Further macro-financial assistance for Georgia

2010/0390(COD) - 13/01/2011 - Legislative proposal

PURPOSE: to propose further macro-financial assistance for Georgia, in the amount of EUR 46 million.

PROPOSED ACT: Decision of the European Parliament and of the Council.

BACKGROUND: The EU completed in early August 2010 the disbursement of a EUR 46 million macrofinancial assistance (MFA) operation to Georgia approved by the Council in November 2009. The assistance, which was provided in the form of grants, was part of a pledge of two possible MFA operations of the same amount made by the European Commission at the International Donors' Conference of October 2008. The approval of the second MFA was conditional on the continued existence of external financing needs over and above those covered by the IMF arrangement.

In a letter from 10 May 2010, the Georgian Minister of Finance requested the activation of the second part of the Commission pledge of EU funds, amounting to EUR 46 million, which is the subject of this proposal.

The Commission considers that the activation of the second part of the MFA pledged in 2008 is warranted. Although the Georgian economy is recovering (following the double shock caused by the military conflict with Russia of August 2008 and the global financial crisis), the balance of payments and budgetary position remain weak and vulnerable.

The new MFA would contribute to help Georgia to address the economic consequences of the conflict with Russia and the global crisis. The new MFA will support the economic reform agenda of the government. It would reduce the short-term financial vulnerability still faced by the economy, while supporting reform measures aimed at achieving a more sustainable balance of payments and budgetary situation over the medium-term.

The assistance would also promote policy measures to strengthen public finance management, as well as measures to foster economic and financial integration with the EU, in particular by exploiting the potential offered by the future Association Agreement, which aims at concluding a Deep Comprehensive Free Trade Agreement between the two parties.

IMPACT ASSESSMENT: the MFA and the economic adjustment and reform programme attached to it will help alleviate Georgia's short-term financing needs while supporting policy measures aimed at strengthening medium-term balance of payments and fiscal sustainability, raising sustainable growth and promoting economic integration and regulatory convergence with the EU. It will also help improve the efficiency and transparency of public finance management, building on the positive impact of the previous MFA operation in the country. MFA will also support the macroeconomic stabilisation and structural policies of the programme agreed with the IMF.

LEGAL BASIS: Article 212 of the TFEU.

CONTENT: the EU shall make the MFA available to Georgia for a total maximum amount of EUR 46 million, half of which will be provided as grants and half as loans. The assistance will contribute to cover Georgia's residual external financing needs in 2009-2011, as identified by the Commission based on the estimates of the IMF.

The assistance will be disbursed in 2011 in two equal instalments, each of them consisting of a grant and a loan element. The assistance will be managed by the

Commission. Specific provisions on the prevention of fraud and other irregularities, consistent with the Financial Regulation, will be taken into account. The main points are as follows:

- the disbursement of the first instalment is expected to take place in the first quarter of 2011;
- the second instalment, conditional on a number of policy measures, could be disbursed in the third quarter of 2011;
- as is usual with the MFA instrument, the disbursements would be conditional on successful programme reviews under the IMF's Stand-By Arrangement;
- in addition, the Commission and the Georgian authorities would agree on specific structural reform measures in a Memorandum of Understanding. In the context of the previous MFA operations, the Commission services have worked closely with the Georgian authorities on public finance management (PFM) reforms that aim at establishing a more transparent, coherent and accountable PFM system;
- in the new MFA operation, the scope of the policy conditionality would be enlarged, notably to measures aimed at fostering the economic and financial integration as well as regulatory harmonisation with the EU in selected areas, under the ENP Action Plan and taking into account the new context created by the plan to conclude an Association Agreement between the EU and Georgia;
- the new MFA would be exceptional and limited in time and is intended to run in parallel to the SBA. It will complement support from international and bilateral donors;
- the proposal includes a sunset clause. The proposed MFA would be made available for 2.5 years starting from the first day after the entry into force of the Memorandum of Understanding.

Following the successful implementation of the last MFA, in which the Georgian authorities demonstrated the political will and the capacity to implement structural reforms, the Commission believes that also this second MFA operation would contribute to the implementation of the government's agenda of structural reforms. The conditions will be consistent with the priorities of the EU-Georgia ENP Action Plan.

The decision to disburse half of the proposed assistance in grants and the other half in loans is justified by Georgia’s level of development (as measured by its per capital income) and debt indicators, and the recent improvement in the country's economic situation. The full use of grants in the previous operation had to be understood as an exceptional decision justified by the very difficult circumstances Georgia found itself in late 2008. The blend of grants and loans is also consistent with the fact that Georgia has been a blend country for the World Bank since January 2009. For the forthcoming World Bank operations, the country is expected to receive one third of the World Bank assistance in the form of the IDA lending, while two thirds of the assistance are expected to be provided on IBRD terms.

The new MFA will reduce the short-term financial vulnerability still faced by the economy, while supporting reform measures aimed at achieving a more sustainable balance of payments and budgetary situation over the medium-term. The assistance will also promote policy measures to strengthen public finance management (building on those of the previous operation and of the EU's sectoral budgetary support operation), as well as measures to foster economic and financial integration with the EU, in particular by exploiting the potential offered by the future Association Agreement, which aims at concluding a Deep and Comprehensive Free Trade Agreement between the two parties.

BUDGETARY IMPLICATIONS: the grant element of the assistance of EUR 23 million would be financed from commitment appropriations of the 2011 budget, under the budget line 01 03 02 (Macroeconomic assistance), with payments taking place in 2011. In line with the Guarantee Fund Regulation, the provisioning of the Guarantee Fund is expected to take place in 2013 and to amount to a

maximum of EUR 2.1 million. This corresponds to 9% of the EUR 23 million loan expected to be disbursed in 2011.