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Proposal for a

COUNCIL DECISION

on macro-financial assistance to Serbia and Montenegro

**and amending Decision 2002/882/EC providing further macro-financial assistance to the
Federal Republic of Yugoslavia**

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. BACKGROUND

Following the political changes in Serbia and Montenegro (SCG, the former “Federal Republic of Yugoslavia”) in late 2000, the authorities of the country 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, and the restructuring of the industrial and financial sector has been initiated. The agenda of economic reforms has been supported through the provision of subsequent EC macro-financial assistance packages, which have been implemented subject to the prior fulfilment of agreed economic and structural policy conditions.

A first package of EUR 345 million was decided in July and December 2001 and implemented in 2001/2002. In November 2002, the Council decided to provide SCG with further Community macro-financial assistance of up to EUR 130 million to underpin economic policies in the context of the three-year IMF Extended Arrangement (2002-2005) approved in May 2002 and to support the balance of payments. A Memorandum of Understanding (MoU) signed in December 2002 specifies the economic policy conditions and structural measures for the release of the second and the third tranches of this assistance.

So far, the first and the second tranches of the original package of EUR 130 million, totalling EUR 105 million, have been released successfully. However, the implementation of the remaining third tranche (EUR 25 million) has been substantially delayed, also reflecting a general slowdown of economic and structural reforms in the country in the course of 2003. The latter was also a result of a difficult political situation in Serbia which led to early general elections towards the end of the year and a difficult formation of a new (minority) government in early 2004.

In November 2003, the Council decided to increase the current EC macro-financial assistance to up to EUR 200 million to help addressing additional financing needs identified by the IMF. The modalities of this additional assistance of up to EUR 70 million, including the precise tranching and attached conditionality, still remain to be negotiated with the authorities, once progress has been made with third tranche conditionality.

2. RECENT DEVELOPMENTS AND OUTLOOK

In 2003, real GDP growth in Serbia reached 2-3%, somewhat lower than initially foreseen under the current IMF Extended Arrangement, mostly due to weaker industrial output and a drought, which led to a decline in agricultural production. For 2004, the authorities project GDP to grow by 4 - 6%, reflecting a recovery in industrial output and an expected rebound in agricultural production. For the year as a whole, the Serbian authorities expect an inflation rate of 8.5%. Montenegro recorded a rather modest real growth during the first quarter of 2004 (0.6%), but the authorities expect an acceleration of growth in the remainder of the year. Prices grew by 1.6% in the year to May, and end of period inflation for the year as a whole is expected to reach 4.5%.

In 2003, the consolidated general government deficit of Serbia and Montenegro reached 4.2% of GDP (3.8% in Serbia and 0.4% in Montenegro, the latter representing 5.2% of Montenegrin GDP). For 2004, the consolidated budget deficit is sought to be reduced by 0.8% to 3.4% of GDP. In Serbia the financing of the 2004 fiscal deficit remains a concern, in particular as revenues from privatisation and foreign financing has so far been lacking.

Despite continued considerable trade deficits, the external situation in 2003 was more favourable than initially expected owing to an exceptionally large net inflow of FDI of USD 1.4 billion (7% of GDP, twice the amount projected), mainly due to privatisation proceeds and greenfield investments, and buoyant private remittances (11.2% of GDP). In early 2004, international reserves which had increased up to USD 3.6 billion at the end of 2003 began to decline moderately, also due to seasonal factors and foreign debt servicing. They reached USD 3.3 billion in April, equivalent to 4 months of projected 2004 imports. The external outlook may improve as a result of an agreement with London Club creditors on a 61% reduction of outstanding debt that was reached in early July and the granting, for the first time, of a credit rating by Standard and Poor's. However, gross financing requirements remain high, and the country requires continued external official financing in the context of the current IMF programme.

Some new momentum on structural reforms has been gained following the creation of a new government in Serbia in March 2004. In particular, a substantial legislative agenda has been submitted to the Serbian Parliament and the process of privatisation seemed to regain momentum. The restructuring of large Socially Owned Enterprises and public utilities, which has not yet really started, still represents a major challenge for economic policies in the future.

For 2004, the IMF's latest programme review projected a remaining balance-of-payments gap, expected to be covered by bilateral macroeconomic support, including funds released under the current EC macro-financial assistance operation. On the basis of preliminary indications from creditors, at least half of this amount is projected to be provided in the form of bilateral debt relief in the form of a capitalisation of moratorium interest.

With regard to the implementation of EC macro-financial assistance, in June/July 2004, Commission services carried out a mission to Serbia and Montenegro to assess recent economic developments and in particular to review progress made with respect to the conditionality for the release of the third tranche. Generally, there were some encouraging developments since the establishment of a new government. Legislative work resumed. The successful third review under the current IMF programme and the agreement on economic policies with the IMF, reached in June and to be implemented in 2004, also provides an important reform stimulus. As regards third tranche conditionality, further progress was made on a number of conditions already fully or broadly met. A number of conditions however still required substantial additional efforts in order to be met. It should be noted that the terms and conditions for the EUR 70 million topping up amount have not yet been agreed with the authorities. Negotiations on these will obviously only start once third tranche conditionality has been met to a satisfactory extent.

3. OTHER CONSIDERATIONS LINKED TO PROVIDING MACRO-FINANCIAL ASSISTANCE

With regard to the recommendations made in the Discharge on the budget execution for 2001 and also in the Court of Auditors' Special report n° 1/2002 concerning macro-financial assistance to third countries, the Commission services are giving due consideration to the five

Genval criteria (exceptional character, political pre-conditions, complementarity, conditionality and financial discipline).

On other budgetary and financial management conditions, the Commission services are taking action in order to fulfil requirements implied by the new Financial Regulation. This is reflected by having made an ex-ante evaluation (attached) of this proposed assistance. In particular, before proceeding with the actual implementation of the remainder of this assistance, the Commission services plan to check (with the help of external consultants) the reliability of Serbia and Montenegro's financial circuits, administrative procedures, internal and external control mechanisms that are relevant to this type of assistance. To this end an Operational Assessment of the reliability of financial circuits and administrative controls has been commissioned to external consultants and its findings were expected by August 2004. Subject to these findings, prior actions could be required before the release of the outstanding funds.

4. PROPOSED DECISION MODIFYING THE LEGAL BASE BY POSTPONING THE EXPIRY DATE

Serbia and Montenegro requires continued external financial support from the Community and other donors in support of its economic stabilisation and reform programme agreed with the IMF. Subject to further progress in meeting conditionality, the remaining third tranche of EC macro-financial assistance under Decision 2002/882/EC could help addressing the financing needs in 2004. However, the current legal base for this assistance provides for an expiry date of 9 November 2004. This was motivated by the expectation that the assistance and the required conditions for its release could be implemented in a two-year period. As mentioned above, the general slowdown in economic reforms during 2003 and the difficult political situation in Serbia have contributed to delays in the implementation of this assistance.

It appears that the new government in Serbia, which took office in March 2003, is committed to accelerate economic reform and could accomplish further action to meet third tranche conditionality to a satisfactory extent. However, even if this can be achieved by end-September 2004 (which appears to be the earliest possible date), it is very unlikely that the actual disbursement of the third tranche could take place before the expiry date. It should be noted that the Operational Assessment of the reliability of financial circuits and administrative procedures could have a bearing on the implementation of the third tranche of EC macro-financial assistance and call for specific prior measures to be taken before proceeding with the release of outstanding amounts.

Moreover, the topping up of up to EUR 70 million was decided by an amendment of Council Decision 2002/882/EC. It will hence not be possible to implement this additional assistance after the expiry of the current legal base. In conclusion, the current legal base does no longer provide for a full implementation of EC macro-financial assistance.

Against this background, it appears appropriate for the Community to modify the expiry date by amending Council Decision 2002/882/EC. It is suggested to change the expiry date to 30 June 2006. This would allow for a smooth and full implementation of this assistance, including of the topping up of up to EUR 70 million, based on appropriate conditionality to be fulfilled by the authorities of Serbia and Montenegro before the subsequent release of tranches.

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**and amending Decision 2002/882/EC providing further macro-financial assistance to the
Federal Republic of Yugoslavia**

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 Commission¹,

Having regard to the opinion of the European Parliament²,

Whereas:

- (1) Council Decision 2002/882/EC of 5 November 2002 providing further macro-financial assistance to the Federal Republic of Yugoslavia³ aims at ensuring a sustainable balance of payments situation and strengthening the country's reserve position.
- (2) Two tranches under this assistance totalling EUR 105 million have been disbursed in 2002 and 2003. Due to the delays in the implementation of agreed structural measures, the implementation of the third tranche (EUR 25 million) is still outstanding. Terms and policy conditions for the additional amount of EUR 70 million decided in 2003 remain to be negotiated and agreed.
- (3) The authorities of Serbia and Montenegro are committed to economic reform and stabilisation under the present IMF programme as evidenced by encouraging signs of a revitalisation of structural reforms.
- (4) The country continues to require external financial support in addition to what can be provided by International Financial Institutions.
- (5) Decision 2002/882/EC should be amended to permit the commitments of grant funds beyond 9 November 2004.
- (6) The Treaty does not provide, for the adoption of this Decision, powers other than those of Article 308.

¹ OJ C

² OJ C

³ OJ L 308, 9.11.2002, p.25. Decision amended by Decision 2003/825/EC (OJ L 311, 27.11.2003, p.28).

(7) After consulting the Economic and Financial Committee,
HAS DECIDED AS FOLLOWS:

Sole Article

Article 6 second subparagraph of Decision 2002/882/EC is replaced by the following:

“It shall apply until 30 June 2006.”

Done at Brussels,

For the Council
The President

FINANCIAL STATEMENT

1. TITLE OF OPERATION

Macro-financial assistance to Serbia and Montenegro.

2. BUDGET HEADING INVOLVED

a) Grant component of the assistance (in EUR)

Budget line: 01 03 02 02

	Commitment Appropriations	Payment Appropriations
Initial Budget 2004	65 000 000	80 000 000
Carry-over 2003/2004	45 000 000	20 000 000
Total for 2004	110 000 000	100 000 000
Serbia and Montenegro, third grant tranche	0 (1)	10 000 000
Albania, macro-financial assistance	16 000 000	0
Available appropriations before action	94 000 000	90 000 000
<i>Bosnia and Herzegovina, third grant tranche</i>	0 (2)	<i>15 000 000</i>
<i>Serbia and Montenegro, additional macro-financial assistance</i>	<i>45 000 000</i>	<i>0</i>

(1) EUR 75 million committed in December 2002

(2) EUR 15 million committed in July 2003

b) Loan component of the assistance

01 04 01 07 – “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

Modification of the expiry date of the Council Decision 2002/882/EC, as amended by Council Decision 2003/825/EC, providing additional macro-financial assistance to Serbia and Montenegro, with a view to supporting the government's reform efforts and ensuring a sustainable balance-of-payments situation.

b) Justification of the action

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. The Guarantee Fund for external actions has already been provisioned in 2002 and 2003 according to the Fund Regulation, for an amount corresponding to 9% of the amount of the guaranteed loan (EUR 80 million). As a result, two transfers of appropriations (n°54/2002 and n°38/2003) totalling an amount of EUR 7.2 million from the Reserve (budget line 01 04 01 13) to the Guarantee Fund (budget line 01 04 01 14) were authorized by the Budgetary Authority in 2002 and 2003 after adoption of the Council Decisions 2002/882/EC and 2003/825/EC.

b) *Effect of the action on intervention credits*

For the grant element, the credits under budget line 01 03 02 02 will be used 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 following updated schedule of appropriations to be financed within the limits of Category 4 of the present Financial Perspective is proposed (in EUR):

	2004	2005
Commitment appropriations	45 000 000	0
Payment appropriations	10 000 000 (1)	45 000 000

(1) EUR 75 million committed in December 2002

(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. According to the Fund Regulation, the provisioning will take place via a transfer of EUR 0.81 million from the Reserve to the Fund.
- 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, according to the provisions of Article 18 of Council Regulation (EC) No 2040/2000 of 26 September 2000 on budgetary discipline;
 - of any overdue payments to the budget for which the budget guarantee had been activated, provided that these payments have not been recorded as revenues;
 - of any margin available under the ceiling of category 4 of the financial perspectives or redeployment therein. In this case, the budget line 01 04 01 07 “European Community Guarantee for the borrowing programmes contracted by the Community to provide financial assistance to the countries of the Western Balkans” would be activated.
- In order to fulfil its obligations, the Commission can provisionally ensure the debt service with funds from its treasury. In that case, Article 12 (3) of the Council Regulation (EC, EURATOM) No 1150/2000 of 22 May 2000 will apply.

8. FRAUD PREVENTION MEASURES

Before the implementation of this assistance, the Commission services, with the support of duly mandated experts, will check the reliability of financial circuits and administrative procedures of the Central Bank and the Ministries of Finance of Serbia and Montenegro. To this end, and in order to fulfil requirements implied by the Financial Regulation applicable to the General Budget of the European Communities, an Operational Assessment has been commissioned and its results

were expected by August 2004. This will cover areas like management structure and organisation, reporting tools, management and control of funds, IT process and security, internal and external audit capacity, as well as the independence of the central bank. Subject to the operational assessment's findings, prior actions could be required before the release of the outstanding funds.

The latter verifications will also take into consideration available conclusions of IMF Safeguard Assessments and of other relevant reports by the IMF and the World Bank.

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 takes place on the basis of a genuine system of macro-economic and structural policy indicators agreed with the authorities of the beneficiary country. In this process, the Commission services may also monitor key areas identified in the above-mentioned operational assessment. Finally, they will 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 annual report to the European Parliament and to the Council has been foreseen in the Council decision 2002/882/EC, and includes an evaluation of the implementation of this operation.

Furthermore, an independent ex-post evaluation of the assistance is foreseen to be carried out by the Commission or duly authorised representatives one to two years after the assistance has been implemented and the authorities of the country are committed to supply all necessary information.

10. ADMINISTRATIVE EXPENDITURE

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

EX ANTE EVALUATION STATEMENT

MACRO-FINANCIAL ASSISTANCE TO SERBIA AND MONTENEGRO

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1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

In 2003, real GDP grew by 2-3%, somewhat slower than initially foreseen under the current IMF Extended Arrangement. For 2004, the authorities project GDP to grow by 4 - 6%, reflecting a recovery in industrial output and an expected rebound in agricultural production.

CPI inflation in Serbia declined to 8.1% in December 2003, but picked up slightly to 10.5% in May, as a result of higher oil prices and a further adjustment of electricity prices. For the year as a whole, the Serbian authorities expect an inflation rate of 8.5%. In real effective terms, the exchange rate remained broadly stable in 2003 and slightly depreciated in the first half of 2004 by some 3%. In Montenegro, which has unilaterally introduced the euro as the sole legal tender, annual inflation reached 6.6% in 2003, suggesting a substantial real appreciation. End of period inflation for the year as a whole is expected to reach 4.5%.

In 2003, the consolidated general government deficit of Serbia and Montenegro reached 4.2% of GDP (3.8% in Serbia and 0.4% in Montenegro, the latter representing 5.2% of Montenegrin GDP). For 2004, the budget deficit is sought to be reduced by 0.8% to 3.4% of GDP. It is planned to achieve this through higher revenue collection, while expenditures are projected to remain unchanged in relation to GDP, but with a focus to raise investments and lower current spending. The financing of the deficit remains a concern this year, in particular as revenues from privatisation have so far been lacking.

Despite continued huge trade deficits, reflecting strong import demand and a generally weak export base, the external situation in 2003 was more favourable due to an exceptionally large net inflow of Foreign Direct Investment (FDI) in the order of 7% of GDP and buoyant private remittances (11.2% of GDP). Gross international reserves increased substantially to USD 3.6 billion. In early 2004 however, international reserves began to decline moderately, also due to seasonal factors and foreign debt servicing. They reached USD 3.3 billion in April, equivalent to 4 months of projected 2004 imports. The external outlook may improve as a result of an agreement with London Club creditors on a reduction of outstanding debt that was reached in July. However, gross financing needs remain high and the country continues to require external financial support from the Community and other donors in support of its economic stabilisation and reform programme.

1.1. Medium term economic outlook

Real GDP growth is expected to average 4-5% in 2004/2005 and annual inflation to come down to 5% by end-2005. In 2005 the fiscal deficit is projected to decline to 2.4% and public debt to below 60%.

In the context of the third review under the current IMF programme completed in June, the Fund and the authorities have reached agreement on balance-of-payments projections and gross financing requirements in 2004. It is projected that FDI and privatisation revenues cannot be sustained at the 2003 level. For 2004, FDI is expected to be halved in USD terms to some USD 700 million (it reached USD 300

million in the first five months). Disbursements from private creditors are projected to stay at the 2003 level. According to the IMF, a macro-financial gap is expected for the whole year 2004 (i.e. the gap to be covered by budget/balance of payments support as opposed to project-related support and after deducting IMF and World Bank disbursements) of USD 193 million, to be financed by EC and other bilateral donors' contributions.

1.2. Structural reforms in the context of the IMF Extended Arrangement

With respect to structural reforms, some new momentum has been gained following the creation of a new government in Serbia in March 2004. In particular, a substantial legislative agenda has been pushed through the Serbian Parliament. 32 new laws, mainly in the economic and financial sphere, have been adopted in the past months or are in the process of being voted, notably on bankruptcy, investment promotion, company registration, foreign trade, insurance, indirect taxation, and energy and railway. A first bank privatisation tender (for Yugobanka) was issued in late May and the Bank Rehabilitation Agency has received offers from eight interested banks. The authorities expect to issue two additional tenders for banks by end-September. The privatisation of companies through tenders, which has stalled since mid-2003, is expected to gain momentum and four important companies are being prepared for privatisation in the second half of the year. The restructuring of large state-owned enterprises and public utilities, which has not yet really started, represents a major challenge for economic policies in the future.

2. OBJECTIVES AND RELATED INDICATORS OF THE MFA OPERATION

2.1. 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 Serbia and Montenegro's transition towards a market economy. In this context and given the challenges and needs identified above the objectives of the proposed MFA operation are to:

- Contribute to covering the residual external financing needs;
- Facilitate and encourage efforts of the authorities of Serbia and Montenegro to implement structural reforms in the area of public finance, private sector development and banking sector reform through appropriate conditionality.

Macroeconomic and structural reform objectives that apply to the original amount of EUR 130 million are defined in a Memorandum of Understanding signed in December 2003. Terms and policy conditions for the additional assistance (topping-up) of EUR 70 million still need to be agreed in a Supplemental Memorandum of Understanding. This could in principle include measures in the following areas:

- restructuring/privatisation of the strategic sectors
- reform of public administration and in particular public finance

- banking sector reform

2.2 Indicators

Quantitative benchmarks included in IMF programmes represent a first category of indicators of a macro-economic nature. Performance indicators are specified in the aforementioned Memorandum of Understanding, in agreement with the authorities of the beneficiary country.

3. ALTERNATIVE DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1. Delivery mechanisms

Macro-financial Assistance is generally provided either in the form of a loan, a grant or a combination of the two. Given the country's high level of indebtedness, a significant part of this assistance is in the form of a grant (EUR 120 million) and the remainder (EUR 80 million) in the form of a loan.

Macro-financial assistance is an untied and undedicated macro-economic support, which helps the country meet its external financing needs, including through a reinforcement of reserves and budget support. Project support would not be able to fill this need in the same way, since it could for example not be used for servicing the country's external debt or strengthening its reserves position. Moreover, as experienced with similar operations, including in Serbia and Montenegro, the economic policy conditionality attached to this support strengthens the stabilisation and reform process.

3.2. Risk assessment

There is a risk that macro-financial assistance, which is not dedicated to specific expenses (contrary to project financing, for example), would be used in a fraudulent way. Generally speaking, this risk is related to factors such as the independence of the central bank, quality of systems and procedures related to the management, control and processing of such assistance, IT security and internal/external audit capacity. Although the provision of assistance in the form of project support may seem to be an alternative, it does not fulfil the country's need for unaffected financing (i.e. not earmarked for specific projects) and also carries other risks of fraud.

Before the release of this assistance, the Commission services, with the support of duly mandated experts, will check the reliability of Serbia and Montenegro's financial circuits, administrative procedures, as well as internal and external control mechanisms that are relevant to this type of assistance (see Financial Statement, section 8).

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.

4. ADDED VALUE OF COMMUNITY INVOLVEMENT

In May 2002, the IMF approved a three-year Extended Arrangement covering the period until May 2005. The main priorities of the programme were ensuring fiscal and monetary stability, enhancing public expenditure control and tax administration, promoting private sector development, and cleaning-up the banking system. 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, and the restructuring of the industrial and financial sector has been initiated. The agenda of economic reforms has been supported through the provision of subsequent EC macro-financial assistance packages, which have been implemented subject to the prior fulfilment of agreed economic and structural policy conditions. Without continued EC complementary macro-support, there is a risk that the stabilisation and reform programme supported by the IMF could not be fully implemented, that popular support for the necessary adjustment efforts could dwindle and that reforms could stall. Furthermore, this assistance would encourage and support efforts that are considered of particular importance for the EC, notably those that foster the establishment of a single economic space in the country.

Finally, macro-financial assistance complements the Community Assistance for Reconstruction, Development and Stabilisation (CARDS) programme which since 2001 has been the main EC financial instrument for co-operation for the Balkan countries and for Serbia and Montenegro in particular. For the period 2000-2004, EUR 1,100 million have been earmarked for the country. The main priorities are justice and home affairs, administrative capacity building, economic and social development, environment and natural resources, and democratic stabilisation. For 2004, a total amount of EUR 195 million has been foreseen.

5. LESSONS FROM THE PAST

In the past, macro-financial assistance to Serbia and Montenegro and other countries has proven to be instrumental in supporting strong stabilisation and reform programmes also backed by IMF arrangements and it has become clear that a proper articulation between EC and IMF conditionality is necessary to ensure complementary and mutual support but to avoid a too heavy cross conditionality.

Although macro-financial assistance was initially provided mainly in the form of loans, presently assistance often combines loans and grants, taking into account the country's level of income, external debt, and the reimbursement capacity.

With regard to the recommendations made in the Discharge on the budget execution for 2001 and also in the Court of Auditors' Special report n° 1/2002 concerning macro-financial assistance to third countries, the Commission services have given due consideration to the five Genva criteria (exceptional character, political pre-conditions, complementarity, conditionality and financial discipline).

6. PLANNING FUTURE 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.

6.1. Monitoring

The monitoring system is ensured by the provision of reports and data by the authorities as set out in the Memorandum of Understanding and the organisation of review missions in the country concerned. Although this assistance is centrally managed, where appropriate, Commission delegations on the spot may also be called to provide reporting.

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. In this process, the Commission services may also monitor key areas identified in the above-mentioned operational assessment. Finally, they will 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 annual report to the European Parliament and to the Council is foreseen in Council Decision 2002/882/EC, which will include an evaluation of the implementation of this operation.

6.2. Evaluation

In the context of DG ECFIN's Multi-annual Evaluation Programme, two to three ex-post evaluations of MFA operations are planned per year. It is in this framework that an independent evaluation of the assistance will be carried out by duly authorised representatives of the Commission in the course of 2005/2006. Financial resources for this evaluation will be drawn from the corresponding MFA budget line

7. ACHIEVING COST-EFFECTIVENESS

The Commission is proposing a modification of the expiry date of the underlying legal base (Council Decision 2002/882/EC as amended by Council Decision 2003/825/EC) in order to ensure a full implementation of this assistance subject to the fulfilment of appropriate conditionality. It is unlikely that any disbursements under this assistance can be made without a modification of the expiry date.

In view of Serbia and Montenegro's external constraints, the loan will carry a maturity of 15 years with a 10-year grace period, which is comparable to conditions of macro-financial assistance loans provided to other Western Balkan countries. The adoption of this assistance would not require any additional provisioning of the Guarantee Fund, given current provisioning rules which require the provisioning to take place upfront after the assistance is decided by the Council. Accordingly, as indicated in the Financial Statement the Guarantee Fund for external actions has already been provisioned in 2002 and 2003, for an amount corresponding to 9% of the amount of the guaranteed loan (EUR 80 million). As a result, two transfers of

appropriations totalling an amount of EUR 7.2 million from the Reserve (budget line 01 04 01 13) to the Guarantee Fund (budget line 01 04 01 14) were authorized by the Budgetary Authority in 2002 and 2003 after adoption of Council Decisions 2002/882/EC and 2003/825/EC.

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