COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

COUNCIL DECISION

on additional macro-financial assistance to Serbia and Montenegro amending Decision 2002/882/EC providing further macro financial assistance to the Federal Republic of Yugoslavia

(presented by the Commission)

EN

EXPLANATORY MEMORANDUM

Over the past two to three years, the authorities of Serbia and Montenegro have achieved remarkable results in economic reform and stabilisation. Macro-economic stability has been achieved and preserved, and important structural reforms have begun. The privatisation of socially-owned enterprises through auctions and tenders has progressed well, and the restructuring of the industrial and financial sector has been initiated.

Despite the current difficult situation in the country following the assassination of the Serbian Prime Minister on 11 March 2003, the authorities continue to be committed to economic reforms. The country has remained relatively stable throughout the state of emergency, introduced for some weeks after the assassination. It seems that the institutions, notably in Serbia proper, absorbed this shock and that political reforms of the last years were not put in jeopardy, though judicial and media reforms and the fight against corruption need to be continued vigorously.

The process of economic reform and stabilisation has been supported through the provision of EC macro-financial assistance. A first package of €345 million was decided in July and December 2001 and implemented in 2001/2002. On 5 November 2002, the Council of the European Union decided to provide to the country further macro-financial assistance of up to €130 million, comprising a loan element of up to €55 million and a grant element of up to €75 million (Council Decision 2002/882/EC). The main objective of this assistance is to ensure a sustainable balance of payments situation and to strengthen the country's foreign reserve position. A first tranche of this assistance amounting to €40 million was disbursed in December 2002 (grant part of €30 million) and February 2003 (loan part of €10 million).

Following the assassination, the Serbian Finance Minister requested additional macro-financial support from the international community on the basis of first estimates by the Serbian government according to which economic prospects for 2003 had significantly worsened. The Commission announced at the GAERC of 14 April its readiness to front-load the remaining EC macro-financial with a relatively large second tranche, subject to conditionality, and to propose additional EC macro-financial support with a view to comforting any additional balance of payments needs that could be identified by the IMF later in the year. The Council "welcomed the proposals by…the Commission (and) …invited the competent bodies to rapidly examine these proposals with a view to early decisions".

Meanwhile Commission services have finalised the second tranche review and concluded that conditionality has been met to a satisfactory degree. Following the completion of internal consultations, the second tranche of €65 million, comprising a grant element of €35 million and a loan element of €30 million, is expected to be disbursed in August 2003. This would leave an amount of €25 million for the third tranche, including a grant element of €10 million.

Moreover, the IMF recently announced at the meeting of the Working Level Steering Group for the Western Balkans on 19 June in Brussels that it had eventually revised its balance of payments projections for 2003 and identified additional financing needs. Indeed, following the assassination of the Serbian Prime Minister, the external outlook of the country appears to be more uncertain. There are considerable downside risks with regard to balance of payments developments and in particular with respect to the size of private capital inflows, including foreign direct investments, while important financing needs continue to put a heavy strain on the economy. Although the authorities of Serbia and Montenegro have so far implemented policies in line with the current IMF programme, additional external financial support seems essential to reach the agreed macro-economic targets with respect to growth, inflation, fiscal and current account balances for 2003, and to continue the reform process.

According to the revised IMF projections, there is now a higher residual external financing gap of some \$321 million (after IFIs), that is expected to be filled through EC and bilateral macro-financial assistance, including debt relief from creditors (i.e. capitalisation of moratorium interest). It should be noted that out of this gap, an amount of around \$200 million has already been committed, including an equivalent of \$113 million under the current EC macro-financial assistance package. Against this background, it seems appropriate for the Community to help comforting the identified additional balance of payments needs by amending Council Decision 2002/882/EC, thereby augmenting the total amount by €70 million to up to €200 million. It is expected that the remaining gap could be filled through additional bilateral assistance. The additional amount could be used to top up the third tranche which could be disbursed in two sub-tranches, subject to an agreement on a Supplemental Memorandum of Understanding specifying appropriate conditionality to support specific reforms, which could include enterprise and banking sector restructuring and economic harmonisation.

In view of the exceptional circumstances, the high level of indebtedness of Serbia and Montenegro in comparison with other countries of the region and its limited borrowing capacity, it is proposed to provide a significant share (i.e. €45 million) of this additional amount in the form of a grants and the remainder (i.e. €25 million) in the form of a loan. The latter would carry a maturity of 15 years and a grace period of 10 years as foreseen in the original package. The corresponding increase of the Community assistance will be based on the understanding that other donors will undertake similar efforts to provide complementary financial support.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 308 thereof,

Having regard to the proposal of the Commission[1],

Having regard to the opinion of the European Parliament[2],

Whereas:

(1) The Commission consulted the Economic and Financial Committee before submitting its proposal.

(2) Council Decision 2002/882/EC[3] provides for macro-financial assistance to be made available to the Federal Republic of Yugoslavia with a view to ensuring a sustainable balance of payments situation and strengthening the country's reserve position.

(3) On 4 February 2003 there was a constitutional change and the country is now called Serbia and Montenegro.

(4) Following the assassination of the Serbian Prime Minister on 11 March 2003, the external outlook of the country appears to be more uncertain, in particular with respect to the size of private capital inflows, including foreign direct investments, while important financing needs continue to put a heavy strain on the economy.

(5) Additional balance of payments needs in 2003 have been identified in the context of the current IMF programme and Serbia and Montenegro will require significant additional external financing in 2003 over and above official financing which could be provided by the International Monetary Fund, the World Bank and other donors, including the Community.

(6) An increase in Community macro-financial assistance to Serbia and Montenegro is an appropriate measure to help, with other donors, ease the country's financial constraints.

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1 OJ C …, …, p. …
2 OJ C …, …, p. …
3 OJ L 308, 9.11.2002, p. 25.

(7) The Treaty does not provide, for the adoption of this Decision, powers other than those of Article 308.

HAS DECIDED AS FOLLOWS:

Sole Article

1. In Articles 1, 2, 3 and 4 the term “FRY” is replaced by the term “Serbia and Montenegro”.

2. Article 1 (2) of Decision 2002/882/EC is replaced by the following:

   “2. The loan component of this assistance shall amount to a maximum principal of €80 million with a maximum maturity of 15 years. To this end, the Commission is empowered to borrow, on behalf of the Community, the necessary resources that will be placed at the disposal of Serbia and Montenegro in the form of a loan”.

3. Article 1 (3) is replaced by the following:

   “3. The grant component of this assistance shall amount to a maximum of €120 million.”

4. In Article 3 (1) the first phrase is replaced by the following:

   “1. The loan and grant component of this assistance should be made available to Serbia and Montenegro in at least three instalments”.

Done at Brussels, [date]

For the Council
The President

FINANCIAL STATEMENT

1. TITLE OF OPERATION

Further macro-financial assistance to Serbia and Montenegro

2. BUDGET HEADING INVOLVED

a) Grant component of the assistance (in €)

Budget line : B7-548

	CA	PA
Initial Budget	80 000 000	80 000 000
Carry-over 2002/2003	-	10 000 000
Total for 2003	80 000 000	90 000 000
Bosnia and Herzegovina, first grant tranche (Febr. 2003)	-	15 000 000
former Yugoslav Republic of Macedonia, third grant tranche (May 2003)	-	10 000 000
Bosnia and Herzegovina, third grant tranche (July 2003)	15 000 000	
Serbia and Montenegro, second grant tranche		35 000 000
Bosnia and Herzegovina, second grant tranche		10 000 000
former Yugoslav Republic of Macedonia, fourth grant tranche		8 000 000
Bosnia and Herzegovina, third grant tranche		15 000 000
Available appropriations before action	65 000 000	- 3 000 000
Serbia and Montenegro, proposed increase of EC macro-financial assistance	*45 000 000*	
Serbia and Montenegro, third grant tranche		*55 000 000*

b) Loan component of the assistance

BO-215 – "EC guarantee for the borrowing programmes contracted by the Community to provide assistance to the countries of the Western Balkans"

3. LEGAL BASIS

Article 308 of the Treaty

4. DESCRIPTION AND JUSTIFICATION OF THE ACTION

a) Description of the action

Increase of Community macro-financial assistance to Serbia and Montenegro to comfort identified additional balance of payments needs.

b) Justification of the action

Identification of additional external financing needs over and above identified official financing which could be provided by the IMF, the World Bank and bilateral donors. The sustainability of the beneficiary country's economic stabilisation and reform achievements heavily depends on external financial assistance from official sources at concessional terms.

5. CLASSIFICATION OF THE EXPENDITURE

a) Grant component: non-compulsory, differentiated.

b) Loan component: compulsory

6. NATURE OF THE EXPENDITURE

a) Straight grant (100% subsidy)

b) Potential activation of budget guarantee for the Community borrowing aimed to fund the loan.

7. FINANCIAL IMPACT

a) *Method of calculation*

The evaluation of the amount of the assistance deemed necessary is based on the present estimates of the beneficiary country's residual external financing needs.

For the loan component of the assistance, it is expected that the budget guarantee will not be called.

b) *Effect of the action on intervention credits*

The budget entry corresponding to the grant component of the assistance will be activated subject to compliance with a number of policy conditions to be agreed with the authorities of Serbia and Montenegro.

The budget entry reflecting the budget guarantee for the loan component of the assistance will be activated only in the case of an effective call on the guarantee.

c) *Financing of intervention*

(i) Grant

The proposed increase in assistance to be provided by this modification is to be financed within the limits of Category 4 of the present Financial Perspective (in €), as follows:

	2003
Commitment appropriations	45 000 000
Payment appropriations	45 000 000

(ii) Eventual call on the budget guarantee

- Recourse to the Guarantee Fund established by Council Regulation (EC, EURATOM) no. 2728/94 of 31 October 1994, most recently amended by Regulation no. 1149/1999 of 25 May 1999.
- In case the Guarantee Fund did not contain sufficient resources, additional payments would be called up from the budget by transfer:

– of any margin remaining in the Reserve for guarantees;

– of any late payments to the budget for which the budget guarantee has been activated (under Article 27(3) of the Financial Regulation);

– of any margin available under the ceiling of category 4 of the financial perspectives or redeployment therein.

- In order to fulfil its obligations, the Commission can provisionally ensure the debt service with funds from its treasury. In that case, Article 12 of the Council Regulation (EC, EURATOM) n°1552/89 of 29 May 1989 will apply.

8. FRAUD PREVENTION MEASURES

The funds will be paid directly to the National Bank of Serbia only after verification by the Commission services, in consultation with the Economic and Financial Committee and in liaison with the IMF services, that the macro-economic policies implemented in these countries are satisfactory and that the specific conditions attached to this assistance are fulfilled.

Furthermore, during the implementation of this assistance, the Commission or duly authorised representatives may carry out an operational assessment of financial systems and controls of the Country.

Finally, the assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and the European Court of Auditors.

9. ELEMENTS OF COST-EFFECTIVENESS ANALYSIS

a) Grounds for the operation and specific objectives

By supporting the country's macro-economic reform efforts and complementing financing by the International Community provided to this country in the context of the IMF-supported programme, this assistance would underpin its transition towards a market economy.

b) Monitoring and evaluation

This assistance is of macro-economic nature and its monitoring and evaluation is undertaken in the framework of the IMF-supported stabilisation and reform programme that the beneficiary country is implementing. In particular, the monitoring of the action by the Commission services will take place on the basis of a genuine system of macro-economic and structural policy indicators to be agreed with the authorities of the beneficiary country. The Commission services will also remain in close contact with the IMF and World Bank services to benefit from their assessment of the recipient country's stabilisation and reform.

An independent ex-post evaluation of the assistance is expected to be carried out by the Commission or duly authorised representatives and the authorities of the Country are committed to supply all necessary information.

An annual report to the European Parliament and to the Council is foreseen in the proposed Council decision, which will include an evaluation of the implementation of this operation.

10. ADMINISTRATIVE EXPENDITURE

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