



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 30.7.2002  
COM(2002) 436 final

2002/0192 (CNS)

Proposal for a

**COUNCIL DECISION**

**providing further macro-financial assistance  
to the Federal Republic of Yugoslavia**

(presented by the Commission)

## **EXPLANATORY MEMORANDUM**

### **1. INTRODUCTION**

Following the political and democratic changes in the Federal Republic of Yugoslavia (FRY) in October 2000, the FRY authorities made considerable progress in (re-)establishing links with international organisations and in particular in normalising the country's financial relations with multilateral and official bilateral creditors. The resumption of IMF membership occurred in December 2000. In the first half of 2001, the FRY became a member of the EBRD and succeeded to the membership of the former Socialist Federal Republic of Yugoslavia in the World Bank. In October 2001, the FRY cleared all its outstanding arrears towards the European Investment Bank (EIB) and thus paved the way for the inclusion of the FRY in the guarantee mandate for external action of the EIB and the subsequent start of first lending operations for investment projects. In November 2001, the FRY concluded an agreement with Paris Club creditors which details a two-phased 66% reduction in the net present value of outstanding obligations to Paris Club creditors (some \$4.500 million at end-2001). The first phase (51%) became effective in early May 2002, when the IMF Board approved a three-year Extended Arrangement to support the FRY's economic programme in 2002 – 2005. The second phase will become effective upon completion of the IMF programme (expected in March 2005). Negotiations are continuing with London Club creditors to settle FRY's outstanding financial obligations towards commercial creditors (some \$2.800 million at end-2001).

Political developments play a major role with regard to the development of the economic framework. The Belgrade Agreement on the restructuring of relations between Serbia and Montenegro was signed in mid-March 2002 by President Kostunica as well as by authorities from both republics. It sets out a general framework for the restructuring of relations between Serbia and Montenegro and has meanwhile been endorsed by the federal and the republican Parliaments. The full implementation of the Belgrade Agreement is of utmost importance for the FRY to make progress in the EU Stabilisation and Association Process. A new Constitutional Charter which still needs to be adopted should clarify the institutional structure of the state. On this basis, political leaders in the country need to live up to their commitment to harmonise their policies and to achieve an internal market and a common trade and customs policy which is essential for further rapprochement with the Union.

Since October 2000, the FRY authorities have accomplished substantial progress toward restoring macro-economic stability, liberalising the exchange, price and trade regimes and improving market confidence. Important legal and regulatory steps have been taken to foster the restructuring of the economy, namely a sound and transparent privatisation framework and new banking legislation has been put in place. Good progress has also been made toward enhancing public expenditure control and tax policies were geared at lower tariffs and a broader tax base, resulting in improved revenue collection.

Apart from general Community support provided under the CARDS program (EUR 434 million in 2000 and 2001, with EUR 195 million expected for 2002), the Community has supported the process of economic reforms in the FRY through macro-financial assistance of EUR 345 million that was provided in the context of the IMF stand-by programme adopted in June 2001. On 16 July 2001, the Council decided to provide to the FRY a Community macro-

financial assistance of up to EUR 300 million.<sup>1</sup> On 10 December 2001, the Council revised this Decision by increasing the grant element from EUR75 million to up to EUR 120 million, thereby augmenting the overall amount of this assistance to up to EUR 345 million.<sup>2</sup> Following up-front clearance of all arrears of the FRY towards the European Investment Bank and the European Community (totalling EUR232 million), the first tranche of the assistance amounting to EUR260 million (comprising EUR225 million loan and EUR35 million grant) was released in October 2001. The second (grant) tranche of EUR40 million was disbursed in January 2002, following a satisfactory review of conditionality and the signature of a Supplemental Memorandum of Understanding (SMoU), which specified the economic and structural policy conditions for the payment of the third (grant) tranche of EUR45 million. In April 2002, the Commission services reviewed recent economic and structural developments, and in particular progress made by the FRY authorities with respect to the conditions specified in the SMoU. The mission found that a large number of the conditions had been fulfilled and agreed with the authorities on a number of further actions to be taken before the third and final tranche could be released. In the meantime, the SMoU conditionality has been satisfactorily met and the release of the final tranche has been launched in early July.

Despite impressive achievements in stabilisation and reform since late 2000, important economic challenges lie ahead that the FRY authorities intend to address in the context of the new IMF programme. Indeed, economic conditions remain difficult with a GDP level still at historically low levels and a weak performance of industry. Reforms need to be continued vigorously to lay the foundation for sustained growth and employment creation. They will have to address in particular the restructuring of a largely insolvent, de-capitalised and over-staffed public enterprise sector. Further action is needed to modernise an under-performing and weak banking sector. New and large investments are essential to upgrade dilapidated infrastructure that has lacked proper maintenance for many years.

The external sustainability of the FRY economy also remains a major challenge even after substantial debt relief agreed by the Paris Club, and despite IFIs providing substantial financial assistance. Hence, important remaining financing requirements will continue to put a heavy strain on the balance of payments. According to IMF projections, the FRY economy will continue to rely on official financing as private funding, although on an upward trend, will by far not reach sufficient levels to match the financing requirements over the medium term.

In these circumstances, and following the consultation of the Economic and Financial Committee, the Commission is now proposing to the Council to adopt a Decision providing further macro-financial assistance to the FRY.

## **2. RECENT ECONOMIC PERFORMANCE**

Real GDP in the FRY grew by an estimated 5.5% in 2001 (incl. 3.5% in Montenegro), somewhat faster than projected, and was mainly driven by agricultural output recovery (20-25%) and increased activity in services. Industrial production has been performing poorly throughout 2001 and in the first two months, industrial output was 4.7% lower than in the same period of the previous year.

---

<sup>1</sup> Decision 2001/549/EC (OJ L 197 of 21.7.2001, p. 36)

<sup>2</sup> Decision 2001/901/EC (OJ L 334 of 18.12.2001, p. 30)

In Serbia, end-year inflation has come down considerably (from 115% at end-2000 to 39% at end-2001) despite increases in electricity prices and indirect taxes; core inflation is estimated at 15%. In the first three months of 2002, monthly inflation averaged at 0.8% pointing to an annualised rate of some 10%, considerably lower than the targeted rate of 20%. Montenegro recorded an end-2001 inflation of some 24%, higher than the target of 15% but lower than in Serbia. Real wage freezes in the public sector have clearly supported the process of disinflation and the FRY authorities agreed with the IMF to keep the state sector wage bill in 2002 constant in relation to GDP.

The consolidated general government accounts in the FRY recorded a cash deficit before grants of some 1.3 % of GDP in 2001 (around \$ 140 million), compared with a revised programme target of 4.0%. This includes a Montenegrin fiscal deficit (before grants) of around 5% of GDP of that republic. The considerably lower than programmed cash deficit was in part due to improved revenue performance as a result of tax policies implemented in the first half of 2001 (turnover taxes, excises and gross income tax). But it mainly reflects the action taken to severely compress expenditures as delays occurred in receiving revenues from privatisation and foreign financial assistance. The deficit was financed through domestic borrowing (0.6% of GDP as planned) and foreign financing (0.8% of GDP as compared to a programmed 2.1%). In line with a sustainable level of expenditure, the consolidated FRY budget deficit for 2002 is expected to be in the order of 5.6% of GDP, to be financed through domestic borrowing (0.6% of GDP), privatisation receipts (1.4%) and foreign assistance (3.6%).

The value of the Dinar remained broadly stable at around YuD59 per EUR, reflecting tight monetary and fiscal policies in Serbia throughout 2001 and quite favourable balance of payments developments. The current account deficit (before grants) was considerably lower than originally projected (10.9% instead of 14.6%), although imports grew more than expected (by 30% instead of 21%) and exports were slightly below the projected amount. This improvement was due to higher than expected inflows of remittances from abroad. Gross reserves of the National Bank of Yugoslavia reached around \$ 1,200 million by end-2001 (compared to \$ 605 million at the beginning of the year), equivalent to 2.4 months of imports, and rose by a further \$160 million in the first two months of 2002. However, the external viability of the FRY economy will remain a major challenge. Important financing requirements, mainly resulting from debt service obligations and the need to further strengthen foreign exchange reserves, will continue to put a heavy strain on the balance of payments.

### **3. MEDIUM TERM ECONOMIC POLICY FRAMEWORK**

#### **3.1. Outline of the main policy objectives for 2002 – 2005**

The framework for medium-term economic policies in the FRY is set in the three-year Extended Arrangement with the IMF that was adopted by the Board on 13 May 2002. The authorities are expecting annual real growth to increase to about 5% in 2003 – 2005 after 4% in 2002. Inflation (end-year) is targeted to be reduced to 8% by end-2004 in Serbia (after 20% in 2002 and 12% in 2003) and to 12% by end-2002 in Montenegro to be followed by further disinflation in 2003 and 2004. The current account deficit is expected to increase in 2002 from 10.9% to 12.9% of GDP and to improve steadily in relation to GDP in the years 2003 to 2005, mostly due to export recovery. However, the authorities are projecting average annual inflows of foreign assistance in the order of \$840 million per year to finance a major share of

the current account deficits. Foreign exchange reserves are targeted to increase to 4.3 months of imports from the end-2001 level of 2.4 months.

### **3.2. Macro-economic policies**

The FRY authorities intend to reach these objectives through a continuation of prudent macro-economic policies over the medium term. Fiscal policies are projected to further contain public spending, in particular through a reduction of subsidies, a reform of the civil service and public sector wage policies, as well as reforms in the area of pension and health care. The expenditure/GDP ratio is expected to decline by 3% of GDP by 2005 from a relatively high level of around 49% in 2002. On the revenue side, the authorities aim to further widen the tax base through improved tax administration and enhanced tax collection. However, as in other transition economies, the fiscal deficit is projected to remain relatively high during the period, mainly due to the need for investment spending to address the obsolete infrastructure, and to external debt service requirements. Also, social spending for the most vulnerable parts of the population is considered essential to maintain public support for reforms. The public debt/GDP ratio is projected to be halved from around 130% at end-2001 to 65% at end-2005.

The overarching goal of monetary policies will continue to be lowering inflation. As in 2001, base money creation will primarily be driven by increases in net foreign assets, while increases in net domestic assets will continue to be strictly limited. To this end, domestic lending from the banking system to the government will remain below 0.5-1.0% of GDP over the medium term. Prudent wage policies in the state sector are considered essential to support further dis-inflation. The policy of a managed float will be continued although the authorities will closely monitor the appropriateness of exchange rate policies taking also into account external competitiveness and export performance. Exchange rate policies might also be reconsidered in view of the recently adopted new law on foreign exchange transactions. Also, the elimination of all current account restrictions and a substantial liberalisation of capital account transactions are foreseen over the medium term.

### **3.3. Structural Reforms**

The authorities envisage the continuation of structural reforms over the medium term, in particular in the fiscal, banking and enterprise sector, as an essential complement to continuous macro-economic stabilisation. This will be accompanied by a further liberalisation of prices, in particular an adjustment of energy prices to cost-recovery levels by mid-2004. In the area of trade, the abolishment of remaining trade barriers, i.e. quantitative restrictions except those for health, environmental and security reasons are envisaged during the period of the Extended Arrangement.

In the *fiscal area*, the implementation of a fully fledged expenditure control system in Serbia and a strengthening of tax administration are considered as priorities in the area of institutional strengthening. As regards expenditure policies, a major re-orientation of public spending is envisaged to increase the quality and effectiveness of public services. Specifically, a better targeting of social transfers and benefits including a comprehensive reform of the pension system, as well as an overhaul of state subsidies should contribute to a further rationalisation of public spending. In Serbia, the main reform in the area of tax policy will be the introduction of VAT, which is scheduled for early 2004.

In the *banking sector*, emphasis is placed on improving banking supervision on the basis of stricter prudential regulations in line with international standards in order to strengthen the

financial position of banks. Further progress is envisaged with regard to the rehabilitation and possible restructuring of those banks that are under enhanced supervision of the National Bank of Yugoslavia or placed in the Bank Rehabilitation Agency. Finally, the authorities plan to accelerate the privatisation of financial institutions. In Montenegro, short-term decisions are needed on whether a number of banks should be re-licensed or closed.

The process of *restructuring and privatisation* of large state-owned enterprises will gain momentum over the medium term. A number of around 150 enterprises have been chosen for tender privatisation; for some 70 companies procedures are well advanced, 28 companies are expected to be sold by end-2002 and the remaining enterprises in the following years. A number of 150–200 companies are currently in the pipeline for privatisation through auctions and are expected to be sold by end-2002. For the majority of some 4,000 state-owned firms, the process of privatisation is envisaged to gain momentum over the medium term and to be completed by mid-2005. The authorities also intend to restructure some 40 large conglomerates prior to possible privatisation.

#### **4. EXTERNAL FINANCING REQUIREMENTS OF THE FRY IN 2002 AND 2003**

Even if the FRY continues with macro-economic stabilisation and sustains a good track record in structural reforms as envisaged under the Extended Arrangement, it can be expected – in line with IMF assessment and projections in a recent staff report (EBS/02/73 of 26 April 2002) - that the country will remain heavily dependent on external financial support over the medium term, including macro-financial assistance. Important financing needs result particularly from external debt service obligations and the need to strengthen foreign exchange reserves, as well as from costs associated with the upgrading of public infrastructure and with enterprise and bank restructuring.

According to IMF balance of payments projections, gross financing requirements in 2002 and 2003 amount to about \$8,450 million, mainly comprising remaining external arrears (some \$4,000 million) and projected current account deficits before grants (some \$3,370 million) as well as a planned increase of gross foreign exchange reserves by around \$900 million by end-2003 to a level of 3.5 months of projected imports that is deemed appropriate in the context of further foreign exchange liberalisation.

The gross financing requirements are expected to be reduced by some net private capital inflows (\$ 1,670 million), by expected debt relief (\$4,231 million), mainly from the London Club on terms equivalent to those agreed by the Paris Club, and by firmly committed bilateral official loans and grants (\$421 million), which leads to a remaining gap of \$2,131 million.

Taking into account firm commitments by IFIs so far in 2002 (\$350 million) as well as expected IMF financing in 2002 and 2003 (\$562 million), this would reduce the gap to around \$1,220, for which additional financing assurances from IFIs and bilateral donors are still needed and expected (\$300 million in 2002 and \$920 million in 2003). As the IMF expects financing from IFIs (excl. IMF) in 2003 in the amount of \$360 million, a residual financing gap of around \$860 million would have to be financed through bilateral financial contributions in 2002 and 2003.

According to information provided by the IMF, a part of this residual financing gap in 2002/2003, namely some \$280 million, represents a macro-financing gap (some \$100 million in 2002 and some \$180 million in 2003). This does not, however, include balance of payments support provided by the Paris Club of bilateral official creditors, i.e; the cash relief

through the capitalisation of moratorium interest estimated at some \$100-120 million for the period 2002/2003.

The IMF indicated that in order to meet a substantial part of this macro-financing gap, further Community macro-financial assistance would be needed, starting already in 2002.

## **5. POSSIBLE FURTHER COMMUNITY MACRO-FINANCIAL ASSISTANCE AND MAIN CHARACTERISTICS OF THIS ASSISTANCE**

The Commission is proposing that the Community will make available to the FRY a further macro-financial assistance in the amount of up to EUR130 million. The proposed amount appears to be consistent with IMF projections of the financing gap for macro-financial support and the funding requirements.

A further Community macro-financial assistance would contribute to bolstering the country's economic, social and political stability, as well as enhancing its important role as a factor of stability in the region. In particular, it is considered an appropriate measure to help ease the country's external financial constraints, support the balance of payments and strengthen the reserve position. A further Community macro-financial assistance would complement resources being made available by International Financial Institutions and bilateral donors. There is a risk that if sufficient official financing is not forthcoming, there would be adverse consequences for a continuation of economic policies envisaged under the IMF Extended Arrangement and thus for overall growth prospects, the level of employment and the standard of living.

The proposed assistance is intended to accompany the first half of the IMF Extended Arrangement in 2002 and 2003. The assistance would be disbursed in at least two tranches and would be subject to appropriate macroeconomic and structural conditionality in line with the main elements of the new IMF programme.

Given that the FRY's borrowing capacity remains weak even after action taken by the Members of the Paris Club, the proposed Community macro-financial assistance foresees a substantial grant element of up to EUR75 million. The budgetary funds are already foreseen on the budget line B7-548 for 2002 and 2003. The loan element of up to EUR55 million of this assistance would have a maturity of up to 15 years, comparable to recent macro-financial assistance packages to other Western Balkan countries. The Community would provide the funds through market borrowing with a guarantee by the general budget. The FRY would subsequently borrow from the Community. The borrowing and lending operations would be perfectly matched and would be without any commercial risk for the Community. In accordance with the Guarantee Fund mechanism, the budgetary implications of a decision to make available a loan of up to EUR55 million to the FRY would imply a EUR4.95 million provisioning of the Guarantee Fund for which sufficient margins exist under the reserve for guarantees.

The Council is therefore requested to adopt the attached draft Decision providing further macro-financial assistance to the FRY.

Proposal for a

**COUNCIL DECISION**

**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 Commission<sup>1</sup>,

Having regard to the opinion of the European Parliament<sup>2</sup>,

Whereas:

- (1) the Commission consulted the Economic and Financial Committee before submitting its proposal;
- (2) the FRY authorities re-established links with international organisations and in particular made progress towards normalising the country's financial relations with multilateral creditors, including the European Investment Bank, and with official bilateral creditors;
- (3) since October 2000, the Federal Republic of Yugoslavia has achieved substantial progress in economic stabilisation and reform and has made important steps towards a well-functioning market economy;
- (4) within the Stabilisation and Association process, the framework for EU relations with the region, it is desirable to support efforts to sustain political and economic stabilisation in the Federal Republic of Yugoslavia, with a view to evolving towards the development of a full co-operation relationship with the Community;
- (5) financial assistance from the Community shall be instrumental in bringing the Federal Republic of Yugoslavia closer to the Community; the Community already provided in 2001 macro-financial assistance of EUR 345 million to the Federal Republic of Yugoslavia<sup>3</sup>;

---

<sup>1</sup> OJ

<sup>2</sup> OJ

<sup>3</sup> Decision 2001/549/EC (OJ L 197 of 21.7.2001, p.36), Decision 2001/901/EC (OJ L 334 of 18.12.2001, p.30)



- (6) the International Monetary Fund (IMF) approved in May 2002 a three-year “Extended Arrangement” for the Federal Republic of Yugoslavia of about \$829 million to support the authorities’ economic programme in 2002 – 2005;
- (7) the World Bank decided in May 2001 to make available to the Federal Republic of Yugoslavia on a temporary basis a package of concessional loans of \$540 million over a three year period; so far two structural adjustment credits of \$70 million and of \$85 million have been approved in January and May 2002, respectively, to support reforms in public finance as well as in the energy and social sector and to foster private sector development;
- (8) the Members of the Paris Club agreed in November 2001 on a substantial debt relief in favour of the Federal Republic of Yugoslavia, already alleviating the balance of payments situation;
- (9) the authorities of the Federal Republic of Yugoslavia have requested financial assistance from the international financial institutions, the Community, and other bilateral donors;
- (10) over and above the estimated financing which could be provided by the IMF and the World Bank, an important residual financing gap remains to be covered to support the policy objectives attached to the authorities’ reform efforts;
- (11) Community macro-financial assistance to the Federal Republic of Yugoslavia is an appropriate measure to help ease the country’s external financial constraints, supporting the balance of payments and strengthening the reserve position;
- (12) financial assistance from the Community in the form of a combination of a long-term loan and a straight grant is an appropriate measure to support the sustainability of the Federal Republic of Yugoslavia’s external financial position, given its limited borrowing capacity;
- (13) the inclusion of a grant component in this assistance is without prejudice to the powers of the budgetary authority;
- (14) this assistance should be managed by the Commission in consultation with the Economic and Financial Committee;
- (15) the Treaty does not provide, for the adoption of this Decision, powers other than those of Article 308,

HAS DECIDED AS FOLLOWS:

*Article 1*

1. The Community shall make available to the Federal Republic of Yugoslavia further macro-financial assistance in the form of a long-term loan and a straight grant with a view to ensuring a sustainable balance-of-payments situation and strengthening the country’s reserve position.
2. The loan component of this assistance shall amount to a maximum principal of EUR 55 million with a maximum maturity of 15 years. To this end, the Commission is

empowered to borrow, on behalf of the European Community, the necessary resources that will be placed at the disposal of the Federal Republic of Yugoslavia in the form of a loan.

3. The grant component of this assistance shall amount to a maximum of EUR 75 million.
4. This Community financial assistance shall be managed by the Commission in close consultation with the Economic and Financial Committee and in a manner consistent with the agreements reached between the IMF and the Federal Republic of Yugoslavia.

#### *Article 2*

1. The Commission is empowered to agree with the authorities of the Federal Republic of Yugoslavia, after consultation with the Economic and Financial Committee, the economic policy conditions attached to further Community macro-financial assistance. These conditions shall be consistent with the agreements referred to in Article 1(4).
2. The Commission shall verify at regular intervals, in collaboration with the Economic and Financial Committee and in co-ordination with the IMF, that economic policies in the Federal Republic of Yugoslavia are in accordance with the objectives of this macro-financial assistance and that its conditions are being fulfilled.

#### *Article 3*

1. The loan and grant components of this assistance shall be made available to the Federal Republic of Yugoslavia in at least two instalments. Subject to the provisions of Article 2, the first instalment is to be released on the basis of a satisfactory track record of the macro-economic programme of the Federal Republic of Yugoslavia under the present Extended Arrangement with the IMF.
2. The second and any further instalments shall be released on the basis of a satisfactory continuation of economic policies referred to in Article 2, and not before one quarter after the release of the previous instalment.
3. The funds shall be paid to the National Bank of the Federal Republic of Yugoslavia.

#### *Article 4*

1. The borrowing and lending operations referred to in Article 1 shall be carried out using the same value date and must not involve the Community in the transformation of maturities, in any exchange or interest rate risks, or in any other commercial risk.
2. The Commission shall take the necessary steps, if the Federal Republic of Yugoslavia so requests, to ensure that an early repayment clause is included in the loan terms and conditions and that it may be exercised.

3. At the request of the Federal Republic of Yugoslavia, and where circumstances permit an improvement in the interest rate of the loan, the Commission may refinance all or part of its initial borrowings or restructure the corresponding financial conditions. Refinancing or restructuring operations shall be carried out in accordance with the conditions set out in paragraph 1 and shall not have the effect of extending the average maturity of the borrowing concerned or increasing the amount, expressed at the current exchange rate, of capital outstanding at the date of the refinancing or restructuring.
4. All related costs incurred by the Community in concluding and carrying out the operation under this Decision shall be borne by the Federal Republic of Yugoslavia, if appropriate.
5. The Economic and Financial Committee shall be kept informed of developments in the operations referred to in paragraph 2 and 3 at least once a year.

#### *Article 5*

At least once a year, and before September, the Commission shall address to the European Parliament and to the Council a report, which will include an evaluation on the implementation of this Decision in the previous year.

#### *Article 6*

This Decision shall take effect on the day of its publication in the *Official Journal of the European Communities*. It shall expire two years after the date of its publication.

Done at ,

*For the Council*  
*The President*

## ANNEX

### BUDGETARY RESOURCES NECESSARY FOR THE PROVISIONING OF THE GUARANTEE FUND IN 2002 AND MARGIN UNDER THE RESERVE FOR LOANS AND LOAN GUARANTEES IN FAVOUR OF THIRD COUNTRIES

(IN EURO MILLION)

Operations	Basis of the calculation <sup>1</sup>	Provisioning of the Fund <sup>2</sup>	Reserve Margin
<b>Decided for project related assistance</b>			213.0 <sup>3</sup>
EIB			
Mediterranean Basin 1997-2000	35.0(a)	2.36	210.64
2000-2007 general lending mandate	2747.7(b)	160.74	49.9
Special Turkey Reconstruction Facility (Terra)	225.0(b)	13.17	36.73
Baltic Sea/Russia special action	25.0(c)	2.25	34.48
<b>Corrections</b>			
EIB			
Cancellation of the 2001 provisioning for Baltic Sea/Russia <sup>4</sup>	(100)(c)	-9.00	43.48
<b>Macrofinancial assistance(d)</b>			
<u>Suspended operation</u>			
Albania: estimated carry over	(20)(e)	-2.80	46.28
<u>Decided operations</u>			
Ukraine Supplementary macro-financial assistance	(92)(e)+110.0	-2.98	49.26
<u>Proposed operations</u>			
Bosnia and Herzegovina further macro-financial assistance	20.0	1.80	47.46
FRY further macro-financial assistance	55.0	4.95	42.51
 Residual Lending and Guarantee capacity <sup>5</sup>			 472.33

<sup>1</sup> The basis of calculation represents 75% (a), 65% (b) or 100% (c) of the nominal amount of the EIB loans and 100% (d) of the macro-financial assistance loans.

<sup>2</sup> According to the provisioning rules provided in the Council regulation (EC, EURatom) n° 2728/94 of 31 October 1994. Since 2000, the provisioning rate has been fixed to 9%. Operations which were decided before 2000(e) have been provisioned at a rate of 14% and re-provisioned at a rate of 9%.

<sup>3</sup> Reserve amount in 2002 under the financial perspective.

<sup>4</sup> Instead of 100 in 2001, the new schedule for disbursement is 25 in 2002, 40 in 2003 and 35 in 2004.

<sup>5</sup> For 100% guarantee loans.

## **FINANCIAL RECORD**

### **1. TITLE OF OPERATION**

Further macro-financial assistance to the Federal Republic of Yugoslavia.

### **2. BUDGET HEADING INVOLVED**

a) Grant component of the assistance

B7-548

b) Loan component of the assistance

B0-215 – “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

Provision of a Community loan (to be financed by Community borrowings in the international capital markets) in the amount of up to EUR55 million and a Community grant of up to EUR75 million (to be financed from the General Budget) to the Federal Republic of Yugoslavia 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), which would be released in at least two successive instalments.

- 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 the Federal Republic of Yugoslavia.

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 schedule of appropriations to be financed within the limits of Category 4 of the present Financial Perspective is proposed (in million EUR):

	2002	2003 <sup>1</sup>
Commitment appropriations	60	15
Payment appropriations	60	15

#### (ii) Eventual call on the budget guarantee

- Recourse to the Guarantee Fund established by Council Regulation (EC, EURATOM) no. 2728 of 31 October 1994, most recently amended by Regulation no. 1149 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;

---

<sup>1</sup> Subject to the approval of the Budget Authority, EUR80 million in Commitment Appropriations have been foreseen by the Commission in the APB 2003.

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 Central Bank of the beneficiary country 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.

The assistance will be subject to verification, control and auditing procedures under the responsibility of the European Court of Auditors and the European Antifraud Office (OLAF).

## **9. ELEMENTS OF COST-EFFECTIVENESS ANALYSIS**

### **a) Grounds for the operation and specific objectives**

By supporting FRY'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 a three-year IMF-supported stabilisation and reform programme that the beneficiary country is implementing.

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 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 in nature and will not involve an increase in the number of Commission staff.