EN

Brussels, 18.8.2008
SEC(2008) 2381

COMMISSION STAFF WORKING DOCUMENT

ACCOMPANYING THE REPORT FROM THE COMMISSION ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE TO THIRD COUNTRIES IN 2007

{COM (2008) 520}

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
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
EIB	European Investment Bank
ESAF	Enhanced Structural Adjustment Facility
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
FESAL	Financial and Enterprise Structural Adjustment Loan
FOREX	Foreign Exchange
FYROM	The former Yugoslav Republic of Macedonia
GDP	Gross Domestic Product
IFIs	International Financial Institutions
IMF	International Monetary Fund
MFA	Macro-Financial Assistance
NIS	New Independent States
PRGF	Poverty Reduction and Growth Facility (formerly ESAF)
SAA	Stabilisation and Association Agreement
SAF	Structural Adjustment Facility
SBA	Stand-By Arrangement
SOE	State Owned Enterprise
USD	Dollar of the United States of America
VAT	Value Added Tax
WTO	World Trade Organisation

TABLE OF CONTENTS

INTRODUCTION

This working document is published in parallel with the Report from the Commission to the Council and to the European Parliament on the implementation of macro-financial assistance to third countries in 2007. This document provides economic and financial information regarding the situation of the beneficiary countries. Statistical data sorting the different macro-financial assistance decisions since 1990, by date and by regions, are included in the annex.

HORIZONTAL SECTION

1. WESTERN BALKANS

The countries of the Western Balkans[1] have moved closer to the EU. This reflects progress, albeit uneven, in reforms and in meeting established criteria and conditions. During 2007, Stability and Association Agreements[2] have been signed with Montenegro and initialled with Bosnia-Herzegovina and Serbia. Important steps have also been taken in regional cooperation, such as the establishment of the Regional Cooperation Council which replaced the Stability Pact. The generally positive economic development of the region continued throughout 2007. The GDP growth rate was quite balanced throughout the region, ranging between 6% and 7%, with the exception of Kosovo (3.5%). Inflationary tensions further decreased during the first half of 2007, whereas in some countries (especially Serbia, Montenegro and Kosovo) the CPI saw a sharp increase in the third and fourth quarter, mainly due to international food and energy price developments. However, the overall annual CPI increase came down to 3.9% on average. External imbalances remained significant, with an average current account deficit of some 14.6% of GDP in 2007. General government balances turned on average from a small surplus in 2006 to a small deficit of 0.8% of GDP in 2007 (excluding Kosovo), with only Montenegro posting a surplus. State building, good governance, administrative and judicial reform, rule of law including the fight against corruption and organised crime, socioeconomic development, and civil society development, remain key reform priorities for the Western Balkans.

[1] The aggregated data are non-weighted averages and include the candidate countries Croatia and the former Yugoslav Republic of Macedonia, the potential candidate countries Albania, Bosnia-Herzegovina, Montenegro and Serbia, and Kosovo (under UNSCR 1244).

[2] SAAs with fYROM (since 2004), Croatia (2005) and Albania (2006) had already been in force.

COUNTRY SECTIONS

2. KOSOVO (UNSC 1244)

2.1. Executive summary

The economic situation in Kosovo remains difficult: Its GDP per capita of around € 1,200 is one of the lowest in Europe[3]. After a sharp increase of GDP in the immediate post-war period, boosted by foreign reconstruction assistance and remittances, growth has been sluggish and negatively affected by declining donor support.

On 17 February 2008, the territory declared its independence from Serbia. It has been recognised since then by a majority of the EU member states, the US, some neighbouring countries, and some other countries throughout the world. In its Conclusions on Kosovo of 18 February, the Council has reaffirmed its commitment to fully and effectively support the European perspective for the Western Balkans and asked the Commission to use community instruments to promote economic and political development.

The Council approved in November 2006 MFA budget support of up to € 50 million. Yet, in 2006 and 2007 the budget execution led to the disappearance of the foreseen financing gap, mainly due to higher than expected revenues and capital underspending. Consequently, the payment of the assistance has been postponed, probably to the second half of 2008 or 2009. The conditionality attached to this assistance was agreed between the Commission and the authorities of Kosovo and a Memorandum of Understanding was accordingly signed in December 2007.

2.2. Macroeconomic performance

For 2007, latest estimates point to GDP growth of around 3.5%. This is considerably higher than the authorities' initial assumption for the budget 2007 of 1% growth. This higher growth is partly due to the delays in the status settlement with the accordingly delayed dismantling of UNMIK and its adverse effect on domestic demand. Private consumption had a positive impact on growth. Overall, growth seems to become more robust compared to previous years, but remains low compared to countries in the region and considering the very low starting point.

The number of registered job seekers continued to increase in 2007 to 332,000 persons as a yearly average, up by 8,500 compared to 2006. Long-term unemployment remains particularly high, indicating limited dynamics and flexibility of the Kosovan economy and labour market. However, the informal economy remains sizable and seems to employ many of the officially unemployed. The unemployment rate is estimated at around 45%.

After years of low –at times even negative- inflation, it accelerated in the second half of 2007 mainly due to food prices, reaching y-o-y rates of 10-11% in the last quarter. However, given a fairly low inflation in the first half of the year, average annual inflation stood at 4.5% in 2007. Assuming that the food price hike will persist over

[3] There are indications, though, for a substantial upward revision of official GDP data. However, the resulting GDP per capita of approximately EUR 1,500 would still be comparatively low.

the medium term, it may turn into a severe negative shock to disposable household income in Kosovo.

The monetary framework remains anchored on the use of the euro as legal tender. The Central Banking Authority, therefore, cannot implement any independent monetary or exchange rate policy. Its role lies in supervising the financial sector and monitoring liquidity in the banking sector and credit expansion, with liquidity ratios and reserve requirements as main policy tools. Despite conservative prudential requirements, annual credit growth accelerated to 41% by the end 2007 (November data; loans to non-financial corporations), and 34% (loans to private households), respectively. Interest rates remained fairly high in 2007 with rates for short-term business loans ranging between 13% and 17% over the year.

The trade deficit widened to 57% of GDP in 2007, mainly due to a very weak export base. The current account deficit for 2007 is estimated at 24% of GDP (including foreign assistance), after 17% in 2006. It is mainly financed by remittances and increasing foreign direct investment related to privatisations. Kosovo currently does not assume any sovereign debt servicing obligations. This situation would change if, as foreseen by the Ahtisaari proposals, some sovereign loans currently serviced by Serbia would be transferred to Kosovo. The amount of sovereign debt to be transferred to Kosovo is still uncertain and will remain so for some time – it will most likely be determined by arbitration. Present estimates range around € 840m, or 36% of GDP, with a high margin of uncertainty.

The execution of the budget in 2007 was characterised by a one-off exceptional revenue of € 75 million for the licence of a second mobile phone operator, higher revenue collection and a continuously weak spending record, especially on capital items. Preliminary data point to an annual budget surplus of 6.5% of GDP. As a result, the cash balance of the government rose from around € 200 million at the beginning of 207 to more than € 400 million (16% of GDP) by the end of the year 2007. However, the high budget surplus may turn out to be of a quite temporary nature and masks a weaker structural budgetary position because it partly stems from one-off measures and is subject to substantial budgetary risks, partly also related to status settlement.

2.3. Structural reforms

The privatisation process of socially-owned enterprises continued in 2007. The Kosovo Trust Agency (KTA) is reported to have tendered around 545 New Companies and that 343 sales contracts have been signed by the end of 2007. The total amount realised from these sales contracts signed is over 308 million Euros. However, since December 2007 the signing of contracts has been interrupted, because KTA is reflecting on a recent Special Chamber judgement in relation to privatisation of property. This judgement may have an effect on the privatisation process because it puts in question some elements of the currently implemented UNMIK Regulations on the Establishment of KTA which, according to the ruling, violate the European Convention for the Protection of Human Rights and Fundamental Freedoms by limiting the rights of former property owners.

The restructuring of publicly-owned enterprises remains one of the biggest challenges of structural policy. Infrastructure remained insufficient and often of poor quality. In particular, the situation in the energy sector is critical - the power supply infrastructure remained unreliable, with frequent power cuts, affecting economic activity at large. Furthermore, the efficiency of the judiciary system and law implementation remained low and only little progress was made in enforcement of court rulings and the establishment of property rights.

2.4. Implementation of macro-financial assistance

On 30 November 2006 the Council adopted a decision providing Kosovo with macro-financial assistance in the form of budget support (grants, up to € 50 million). This followed a needs assessment, prepared by UNMIK and the Provisional Institutions of Self Government (PISG), and coordinated with the Commission, the IMF and the World Bank. This assessment (the "Medium-Term Expenditure Framework" - MTEF) foresaw that by end 2006 or early 2007 the situation of the budget would become unsustainable without donors support, as cash reserves financing the deficit were expected to dry up. This assistance was thus initially conceived as *bridge support*, to be topped up by another package from the EC and other international donors upon status settlement.

However, the general government balance for 2006 and 2007 turned out very differently than initially foreseen: after a surplus of 3.6% of GDP in 2006, an even higher surplus 6.5% of GDP) was preliminarily recorded for 2007, mainly due to good revenue performance and under-spending of budgeted capital expenditure, due to the weak planning and implementation capacity for investment projects.

Therefore, the outstanding EC support remains available, but it will, unlike initially foreseen, not serve as bridge support pending status settlement. A donor's conference is planned to take place on 11 July 2008 to address Kosovo's financing needs. Payments of EC budget support are now expected to take place towards the end of 2008 or in 2009.

Meanwhile, the Commission and the authorities of Kosovo have agreed on the Memorandum of Understanding (MoU) laying out the policy conditions for this assistance to be met and signed it in December 2007. This MoU stipulates that the assistance will be paid if: (i) budgetary financing needs occur; (ii) the authorities reach an understanding or arrangement with the IMF in support of sustainable economic and fiscal policies and implement it properly; and (iii) policy conditions attached to this assistance, mainly in the area of public finance reform, management and control, are satisfactorily met.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

The price setting mechanism is basically free. The authorities do not intervene, even in the case of housing prices. Current governance arrangements as regards publicly-owned enterprises, which remain under the authority of UNMIK – Pillar IV, normally ensure the absence of government interference in the price setting mechanism of their services. However, the government intervened in one case by refusing a raise in electricity prices proposed by the electricity regulator.

2. Trade liberalisation

Regional trade integration and liberalisation continued. In 2007, the Central European Free Trade Agreement came into force between Albania, Bosnia and Herzegovina, Croatia, Kosovo (UN 1244), the former Yugoslav Republic of Macedonia, Moldova, Montenegro and Serbia.

3. Exchange regime

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

4. Foreign Direct Investment

FDI inflows continued to increase slightly in 2007, mainly related to the privatisation process. FDI inflows, including privatisation proceeds, are estimated to have reached 12% of GDP in 2007.

5. Monetary policy

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

6. Public Finance

The authorities finalised a revised Medium-Term Expenditure Framework in September 2007. The execution of the budget in 2007 was characterised by high revenues and low capital spending. Preliminary data point to an annual 2007 budget surplus of 6.5% of GDP. However, the high budget surplus may turn out to be of a quite temporary nature and masks a weaker structural budgetary position because it partly stems from one-off measures and is subject to substantial budgetary risks, partly related to status settlement (i. e. debt servicing).

7. Privatisation and Enterprise Restructuring

The privatisation of socially-owned enterprises continued successfully in 2007. However, since December 2007 the signing of contracts has been interrupted, because the Kosovo Trust Agency is reflecting on a recent Special Chamber judgement which may affect the privatisation process because it puts in question some elements of the currently implemented UNMIK Regulations.

8. Financial Sector Reform

The financial sector in Kosovo appeared to be sound, profitable and well capitalised. It is entirely private and mostly foreign-owned. In December 2007, two local banks merged and a full banking license was granted to a Turkish owned institute. Altogether, 10 commercial banks operate in Kosovo. Credit supply is sufficient and banks have widened their range of products. However, competition remained limited.

HORIZONTAL SECTION

3. EASTERN NEIGHBOURHOOD COUNTRIES

Economic growth in the New Independent States (NIS), which is for some years now the second fastest growing region in the world (behind East Asia), accelerated in 2007 from about 7.5% to nearly 8.5%. The fastest growing economy is once again Azerbaijan (plus 25%). In all the other countries of the region but one (Moldova) GDP increased by more than 7%. In Moldova, the economic growth was more than 8% in the first half of 2007 but it was finally reduced to only 3%, due to a severe drought in summer 2007. The factors behind this growth differ from country to country, but in the majority of them, including the two largest economies of the region, Russia and Ukraine, growth is driven primarily by domestic demand, boosted by profits of the enterprises, credit expansion and fiscal stimulation. Several countries of the region are benefitting also from high commodity prices (notably, energy) or capital transfers, mainly private.

The improving general economic conditions allowed a strong fiscal expansion in a number of countries of the region, which, as a rule, led to the reduction of budget surpluses (e.g. Russia, Kazakhstan, Belarus) or to the widening of deficits (e.g. Ukraine Georgia). Despite the worsening fiscal balances, the overall trend for the reduction of the public debt as part of GDP continued in 2007. One otable exception to this rule was Tajikistan, where due to the launch of large infrastructure projects financed by concessional credits extended by the Chinese Ex-Im Bank the budget moved from a surplus to a deficit of more than 6% of GDP, and the public debt increased from 37 to over 40% of GDP.

One of the effects of the fiscal loosening was its contribution to the acceleration of inflation. The other factors behind this inflation surge – price rises were again over 10% or approaching this figure in the majority of the countries of the region – are the international price rises and the monetary expansion fuelled by the capital inflows resulting from either commodity exports, foreign direct investments, or private capital transfers, in particular remittances from workers abroad.

The region's variable endowment in natural resources translates in a very variable situation of the balance of payments – strong trade and current account surpluses for energy exporters, strong deficits for energy importers. Overall, demand-led import growth increased faster than exports, and therefore on average the current account balances in the region have deteriorated, with the current account surpluses going down (both as percentage of GDP and in absolute numbers), and current account deficits widening, sometimes to very high proportions of GDP (Georgia – nearly 20%, Moldova – nearly 16%). However, these deficits are generally comfortably financed by capital inflows, including foreign direct investments, on the rise in all the countries of the region.

Progress in structural reforms has been uneven across the region and the implementation of second-phase institutional reforms supporting markets and private enterprise is still little advanced in most NIS. Among the current and past beneficiaries of the Community macro-financial assistance, Georgia was probably the one to advance most. Also, Georgia is, together with Armenia, the two front-runners in terms of the creation of a favourable business environment conducive to investments and growth. This overall good record in implementing market reforms is translating in a strong growth performance: both countries registered double-digit economic growth in 2007.

4. GEORGIA

4.1. Executive summary

Economic growth accelerated to about 12% in 2007, supported by inflows of foreign direct investment which comfortably financed a widening current account deficit. Strong growth in financial intermediation and infrastructure investment enhanced growth prospects in several sectors of the economy.

Georgia's IMF-supported economic program remained on on-track, allowing the IMF Board to complete the fifth and sixth (final) reviews under the PRGF (Poverty Reduction and Growth Facility) arrangement in February and August 2007. Currently, the IMF continue post-program monitoring in Georgia but no new financing needs have been identified.

Uneven progress was made by Georgia during the past year in the implementation of the agreed policy measures in public finance management. Therefore, the payment of the final grant instalment of the macro-financial assistance was still pending at end-2007 the enactment of a new law on external audit.

In April 2008, a first progress report on the EU-Georgia European Neighbourhood Policy Action Plan was adopted, informing the next directions in the deepening of the political and economic relations as well as in closer cooperation in many sectors.

4.2. Macroeconomic performance

Strong economic performance continued in 2007, unabated by Russia's economic embargo and higher energy import prices. After large-scale privatisation and the completion of oil and gas pipeline projects, foreign capital inflows now contribute to growth in several other areas of the economy. Construction and financial intermediation in particular have been driving economic growth that accelerated to about 12% in 2007 against 9.4% in 2006. Mining and trade were other sectors of rapid growth. Infrastructure investment on transport and electricity generation also facilitates robust growth in the economy. Nominal GDP is estimated to be about USD 10 billion (about USD 2300 per capita).

Central bank legislation is being amended to establish price stability as the main objective of the National Bank of Georgia, to be pursued through a monetary policy framework of inflation targeting. This will mean that the lari will be allowed to float more freely with minimal interventions by the NBG. Although the acceleration of consumer price inflation in 2007 to 11% partly owes to international commodity price trends, the rapid growth in monetary aggregates did raise more concern for inflationary pressures. Accordingly, the NBG considerably tightened the monetary stance. Bank assets grew from 30.7% of GDP to 43.5% by end-2007. As rapid credit growth continues to drive economic growth, systemic financial sector development is upmost important also for macroeconomic stability. Higher monetisation of the economy is nevertheless a sign of enhanced confidence of businesses and the public.

Demand for imports increased in line with growing incomes and brisk investment activity, leading to a widening trade deficit of about 28% of GDP. The import bill was also increased because of more expensive natural gas imports from Russia and Azerbaijan. Exports revenue growth, although held back by the economic embargo by Russia of Georgian exports, was supported by high world market prices for metals. Foreign capital inflows (mostly foreign direct investment) financed the current account deficit of nearly 20%. Workers' remittances transferred through banks increased by 83% from 2006 (64% originating from Russia). Net FDI is estimated at about 15% of GDP in 2007.

For the first time, international reserves of the National Bank of Georgia surpassed the level equivalent to three months of imports. Georgia's total external debt is at a low level of 17% of GDP as public external debt has not been increased in nominal terms and the private sector (the leading banks) have gained access to international capital markets only in the past two years. In January 2008, Standard & Poor's confirmed a positive outlook for Georgia's sovereign credit rating (B+). The sovereign credit rating is, however, constrained by a narrow economic structure, external imbalances and political risks which also stem from Georgia's relatively weak institutional framework.

Public spending was increased over the year in several supplemental budgets as tax revenues continued to perform strongly as a result of robust nominal GDP growth and a strengthened tax administration. The tax revenues to GDP ratio is estimated at 25% which is a marked step up from the average of 20% in 2004-2006. A priority was given to defence spending which surged to 30% of total spending in 2007 (9% of GDP). The public protests in November 2007 prompted the government to revise spending priorities for 2008, allocating more resources to pensions, salaries and social and employment programmes. Defence spending is projected to account for 19% of total public expenditures in 2008. Public debt (about 28% of GDP) and fiscal deficits (below 3% of GDP) are under control, and the implementation of a planned new fiscal rule would further ensure that balanced budgets are the norm in the future. Any budget surplus would be saved in special funds retained for future development projects.

4.3. Structural reforms

The government's efforts to tackle corruption and to deregulate the economy continued to show results in several areas, as reflected in the World Bank's Doing Business Report. The World Bank ranks Georgia's business environment in 18th place in the world, a further improvement from the 37th place from 2006. Equally, according to the Transparency International, perceptions on the extent of corruption showed a reduction from the previous year, and Georgia's score improved from 2.8 (out of max 10) to 3.4.

Putting in place new liberal legislative frameworks in taxation and customs, inspection, permits, certification and standardisation has improved the business environment, and the main challenge now is to strengthen the public institutions which are tasked with their implementation. Another major priority for reform concerns the independence and accountability of the judiciary and law enforcement, which has become under focus for instance in the context of property rights' violations. Other positive developments include legislative changes in 2007 to shorten the maximum time for bankruptcy proceedings to five months. Corporate governance has been strengthened to provide better investor protection also for minority shareholders.

Georgia conducts a liberal trade policy in a multilateral setting, having abolished most import tariffs apart from some agricultural goods and construction materials. In 2007 Georgia finalised negotiations with Turkey on a free trade agreement which has not yet been implemented. Georgia qualifies for the EU's enhanced trade preferences under the GSP+. Although the overall tax burden on businesses is already fairly low (corporate income tax is reduced to 15%), the government has launched free industrial zones (for instance in the Black Sea port of Poti) that would offer special tax and regulatory regimes. Georgia's export potential is not realised because of the lack of capacity to implement sufficient regulatory frameworks. The bottlenecks concern sanitary and phyto-sanitory systems, conformity assessment, technical regulations and standards of industrial goods, whereas concerning imports to Georgia technical regulations of OECD countries are fully recognised as such by Georgia.

The impressive economic growth record has not yet improved the aggregate employment situation markedly as large shifts of labour from the public sector to the private sector have been underway. The government has launched short-term traineeship programmes in cooperation with the private sector. For a sustainable job creation, the employers' requirements for skills and training need to be better addressed in the reforms of vocational and higher education. Unemployment has been fairly stable at about 14%. The relatively large share of agriculture (55% of total employment) continues to be a prominent feature of the Georgian economy. The small plot sizes and low productivity are straining the agricultural sector's contribution to poverty reduction.

Extreme poverty (10.7% in 2006) and the overall poverty rate (31%) are declining as a result of government's measures such as targeted poverty benefits and higher pensions. The targeting of the social assistance still needs to be improved and the government has now a database to help the targeting. Initially, the share of the extreme poor receiving the targeted social benefit was estimated by the World Bank at 25% (2006). This share is planned to increase to at least 60%. The impact of higher gas tariffs is mitigated through voucher schemes and lifeline tariffs but the higher living costs (especially food and energy) put a pressure on most households. Social and education spending has been increased, reaching about one third of total public spending in 2008.

Since the Georgian government is committed to limit the role of the state in every respect, efforts are focused mostly on improving service delivery by involving the private sector. The government is for instance implementing an ambitious health sector reform in cooperation with private sector operators. Over three years, 100 new privately managed hospitals will be in operation. A new health insurance scheme will be put in place in 2008. Given that the government departments and agencies have been in a flux and subject to frequent management changes, the civil service reform has not been rooted yet. In the process, some areas such as the statistics department have become seriously under-resourced. In public finance management, the reform process has advanced in parallel both in budget planning and preparation as well as in treasury management and has now reached a stage where the internal control and external oversight functions also need to be addressed in order to have a balanced, modern public finance management system.

The EU and Georgia are implementing the European Neighbourhood Policy Action Plan which was endorsed by the EU-Georgia Cooperation Council in November 2006. The first progress report was made public in April 2008. In the economic policy area, the Commission has conducted a feasibility study on a possible free trade area with Georgia so as to inform the future directions for the enhancement of bilateral trade relations and the improvement of the business and investment climate in Georgia.

4.4. Implementation of macro-financial assistance

On 24 January 2006 the EU Council decided to provide macro-financial assistance to Georgia up to EUR 33.5 million in grants (Decision 2006/41/EC, published in the Official Journal of 28 January 2006). The first and second grant instalments were paid in 2006 (EUR 22 million in total). In parallel, Georgia reduced the amount of its outstanding debt to the Community to EUR 57.5 million. Under the macro-financial assistance, the Commission focused its policy dialogue with the Georgian authorities on public finance management. In this context the Commission has cooperated closely with the World Bank which is also supporting the strengthening of public sector accountability, efficiency and transparency under its series of Poverty Reduction Support Operations (PRSO). During 2007, the Commission monitored progress in the areas of budget planning, budget execution, internal controls and internal audit as well as external audit as had been agreed in the Memorandum of Understanding.

Uneven progress was noted in the reform process. Budget planning and execution progressed smoothly following major reform efforts that had been started few years ago; whereas in the area of internal controls and internal audit the authorities have not yet decided how to develop in Georgia a coherent legal framework in line with EU principles and in external audit the timeframe for the adoption of external audit standards (INTOSAI) has not been decided yet. As a consequence of the political turmoil that led to the pre-term presidential elections in January 2008, the parliament's legislative process was also affected so that the adoption of the Law on the Chamber of Control was further delayed till 2008. The draft bill had been submitted to the parliament in 2006. Given that the adoption of international standards in external audit will be an important step in the process of democratic reforms in Georgia, the release of the final grant instalment of the macro-financial assistance (EUR 11.5 million) was pending the enactment of the Chamber of Control Law.

SUMMARY STATUS OF ECONOMIC REFORM
1. Price liberalisation No administratively set prices exist outside the utilities sector. Administered prices account for about 5% of the CPI basket.
2. Trade liberalisation Liberal trade policy. Georgia has been member of the WTO since June 2002. In September 2006, the number of tariff bands on imported goods was reduced from 16 to three (0%, 5%, and 12%). The maximum tariff of 12% is applied to those agricultural products and building materials which compete with domestic goods. The average weighted tariff is estimated to be 1½%. Non-tariff barriers allowed for environmental, security and health reasons only (in line with the Partnership and Cooperation Agreement with the EU). A free trade agreement with Turkey was agreed in late 2007.
3. Exchange regime Floating exchange rate of the lari with limited official intervention by the National Bank of Georgia. No restrictions on current international transactions in conformity with Article VIII of the IMF's Articles of Agreement.
4. Foreign Direct Investment Adequate overall legislation. Unlimited repatriation of capital and profits. Net inflows of FDI about 15% of GDP (2007 estimate).
5. Monetary policy The NBG has developed monetary policy instruments, e.g. by introducing in 2006 certificates of deposits. The securitisation of government debt held by the NBG also introduced marketable securities for the NBG's open market operations. Amendments to the central bank legislation are underway to enshrine price stability as the NBG's prime policy objective, to be pursued through inflation targeting. Dollarisation of the economy has decreased in the past few years but still remains high at 65% of total deposits.
6. Public Finance Total fiscal revenues (including grants) estimated at 27% of GDP (2007), of which tax revenues 25% of GDP. Total expenditure and net lending estimated at about 30% of GDP (2007) implying a fiscal deficit of 3% on commitment basis. Under the Budget System Law, which became effective on January 1, 2004, the treasury system is reformed, with a fully functioning Single Treasury Account as of January 2006. A medium-term expenditure framework is in place and is further developed with stronger policy content. A new liberal tax code is effective as of January 1, 2005.
7. Privatisation and Enterprise Restructuring The private sector now accounts for about 80% of GDP (against 65% in 2005). Small scale privatisation largely completed while large scale privatisation also accelerated significantly since 2004. New legislation adopted in 2005 on land privatisation.
8. Financial Sector Reform There are 17 operating banks (of which 10 foreign-owned). No state-owned banks. Further consolidation is expected as the minimum capital requirement is increased to GEL 12 million (approx. EUR 4.5 million). Banking supervision has been strengthened in the past few years. The areas still to be addressed include "fit and proper" criteria for bank owners and managers, identification of "true" owners, monitoring of connected lending and consolidated supervision.

5. REPUBLIC OF MOLDOVA

5.1. Executive summary

The economy of the Republic of Moldova continued growing in 2007 despite a severe drought, but economic growth decelerated to just 3%. Moldova's surprisingly resilient performance is supported by inflows of foreign capital, in the form of remittances (primarily) and direct investment; Capital inflows more than financed a trade deficit approaching 50% of GDP.

The inflows of capital from abroad have translated in inflationary pressures and in a persistent and even accelerating inflation, despite the sterilisation efforts of the National Bank of Moldova and restrictive fiscal policy (the budget deficit was very low and public debt as a share of GDP decreased markedly).

The developments in 2007 suggest that Moldova's growth model based primarily on households demand fuelled by inflows of capital from Moldova’s workers abroad is gradually changing. An increasing part of remittances seems to be going now into investments, and not just household consumption and residential construction. This gradual change is confirmed by a modest increase in output and employment in some manufacturing industries (particularly, textiles) where Moldova maintains a competitive advantage due to its low labour costs, despite strong appreciation of the real exchange rate.

Moldova's financing arrangement with the IMF concluded in May 2006 and supported by the Fund's PRGF (Poverty Reduction and Growth Facility) was on track, allowing the IMF Board to complete in 2007 the second and third programme reviews. The World Bank is currently preparing the second Poverty Reduction Support Credit (PRSC 1 was disbursed in autumn 2006).

The Republic of Moldova achieved progress in several areas of structural reforms, including trade and enterprise policy, competition, financial sector regulation and supervision and public finance management. Yet, the business conditions and governance remain weak, and their improvement still remains a key challenge for the policy agenda. The government's expectations are that further progress in structural reforms implemented in the framework of the new National Development Strategy and of the EU-Moldova ENP Action Plan will gradually translate in better governance and higher quality market institutions, and contribute to the improvement of the business conditions in Moldova.

5.2. Macroeconomic performance

Moldova's economic performance in the recent period has been surprisingly strong in view of the external shocks faced by the country. In 2007, despite a severe drought that hit Moldova in summer and reduced agriculture’s output by nearly a quarter (by 23.1%, according to preliminary figures), the country's GDP increased by 3%. The non-agricultural GDP is estimated to have increased by 8 to 9%. In the first half of 2007, economic growth in Moldova had exceeded 8%.

Like in the past, growth is exclusively due to the services sectors, notably construction and trade. Industrial production as a whole is reported to have contracted by an estimated 2.7%, after a drop of nearly 5% in 2006, reflecting primarily the adverse conditions in which food industry continued to operate (drought, but also the persistent effects of the Russian ban on wine exports introduced in 2006, which are being overcome only gradually). Yet, there are indications that new small-scale industries are developing and creating jobs (e.g. in the textiles sector). Growth is mainly driven by domestic demand, but unlike the previous years, growth in investments, both residential and, what is new, industrial, seems to be much stronger than growth in household consumption – more than 20% in 2007 against 4%.

The slowdown in the output of the tradables sectors (agriculture and industry) and strong domestic demand translated in a further surge in imports, whose dollar value increased in 2007 by more than 37%. At the same time, growth of exports (which had stagnated in 2006) was more modest (30%), which resulted in a widen ing of the trade deficit from USD 1.6 billion to 2.3 billion. Trade deficit is approaching 50% of Moldova's GDP. This deficit was again only partly compensated by remittances from Moldova's workers abroad (remittances are estimated to amount to about one-third of GDP). As a result, for a third year in a row, Moldova's current account deficit increased and was in 2007 nearly 16% of GDP. This deficit seems, however, sustainable in the short run as capital inflows, in the form of foreign direct investment (FDI) or credit to commercial banks or industrial enterprises (foreign debt of the non-government sector increased in 2007 to 50% of GDP from 40% three years earlier), are well in excess of this amount. FDI almost doubled and exceeded 9% of GDP in 2007, but remains low in absolute terms and per capita. Large capital inflows have also translated in an accumulation of international reserves of the National Bank of Moldova (NBM) beyond the target of three months of imports set in the PRGF programme.

Massive capital inflows are also generating inflationary pressures which, combined with the effects of the drought on food prices, prevented the NBM from meeting its objectives in terms of cutting down consumer price rises, despite its continued efforts to sterilise the inflows of foreign exchange. Twelve-month inflation in 2007 remained well above the 10% level, at more than 13%; it accelerated further to 15.6% by the end of the first quarter of 2008. Accelerating inflation, together with the appreciation of the exchange rate of the Moldovan leu (the NBM is gradually shifting towards inflation targeting and allowing exchange rate appreciation) is leading to loss of competitiveness of Moldova's economy. The leu's real effective exchange rate appreciated by more than 10% in 2007.

The key challenge of Moldova's macroeconomic policy – controlling inflation – is constrained by weak transmission mechanisms of monetary policy and by huge developments needs (Moldova remains the poorest country in Europe). Yet, in the near future, the fiscal policy is expected to continue supporting the disinflation efforts of the National Bank. In 2007, the budget deficit was lower than planned – just a quarter of a percent of GDP – reflecting primarily stronger revenue performance, while the government succeeded to keep spending increases below revenue rises. Restrictive fiscal policy has also allowed a further reduction of public debt, to just over 25% of GDP (down from nearly 30% the year before and nearly 40% in 2004). The bulk of this debt is external debt; it increased slightly in dollar terms in 2007 but went down to less than 20% of GDP.

5.3. Structural reforms

Moldova's policy agenda is increasingly defined by the government's European ambitions. In 2007, the government adopted a new policy document, the National Development Strategy (NDS), built on and replacing the Economic Growth and Poverty Reduction Strategy Paper (EGPRSP) adopted in 2004. The NDS, which reflects largely the priorities of the EU-Moldova ENP Action Plan, adopted in February 2005 for a period of three years, is aimed at becoming the reference tool for defining short- and medium-term policy government priorities. It will be accompanied by National Developments Plans, prepared for three-year periods, consistent with the medium-term budget planning in the framework of three-year Medium-Term Expenditure Frameworks (MTEF). This is indeed a very welcome development since until recently the budget priorities were often disconnected from the proclaimed policy priorities.

In April 2008, the EU published the second progress report evaluating the implementation of the EU-Moldova ENP Action Plan. The report identifies a number of positive developments in the field of structural reforms in 2007, some of which are reviewed below.

In the area of trade policy, the Commission services concluded that the Republic of Moldova had made sufficient progress in improving its institutional framework and system of controls and certification of origin of goods to meet the formal requirements for receiving additional Autonomous Trade Preferences (ATPs) from the EU. The Commission's proposal for granting additional ATPs to the Republic of Moldova was adopted in January 2008 and entered into force in March 2008. At the same time, while Moldova's trade regime remains generally open, the authorities have still not dismantled all the administrative restriction on trade. So, with the world prices for wheat increasing, proposals to limit or ban wheat exports were floated. Also, a new cumbersome system of approving meat and dairy imports was introduced in 2007. This new system will be removed and no new restriction should in principle be introduced.

In the area of enterprise policy, several new laws were adopted in 2007 leading to some improvement of the business environment (i.e. Law on State Registration of Legal Entities and Individual Enterprises or Law on Joint Stock Companies). Also, the government decided to revitalize the privatisation process that had been stalled for several years. So, the authorities are planning to speed up the privatisation of the telecom operator.

Yet, there are still barriers to establishment of businesses, in particular due to the heavy and sometimes arbitrary administrative requirements and controls imposed on investors. Not surprisingly, the business environment in Moldova is still perceived as not attractive. Indeed, Moldova's ranking in the World Bank's Doing Business survey remained essentially unchanged in 2007 (it even deteriorated slightly from the 90th position in the 2007 Doing Business Report to the 92nd in the 2008 Report).

In the area of financial services, progress was made in the banking regulation and supervision. The Republic of Moldova continued to implement the recommendations of the IMF's Financial Sector Assessment Programme (FSAP), but does not yet fully comply with them. Referring to the development of the non-banking financial intermediation (insurance, securities markets), some progress in the area of administrative capacity building was achieved with the setting up of a new central regulating authority. Also, new legislation was adopted in the area of insurance.

In 2007 the Republic of Moldova took several measures to implement the 2006-2010 Strategy for the Development of the Tax Service, such as the setting up of a Division for combating tax fraud and the strengthening of the work of the Large Taxpayers Division. In April 2007 several amendments to the existing taxation legislation were approved. A 0% corporate income tax on undistributed income was introduced as from 1 January 2008 in replacement of all other investment incentives. Moreover, a possibility for capital legalisation will remain open until 3 December 2008 and a fiscal amnesty for tax liabilities from before January 2007 was decided.

There was good progress on competition policy through the establishment of the National Agency for the Protection of Competition as an independent authority (NAPC) in February 2007. A number of investigations were carried out in 2007 but to be fully operational the NAPC would require additional budgetary means and trained personnel.

Further progress was made with the entry into force in October 2007 of the new law on public procurement. Sound implementation of the law, along the lines of a specific Action Plan, now requires the reinforcement of the administrative and training capacities of the Public Procurement Agency as well as awareness-raising activities of the contracting authorities and the stakeholders. The Republic of Moldova is not yet party to the WTO agreement on Public Procurement.

Progress can be noted in the field of internal and external audit and financial control and accounting with the entry into force in January 2008 of new laws which contribute to bringing legislation closer into line with EU standards.

5.4. Implementation of macro-financial assistance

On 16 April 2007, the Council adopted a decision on macro-financial assistance to the Republic of Moldova (Decision 2007/59/EC, published in the Official Journal of 28 April 2008). Under the decision, Moldova will receive grants of a total amount of EUR 45 million, in three instalments. The assistance is designed to contribute to covering the country’s external financing needs in 2007-2008 identified by the IMF in the context of the PRGF arrangement approved in May 2006. It will be complementary to, inter alia, support provided by the Bretton Woods institutions (IMF financing under the PRGF and World Bank’s Poverty Reduction Support Credit) and budgetary support provided by the EU under the Food Security Programme (FSP) and the European Neighbourhood and Partnership Instrument (ENPI).

Prior to the implementation of macro-financial assistance, the Commission conducted an operational assessment (OA) of financial procedures and circuits in the Moldovan Ministry of Finance and in the National Bank. The results of the OA were one of the inputs to the policy dialogue with the authorities of the Republic of Moldova in the context of the implementation of macro-financial assistance that the Commission focused on public finance management. The particular areas identified in the course of this dialogue are the improved financial management of the social benefits programmes (one of the top priorities of Moldova’s government in the social policy area), the establishment of the functioning public internal financial control system (PIFC) and the reform and strengthening of the public procurement. In all three areas, the Commission has cooperated closely with the other donors involved, in particular the World Bank and the Commission's EuropAid (implementing budget support under the FSP and the ENPI).

The Commission made one disbursement under the programme in 2007: the first instalment of EUR 20 million was released in early October. The Commission expects to disburse the second and the third tranches, amounting to respectively EUR 10 and 15 million, before the end of 2008.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices have been liberalised.

2. Trade liberalisation

Relatively liberal international trade policy, but restrictions still exist on some key commodities. Moldova became a member of the WTO in June 2000. In early 2008 the EU granted the Republic of Moldova Autonomous Trade Preferences.

3. Exchange regime

Increasingly, floating exchange rate of the leu with limited official intervention by the National Bank of Moldova. No restrictions on current international transactions in conformity with Article VIII of the IMF's Articles of Agreement.

4. Foreign Direct Investment

Unlimited repatriation of capital and profits and no limitations on holding foreign currency bank accounts. Adequate overall legislation, but implementation is often problematic, which weakens the business climate. A new investment law introducing equal treatment of domestic and foreign investors adopted in 2004. FDI increased to over 9% of GDP in 2007 but is still modest.

5. Monetary policy

The National Bank of Moldova is gradually moving to inflation targeting but inflationary pressures in 2007, mostly resulting from capital inflows, did not allow a meaningful deceleration of inflation. Inflation again accelerated in the beginning of 2008. The National Bank expected to pursue a tighter policy course aimed at increasingly privileging control of inflation over exchange rate stability while still continuing to accumulate forex reserves, which exceeded for the first time the equivalent of three months of imports.

6. Public Finance

Budget revenue continued increasing in 2007 reflecting rising revenue from taxation of consumption. As expenditure was also increased, the budget was still in small deficit (a quarter of a percentage point of GDP). Public external debt went down to less than 20% of GDP. Reform of Public Finance Management continued, with progress achieved in particular in developing the Medium-Term Expenditure Framework, in moving towards the single Treasury account, in strengthening tax administration and in developing the system of public internal financial control.

7. Privatisation and Enterprise Restructuring

Structural reforms are being implemented in the framework of the National Development Plan (NDP) and the EU-Moldova ENP Action Plan. Progress is being achieved in strengthening bankruptcy procedures, management of state property and simplification and streamlining of the regulatory environment of the enterprises. Yet enforcement remains a serious concern and business environment suffers from state intervention and formal and informal business restrictions. Also, the privatisation process was stalled for several years, only to be revitalized in 2008. Other key areas of structural reforms – public administration and social protection reforms – progressed.

8. Financial Sector Reform

Restructuring and consolidation of the financial sector progressed, with significant foreign investments. Further strengthening is crucial to mobilize savings and promote investment.

6. LEBANON

Mediterranean Countries taking part of the European neighbourhood Policy are eligible to MFA under the Genval Criteria. Lebanon is the first country of this group benefiting from MFA since the balance of payments loan granted in 1994 to Algeria (Decision94/933/EC).

6.1. Executive summary

The economy is recovering from the 2006 conflict with Israel in a context of continuous political stalemate and recurrent outbreaks of violence. Real GDP growth in 2007 is estimated to 4%, a much better result than initially foreseen. Inflation has declined despite the depreciation of the US dollar, to which the Lebanese pound is pegged. Reflecting reconstruction needs, the current account deficit is estimated to have increased to 10.7% of GDP. However, it is largely financed by official inflows and foreign direct investment. The fiscal deficit was contained on the back of stronger than projected revenue collection. Public debt-to-GDP ratio decreased slightly (to 171% by the end of 2007), but remains very high.

The government continues to strike a careful balance between reconstruction and social needs, and the challenges resulting from the large public debt overhang. Fiscal policy aims at containing the primary deficit while accommodating reconstruction and relief spending. Lebanon pursued its ambitious programme of structural reforms, but the difficult political context and the paralysis of legislative activity limited progress in many fields.

Lebanon's financing arrangement with the IMF concluded in April 2007 under the Fund's Emergency Post-Conflict Assistance (EPCA) was successfully completed in early 2008.

Since January 2007, Lebanon and the EU are implementing an European Neighbourhood Policy Action Plan. The first progress report on the Action Plan implementation was issued by the Commission in April 2008, but it does not contain an overall assessment.

In December 2007, the Council adopted a decision on a macro-financial assistance to Lebanon amounting to EUR 80 million – a combination of medium-term loans (EUR 50 million) and grants (EUR 30 million). The disbursements under the assistance programme are expected to take place in 2008.

6.2. Macroeconomic performance

In 2007, the economy of Lebanon continued its slow recovery from the 2006 conflict with Israel in a context of continuous political stalemate and recurrent outbreaks of violence. Once again, it showed resilience to pressures, which was reflected in growth figures and financial conditions. Real GDP growth of 4% is well above the rates initially expected. The negative impact of oil price increases and uncertain political environment was broadly compensated by boosted regional demand and high financial aid from the region. Despite the difficult political situation, the current caretaker government of Prime Minister Siniora continues to ensure the regular administration of the country in accordance with the constitution.

Fiscal outcomes in 2007 were better than expected at the beginning of the year. The budget deficit reached 11% of GDP, a result comparable to that of 2006. It exceeded initial targets on the back of stronger than projected revenue collection. Lower-than-foreseen foreign financed capital expenditure (partly on account of delays in donors' disbursements) contributed to this fiscal over-performance. External grants and loans helped to achieve a primary surplus of 1.8% of GDP (0.4% without foreign assistance). Public debt-to-GDP ratio decreased to 171% by the end of 2007 from 177% in 2006.

The deficit is expected to further decrease in 2008 although risks of unforeseen expenditure, such as security measures and transfers to Electricité du Liban on account of higher oil prices, remain. The 2008 Budget foresees an increase of VAT rate to 12% from the current 10% and of taxes on interest income from 5% to 7%, in line with the programme of reforms supported by the international donor community (agreed in the Paris III conference). Privatisation should reduce public debt by about 30 percentage points of GDP.

The authorities succeeded in maintaining macro-economic stability. Despite pressures on reserves, confidence loss and deposits outflows, the situation was managed and confidence restored fairly quickly. Money demand has remained robust. Interest rates remained unchanged. Bank deposits, which represent almost three times the size of the GDP (out of which 77% in foreign currency), increased by 10.5%. Profits of the banking sector rose by 10% compared to 2006. Gross reserves, excluding gold, remained stable. Saudi Arabia deposited once again early 2008 USD 1 billion at Banque du Liban to bolster monetary and financial stability in the country. The value of Lebanon's gold reserves, estimated to more than 9 million ounces of gold, surged thanks to the rise in price of the metal in international markets. Inflation has declined compared to 2006 despite the depreciation of the US dollar, to which the Lebanese pound is pegged.

Reflecting reconstruction needs, the current account deficit is estimated to have increased to 10.7% of GDP (2006: 6%) on account of a higher trade deficit. The current account deficit is largely financed by official inflows and sustained foreign direct investment.

In April 2007, the IMF Board approved Emergency Post-Conflict Assistance (EPCA) to Lebanon amounting to SDR 50.75 million. The full amount was disbursed shortly after, but the IMF continued monitoring the implementation of agreed policy actions. In April 2008, the IMF Board concluded that Lebanon has met comfortably all the indicative targets under EPCA.

6.3. Structural reforms

Lebanon pursued its programme of structural reforms focused on privatisation, improvements in the business climate and opening of markets. However, the difficult political context and the paralysis of legislative activity limited progress in many fields. The government took steps to prepare the ground for reforming the energy and social sector with the aim of limiting open-ended transfers from the budget while protecting capital and social expenditure. Addressing power sector losses will contribute to fiscal sustainability. In the telecom sector measures were taken to prepare for the corporatisation of Liban Telecom and for the privatisation of the two mobile operators. The valuation of the mobile networks, the timing of the auction, the impact of the privatisation on public finances and the role of parliament remain uncertain. A Telecommunication Regulatory Authority was also created to ensure proper competition in the sector. Progress in this field has been, however, controversial and slower than expected. The government approved end October 2007 a draft law on competition that aims to increase competition by fighting monopoly and non-competitive arrangements. The Law foresees the creation of a Competition Council which would become the official reference for all related issues.

Despite some progress in reforms, Lebanon regressed in the overall 2007 World Bank “Doing Business" rankings. The authorities still need to improve investor protection laws and the system to enforce commercial contracts. A Business Registration Simplification project that aims to reduce the time and cost of registering new companies is under preparation.

The financial sector continued proving its resilience to shocks despite the large public debt and significant external vulnerabilities. Its strength is attributed to three factors: (i) perceived implicit guarantee from donors; (ii) Lebanon's track record of having never defaulted on external debt or deposits and (iii) unique market structure for Lebanese debt that is dominated by local banks and dedicated investors and depositors.

In the area of trade policy, Lebanon did not succeed in 2007 to achieve WTO membership. Progress in negotiations has been halted by the paralysis of the legislative activity. In the meantime, the efforts of the authorities focused on ensuring energy supply to the country under favourable conditions, which resulted in a renewed electricity agreement with Syria and an agreement with Egypt on natural gas imports. Some protectionist actions have also been taken in contradiction of the Arab Free Trade Agreement.

Lebanon’s position in various governance rankings deteriorated compared to 2006. It lagged behind other countries in the southern ENP region in the Transparency International Corruption perception Index in 2007 performing just slightly better than Egypt, Libya and Syria and at the same level as Algeria. Lebanon regressed as well in the rankings on the six World Bank governance indicators. On the other hand, the Ministry of Finance was among the winners of the United Nations Public Service Awards for 2007 for the category "Taxpayer Service".

Regarding public finance management, the government reform efforts focused on budget formulation and execution as well as medium-term planning and prioritisation of expenditures across ministries and public agencies. Measures aiming at improving cash management and implementing a single treasury account are a key part of the government’s Medium-Term Public Financial Management Reform Action Plan. A global income tax law was adopted by the Council of Ministers in November 2007 but still requires parliamentary approval.

The EU and Lebanon are implementing the European Neighbourhood Policy Action Plan which was adopted in January 2007. The first progress report was made public in April 2008. Because of the short period of implementation of the Action Plan, the Commission did not give an overall assessment of progress for any of the areas of cooperation, including the economic and financial partnership.

6.4. Implementation of macro-financial assistance

On 30 November 2006 the Council adopted a decision providing Kosovo with new On 20 August 2007, the Commission adopted a proposal for a Council decision providing macro-financial assistance to Lebanon, with a view to supporting Lebanon's public finances and balance of payments. The Commission proposed that the assistance would be in the form of a combination of a medium-term loan and a grant, of respectively EUR 50 and 30 million. The proposal was eventually adopted by the Council on 10 December 2007 (Council Decision 2007/860/EC, published in the Official Journal on 21 December 2007). The assistance seen as part of the EC assistance package will complement support from the Bretton Woods Institutions, bilateral donors (including EU Member States and Arab countries), and finally the EU's own grants (under the ENPI) and loans (by the EIB). Macro-financial assistance is conditional, in particular, on progress in the implementation of the IMF EPCA arrangement and subsequent IMF-supported programmes.

The EC macro-financial assistance aims primarily at supporting the authorities' effort of fiscal consolidation. Thus, the specific reform measures to be targeted by the programme focus on public finance management (PFM) and on two specific sectoral policies of particular importance for fiscal adjustment and debt reduction, namely the power sector and the social sector.

In identifying the policy conditions of the assistance, the Commission staff used as inputs the government programme of reforms, specific sectoral strategies, such as the Medium Term Public Financial Management Reform Action Plan, the results of the Operational Assessment of administrative procedures and financial circuits conducted by external experts for the Commission in October 2007 and discussions with major donors on the reform conditions attached to budget support. The agreement on the conditions to be attached to the disbursement of the assistance was expected to be finalised in April-May 2008. The Commission intends to make the disbursements before the end of 2008.

SUMMARY STATUS OF ECONOMIC REFORM

1. Price liberalisation

Most prices are free.

2. Trade liberalisation

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

3. Exchange regime

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

4. Foreign Direct Investment

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

5. Monetary policy

The Banque du Liban (BdL)) uses a wide menu of monetary policy instruments to maintain financial stability and provide liquidity to the banking sector. It also occasionally provides financing to the government (on a temporary basis). The exchange rate peg is regarded as a key factor in maintaining financial stability. Gross international reserves are increasing, partly because of higher gold prices (BdL holda a large gold stock).

6. Public Finance

Fiscal performance in 2007 was better than planned reflecting rising revenue from taxation and delays in spending. Public finance management reform focuses on budget formulation and execution and medium-term planning.

7. Privatisation and Enterprise Restructuring

Structural reforms programme focuses on privatisation, improvement of business climate and opening of markets, but progress is limited due to the political situation. Government approved a draft law on competition. Yet business environment rating of Lebanon regressed in 2007.

8. Financial Sector Reform

Lebanon has a sophisticated and developed financial sector which proved resilient to shocks despite vulnerabilities.

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

Status of effective disbursements as of end-December 2007 (in millions of euro)

	Authorisations			Disbursements				Repayments			
Country	Date of Council Decision	Reference of Council Decision	**Maximum amount**	Dates of disbursements	**Amounts of disbursements**	**Totals**	**Undisbursed**	Dates of repayments	**Amounts of repayments**	**Totals**	**Outstanding**
Hungary I	22.02.90	90/83/EC	**870**	Apr. 1990	**350**	**610**	**260**	Apr. 95	**350**	**610**	
(Structural adjustment loan)				Feb. 1991	**260**		**(Suspended)**	févr-96	**260**		
Czech and Slovak Federal Republic	25.02.91	91/106/EC	**375**	Mar. 1991	**185**	**375**		mars-98	**185**	**375**	
(BOP loan)				Mar. 1992	**190**			déc-97	**190**		
Hungary II	24.06.91	91/310/EC	**180**	Aug. 1991	**100**	**180**		mars-98	**100**	**180**	
(BOP loan)				Jan. 1993	**80**			déc-97	**80**		
Bulgaria I	24.06.91	91/311/EC	**290**	Aug. 1991	**150**	**290**		mars-98	**150**	**290**	
(BOP loan)				Mar. 1992	**140**			déc-97	**140**		
Romania I	22.07.91	91/384/EC	**375**	Jan. 1992	**190**	**375**		févr-99	**190**	**375**	
(BOP loan)				Apr. 1992	**185**			mars-98	**185**		
Israel (1)	22.07.91	91/408/EC	**187,5**	Mar. 1992	**187,5**	**187,5**		déc-97	**160**	**160**	
(Structural adjustment soft loan)											
Algeria I	23.09.91	91/510/EC	**400**	Jan. 1992	**250**	**400**		déc-97	**250**	**250**	**150**
(BOP loan)				Aug. 1994	**150**			août-01			
Albania I	28.09.92	92/482/EC	**70**	Dec. 1992	**35**	**70**					
(BOP grant)				Aug. 1993	**35**						
Bulgaria II	19.10.92	92/511/EC	**110**	Dec. 1994	**70**	**110**		déc-01			**110**
(BOP loan)				Aug .1996	**40**			août-03			
Baltics	23.11.92	92/542/EC	**220**			**135**	**85**		**110**	**110**	**25**
(BOP loans)							**(Suspended)**				
of which :											
Estonia			**(40)**	Mar. 1993	**20**	**(20)**	**(20)**	mars-00	**(20)**		
Latvia			**(80)**	Mar. 1993	**40**	**(40)**	**(40)**	mars-00	**(40)**		
Lithuania			**(100)**	Jul. 1993	**50**	**(75)**	**(25)**	juil-00	**(50)**		**(25)**
				Aug. 1995	**25**			août-02			
Romania II	27.11.92	92/551/EC	**80**	Feb. 1993	**80**	**80**		févr-00	**80**	**80**	
(BOP loan)											
Moldova I	13.06.94	94/346/EC	**45**	Dec. 1994	**25**	**45**		From 12/2000	**5**	**5**	**40**
(BOP loan)				Aug. 1995	**20**			From 08/2001			
Romania III	20.06.94	94/369/EC	**125**	Nov. 1995	**55**	**125**		nov-02			**125**
(BOP loan)				Sep. 1997	**40**			sept-04			
				Dec. 1997	**30**			déc-04			
Albania II	28.11.94	94/773/EC	**35**	Jun. 1995	**15**	**35**					
(BOP grant)				Oct. 1996	**20**						
Algeria II	22.12.94	94/938/EC	**200**	Nov. 1995	**100**	**100**	**100**	nov-02			**100**
(BOP loan)							**(Suspended)**				
Slovakia	22.12.94	94/939/EC	**130**	Jul. 1996			**130**				
(BOP loan)							**(Cancelled)**				
Ukraine I	22.12.94	94/940/EC	**85**	Dec. 1995	**85**	**85**		From 12/2001			**85**
(BOP loan)											
Belarus	10.04.95	95/132/EC	**55**	Dec. 1995	**30**	**30**	**25**	From 12/2001			**30**
(BOP loan)							**(Suspended)**				
Ukraine II	23.10.95	95/442/EC	**200**	Aug. 1996	**50**	**200**		From 08/2002			**200**
(BOP loan)				Oct. 1996	**50**			From 10/2002			
				Sep. 1997	**100**						
Moldova II	25.03.96	96/242/EC	**15**	Dec. 1996	**15**	**15**		From 10/2002			**15**
(BOP loan)								in 5 tranches			
fYRoM I	22.07.97	97/471/EC	**40**	Sep. 1997	**25**	**40**		oct-08			**40**
(BOP loan)				Feb. 1998	**15**						
Bulgaria III	22.07.97	97/472/EC	**250**	Feb. 1998	**125**	**250**		févr-05			**250**
(BOP loan)				Dec. 1998	**125**			déc-05			

	Authorisations			Disbursements				Repayments			
Country	Date of Council Decision	Reference of Council Decision	**Maximum amount**	Dates of disbursements	**Amounts of disbursements**	**Totals**	**Undisbursed**	Dates of repayments	**Amounts of repayments**	**Totals**	**Outstanding**
Armenia, Georgia and Tajikistan (2)	17.11.97	97/787/EC	**375**			**294,5**	**80,5**				**138**
(Structural adjustment loans and grants)	modified by										
of which	28.3.00	00/244/EC									
Armenia			**(58)**	Dec. 1998 (loan)	**28**	**58**	**0**				
				Dec. 1998 (grant)	**8**						
				Dec. 1999 (grant)	**4**						
				Feb. 2002 (grant)	**5,5**						
				Dec. 2002 (grant)	**5,5**						
				June 2004 (grant)	**5,5**						
				Dec 2005 (grant)	**1,5**						
Georgia			**(175)**	Jul. 1998 (loan)	**110**	**141,5**	**33,5**				
				Aug. 1998 (grant)	**10**						
				Sep. 1999 (grant)	**9**						
				Dec. 2001 (grant)	**6**						
				Dec 2004 (grant)	**6,5**						
Tajikistan			**(95)**	Mar. 2001 (loan)	**60**	**95**					
				Mar. 2001 (grant)	**7**						
				Dec. 2001 (grant)	**7**						
				Feb. 2003 (grant)	**7**						
				May 2005 (grant)	**7**						
				Oct 2007 (grant)	**7**						
Ukraine III	15.10.98	98/592/EC	**150**	Jul. 1999	**58**	**58**	**92**				**58**
(BoP loan)	12.07.02	02/639/EC					**(Cancelled)**				
Albania III	22.04.99	99/282/EC	**20**				**20**				
(BOP loan)											
Bosnia I (3)	10.05.99	99/325/EC	**60**	Dec. 1999 (grant)	**15**	**60**					**20**
(BOP loan and grant)	modified by			Dec. 1999 (loan)	**10**						
	10.12.01	01/899/EC		Dec. 2000 (grant)	**10**						
				Dec. 2000 (loan)	**10**						
				Dec. 2001 (grant)	**15**						
Bulgaria IV	08.11.99	99/731/EC	**100**	Dec. 1999	**40**	**100**					**100**
(BOP loan)				Sep. 2000	**60**						
fYRoM II (4)	08.11.99	99/733/EC	**80**	Dec. 2000 (grant)	**20**	**98**					**10**
(BOP loan and grant)	modified by		**18**	Dec. 2000 (loan)	**10**						
	10.12.01	01/900/EC		Dec. 2001 (loan)	**12**						
				Dec. 2001 (grant)	**10**						
				May 2003 (grant)	**10**						
				June 2003 (loan)	**10**						
				Dec. 2003 (loan)	**18**						
				Dec. 2003 (grant)	**8**						
Romania IV	08.11.99	99/732/EC	**200**	Jun. 2000	**100**	**150**	**50**				**150**
(BOP loan)				July 2003 (loan)	**50**						
Kosovo I (5)	19.02.00	00/140/EC	**35**	Mar. 2000	**20**	**35**					
(Grant budgetary support)				Aug. 2000	**15**						
Montenegro (5)	22.05.00	00/355/EC	**20**	Aug. 2000	**7**	**20**					
(Grant budgetary support)				Dec. 2000	**13**						
Moldova III	10.07.00	00/452/EC	**15**				**15**				
(BOP loan)	19.12.02	02/1006/EC					**(Cancelled)**				
Kosovo II (3)	27.06.01	01/511/EC	**30**	Sep. 2001	**15**	**30**					
(Grant budgetary support)				Dec. 2002	**15**						
Serbia and Montenegro (ex FRY) I (6)	16.07.01	01/549/EC	**345**	Oct. 2001	**225**	**345**					**225**
(BOP loan and grant)	modified by			Oct. 2001	**35**						
	10.12.01	01/901/EC		Jan. 2002	**40**						
				Aug. 2002	**45**						
Ukraine IV	12.07.02	02/639/EC	**110**				**110**				
(BOP loan)											
Serbia and Montenegro II (ex FRY) (7)	05.11.02	02/882/EC	**130**	Dec. 2002 (grant)	**30**	**105**	**25**				
				Fev. 2003 (loan)	**10**						
				Aug. 2003 (grant)	**35**						
				Aug. 2003 (loan)	**30**						
	modified by										
	25.11.03	03/825/EC	**70**	Dec 2004 (grant)	**10**	**50**	**20**				
	07.12.2004	04/862/EC									
				April 2005 (loan)	**15**						
				Dec 2005 (grant)	**25**						
Bosnia II (8)	05.11.02	02/883/EC	**60**	Fev. 2003 (grant)	**15**	**60**					
	modified by			Dec. 2003 (grant)	**10**						
	7/12/2004	04/861/EC									
				Dec 2004 (loan)	**10**						
				Jun 2005 (grant)	**15**						
				Feb 2006 (loan)	**10**						
Moldova IV	19.12.02	02/1006/EC	**15**				**15**				
Albania IV (9)	29.04.04	04/580/EC	**25**	Nov 2005 (grant)	**3**	**25**					
				March 2006 (loan)	**9**						
				July 2006 (grant)	**13**						
Georgia II	24.01.06	06/41/EC	**33,5**	August 2006 (grant)	**11**	**22**	**11,5**				
				Dec 2006 (grant)	**11**						
Kosovo	30.11.06	06/880/EC	**50**				**50**				
Moldova	16.04.07	07/259/EC	**45**	Oct 2007 (grant)	**20**	**20**	**25**				
Lebanon	10.12.07	07/860/EC	**80**				**80**				
			-------			-------	-------		-------	-------	-------
TOTAL			**6404**			**5210,0**	**1194,0**		**2435**	**2435**	**1871**

(1) Assistance to Israel includes a loan principal amount of € 160 million and grants of € 27.5 million in the form of interest subsidies.
(2) Exceptional financial assistance, which includes a ceiling of euro 245 million for the loans and a ceiling of euro 130 million for the grants
Out of the global amount of euro 375 million, maximum amounts of euro 58 million, euro 175 million and euro 95 million were actually agreed with the beneficiary countries.
(3) Includes a loan principal amount of up to € 20 million and grants of up to € 40 million.
(4) Includes a loan principal amount of up to € 50 million and grants of up to € 48 million.
(5) Exceptional financial assistance.
(6) Includes a loan principal amount of € 225 million and grants of € 120 million.
(7) Includes a loan principal amount of € 55 million and grants of € 75 million
(8) Includes a loan principal amount of € 20 million and grants of € 40 million
(9) Includes a loan principal amount of € 9million 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 2007 (in millions of euro)

	Authorisations			**Disbursements**				**Repayments**			
Country	Date of Council Decision	Reference of Council Decision	**Maximum amount**	Dates of disbursements	**Amounts of disbursements**	**Totals**	**Undisbursed**	Dates of repayments	**Amounts of repayments**	**Totals**	**Outstanding**
A. EU Accession countries											
Baltics	23.11.92	92/542/EC	**220**			**135**	**85**		**110**	**110**	**25**
(BOP loans)							**(Suspended)**				
of which :											
Estonia			**(40)**	Mar. 1993	20	**(20)**	**(20)**	mars-00	**(20)**		
Latvia			**(80)**	Mar. 1993	40	**(40)**	**(40)**	mars-00	**(40)**		
Lithuania			**(100)**	Jul. 1993	50	**(75)**	**(25)**	juil-00	**(50)**		**(25)**
				Aug. 1995	25			août-02			
Bulgaria I	24.06.91	91/311/EC	**290**	Aug. 1991	150	**290**		mars-98	**150**	**290**	
(BOP loan)				Mar. 1992	140			déc-97	**140**		
Bulgaria II	19.10.92	92/511/EC	**110**	Dec. 1994	70	**110**		déc-01			**110**
(BOP loan)				Aug .1996	40			août-03			
Bulgaria III	22.07.97	97/472/EC	**250**	Feb. 1998	125	**250**		févr-05			**250**
(BOP loan)				Dec. 1998	125			déc-05			
Bulgaria IV	08.11.99	99/731/EC	**100**	Dec. 1999	40	**100**					**100**
(BOP loan)				Sep. 2000	60						
Czech and Slovak Federal Republic	25.02.91	91/106/EC	**375**	Mar. 1991	185	**375**		mars-98	**185**	**375**	
(BOP loan)				Mar. 1992	190			déc-97	**190**		
Hungary I	22.02.90	90/83/EC	**870**	Apr. 1990	350	**610**	**260**	Apr. 95	**350**	**610**	
(Structural adjustment loan)				Feb. 1991	260		**(Suspended)**	févr-96	**260**		
Hungary II	24.06.91	91/310/EC	**180**	Aug. 1991	100	**180**		mars-98	**100**	**180**	
(BOP loan)				Jan. 1993	80			déc-97	**80**		
Romania I	22.07.91	91/384/EC	**375**	Jan. 1992	190	**375**		févr-99	**190**	**375**	
(BOP loan)				Apr. 1992	185			mars-98	**185**		
Romania II	27.11.92	92/551/EC	**80**	Feb. 1993	80	**80**		févr-00	**80**	**80**	
(BOP loan)											
Romania III	20.06.94	94/369/EC	**125**	Nov. 1995	55	**125**		nov-02			**125**
(BOP loan)				Sep. 1997	40			sept-04			
				Dec. 1997	30			déc-04			
Romania IV	08.11.99	99/732/EC	**200**	Jun. 2000	100	**150**	**50**				**150**
(BOP loan)				July 2003	50						
Slovakia	22.12.94	94/939/EC	**130**			**Cancelled**	**130**				
(BOP loan)						(Jul. 1996)	**Cancelled**				
			-------			-------	-------				-------
TOTAL A			**3305**			**2780**	**525**				**760**
B. Western Balkans											
Albania I	28.09.92	92/482/EC	**70**	Dec. 1992	35	**70**					
(BOP grant)				Aug. 1993	35						
Albania II	28.11.94	94/773/EC	**35**	Jun. 1995	15	**35**					
(BOP grant)				Oct. 1996	20						
Albania III	22.04.99	99/282/EC	**20**				**20**				
(BOP loan)							**(Cancelled)**				
Bosnia I (1)	10.05.99	99/325/EC	**60**	Dec. 1999 (grant)	15	**60**					**20**
(BOP loan and grant)	modified by			Dec. 1999 (loan)	10						
	10.12.01	01/899/EC		Dec. 2000 (grant)	10						
				Dec. 2000 (loan)	10						
				Dec. 2001 (grant)	15						
fYRoM I	22.07.97	97/471/EC	**40**	Sep. 1997	25	**40**					**40**
(BOP loan)				Feb. 1998	15						
fYRoM II (2)	08.11.99	99/733/EC	**80**	Dec. 2000 (grant)	20	**98**					**10**
(BOP loan and grant)	modified by			Dec. 2000 (loan)	10						
	10.12.2001	01/900/EC	**18**	Dec. 2001 (loan)	12						
				Dec. 2001 (grant)	10						
				May 2003 (grant)	10						
				June 2003 (loan)	10						
				Dec. 2003 (loan)	18						
				Dec.) 2003 (grant)	8						

	Authorisations			Disbursements				Repayments			
Country	Date of Council Decision	Reference of Council Decision	**Maximum amount**	Dates of disbursements	**Amounts of disbursements**	**Totals**	**Undisbursed**	Dates of repayments	**Amounts of repayments**	**Totals**	**Outstanding**
Kosovo I (3)	19.02.00	00/140/EC	**35**	Mar. 2000	20	**35**					
(Grant budgetary support)				Aug. 2000	15						
Kosovo II (3)	27.06.01	01/511/EC	**30**	Sep. 2001	15	**30**					
(Grant budgetary support)				Dec. 2002	15						
Montenegro (3)	22.05.00	00/355/EC	**20**	Aug. 2000	7	**20**					
(Grant budgetary support)				Dec. 2000	13						
Serbia and Montenegro I	16.07.01	01/549/EC	**345**	Oct. 2001 (grant)	35	**345**		Oct.-16			**225**
(ex FRY) (4)		modified by		Oct. 2001 (loan)	225						
	10.12.2001	01/901/EC		Jan. 2002 (grant)	40						
				Aug.2002 (grant)	45						
Serbia and Montenegro II	05.11.02	02/882/EC	**130**	Dec. 2002 (grant)	30	**105**	**25**				
(ex FRY) (5)				Fev. 2003 (loan)	10						
(BOP loan and grant)				Aug. 2003 (grant)	35						
	modified by			Aug. 2003 (loan)	30						
	25.11.03	03/825/EC (7)	**70**	Dec 2004 (grant)	10	**50**	**20**				
	07.12.04	04/862/EC									
				April 2005 (loan)	15						
				Dec 2005 (grant)	25						
Bosnia II (6)	05.11.02	02/883/EC	**60**	Fev. 2003 (grant)	15	**60**					
(BOP loan and grant)				Dec. 2003 (grant)	10						
				Dec 2004 (loan)	10						
	modified by										
	07.12.04	04/861/EC		June 2005 (grant)	15						
				Feb 2006 (loan)	10						
Albania IV (8)	29.04.04	04/580/EC	**25**	Nov 2005 (grant)	3	**25**					-------
(loan and grant)				Mar 2006 (loan)	9						
				Jul 2006 (grant)	13						
Kosovo	30.11.06	2006/880/EC	**50**				**50**				
TOTAL B			**1088**			**973**	**115**				**70**
			-------			-------	-------				

(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

Country	Authorisations Date of Council Decision	Reference of Council Decision	Maximum amount	Disbursements Dates of disbursements	Amounts of disbursements	Totals	Undisbursed	Repayments Dates of repayments	Amounts of repayments	Totals	Outstanding
C. New Independent States (NIS)											
Armenia, Georgia and Tajikistan (9) (Structural adjustment loans and grants) of which	17.11.97 modified by 28.3.00	97/787/EC 00/244/EC	**375**			**294,5**	**80,5**				**138**
Armenia			**(58)**	Dec. 1998 (loan) Dec. 1998 (grant) Dec. 1999 (grant) Feb. 2002 (grant) Dec. 2002 (grant) Jun 2004(grant) Dec 2005(grant)	28 8 4 5,5 5,5 5,5 1,5	**(58)**	**0**		 **7**		
Georgia			**(175)**	Jul. 1998 (loan) Aug. 1998 (grant) Sep. 1999 (grant) Dec. 2001 (grant) Dec. 2004 (grant)	110 10 9 6 6,5	**(141,5)**	**(33,5)**				
Tajikistan			**(95)**	Mar. 2001 (loan) Mar. 2001 (grant) Dec. 2001 (grant) Feb 2003 (grant) May 2005 (grant) Oct 2006 (grant)	60 7 7 7 7 7	**(95)**					
Belarus (BOP loan)	10.04.95	95/132/EC	**55**	Dec. 1995	30	**30**	**25** **(Suspended)**	From 12/2001			**30**
Moldova I (BOP loan)	13.06.94	94/346/EC	**45**	déc-94 Aug. 1995	25 20	**45**		From 12/2000 From 08/2001	**5**	**5**	**40**
Moldova II (BOP loan)	25.03.96	96/242/EC	**15**	Dec. 1996	15	**15**		From 10/2002 in 5 tranches			**15**
Moldova III (BOP loan)	10.07.00 19.12.02	00/452/EC 02/1006 EC	**15**				**15** **(cancelled)**				
Moldova IV (BOP grant)	19.12.02	02/1006/EC	**15** *(15)*				**15**				
Ukraine I (BOP loan)	22.12.94	94/940/EC	**85**	Dec. 1995	85	**85**		From 12/2001			**85**
Ukraine II (BOP loan)	23.10.95	95/442/EC	**200**	Aug. 1996 Oct. 1996 Sep. 1997	50 50 100	**200**		From 08/2002 From 10/2002			**200**
Ukraine III (BoP loan)	15.10.98 12.07.02	98/592/EC 02/639/EC	**150**	Jul. 1999	58	**58**	**92** **(cancelled)**				**58**
Ukraine IV (BOP loan)	12.07.02	02/639/EC	**110** *(15)*				**110**				
Georgia II	21.01.06	06/41/EC	**33,5**	Aug 2006 Dec 2006	11 11	**22**	**11,5**				
Moldova	16.04.07	07/259/EC	**45**	Oct 2007	20	**20**	**25**				
			-------			-------	-------				-------
TOTAL C			**1143,5**			**769,5**	**374**				**566**
D. Mediterranean countries											
Israel (10) (Structural adjustment soft loan)	22.07.91	91/408/EC	**187,5**	Mar. 1992	187,5	**187,5**		déc-97	**160**	**160**	
Algeria I (BOP loan)	23.09.91	91/510/EC	**400**	Jan. 1992 Aug. 1994	250 150	**400**		déc-97 août-01	**250**	**250**	**150**
Algeria II (BOP loan)	22.12.94	94/938/EC	**200**	Nov. 1995	100	**100**	**100** **(Suspended)**	nov-02			**100**
Lebanon	10.12.07	07/860/EC	**80**				**80**				
			-------			-------	-------				-------
TOTAL D			**867,5**			**687,5**	**180**			**2435**	**250**
TOTAL A+B+C+D			**6404**			**5210,0**	**1194,0**				**1646**

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 interesr subsidies.