50</b> <b>100</b>	<b>200</b>	
<b>Moldova II</b> (BOP loan)	25.03.96	96/242/EC	<b>15</b>	Dec. 1996	<b>15</b>	<b>15</b>	
<b>fYRoM I</b> (BOP loan)	22.07.97	97/471/EC	<b>40</b>	Sep. 1997 Feb. 1998	<b>25</b> <b>15</b>	<b>40</b>	
<b>Bulgaria III</b> (BOP loan)	22.07.97	97/472/EC	<b>250</b>	Feb. 1998 Dec. 1998	<b>125</b> <b>125</b>	<b>250</b>	
<b>Armenia, Georgia and Tajikistan (2)</b> (Structural adjustment loans and grants) of which	17.11.97 28.3.00	97/787/EC modified by 00/244/EC	<b>375</b>			<b>287,5</b>	<b>87,5</b>
<b>Armenia</b>			<b>(58)</b>	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant) June 2004 (grant) Dec 2005 ( grant)	<b>28</b> <b>8</b> <b>4</b> <b>5,5</b> <b>5,5</b> <b>5,5</b> <b>1,5</b>	<b>58</b>	<b>0</b>

<b>Georgia</b>			<b>(175)</b>	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant) Dec 2004 (grant)	<b>110</b> <b>10</b> <b>9</b> <b>6</b> <b>6,5</b>	<b>141,5</b>	<b>33,5</b>
<b>Tajikistan</b>			<b>(95)</b>	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant) Feb. 2003 (grant) May 2005 (grant)	<b>60</b> <b>7</b> <b>7</b> <b>7</b> <b>7</b>	<b>88</b>	<b>7</b>
<b>Ukraine III</b> (BoP loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	<b>150</b>	Jul. 1999	<b>58</b>	<b>58</b>	<b>92</b> <b>(Cancelled)</b>
<b>Albania III</b> (BOP loan)	22.04.99	99/282/EC	<b>20</b>				<b>20</b>
<b>Bosnia I (3)</b> (BOP loan and grant)	10.05.99 10.12.01	99/325/EC modified by 01/899/EC	<b>60</b>	Dec. 1999 (grant) Dec. 1999 (loan) Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (grant)	<b>15</b> <b>10</b> <b>10</b> <b>10</b> <b>15</b>	<b>60</b>	
<b>Bulgaria IV</b> (BOP loan)	08.11.99	99/731/EC	<b>100</b>	Dec. 1999 Sep. 2000	<b>40</b> <b>60</b>	<b>100</b>	
<b>fYRoM II (4)</b> (BOP loan and grant)	08.11.99 10.12.01	99/733/EC modified by 01/900/EC	<b>80</b> <b>18</b>	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant) May 2003 (grant) June 2003 (loan) Dec. 2003 (loan) Dec. 2003 (grant)	<b>20</b> <b>10</b> <b>12</b> <b>10</b> <b>10</b> <b>10</b> <b>18</b> <b>8</b>	<b>98</b>	
<b>Romania IV</b> (BOP loan)	08.11.99	99/732/EC	<b>200</b>	Jun. 2000 July 2003 (loan)	<b>100</b> <b>50</b>	<b>150</b>	<b>50</b>
<b>Kosovo I (5)</b> (Grant budgetary support)	19.02.00	00/140/EC	<b>35</b>	Mar. 2000 Aug. 2000	<b>20</b> <b>15</b>	<b>35</b>	
<b>Montenegro (5)</b> (Grant budgetary support)	22.05.00	00/355/EC	<b>20</b>	Aug. 2000 Dec. 2000	<b>7</b> <b>13</b>	<b>20</b>	
<b>Moldova III</b> (BOP loan)	10.07.00 19.12.02	00/452/EC 02/1006/EC	<b>15</b>				<b>15</b> <b>(Cancelled)</b>
<b>Kosovo II (3)</b> (Grant budgetary support)	27.06.01	01/511/EC	<b>30</b>	Sep. 2001 Dec. 2002	<b>15</b> <b>15</b>	<b>30</b>	
<b>Serbia and Montenegro (ex FRY) I (6)</b> (BOP loan and grant)	16.07.01 10.12.01	01/549/EC modified by 01/901/EC	<b>345</b>	Oct. 2001 Oct. 2001 Jan. 2002 Aug. 2002	<b>225</b> <b>35</b> <b>40</b> <b>45</b>	<b>345</b>	
<b>Ukraine IV</b> (BOP loan)	12.07.02	02/639/EC	<b>110</b>				<b>110</b>
<b>Serbia and Montenegro II (ex FRY) (7)</b>	05.11.02 25.11.03 07.12.2004	02/882/EC modified by 03/825/EC 04/862/EC	<b>130</b> <b>70</b>	Dec. 2002 (grant) Fev. 2003 (loan) Aug. 2003 (grant) Aug. 2003 (loan) Dec 2004 (grant)	<b>30</b> <b>10</b> <b>35</b> <b>30</b> <b>10</b>	<b>105</b> <b>50</b>	<b>25</b> <b>20</b>
<b>Bosnia II (8)</b>	05.11.02 7/12/2004	02/883/EC modified by 04/861/EC	<b>60</b>	Fev. 2003 (grant) Dec. 2003 (grant) Dec 2004 (loan) Jun 2005 (grant)	<b>15</b> <b>10</b> <b>10</b> <b>15</b>	<b>50</b>	<b>10</b>
<b>Moldova IV</b>	19.12.02	02/1006/EC	<b>15</b>				<b>15</b>
<b>Albania IV (9)</b>	29.04.04	04/580/EC	<b>25</b>	Nov 2005 (grant)	<b>3</b>	<b>3</b>	<b>22</b>
<b>Georgia II</b>	24.01.06	06/41/EC	<b>33,5</b>				<b>33,5</b>
<b>TOTAL</b>			<b>6229,0</b>			<b>5129,0</b>	<b>1100,0</b>

(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 € 7,5 million

(8) Includes a loan principal amount of € 20 million and grants of € 40 million

(9) Includes a loan principal amount of € 9 million and grants of € 16 million

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

Status of effective disbursements as of end-December 2005 (in millions of euro)

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

## **B. Western Balkans**

<b>Albania I</b> (BOP grant)	28.09.92	92/482/EC	<b>70</b>	Dec. 1992 Aug. 1993	35 35	<b>70</b>	
<b>Albania II</b> (BOP grant)	28.11.94	94/773/EC	<b>35</b>	Jun. 1995 Oct. 1996	15 20	<b>35</b>	
<b>Albania III</b> (BOP loan)	22.04.99	99/282/EC	<b>20</b>				<b>20</b> (Cancelled)
<b>Bosnia I (1)</b> (BOP loan and grant)	10.05.99 10.12.01	99/325/EC modified by 01/899/EC	<b>60</b>	Dec. 1999 (grant) Dec. 1999 (loan) Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (grant)	15 10 10 10 15	<b>60</b>	
<b>fYRoM I</b> (BOP loan)	22.07.97	97/471/EC	<b>40</b>	Sep. 1997 Feb. 1998	25 15	<b>40</b>	
<b>fYRoM II (2)</b> (BOP loan and grant)	08.11.99 10.12.2001	99/733/EC modified by 01/900/EC	<b>80</b> <b>18</b>	Dec. 2000 (grant) Dec. 2000 (loan) Dec. 2001 (loan) Dec. 2001 (grant) May 2003 (grant) June 2003 (loan) Dec. 2003 (loan) Dec.) 2003 (grant)	20 10 12 10 10 10 18 8	<b>98</b>	
<b>Kosovo I (3)</b> (Grant budgetary support)	19.02.00	00/140/EC	<b>35</b>	Mar. 2000 Aug. 2000	20 15	<b>35</b>	
<b>Kosovo II (3)</b> (Grant budgetary support)	27.06.01	01/511/EC	<b>30</b>	Sep. 2001 Dec. 2002	15 15	<b>30</b>	
<b>Montenegro (3)</b> (Grant budgetary support)	22.05.00	00/355/EC	<b>20</b>	Aug. 2000 Dec. 2000	7 13	<b>20</b>	
<b>Serbia and Montenegro I</b> (ex FRY) (4)	16.07.01 10.12.2001	01/549/EC modified by 01/901/EC	<b>345</b>	Oct. 2001 (grant) Oct. 2001 (loan) Jan. 2002 (grant) Aug. 2002 (grant)	35 225 40 45	<b>345</b>	
<b>Serbia and Montenegro II</b> ( ex FRY) (5) (BOP loan and grant)	05.11.02	02/882/EC	<b>130</b>	Dec. 2002 (grant) Fev. 2003 (loan) Aug. 2003 (grant) Aug. 2003 (loan)	30 10 35 30	<b>105</b>	<b>25</b>
	25.11.03	03/825/EC (7)	<b>70</b>	Dec 2004 (grant)	10	<b>50</b>	<b>20</b>
	07.12.04	04/862/EC		April 2005 (loan) Dec 2005 (grant)	15 25		
<b>Bosnia II (6)</b> (BOP loan and grant)	05.11.02 07.12.04	02/883/EC modified by 04/861/EC	<b>60</b>	Fev. 2003 (grant) Dec. 2003 (grant) Dec 2004 (loan) June 2005 (grant)	15 10 10 15	<b>50</b>	<b>10</b>
<b>Albania IV (8)</b> (loan and grant)	29.04.04	04/580/EC	<b>25</b>	Nov 2005 (grant)	3	<b>3</b>	<b>22</b>
<b>TOTAL B</b>			<b>1038</b>			<b>941</b>	<b>97</b>

- (1) Includes a loan principal amount of € 20 million and grants of € 40 million.  
(2) Includes a loan principal amount of up to € 50 million and grants of up to € 48 million.  
(3) Exceptional financial assistance.  
(4) Includes a loan principal amount of € 225 million and grants of € 120 million.  
(5) Includes a loan principal amount of € 55 million and grants of € 75 million  
(6) Includes a loan principal amount of € 20 million and grants of € 40 million  
(7) Includes a loan principal amount of € 25 million and grants of € 45 million  
(8) Includes a loan principal amount of € 9 million and grants of € 16 million

### C. New Independent States (NIS)

<b>Armenia, Georgia and Tajikistan (9)</b> (Structural adjustment loans and grants) of which	17.11.97 modified by 28.3.00	97/787/EC 00/244/EC	<b>375</b>			<b>287,5</b>	<b>87,5</b>
<b>Armenia</b>			<b>(58)</b>	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant) Jun 2004( grant) Dec 2005(grant)	28 8 4 5,5 5,5 5,5 1,5	<b>(58)</b>	<b>0</b>
<b>Georgia</b>			<b>(175)</b>	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant) Dec. 2004 (grant)	110 10 9 6 6,5	<b>(141,5)</b>	<b>(33,5)</b>
<b>Tajikistan</b>			<b>(95)</b>	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant) Feb 2003 (grant) May 2005 (grant)	60 7 7 7 7	<b>(88)</b>	<b>(7)</b>
<b>Belarus</b> (BOP loan)	10.04.95	95/132/EC	<b>55</b>	Dec. 1995	30	<b>30</b>	<b>25</b> <b>(Suspended)</b>
<b>Moldova I</b> (BOP loan)	13.06.94	94/346/EC	<b>45</b>	déc-94 Aug. 1995	25 20	<b>45</b>	
<b>Moldova II</b> (BOP loan)	25.03.96	96/242/EC	<b>15</b>	Dec. 1996	15	<b>15</b>	
<b>Moldova III</b> (BOP loan)	10.07.00 19.12.02	00/452/EC 02/1006 EC	<b>15</b>				<b>15</b> <b>(cancelled)</b>
<b>Moldova IV</b> (BOP grant)	19.12.02	02/1006/EC	<b>15</b> <i>(15)</i>				<b>15</b>
<b>Ukraine I</b> (BOP loan)	22.12.94	94/940/EC	<b>85</b>	Dec. 1995	85	<b>85</b>	
<b>Ukraine II</b> (BOP loan)	23.10.95	95/442/EC	<b>200</b>	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	<b>200</b>	
<b>Ukraine III</b> (BoP loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	<b>150</b>	Jul. 1999	58	<b>58</b>	<b>92</b> <b>(cancelled)</b>
<b>Ukraine IV</b> (BOP loan)	12.07.02	02/639/EC	<b>110</b> <i>(15)</i>				<b>110</b>
<b>Georgia II</b>	21.01.06	06/41/EC	<b>33,5</b>				<b>33,5</b>
<b>TOTAL C</b>			<b>1098,5</b>			<b>720,5</b>	<b>378</b>

### D. Mediterranean countries

<b>Israel (10)</b> (Structural adjustment soft loan)	22.07.91	91/408/EC	<b>187,5</b>	Mar. 1992	187,5	<b>187,5</b>	
<b>Algeria I</b> (BOP loan)	23.09.91	91/510/EC	<b>400</b>	Jan. 1992 Aug. 1994	250 150	<b>400</b>	
<b>Algeria II</b> (BOP loan)	22.12.94	94/938/EC	<b>200</b>	Nov. 1995	100	<b>100</b>	<b>100</b> <b>(Suspended)</b>
<b>TOTAL D</b>			<b>787,5</b>			<b>687,5</b>	<b>100</b>
<b>TOTAL A+B+C+D</b>			<b>6229,0</b>			<b>5129,0</b>	<b>1100,0</b>

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

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



### ANNEX 3: Selected economic indicators

	2002	2003	2004	2005	
				Programme (1)	Estimates
<b>GDP at constant prices</b>	(Percent change)				
Albania	2,9	5,7	5,9		5,5
Armenia	13,2	13,9	10,1	8,0	11,0
Bosnia-Herzegovina	5,3	4,0	5,7		5,4
Bulgaria	4,9	4,5	5,6		5,8
FYROM	0,9	2,8	4,1		3,7
Georgia	5,5	11,1	6,2	6,0	8,5
Kosovo	-0,1	-0,5	4,1		0,2
Moldova	7,8	6,6	7,3		7,1
Montenegro	1,7	2,3	3,7		4,1
Romania	5,1	5,2	8,3		4,1
Tajikistan	9,1	10,2	10,6	8,0	7,5
Ukraine	5,2	9,6	12,1	6,0	2,6
<b>Consumer price (end year)</b>	(Percent change)				
Albania	5,2	2,4	2,9		2,5
Armenia	2,0	8,6	2,0	3,0	1,5
Bosnia-Herzegovina	0,3	0,6	0,4		1,0
Federation	-0,2	0,2	-0,3		1,0
Republika Srpska	1,7	1,8	2,2		1,0
Bulgaria	5,8	2,3	6,1		5,0
FYROM	2,4	1,2	-0,3		1,2
Georgia	5,4	7,0	7,5	5,0	6,2
Kosovo	3,6	1,2	-1,5		-0,8
Moldova	4,4	15,7	12,6		10,0
Montenegro	9,4	6,7	4,3		1,8
Romania	22,8	15,3	11,9		9,0
Tajikistan	14,5	13,7	5,6	7,0	7,0
Ukraine	-0,6	8,2	12,3	7,0	10,3
<b>Fiscal balance</b>	(Percent of GDP)				
Albania	-6,6	-4,5	-5,1		-3,8
Armenia	-0,4	-1,1	-1,7	-2,9	-2,4
Bosnia-Herzegovina	-4,1	-1,7	-1,9		-1,3
Federation	-0,2	0,4	1,0		-0,6
Republika Srpska	0,0	0,0	0,0		0,0
Bulgaria	-0,2	0,6	1,3		2,3
FYROM	-5,6	-0,1	0,7		-0,8
Georgia	-1,9	-1,3	-0,2	-1,9	-2,7
Kosovo	4,0	1,9	-5,4		-2,8
Moldova	-1,8	0,7	0,7		1,5
Montenegro	-1,8	-4,0	-3,1		-2,4
Romania	-2,0	-2,0	-1,4		-1,0
Tajikistan	-0,1	0,9	0,7	-0,5	0,1
Ukraine	0,5	-0,9	-4,4	-1,6	-2,9
<b>Current account</b>	(Percent of GDP)				
Albania	-7,2	-5,5	-3,8		-5,5
Armenia	-6,2	-6,8	-4,6	-5,1	-3,9
Bosnia-Herzegovina	-21,7	-17,7	-17,3		-22,5
Bulgaria	-5,6	-9,2	-8,5		-11,8
FYROM	-8,4	-3,5	-8,2		-6,5
Georgia	-5,8	-7,2	-7,6	-8,1	-9,0
Kosovo	3,0	1,0	-3,9		-9,3
Moldova	-4,4	-6,8	-2,7		-5,5
Montenegro	-13,0	-7,3	-9,7		-8,6
Romania	-3,3	-6,0	-8,4		-8,8
Tajikistan	-2,7	-1,3	-4,0	-4,9	-3,6
Ukraine	7,5	5,8	10,5	4,1	4,8
<b>Official foreign exchange reserves (end year)</b>	(Months of imports)				
Albania	4,4	3,9	4,1		4,1
Armenia	3,7	4	3,6	3,9	4,0
Bosnia-Herzegovina	4,5	5,3	6,1	5,4	6,1
Bulgaria	4,9	4,8	5,3		5,2
FYROM	3,8	3,3	2,9		3,6
Georgia	1,7	1,3	1,7	1,6	1,8
Kosovo	n.a.	n.a.	n.a.	n.a.	n.a.
Moldova	1,9	1,7	2,1		2,2
Montenegro	n.a.	n.a.	n.a.	n.a.	n.a.
Romania	3,6	2,8	4,2		5,7
Tajikistan	1,8	1,9	1,8	1,9	1,9
Ukraine	1,9	2,4	2,7	3,9	4,7

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

Sources: National authorities and IMF