COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 16.10.2009
SEC(2009) 1310 final

COMMISSION STAFF WORKING DOCUMENT

Ex ante evaluation statement Macro-financial assistance to Georgia

Accompanying document to the

Proposal for a Council decision providing macro-financial assistance to Georgia

COM(2009) 523 final

Ex ante evaluation statement

Macro-financial assistance to Georgia

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1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1. Background

Until August 2008, when the military conflict with Russia started, Georgia's macro-economic performance had been very strong. Georgia's real growth figures have been above 9% in 2005 and 2006 and 12% in 2007. And also for the first half of 2008 the real growth rate remained robust at 8.6% annual growth. The military conflict with Russia undermined the strong growth performance of the early 2000s.

The IMF Board approved in mid-September 2008 an 18-month stand-by arrangement for USD 750 million which constitutes exceptional access at 300 percent of Georgia's quota. Given the need to replenish international reserves of the National Bank of Georgia (NBG) in the immediate aftermath of August 2008 crisis, the arrangement was frontloaded and enabled Georgia to draw USD 250 million from the Fund upon the Board approval of the programme.

Georgia received strong support from the international donor community at the Brussels Donor Conference on 22 October 2008 that was jointly organised by the European Commission and the World Bank. In total, USD 4.5 billion was pledged in post-conflict support to Georgia, including up to EUR 500 million from the European Community for the period of 2008-2010. The pledged assistance was based on a Joint Needs Assessment by the World Bank and the United Nations. The European Commission proposes to provide macro-financial assistance to Georgia in the form of grant instalments with a view of supporting Georgia's balance of payments, amounting to a maximum total amount of EUR 46 million. This assistance is part of a comprehensive Community package of up to EUR 500 million to support Georgia's economic recovery in the aftermath of the August 2008 armed conflict with Russia. The Community macro-financial assistance will contribute to covering Georgia's residual external financing needs in 2009-2010 as identified by the International Monetary Fund. The funds will be channelled to the state budget of Georgia to help meet budgetary needs.

1.2. Economic outlook and macroeconomic policy framework

The continued Russian military presence in South Ossetia and Abkhazia means that these regions remain outside the control of the Georgian authorities. Apart from the direct damage caused by the conflict, the ensuing displacement of people, contraction in liquidity, capital outflows, weakening of confidence and decline in tourism took a toll on economic activity. The global financial crisis that became manifest in late 2008-early 2009 further aggravated Georgian economic fundamentals (see Table 1 below).

The crisis affects Georgia in the situation when a further aggravation of socio-economic indicators could be very painful: registered unemployment that usually strongly underestimates the real figure has been at over 13% of the labour force in 2005-2007. For the last two years no official unemployment figures have been provided by public statistic authorities. The authorities put poverty rate when measured as 60% of median income of the population at 24% for 2005-2007.

Table 1. Georgia: Selected Macroeconomic Indicators, 2007–14

	2007	2008 Prel.	2009 Proj.	2010 Proj.	2011 Proj.	2012 Proj.	2013 Proj.	2014 Proj.
	(Annual percentage change, unless otherwise indicated)							
National accounts								
Real GDP growth	12.3	2.1	-4.0	2.0	4.0	5.0	5.0	5.0
Population (million) 1/	4.4	4.4	4.4	4.4	4.4	4.4	4.4	4.4
Consumer price index, period average	9.2	10.0	1.8	3.2	4.0	5.0	5.0	5.0
Consumer price index, end-of-period	11.0	5.5	3.4	3.0	5.0	5.0	5.0	5.0
GDP per capita (US$)	2,324	2,924	2,497	2,457	2,570	2,780	3,007	3,236
Poverty rate (in percent)	21.3	…	…	…	…	…	…	…
Unemployment rate (in percent)	13.3	16.5	…	…	…	…	…	…
Investment and saving								
Investment	25.7	22.5	19.0	20.5	21.5	22.0	22.0	22.0
Public	3.4	4.3	7.1	5.5	5.3	5.1	4.9	5.1
Private	22.3	18.2	11.9	14.9	16.3	16.9	17.1	16.8
Gross national saving	8.1	-0.1	2.9	3.9	5.5	7.0	8.1	9.5
Public	4.2	2.2	-0.2	-0.5	1.5	1.8	2.4	2.5
Private	3.8	-2.4	3.1	4.4	4.0	5.2	5.7	7.0
Saving-investment balance	-19.6	-22.7	-16.1	-16.6	-16.0	-14.9	-13.8	-12.5
Consolidated government operations								
Revenue	29.3	30.7	29.6	26.9	26.9	25.7	25.7	25.7
Expenses	25.0	28.5	29.8	27.3	25.4	23.9	23.2	23.2
Operating balance	4.2	2.2	-0.2	-0.5	1.5	1.8	2.4	2.5
Capital spending and net lending	9.0	8.6	9.3	6.9	6.3	5.8	5.3	5.4
Overall balance	-4.7	-6.3	-9.4	-7.3	-4.8	-4.0	-2.9	-2.9
Statistical discrepancy	0.1	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Total financing	4.6	6.2	9.4	7.3	4.8	4.0	2.9	2.9
Domestic	-0.8	-2.5	2.8	-0.4	1.5	1.0	1.5	2.6
External	0.2	5.0	4.2	6.4	2.3	2.3	1.0	0.1
Privatization receipts	5.2	3.7	2.5	1.3	1.0	0.7	0.4	0.2
Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	(Annual percentage change, unless otherwise indicated)							
Monetary sector								
Reserve money	25.6	-4.5	15.0	12.0	…	…	…	…
Broad money (including foreign exch. deposits)	49.6	7.0	-2.0	15.0	…	…	…	…
Commercial bank credit to the private sector	71.3	31.0	-5.8	7.1	…	…	…	…
External sector								
Exports of goods and services (percent of GDP)	31.1	28.7	26.8	30.7	32.6	33.2	33.8	34.1
Annual percentage change	24.7	15.9	-20.1	12.0	11.8	10.8	10.1	9.1
Imports of goods and services (percent of GDP)	57.9	58.3	49.8	54.6	55.5	54.3	53.2	52.0
Annual percentage change	34.1	26.7	-27.1	7.5	6.8	6.4	5.9	5.8
Net imports of oil (in US$)	556.3	762.5	503.4	564.0	614.1	658.2	701.9	741.2
Current account balance (in millions of US$)	-2,009	-2,915	-1,768	-1,782	-1,813	-1,837	-1,838	-1,795
In percent of GDP	-19.6	-22.7	-16.1	-16.6	-16.0	-14.9	-13.8	-12.5
Gross international reserves (in millions of US$)	1,361	1,480	1,708	1,942	2,115	2,124	1,950	1,913
In months of next year's imports of goods and services	2.2	3.2	3.5	3.7	3.8	3.6	3.1	2.9
Foreign direct investment (percent of GDP)	17.1	12.2	8.3	9.7	10.8	11.2	11.2	11.2
Average exchange rate (lari per dollar)	1.66	1.48	…	…	…	…	…	…

Source: Georgian authorities; and Fund staff estimates.

1/ Excludes Abkhazia residents.

Source: IMF

The severe contraction of external financing inflows, including export receipts, remittances and foreign direct investment, combined with the tightening of bank credits, depressed domestic demand. This translated in a sharp fall of both domestic output and imports. For 2009, the IMF forecasts real GDP contraction at 4%.

The external vulnerability of Georgian economy has been visible in its monetary and exchange rate policy. The central bank legislation was amended in the Spring 2008 to establish price stability as the NBG's core objective to be implemented with a monetary policy framework of inflation-targeting. Yet, during the August 2008 conflict, the authorities had announced a temporary peg of the lari to the US dollar in order to provide a confidence-boosting anchor. However, interventions in the exchange markets proved unable to counter the pressure on the lari which had resurfaced as the global financial crisis deepened in the autumn. Consequently, in early November 2008 the authorities allowed it to rapidly depreciate –by around 17%– against the US dollar. More recently, seeing consumer inflation decreasing due to decreasing domestic demand, the NBG focused on providing sufficient liquidity to the banking system, while at the same time intervening to limit the depreciation of the lari so as to support consumer confidence. The de facto peg to the dollar has been relaxed and the NBG is likely to resume a managed float of the lari with no predetermined path.

The economic slowdown has also resulted in a deterioration of the fiscal position. Already in 2008, the general government deficit had widened from 4.7% of GDP to more than 6.3%, despite significantly larger official grants. This deficit could be comfortably financed, through both privatisation receipts and official credits (in particular, from the World Bank and the US). For 2009, the government's objective is to maintain a comparable level of fiscal deficit, which would be consistent with the available financing (again, mainly external). In view of the shortfall of budget revenues, to achieve this objective, the Georgian authorities are constrained to substantially reduce the capital spending in the budget, thus reducing also government's ability to provide fiscal stimulus and act counter-cyclically. Also, amidst general risk aversion towards emerging markets, public borrowing in the international financial markets became practically impossible: country risk measured by international bond yield spreads have been high.

On the back of economic difficulties, the first review of the IMF stand-by arrangement (SBA) was completed in December 2008. At that time, in view of a relatively limited direct impact on the economy of the August war, a relatively positive outlook for foreign direct investment in 2009 and the fear to damage investor confidence in the country, the authorities decided not to draw the second tranche under the SBA. However, subsequently the economic situation worsened again as the result of the stronger-than-anticipated impact on Georgia of the global economic crisis. In these conditions, to limit the impact of the economic slowdown, the Georgian authorities decided to take full advantage of potential donor financing. Thus, upon the completion of the second review of the IMF's SBA in March, Georgia drew two instalments under the arrangement, an amount equivalent to some USD 187 million. The third programme review under the SBA was approved by the IMF Board on the 6th of August 2009. The main result of this review is the extension of the duration of the SBA until June 2011 and the increase in the financing package by SDR 270 million (about USD 424 million). Also, Georgia will be able to draw some USD 148 million immediately.

1.3. Balance of payments financing needs

A residual external financing gap was identified by the original IMF assessment presented to the IMF Board of Directors in September 2008. This original assessment has constituted the basis for EU's MFA pledge and Commission's MFA programme proposal that would cover 13% of the residual financing gap. The latest projections made by the IMF in the context of the second programme review (completed in

March 2009) suggest that despite the macro-economic adjustments that took place since the original assessment of Georgia's external financing needs, fundamentally, external position of Georgia remains highly fragile (see Table 1). For 2009, the current account deficit is projected to decrease, yet it is still expected to reach approximately 16% of GDP. At the same time, Georgia's main source of financing of this current account deficit – foreign direct investments and remittances – dramatically fell since the crisis year 2008: if in 2007 Georgia could attract USD 1.75 billion foreign direct investment, in 2008, the amount of FDI inflows was scaled down attaining EUR 1.56 billion. For 2009, the forecast of IMF was revised down to USD 0.9 billion and even this figure might be too optimistic. Also, other private sector investment was scaled down significantly in the latest IMF projections for 2009.

At the time of the preparation of the programme, the IMF estimated that Georgia's external financing needs for the period 2008-2010 not covered by the resources expected from the IMF would be about USD 650 million. Based on this estimated external financing gap, the Commission pledged macro-financial assistance of EUR 46 million. MFA from the EU would cover about 13% of the residual financing needs in 2009-2010.

The more severe than anticipated decline in economic activity since the beginning of 2009 is translating in significant changes in the external accounts (see Table 2). The latest IMF's projections of Georgia's balance of payments in 2009-2010 point to a combination of narrowing trade and current account deficits and much lower private capital inflows. The contraction of the projected net capital inflows reflects several factors, including lower foreign direct investment inflows and higher credit amortisation. All in all, the currently projected Georgia's external financing needs resulting from these developments are not substantially different from what was expected in September 2008.

Table 2: Georgia - External Financing Requirements

in million USD

	Projections Sept. 2008			Est.	Projections July 2009	
	2008	**2009**	**2010**	**2008**	**2009**	**2010**
Total financing needs, before donor financing	**-1.303**	**-976**	**-567**	***-573***	***-1.079***	***-890***
Current account balance	-2.757	-2.618	-2.513	*-2.851*	*-1.768*	*-1.782*
Capital outflows: repayment of long term debt	-494	287	-89	*-363*	*-699*	*-501*
Private financing sources	1.817	1.840	2.231	*2.329*	*1.597*	*1.627*
Foreign direct investment (net)	1.237	1.198	1.452	*1,564*	*907*	*1.046*
Other (*)				*443*	*21*	
Change in reserves (- increase)	131	-485	-196	*-131*	*-230*	*-234*
Available donor financing as identified by IMF	**1.103**	**651**	**442**	***571***	***1.076***	***900***
Public sector project grants and loans	753	326	367	*314*	*668*	*525*
Long-term loan disbursements to public sector	615	92	181	*227*	*466*	*384*
Incl. new Donor Conference commitments					*342*	*158*
IMF SBA	350	325	75	*257*	*408*	*375*
Residual financing needs	**-200**	**-325**	**-125**		***-3***	***10***
Residual financing needs before new commitments					***-345***	***-148***

Source: IMF and Commission calculations

(*) Including receipts of bond issuance, change in arrears and advance repayments.

These projections remain extremely uncertain and the financing needs may well be substantially higher reflecting significant downside risks. In particular, foreign direct investment estimates have been revised down from above 10% to 8.3% of GDP for 2009. Also, should import demand pick up and approach its 2008 level over the course of 2009 (imports are currently some 30% below their 2008 level), the stock of international currency reserves can be expected to go down very quickly. At the same time, while the level of gross reserves is relatively comfortable (they approach three months of imports), the foreign liabilities of the Georgian banking sector are larger.

Large amounts of assistance pledged at the October 2008 Donor Conference, including the EU macro-financial assistance, appear to be sufficient to cover Georgia's currently estimated external financing needs, even if much of donor support promised at that time still needs to be confirmed, or its timing still needs to be clarified. As a result, the projections of the financing requirements for 2009-2010 made by the IMF do not show any residual financing gap. This was indeed the objective of the Donor Conference. At the same time, the financing gap might re-emerge should the assistance pledged, also including the EU MFA, not materialise.

In addition to the external balance of payments financing needs, also budgetary needs remain high. The deepening of the global economic and financial crisis has diminished the prospects for a rapid economic recovery in Georgia. Unemployment and poverty levels are expected to increase in 2009 and 2010. The World Bank's Joint Needs Assessment projected an increase in poverty and unemployment rates over these two years. Furthermore, in the aftermath of the military conflict with Russia, Georgian government is under pressure to meet the needs arising from the increased number of internally displaced persons. The EU's macro-financial assistance, intended to be allocated to the financing of the deficit of the state budget could to some extent help preserve the levels of public social expenditure and could ensure that the existing social safety net remains operational.

Finally, also the issue of debt sustainability is important in this context. Debt sustainability analysis of the IMF shows that several years of strong growth and prudent debt management have reduced significantly Georgia’s external vulnerability. Public and publicly guaranteed external debt fell from 50% of GDP in 2000 to about 17.5% of GDP in 2007. The concessionality of the public external debt increased over the period as Georgia benefited from access to multilateral creditors. The declining trend stopped in Spring 2008 when Georgia accessed for the first time the Eurobond market. The IMF-supported programme accommodates higher external borrowing and sovereign guarantees also in 2009 and 2010 on the account of the public infrastructure projects which are intended to support growth in the post-conflict economic environment. Accordingly, external public debt is projected to peak in 2009 at 32% of GDP. The external public debt service will remain however manageable although the maturity structure may pose some challenges for repayment/rollover at particular points of time. Despite a relative low debt vulnerability of the country, public debt repayment will become acute in 2009. The total Georgian public outstanding debt to the European Community amounts to EUR 57.5 million as of end-December 2008. Georgia paid back a part of its previous MFA loan amounting to EUR 22 million on July 24th 2009 (the interest of EUR 654 thousand is still outstanding and overdue).

2. OBJECTIVES AND RELATED INDICATORS OF THE MACRO-FINANCIAL ASSISTANCE

2.1. Objectives

The ***general objectives*** of the proposed macro-financial assistance operation are to:

- Contribute to the financing of Georgia's external financing needs (reserve build-up) in the context of a significant deterioration of Georgia's external accounts brought about by the military conflict with Russia and subsequently the economic and financial crisis;

- Support Georgia to meet its acute budgetary needs;

- Help Georgia alleviate the financial constraints on the implementation of the stabilisation programme supported by the stand-by arrangement with the IMF and aiming at rebuilding international reserves, avoiding liquidity disruptions and re-installing investor confidence;

- Facilitate and encourage efforts of the authorities of Georgia to implement reforms identified under the EU-Georgia ENP Action Plan.

Linked to these general objectives of the programme, ***specific objectives*** in terms of financial and structural reforms will be detailed during the implementation of the programme and will be laid down in the Memorandum of Understanding that the Commission will negotiate with the authorities of Georgia.

2.2. Indicators

Several types of indicators will be used in the implementation of the programme

The fulfilment of the general objectives of the programme will be assessed in the context of the ex-post evaluation of the programme. The standard ***impact indicators*** of external and fiscal sustainability will be used.

The fulfilment of the specific objectives of the programme will be monitored throughout the implementation period of the assistance and evaluated together with the general objectives. Impact indicators related to particular structural reforms will be defined in the context of the programme’s evaluation.

To monitor the programme, the Commission will use two types of ***result indicators***:

- Adherence to IMF-supported programmes; it will be a sine qua non for the implementation of the assistance;

- Specific indicators in the areas of relevant structural reforms; those indicators linked to specific structural policy conditionality will be specified in the aforementioned Memorandum of Understanding, to be agreed with the Georgian authorities.

3. ALTERNATIVE DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1. Delivery mechanisms

Macro-financial assistance is an untied and undedicated macro-economic support instrument, which helps the beneficiary country meet its external financing needs, including through a reinforcement of gross international reserves. Macro-financial assistance can be provided either in the form of a loan, a grant or a combination of the two.

The Commission considers appropriate to provide the total of this assistance in the form of a grant in view of Georgia's persisting external vulnerability and taking into account significant amounts of loans that were pledged in the Donors' Conference, including from the European Investment Bank under the Community guarantee fund (to cover Georgia's large infrastructure investment needs). The funds will be channelled to the state budget of Georgia. The euro-denominated grant is converted into local currency by the central bank and transferred to the single treasury account as EC's budget support to Georgia.

3.2. Risk assessment

Among economic risks, there is a risk that the macro-financial assistance could be used in a fraudulent way as any other type of assistance. In general terms, this risk is related to factors such as central bank independence, quality of management systems and administrative procedures, control and oversight functions in the financial circuits, security of IT systems, and adequate internal and external audit capabilities. Further risks to Georgia's post-conflict economic recovery now relate to a prolonged impact of the international financial crisis on foreign direct investment and other private capital inflows. Furthermore, Georgia's current dependence on external financing represents a risk in the medium term.

Political risks also remain high: tensions have recently arisen in the domestic political context given that some prominent figures from the government coalition that came in power after the peaceful Rose Revolution of November 2003 have now joined the opposition and have been demonstrating against the government since the 9 April 2009, with the demand for President Saakashvili's resignation. Continuation and consolidation of the democratic reforms and institutions, media freedom and human rights are issues at the core of the EU's relations with Georgia, as outlined in the EU-Georgia ENP Action Plan. A further political risk is a continued frequent reshuffling of Ministers and other government officials that distracts from policy planning and implementation.

A more positive development has been Georgia's recent interest in regulatory alignment with the EU in trade and investment related areas, leading possibly to a deep and comprehensive free trade agreement with the EU when the conditions are met.

4. ADDED VALUE OF COMMUNITY INVOLVEMENT

The Community financial support to Georgia's economic recovery reflects the country's strategic importance to the EU in the context of the European

Neighbourhood Policy and the newly established Eastern Partnership. International donors pledged a total of EUR 3.4 billion in Post-Conflict Support to Georgia at a joint European Commission/World Bank Conference held in Brussels on 22 October 2008. The European Commission pledged up to EUR 500 million subject to review based on the pace of recovery and evolution of the Georgian economy. The EU Member States pledged in addition EUR 131 million. The European Investment Bank can envisage lending to Georgia up to EUR 250 million in the medium-term.

The instrument of macro-financial assistance is included in the overall EC package of assistance on the grounds of establishing synergies with the IMF-supported economic programme to which the instrument is directly linked.

5. GENVAL CRITERIA ON MACRO-FINANCIAL ASSISTANCE

The Council reconfirmed a set of principles on the use of the Community's macro-financial assistance instrument (so called Genval criteria) on 8 October 2002. These criteria underline the exceptional character of the assistance, its complementarity to financing from the International Financial Institutions (IFIs) and policy conditionality attached to the assistance. Political pre-conditions are defined for prospective recipients of the assistance, taking also into account their geographical proximity to the EU. Finally, financial discipline is established through the annual budget appropriations.

5.1. Exceptional Character and Limited Timeframe

The overall EC package to Georgia covers the years 2008-2010 but given the high uncertainty on the pace of the recovery, the European Commission announced in the October 2008 Donor Conference that it will review the situation in twelve months based on the evolution of the Georgian economy so as to determine later the possible use of the EC assistance tentatively foreseen for 2010. In this setting, the macro-financial assistance instrument was deemed an appropriate component in the EC package given its contingency on the ultimate use by Georgia of IMF funds.

Georgia’s financing gap in the balance of payments has its origin in the loss of investor confidence as a result of the armed conflict that broke out in early August. The international financial crisis which has affected emerging economies since September - October 2008 brought an additional layer of uncertainty to the prospects of recovery of Georgia’s economy. The government’s aim has been to attract financing from the IFIs to boost public infrastructure investment in the short-term so as to maintain as much as possible economic growth until private capital inflows are resumed. Against this background, the macro-financial assistance earmarked for 2009 is proposed to be disbursed in the course of 2009 and early 2010.

5.2. Political pre-conditions

MFA is reserved to the third countries that are geographically close to the EU territory and that respect democracy and human rights. With these countries, the EU has important political, economic and commercial ties. Georgia fulfils this criterion. The extraordinary European Council held in Brussels on 1 September 2008 decided inter alia to step up relations with Georgia. During the Prague Summit on 7 May

2009, these close Georgia-EU relations have entered a new phase with the launch of the Eastern Partnership of the European Union, a multilateral project endorsed by the heads of 27 EU member states or governments and the six partner countries among which is Georgia.

5.3. Complementarity of EC Instruments

A macro-financial assistance can take place if it is complementary to IMF financing and to support of other donors. It can only take place when a residual external financing gap is identified over and above the IFI resources and under the condition of a fair burden sharing with bilateral donors. The complementarity condition is fulfilled in the case of an MFA for Georgia for 2009-2010. A residual external financing gap was identified by the IMF in September 2008. This original assessment has constituted the basis for EU's MFA pledge and Commission's MFA programme proposal that would cover 13% of the residual financing gap. The later evaluations of Georgia's financing needs confirm the original IMF assessment.

5.4. Conditionality

As usual with the macro-financial assistance instrument, the disbursements will be conditional on successful programme reviews under the stand-by Arrangement and Georgia's subsequent decisions to draw funds. In addition, the Commission and the Georgian authorities will agree on some specific structural reform measures in a Memorandum of Understanding. Given the relatively short time span of the planned MFA operation, it is the Commission's intention to continue policy dialogue with the authorities in the area of public finance management which has been under focus in the previous MFA operation. Although significant progress has been achieved in several areas of the PFM reform in recent years, there remains some concern on the sustainability and capacity given the frequent changes in the staff and management while the government is politically committed to a small government apparatus.

The Commission services have worked closely with the Georgian authorities in recent years on public finance management reforms in the context of previous macro-financial assistance, the EC's Food Security Programme and since 2007 also the EC's sector budget support under the ENPI. To take stock of the achievements of the Georgian authorities and the remaining challenges, the World Bank and the European Commission financed a joint Public Expenditure and Financial Accountability (PEFA) assessment in Georgia in 2007-2008. After an interruption due to the August conflict, work on the PEFA was completed in the beginning of 2009. The final report was presented to Georgia's donor community in February 2009. In parallel and based on the PEFA findings, the Finance Ministry prepared its own Reform Policy Vision 2009-2013 and Action Plan for 2009 on public finance management. This document can serve as the basis for agreeing on conditionality of the macro-financial assistance.

To assist the authorities in taking the reform efforts one step further, the Commission has a technical assistance project in the Ministry of Finance which has prepared a

PIFC[1]Gap Analysis. It compares internal audit and internal control in the government of Georgia with EU best practices. Based on the Gap Analysis, the Ministry of Finance has prepared a first draft for a policy paper and an action plan in the area of PIFC. Although there are several forms of controls already in place, the authorities and the donors both agree that this reform process will take time as it touches upon fundamental working methods and long-standing practices in the government, including striking a balance between decentralisation and appropriate support and coordination by the Ministry of Finance. The continuation of the macro-financial assistance will provide an opportunity to strengthen the policy dialogue since the authorities are now in the process of deciding on an appropriate organisation of PIFC in the government.

Finally, the delivery of the macro-financial assistance is conditional to the fulfilment of the commitments agreed to by the Georgian government in a joint statement with the Commissioner Ferrero-Waldner on 20 January 2009. This statement lays out the political framework under which the EC post-conflict assistance to Georgia could be delivered.

5.5. Financial discipline

The Commission aims at the adoption of the Council decision on MFA to Georgia before the end of 2009 so that the commitment appropriations in the 2009 Community budget would be used to finance the MFA grant. Given the low likelihood of the adoption by the Council of other decisions on MFA involving large grant amounts in 2009 (the only possible programmes requiring use of grant appropriations are programmes in favour of Armenia and Kosovo), the planned appropriations on the MFA budget line (01 03 02)[2] are deemed sufficient to finance a grant amount of EUR 46 million to Georgia, subject to the final decision of the budgetary authority.

To ascertain that the beneficiary has in place a sound financial management in line with the requirements of the Financial Regulation, the Commission services continue regular monitoring and intend to contract services to update the Operational Assessment of 2005 on the reliability of financial circuits and administrative controls at the Ministry of Finance and the National Bank of Georgia. Close contacts are also maintained with the IMF; the Fund intends to conduct an update of the 2004 safeguards assessment of the National Bank of Georgia. The NBG publishes IFRS financial statements which have been externally audited in accordance international standards. The recent joint PEFA by the World Bank and the European Commission gives detailed information on Georgia's budget preparation and execution as well as on control and oversight functions, and will therefore serve as the basis for any specific controls to be launched in the context of the macro-financial assistance.

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1 The EU's Public Internal Financial Control (PIFC) framework. The PIFC has now been incorporated also in the ENP Action Plans with the partner countries following its application in the candidate countries

2 Commitment appropriations in a total amount of EUR 99 million (2009 PDB).

6. LESSONS FROM THE PAST

Previous macro-financial assistance operations for Georgia have not yet been subject to external ex-post evaluations. However, the external evaluations of MFA programmes in favour of a number of partner countries (Romania, Bosnia and Herzegovina, Albania, former Yugoslav Republic of Macedonia, Serbia, Armenia and Tajikistan) focussed on the following five dimensions: relevance of the MFA operation in relation to identified needs, effectiveness of the operations for the short-term macroeconomic stabilisation, unexpected impacts of the MFA assistance, sustainability of MFA financing in terms of country's external position in the medium to longer term, and finally, efficiency of MFA operations in terms of design and implementation. A study drawing lessons from the individual evaluations is currently being finalised and will be available on time for the start of the preparation of the implementation phase of macro-financial assistance to Georgia. Also, the Commission has recently launched an evaluation of the MFA provided to Georgia under the Council Decision (2006/41/EC). This study will also be completed on time for the launching of the current MFA programme. The findings of both studies will be used by the Commission, in particular for the design of the conditionality of the proposed programme.

7. PLANNING OF FUTURE MONITORING AND EVALUATION

This assistance has a relatively short timeframe for implementation given the context of macro-economic stabilisation in the post-war economic situation compounded by the impact of the economic crisis. Monitoring and evaluation will be undertaken in line with the standard Commission procedures.

7.1. Monitoring

The monitoring system will be ensured by the provision of reports and data by the authorities and by the organisation of review missions to Georgia by Commission staff. Although this assistance is centrally managed, where appropriate, the EC Delegation in Tbilisi will also be called to provide additional reporting. The monitoring of the action by the Commission services will take place on the basis of macro-economic and structural policy indicators which are to be agreed with the Georgian authorities in a Memorandum of Understanding. The Commission services may also monitor key areas of the public finance management system, to be identified in the update of the Operational Assessment so as to have the relevant information on any changes in the control environment.

An annual report to the European Parliament and to the Council on the implementation of macro-financial assistance is foreseen in the proposed text of the Council Decision.

7.2. Evaluation

Two to three ex-post evaluations of macro-financial assistance operations are planned per year in the Multi-annual Evaluation Programme of the Economic and Financial Affairs Directorate-General. An ex-post evaluation of the proposed macro-financial assistance will be launched in the future, upon completion of the operation.

A provision foreseeing the ex-post evaluation will be included in the Memorandum of Understanding. Financial resources for this evaluation will be drawn from the macro-economic assistance budget line.

8. ACHIEVING COST-EFFECTIVENESS

In implementing the assistance, the Commission will be guided by the following principles:

- The assistance will be made available to Georgia in two instalments. Both grant instalments are released conditional on Georgia's satisfactory track record in implementing the macro-economic programme supported by the IMF under the stand by arrangement and on satisfactory progress with some specific economic policy conditions which will be agreed with the authorities and laid down in the Memorandum of Understanding.

- In negotiating the specific policy conditions, the Commission will streamline the measures with the strategies and reform plans of the Georgian government in close cooperation with the relevant donors, notably the IMF and the World Bank.

- This action is exceptional by nature and will not involve an increase in the number of Commission staff.