Proposal for a

COUNCIL DECISION

amending Council Decision 2002/883/EC providing further macro-financial assistance to Bosnia and Herzegovina

(presented by the Commission)
EXPLANATORY MEMORANDUM

1. BACKGROUND

On 5 November 2002 the Council of the European Union decided to provide Bosnia and Herzegovina (BiH) with macro-financial assistance of up to EUR 60 million, comprising a loan facility of up to EUR 20 million and a grant facility of up to EUR 40 million (Decision1 2002/883/EC).

The objective of this assistance has been to support the balance of payments and help ease the country's external financial constraints, as well as to comfort reform efforts and the implementation of common institutions and policies, consistent with the Dayton peace agreement. The assistance has been conditional upon a satisfactory track record in the adjustment and reform programme of BiH in the framework of an IMF Stand-by Arrangement which was approved in August 2002. The final and positive review of the IMF arrangement was approved by the IMF board in February 2004. The IMF and the BiH authorities are currently holding discussions on a successor arrangement.

After the signature of a Memorandum of Understanding (MoU) on 27 December 2002, setting out the conditions for the disbursement of the second tranche, the first tranche of the assistance (in the form of a EUR 15 million grant) was released in February 2003. A Supplemental MoU (SMoU) was signed in July 2003 with the authorities. It fixed the second tranche amount at EUR 20 million (comprising a grant component of EUR 10 million and a loan component of EUR 10 million) and set out a number of economic policy conditions to be implemented before the third tranche’s release. The final and last tranche of up to EUR 25 million will comprise a loan element (up to EUR 10 million) and a grant element (up to EUR 15 million).

Owing to: (i) delays of the BiH authorities in implementing the required policy reforms; (ii) delays in ratifying the Loan Agreement by the BiH Parliament (which took over four months); and (iii) the need to amend the SMoU in order to comply with the obligations of the new EC Financial Regulation, the second tranche requirements were only met by the end of 2003, and it was released by the end of December 2003 (grant component) and January 2004 (loan component). Further delays in the implementation of the authorities’ reform agenda have also delayed the release of the third tranche, which is still outstanding.

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2. **Recent Developments and Outlook**

After the high real GDP growth rates observed during the reconstruction period (on average above 30% between 1996 and 1999), annual growth has slowed to 5.5% in 2002 and further down to around 3.5% in 2003. Recent trends are however more favourable. Preliminary figures indicate that industrial production grew by 20% during the first five months of 2004. Growth is expected to resume and be around 5% in 2004. Inflation has been brought under control owing to the successful implementation of the currency board regime and is expected to remain close to 1% in 2004. Fiscal consolidation progressed successfully over the last two years. The consolidated budget deficit is being brought down from 2.2% after grants in 2002 and 2003 to close to zero (-0.1% of GDP) in 2004 (programmed deficit).

External imbalances continue to put a strain on the economy, and the current account deficit is expected to slightly increase to around 19% of GDP in 2004, on the back of a high demand for import goods, against some 18% of GDP in 2003. Foreign direct investment (FDI) which resumed over the last few years, however from a very low level, is expected to increase from an estimated USD 320 million in 2003 to around USD 420 EUR million in 2004. In spite of uncertainties related to capital inflows, the IMF did not anticipate in 2004 any additional residual external financing needs, over and above those which it expected the EC to contribute financing with the release of the macro-financial assistance third tranche. Under IMF assumptions of the final review of the Stand-By Arrangement in February 2004, the third tranche would be disbursed in 2004 and basically close the residual macro-economic financing gap (after IMF and World Bank contributions) for 2004.

The process of structural reforms has continued, with most progress observed in the management of public finances and in the financial sector. Privatisation speeded up by the end of 2003 and early 2004 and a number of tenders of large enterprises were successfully completed in the first semester of 2004. In November 2003 the Commission finalised the Feasibility Study concerning the opening of negotiations on a Stabilisation and Association Agreement. Before the Commission can recommend to the Council the opening of negotiations, BiH needs to make significant progress in the course of 2004 on 16 priorities, including in the area of economic reforms such as public finances, indirect taxes and statistics.

BiH successfully completed in February 2004 the IMF Stand-By-Arrangement approved in August 2002, which was prolonged for three months beyond its initially foreseen completion date of November 2003. The BiH authorities are committed to continue with economic stabilisation and reform, and intend to agree with the IMF on a successor programme, expected to start in the fourth quarter of 2004. In June 2004, an IMF staff mission went to BiH to hold discussions with the authorities on a new IMF arrangement, expected, as the previous one, to take the form of a fifteen-month Stand-By Arrangement.

With regard to the implementation of EC macro-financial assistance, a Commission staff mission in June 2004 reviewed the state of progress related to conditions for the release of the third and last tranche. It found that material progress in conditionality compliance had taken place over the first semester 2004. However, on a number of conditions additional progress remained mandated. Subject to further achievements in this respect in the following few months, the third tranche could tentatively be disbursed by December 2004 or early 2005.
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. It is also reflected by having concluded with the authorities in December 2003 an amendment to the SMoU, consisting in taking up a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. In particular, before proceeding with the actual implementation of the remainder of this assistance, the Commission services plan to check the reliability of Bosnia and Herzegovina’s financial circuits, administrative procedures, internal and external control mechanisms that are relevant to this type of assistance. To this end an Operational Assessment has been commissioned to external consultants and its findings were expected by September 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

Bosnia and Herzegovina requires continued financial support from the Community and other bilateral and multilateral donors in support of its economic stabilisation and reform efforts. However, the underlying Council decision (2002/883/EC of 5 November 2002) was founded on the expectation that the economic stabilisation and reform programme of the BiH authorities, as agreed under the IMF stand-by-arrangement, would be implemented in 2002 and 2003 and would last 15 months, from August 2002 until November 2003. The IMF agreed to extend it until February 2004, date of the last review. In the context of this final review, the IMF has foreseen the release of the EC third and final tranche to finance balance-of-payments financing needs for 2004.

Article 6 of the 5 November 2002 Council Decision stipulates that it shall apply until two years after the date of its publication in the Official Journal. The decision was published on 9 November 2002 and hence expires on 9 November 2004.

Against this background, it now appears necessary to amend Council Decision 2002/883/EC, so as to allow the continued implementation of this assistance and the release of the EUR 25 million third and final tranche by the end of 2004 or, possibly, the first semester of 2005. In line with budgetary requirements, the amended Council Decision would stipulate a revised expiry date of the Decision on 30 June 2005.
Proposal for a

COUNCIL DECISION

amending Council Decision 2002/883/EC providing further macro-financial assistance to Bosnia and Herzegovina

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 from the Commission²,

Having regard to the opinion of the European Parliament³,

Whereas:

(1) Council Decision 2002/883/EC⁴ of 5 November providing further macro-financial assistance to Bosnia and Herzegovina includes a loan component of a maximum principal of EUR 20 million and a grant component of a maximum of EUR 40 million.

(2) Due to delays in the implementation of the required policy reforms as agreed between the European Commission and Bosnia and Herzegovina, so far only a first (EUR 15 million) and a second tranche (EUR 20 million) could be released. A third and final tranche of up to EUR 25 million is still outstanding.

(3) Bosnia and Herzegovina is committed to a continued economic stabilisation and reform path. Following the successful completion of the previous IMF Stand-By Arrangement in February 2004 negotiations were under way on a new IMF supported programme.

(4) The country continues to require external financial support in addition to what can be provided by International Financial Institutions.

(5) The existing Council Decision 2002/883/EC should be amended to permit the commitment 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.

² OJ C […], […], p. […].
³ OJ C […], […], p. […].
(7) After consulting the Economic and Financial Committee,

HAS DECIDED AS FOLLOWS:

Sole Article

Article 6, second subparagraph of Decision 2002/883/EC is replaced by the following:

"It shall apply until 30 June 2005".

Done at Brussels, […]

For the Council
The President
FINANCIAL STATEMENT

1. **TITLE OF OPERATION**
   Macro-financial assistance to Bosnia and Herzegovina.

2. **BUDGET HEADING INVOLVED**

   a) Grant component of the assistance (in EUR)

   Budget line: 01 03 02 02

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

   (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 Council Decision 2002/883/EC, providing further macro-financial assistance to Bosnia and Herzegovina, 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 been provisioned in 2002 according to the Fund Regulation, for an amount corresponding to 9% of the amount of the guaranteed loan. As a result, a transfer of appropriations (n° 54/2002) of EUR 1.8 million from the Reserve (budget line 01 04 01 13) to the Guarantee Fund (budget line 01 04 01 14) was authorized by the Budgetary Authority in 2002 after adoption of the Council Decision 2002/883/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 Bosnia and Herzegovina.

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):

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commitment appropriations</td>
<td>0(^{(1)})</td>
</tr>
<tr>
<td>Payment appropriations</td>
<td>15 000 000</td>
</tr>
</tbody>
</table>

1) EUR 15 million already committed in July 2003

(ii) Eventual call on the budget guarantee


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 (at State and Entity level) of Bosnia and Herzegovina. To this end an Operational Assessment has been commissioned, in the context of the ongoing process of assessment of these circuits and procedures in all third countries benefiting from macro-financial assistance, in order to fulfil requirements implied by the Financial Regulation applicable to the General Budget of the European Communities. Its results were expected by September 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.

This review, the purpose of which will be announced and clearly explained to the authorities concerned, will also take into consideration available conclusions of IMF Safeguard Assessments and of other relevant reports by the IMF and the World Bank.

Moreover, fraud prevention measures have been agreed following a December 2003 amendment to the SMoU, consisting in a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption.

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 Council decision 2002/883/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 BOSNIA AND HERZEGOVINA
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1. **Problem Analysis and Needs Assessment**

Real GDP growth in Bosnia and Herzegovina is estimated to have reached 3.5% in 2003, compared to 5.5% in the previous year and an average above 30% between 1996 and 1999. In 2004, it is expected to increase to about 5%, on the basis of higher foreign direct investments and exports. The consolidated fiscal deficit, excluding grants, reached 3% of GDP in 2003 (0.4% after grants, a slight surplus). The 2003 current account deficit is estimated to have reached around 18% of GDP, from a similar level in 2002.

1.1 **Economic outlook**

Recent trends are however more favourable. Preliminary figures suggest that industrial production grew by 20% during the first five months of 2004. Growth is expected to be above 5% in 2004. The 2004 budget deficit was initially planned to reach -0.1% of GDP. This target will however now be difficult to reach following weak budget revenue performance over the first semester 2004, owing to a sharp decrease in customs revenue linked to the entry into force of Free Trade Agreements with neighbouring countries.

External imbalances are expected to continue to put a strain on the economy. The current account deficit is expected to reach around 19% of GDP in 2004, slightly higher that in 2003 (18% of GDP) owing to sustained imports growth, and in spite of a resumption of exports growth over the first months of the year. Foreign direct investment (FDI) resumed over the last few years, however from a very low level. The IMF anticipated an increase in FDI from an estimated $320 million in 2003 to around $420 million in 2004. However this will be insufficient to finance the current account deficit and the country continues to rely on donors’ support, including EC macro-financial assistance, to finance its external financing needs.

1.2 **Structural reforms in the context of the IMF Stand-By Arrangement and the EC Feasibility Study recommendations**

Under the previous IMF Stand-By Arrangement, which was launched in August 2002, a number of key steps were foreseen to promote the private sector: entry on the market and streamlined exit process, also supported by a World Bank Business Environment Credit; privatisation of large strategic enterprises slated for sale; privatisation and/or restructuring of remaining state-owned banks; and trade liberalisation measures. Reforms progressed well in all these areas and the programme was positively concluded in February 2004. In its February 2004 Review of Bosnia and Herzegovina under Article IV of its Statute, the IMF identified a number of challenges which are expected to be important elements of the forthcoming Stand-By Arrangement: corporate restructuring which needs to be speeded up, notably with improved state-owned enterprise governance, further privatisation, and the establishment of a more business friendly environment; addressing labour market rigidities; and broad improvements in the fiscal architecture, including shifting of spending to investment and operations, preparing VAT introduction, and improving fiscal coordination.
Furthermore, the Commission’s 2003 Feasibility Study has identified a number of priorities to be addressed by the country’s authorities before negotiations on a Stabilisation and Association can start. While a number of these priorities aim at addressing political issues, several imply further significant progress with structural reforms: a more effective public administration; customs and taxation reform; budget legislation and practice; a consistent trade policy; and integrated energy market and the development of the BiH economic space. In the European Partnership for Bosnia and Herzegovina adopted on 14 June 2003, the Council identified key short term and medium term priorities for BiH, based on the Feasibility Study Analysis and, as regards economic policy, very much in line with IMF priorities as well.

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 programmes (the last Stand-By Arrangement supported programme was successfully completed in February 2004 and a successor arrangement is expected to be agreed in the third quarter of 2004), this assistance would underpin Bosnia and Herzegovina’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 residual external financing needs in the 2004 balance of payments;
- Facilitate and encourage efforts of BiH authorities to implement reforms (including in the context of Stabilisation and Association process).

Macroeconomic and structural reform objectives have been detailed in the context of the Supplemental Memorandum of Understanding (SMoU) agreed in July 2003:

- Public finance reform and administration
- Financial sector reform
- Private sector development and business environment
- Statistics

2.2 Indicators

Quantitative benchmarks included in IMF programmes represent a first category of indicators of a macro-economic nature. Performance indicators were specified in the aforementioned Supplemental Memorandum of Understanding, in agreement with the authorities of Bosnia and Herzegovina.
3. ALTERNATIVE DELIVERY MECHANISMS AND RISK ASSESSMENT

3.1 Delivery mechanisms

Macro-financial Assistance is provided either in the form of a loan, a grant or a combination of the two. Given the country’s relatively low level of development (Bosnia Herzegovina’s GDP per capita stands at some EUR 1400 and the country is eligible to concessional International Development Association (IDA) “blended terms”), it has been deemed appropriate in the 2002 Council decision to provide a significant part of this assistance in the form of a grant (EUR 40 million) and the remainder (EUR 20 million) in the form of a loan. On the outstanding undisbursed amount (EUR 25 million), the share of the grant and loan components is respectively EUR 15 and EUR 10 million.

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 Bosnia and Herzegovina, 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) under the IMF programme and also carries other risks of fraud.

To mitigate the risks of fraudulent use, several measures have been taken. In December 2003 an amendment to the SMoU was agreed, consisting in a set of provisions on inspection, fraud prevention, audits, and recovery of funds in case of fraud or corruption. Also, macro-financial assistance is paid to clearly identified accounts of the central bank or the government. Moreover, before the release of the outstanding third tranche of this assistance, the Commission services, with the support of duly mandated experts, are proceeding to a check the reliability of Bosnia and Herzegovina’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). An operational assessment on the reliability of the country’s financial circuits and administrative procedures has been commissioned to this end and its results were expected by September 2004.

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 August 2002, the IMF board approved a 15 month Stand-By Arrangement covering the period August 2002-November 2003. The main priorities of the programme were to continue with fiscal consolidation, maintain strong international reserves, and keep inflation at low levels (through strict adherence to the currency board arrangement), and further structural reforms. The Bosnian authorities made good progress in the course of the programme which was successfully completed at the last IMF board review of February 2004. In this last review the IMF expected outstanding amounts of EC macro financial assistance to be fully released in 2004. Without the EC complementary macro-support, there is a risk that balance-of-payments developments foreseen by the Fund will not be achievable in 2004. This could affect the level of foreign currency reserves of BiH which is crucial in the context of the currency board arrangement governing the monetary and exchange rate regime of Bosnia and Herzegovina, and to some extent undermine the BiH governments’ efforts to pursue their stabilisation and reform policies.

Furthermore, this assistance would encourage and support efforts that are considered of particular importance for the EC. This includes conditions included in the IMF/WB programmes, as well as priorities identified in the context of the Feasibility Study such as e.g. state-wide indirect tax administration reform, enhancements of public finance management and of the statistical system, which are a common policy conditions of the above mentioned Supplemental Memorandum of Understanding and of the Feasibility Study.

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 Western Balkan countries, and for Bosnia and Herzegovina in particular. The EC annual CARDS assistance programme amounted to EUR 63 million in 2003 and EUR 65 million in 2004. Its main priorities in Bosnia and Herzegovina are ‘Economic and Social Development’, ‘Democratic Stabilisation’, ‘Administrative Capacity Building’, ‘Environmental and Natural Resources’, and ‘Justice and Home Affairs’.

5. **LESSONS FROM THE PAST**

In the past, macro-financial assistance to Bosnia and Herzegovina 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 avoiding 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 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 Genval 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 Bosnia and Herzegovina has been implementing and was expected
to resume in the context of a 15-month Stand-By Arrangement tentatively scheduled
to start in October 2004.

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 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 is foreseen in
Council Decision 2002/883/EC (Article 5), 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 that the Community extends the availability of
outstanding amounts of EUR 25 million under the 2002 Council Decision beyond the
initial expiry date of 9 November 2004 as a complement to funding available from
the IMF, World Bank and other donors, in the form of a grant (€ 15 million) and the
remainder (EUR 10 million) in the form of a loan.

In view of Bosnia and Herzegovina’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 EUR 1.8 million were already provisioned in 2002 corresponding to the full loan component (EUR 20 million) of Council Decision 2002/883/EC.

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

The loan and grant components of this assistance will be made available by the Commission to Bosnia and Herzegovina in one remaining instalment, as foreseen in the above mentioned July 2003 SMoU, on the basis of a satisfactory track record of the macro-economic programme of Bosnia and Herzegovina and the economic policy and financial conditions attached to the assistance.