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Annex to the

Proposal for a Council Decision

providing macro-financial assistance to Georgia

EX ANTE EVALUATION STATEMENT

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1. PROBLEM ANALYSIS AND NEEDS ASSESSMENT

1.1. Background

The programme of exceptional financial assistance (EFA) to Armenia, Georgia and Tajikistan was aimed at supporting economic adjustment and reform strategies of the three countries. In addition to this general objective, the programme was particularly targeting the beneficiaries' financial sustainability in helping them to reduce their external liabilities. This key aspect of the programme was reflected in the link between the disbursements of the assistance and repayments by the three beneficiaries of their debts towards the Community.

The EFA programme whose implementation started in 1998 (for Armenia and Georgia) and 2001 (for Tajikistan) helped the three beneficiaries normalise their financial relations with the European Community and contributed to the goal of achieving a sustainable medium-term financial position. However, the programme's objectives in terms of reduction of the three countries' net debtor position towards the Community have not been fully met. At EUR 85.5 million, outstanding debt obligations of Georgia are well above the targets set at the time of the preparation of the EFA programme. This situation is the result of disappointing overall record in implementing adjustment and reform programmes during the period covered by the EFA programme. For most of this period, in particular since 2001, Georgia's authorities were not in a position of having a working financing arrangement with the IMF. The political situation remained unfavourable to reforms until the "Rose Revolution" of November 2003.

1.2. Medium term economic outlook and policy framework in Georgia

In view of the recent favourable economic developments and of the better quality of the economic policy framework, which is supported by the International Financial Institutions, prospects for achieving in the near future progress in reforms and external financial sustainability are improved in Georgia. The Joint Staff Advisory Note of the IMF and the World Bank (June 2005) commended the implementation of Georgia's poverty reduction strategy over the past year, in particular the efforts to reduce corruption and tax evasion and to improve the business climate which underpin substantial improvements in tax revenue collection.

Following the political regime change of late 2003, the new authorities embarked on a strong adjustment and reform programme essentially aimed at making radical changes in two areas where Georgia's performance in the previous years was most criticised by the donor community and the International Financial Institutions: transparency, efficiency and effectiveness of the government and macro-economic (mainly fiscal) management. The main components of the Government's policy agenda are fiscal consolidation and sound public finance management, restructuring and reform of the public administration accompanied by the fight against corruption and structural reforms in the key sectors of the economy aimed at a decisive improvement of the business climate. The programme is backed by a financing arrangement under the IMF's Poverty Reduction and Growth Facility (approved in June 2004 and expiring in June 2007) and adjustment lending from the World Bank (the new WB Country Assistance Strategy is nearly finalised).

The Georgian authorities are confident that the successful implementation of the programme will also help the country regain rapidly the confidence of investors to secure higher investment flows, notably as a result of the new privatisation policies. They hope thus that the improvement of the fundamentals, accompanied by strong support by the international donor community, will help the country reach its objectives in terms of financial sustainability and ultimately significant poverty reduction.

The strong commitment of the authorities to the objectives of the reform programme was witnessed at the Brussels Donor Conference in June 2004 and shortly after in the Paris Club meeting of official creditors who agreed in July 2004 to restructure arrears and maturities on Georgia's official bilateral debt falling due in the period covered essentially by the IMF arrangement.

2. OBJECTIVES AND RELATED INDICATORS OF THE MFA OPERATION

2.1. Objectives

Among the instruments presently at the disposal of the European Community, the exceptional macro-financial assistance would provide a real opportunity for Georgia to further improve its external financial situation by substantially reducing its outstanding debt obligations vis-à-vis the Community, thereby improving its debt profile and debt sustainability in the medium-term.

By providing further macro-financial assistance in the form of grants, the Community will continue supporting Georgia's economic reform efforts. The Community will in particular target medium term external sustainability and will thus aim at completing the objectives of the EFA programme.

In this context, the following ***general objectives*** of the proposed programme have been identified:

- Foster external and fiscal sustainability by encouraging the authorities to implement appropriate macro-economic and structural policies

- Help the authorities to improve the external financial position of Georgia through a reduction in the country's net debtor position towards the Community[1]

Linked to the general objectives of the programme, ***specific objectives*** in terms of financial and structural reforms, as well as in terms of the reduction in the net debtor position of the beneficiary country, 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. The EC's Country Strategy Paper on Georgia (2003-2006) pays particular attention to the issue of governance at different levels, including through the use of conditionalities. The Strategy envisages that the EC Macro-Financial Assistance, together with the EC Food Security Programme, can directly address the domain of good governance in

[1] Grant financing provided by the Community under the programme will therefore be contributing to covering Georgia's financing needs linked to early repayments of debt owed to the Community.

public finance and public expenditure management and the related administrative reforms. Financial sector strengthening is another area which can be addressed in particular through this Community instrument given the direct contacts with the central bank (National Bank of Georgia). Detailed objectives related to structural reforms relevant for the objectives of the programme may therefore include specific measures in these two areas:

The specific objectives of the programme will be consistent with those of the adjustment and reform programme implemented by Georgia with financial support from the IMF and the World Bank that will constitute the operational framework for the implementation of the assistance.

The ***operational objectives*** of the programme will be set in terms of both grant disbursements and early debt repayments and, like for the specific objectives in terms of economic reforms, will be laid down in the Memorandum of Understanding.

2.2. Indicators

Several types of indicators will be used in the implementation of the programme, depending on the category of the objectives referred to.

The fulfilment of the general objectives of the programme will be assessed in the context of the ex post evaluation of the programme (cf. infra, Section 6). The standard ***impact indicators*** of external and fiscal sustainability, in particular indicators on the debt stock and debt service, 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. 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.

Specific impact indicators related to particular structural reforms will be defined in the context of the programme's evaluation.

Finally, the operational objectives of the programme will be reflected in the actual repayments of the debt owed by Georgia to the Community and in the grant disbursements by the Community. These will be monitored through the ***indicators of programme's outputs***.

The table below summarises the objective setting for the proposed programme.

General objectives			
Objectives	**Targets**	**Indicators**	**Source**
Encourage the authorities of Georgia to implement macro-economic and structural reform policies fostering external and fiscal sustainability	Improvement of the external and internal financial sustainability	Internationally agreed external and fiscal sustainability indicators	Evaluation
Help Georgia to improve its external financial position through the reduction of the net debtor position towards the Community	Improvement of the external debt and debt service profile	Internationally agreed debt stock and debt service indicators	Evaluation
NB: The precise set of indicators will be decided in the context of the ex post evaluation			

Specific objectives			
Objectives	**Targets**	**Indicators**	**Source**
Encourage the authorities to maintain a good track record in implementing sound macro-economic and reform policies	Adherence to IMF-supported programmes	Yes/No	IMF
Encourage the authorities to implement reforms in key relevant areas	Implementation of all policy measures included in the conditionality by the time of the conditionality reviews Positive results/impact from the implementation of the programme conditionality by 2008	Percentage of policy measures included in the conditionality implemented by the time of the conditionality review Impact of policy measures implemented during the programme period (indicators to be defined in the context of the ex post evaluation)	Conditionality reviews Evaluation
Help Georgia reduce the outstanding debt to the Community	Bringing Georgia's net debtor position towards the Community by end-2007 to a target amount to be defined in the Memorandum of Understanding	Georgia's net debtor position towards the Community	EU data
NB: The specific objectives (structural reforms) and targets (net debtor position/early debt repayments and grants) will be specified/confirmed in a Memorandum of Understanding to be agreed with the authorities			

Operational objectives			
Objectives	**Targets**	**Indicators**	**Source**
Early debt repayments take place (linked to grant instalments)	Amounts of early debt repayments agreed for grant instalments consistent with the programme's objectives (in terms of reduction of net debtor position)	Actual amounts of early debt repayments	EU data
Grant amounts disbursed as programmed	Full amount of grant instalments disbursed	Actual grant payments	EU data

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 and budget support. Project financing/technical assistance 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.

Macro-financial assistance is provided either in the form of a loan, a grant or a combination of the two. Given that Georgia is eligible to highly concessional aid (IDA eligible) and given that helping the country reduce external indebtedness is an explicit objective of the programme, providing the total of this assistance in the form of a grant is considered to be the only appropriate way to achieve the objectives of the programme.

3.2. Risk assessment

There is a risk that macro-financial assistance, which is not dedicated to specific expenses, could be used in a fraudulent way. Generally speaking, this risk is related to factors such as the independence of the central bank, quality of management systems and administrative procedures, control and oversight functions in the financial circuits and processing of such assistance, security of IT systems, and adequate internal and external audit capabilities.

To mitigate the fiduciary risks, macro-financial assistance is paid to a clearly identified account of the central bank. Moreover, the Commission services, with the support of duly mandated external experts, check the reliability of Georgia's financial circuits, administrative procedures, as well as internal and external audit mechanisms that are relevant to this type of assistance and continue to monitor these functions during the implementation of the assistance. In the light of these "Operational Assessments", specific mechanisms applying to the management of the funds by the beneficiaries may be introduced in agreement with the national authorities. The Commission may also use other assistance instruments at its disposal, notably technical assistance under the Food Security Programme and Tacis, to help the beneficiary countries improve their public finance management systems if this area is not sufficiently covered by other donors.

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 by the European Court of Auditors.

4. ADDED VALUE OF COMMUNITY'S INVOLVEMENT

By providing financing complementary to resources made available to Georgia by the International Financial Institutions, the Community would encourage and strengthen the implementation of the adjustment and reform programmes. This will be particularly important in the areas targeted by the programme's conditionality. Moreover, the effect of the Community's involvement will be strengthened as a result of the synergy with other Community programmes for the region (notably the Food Security Programme and Tacis) which target institution and capacity building in the longer-term, partly in the same policy areas. The macro-financial assistance is a policy-based instrument and would therefore also contribute to the process of re-orientating the Community's future assistance to Georgia further to that direction under the new financial perspectives in the context of the new European Neighbourhood and Partnership Instrument.

Another major contribution of the Community assistance to reforms in Georgia stems from the particular feature, which makes it different from most other macro-financial assistance programmes, i.e. the link between the disbursements of EC grant assistance and the early debt repayments to the EC. Therefore, the added value of the Community involvement is clearly the reduction in Georgia's external indebtedness whose effects should be mainly appreciated as an improvement in medium-term external debt sustainability. In parallel, interest payments due to the Community on the remaining amount of the debt will be reduced.

In a broader perspective, the assistance programme will support the European Union's strategy towards Georgia, in particular in the context of the European Neighbourhood Policy. The European Neighbourhood Policy Action Plan, currently under negotiation, will be providing the framework for deeper bilateral relations between the EU and Georgia.

5. LESSONS FROM THE PAST

The Exceptional Financial Assistance implemented in 1998-2004 in favour of Armenia, Georgia and Tajikistan contributed to some key aspects of adjustment and transition processes in the three countries in a broad context of financial support by the International Financial Institutions, notably through the conditionality attached to the disbursements. Also, the programme brought substantial financial benefits to the beneficiaries. In particular, it helped them normalise their financial relations with the European Community and contributed to progress towards the goal of achieving a more sustainable medium-term financial position.

However, the impact of the Community assistance programme is not identical across the three countries and areas of reform process, the results depending largely on the overall political situation and adherence of the three countries to the IMF and World Bank-supported programmes. Armenia's and Tajikistan's track record in terms of macroeconomic stabilisation and adjustment is broadly satisfactory, and progress has been made in several areas of the structural reform, although much remains to be achieved to meet the objectives of the poverty reduction strategies. Georgia's situation is much less satisfactory; for most of the period covered by the EFA Georgia had no working financing arrangement with the IMF. Regarding the specific objective of achieving a sustainable financial position, in Armenia the external financial situation has improved quite substantially, and to some extent also in the case of Tajikistan, whereas progress has been much more modest for Georgia.

Even in the case of Armenia where the EFA programme was implemented successfully in terms of debt reduction, the overall results are mixed. The preliminary findings of an evaluation of the programme implementation in Armenia, while acknowledging progress in the field of medium-term external financial sustainability, point to a low impact of the assistance in some key areas of structural reforms.

In view of the above observations, it has become clear that the overall quality of the policy and institutional environment, which is largely determined (i) by the political commitment of the authorities towards reforms and (ii) by the availability of adequate financial and technical support from the donor community, is a key condition for the success of macro-financial assistance operations. To help improve the policy environment, a better articulation between the EC and the IFI conditionality is required. For a higher impact, there is also a need to focus the policy conditionality of the Community assistance on a more limited number of key reforms, where adequate monitoring and a closer policy dialogue with the authorities can be maintained by Commission services. Synergy between macro-financial assistance and other types of Community support (notably, food security and technical assistance programmes) also needs to be further developed.

6. PLANNING OF 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 economic 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 by the organisation of review missions by Commission staff. Although this assistance is centrally managed, where appropriate, the Commission delegation in Tbilisi may 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 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 Assessments on public finance management. Finally, close contacts and coordination will be maintained with the IMF and World Bank throughout the implementation period.

An annual report to the European Parliament and to the Council is foreseen in the proposed Council Decision.

6.2. Evaluation

An independent ex-post evaluation of the assistance will be carried out by the Commission or duly authorised representatives one to two years after the assistance has been implemented. A provision foreseeing the evaluation will be included in the Memorandum of Understanding.

7. ACHIEVING COST-EFFECTIVENESS

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

- The assistance will be made available by the Commission to Georgia in principle in at least two grant instalments. Each instalment will be released on the basis of a satisfactory track record in implementing the macro-economic programmes under the IMF's Poverty Reduction and Growth Facility and the specific economic policy conditions attached to the assistance. The latter will be negotiated with the authorities as soon as possible and laid down in a Memorandum of Understanding concluded to this effect.

- In negotiating specific policy conditions, the Commission will draw on all the expertise, including in the International Financial Institutions and in bilateral and multilateral aid agencies active in the same areas. In addition, the Commission will aim at synergies with other Community policies and instruments that could be used to support the implementation by the beneficiary of the relevant measures (notably the Food Security Programme and TACIS technical assistance programme). Where appropriate, links to any related actions under the European Neighbourhood Policy can also be established.

- The exact amounts of early debt repayments, to which the grant disbursements will be linked, will be agreed with the Georgian Ministry of Finance on the basis of the assessment of their capacity to make net debt repayments to the Community from the annual state budgets over the implementation period. This will be determined largely by the success of the government's privatisation efforts. The aforementioned assessment will take into account both the external financing and cash management constraints and the overall fiscal situation and will be conducted in close coordination with the International Monetary Fund.

In this way, the Commission will aim at maximising the effect of the assistance on the achievement of the programme's objectives, e.g. bringing Georgia's debt obligations towards the Community to sustainable levels and fostering reforms in key areas relevant for the improvement of the country's financial sustainability.