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Commission Staff Working Document accompanying the Proposal for a Framework Regulation for Macro-Financial Assistance

Accompanying the document

Regulation of the European Parliament and of the Council

Regulation of the European Parliament and of the Council laying down general provisions for Macro-Financial Assistance to third countries

{COM(2011) 396 final}

LIST OF ABBREVIATIONS

DSA	Debt Sustainability Analysis
EC	European Community
ECA	European Court of Auditors
ECOFIN Council	Economic and Financial Affairs Council
EFC	Economic and Financial Committee
EIB	European Investment Bank
ENP	European Neighbourhood Policy
ENPI	European Neighbourhood Partnership Instrument
EU	European Union
EUR	Euro
EURATOM	European Atomic Energy Community
IBRD	International Bank for Reconstruction and Development (World Bank)
IDA	International Development Association (World Bank)
IFIs	International Financial Institutions
IMF	International Monetary Fund
IPA	Instrument for Pre-Accession
MFA	Macro-Financial Assistance
MoU	Memorandum of Understanding
NIS	Newly Independent States
OECD	Organisation for Economic Cooperation and Development
PFM	Public Finance Management
PRGT	Poverty Reduction and Growth Trust Fund (IMF)
TFEU	Treaty on the Functioning of the European Union

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1. INTRODUCTION

This Working Document prepared by the Staff of the European Commission accompanies the Commission's proposal for a Framework Regulation for the European Union's (EU) Macro-Financial Assistance (MFA) operations in third countries. It provides background information and discusses the main motivations for, and key features of, the proposed Regulation.

Section 2 introduces the context, justification and main aims of the proposal. Section 3 explains the main purpose of the MFA instrument, its legal base and basic principles and the experience gathered since the instrument was introduced in the early 1990s. It assesses the main achievements of the MFA, as well as a number of shortcomings, drawing on the ex-post evaluations conducted on MFA operations, previous institutional reports and resolutions and analysis by the Commission staff on the average decision-making lags. It also discusses the implications of the changes in the legal basis for MFA introduced by the Lisbon Treaty, arguing that they strengthen the case for adopting a Framework Regulation and streamlining the decision-making process. Section 4 describes the main elements of the proposed Regulation, distinguishing the changes in the decision-making process from the formalisation and, in some cases, updating of the rules governing MFA operations. Finally, Section 5 summarises the main findings and conclusions of the Document.

2. CONTEXT, RATIONALE AND OBJECTIVES OF THE PROPOSAL

2.1. MFA has proved a useful stabilisation instrument but could still gain in efficiency and transparency

MFA to non-EU countries is an important external financial instrument set up by the EU in 1990 primarily to alleviate the external shocks experienced by transition countries, many of which were candidates for EU accession. The instrument, which is mobilised at the request of partner countries, is meant to address their exceptional external financing needs in the form of balance of payment support through loans and/or grants. It was subsequently extended to potential candidate and neighbourhood countries. Since 1990, 48 MFA decisions have resulted in combined disbursement of some EUR 5.4 billion[1] (see Section 3.2).

This instrument has contributed to strengthen macroeconomic and financial stability in countries neighbouring, or geographically close to, the EU, while encouraging their implementation of appropriate structural reforms. Between 2004 and 2008, the Commission's Directorate General for Economic and Financial Affairs (DG ECFIN) conducted ex-post evaluations of all the recent MFA operations. The findings of these evaluations were reviewed and assessed in a meta-evaluation completed in late 2009[2]. In the context of the meta-evaluation, the Commission organised a high-level workshop in May 2009, gathering officials from the relevant Commission services, the IMF and the World Bank. By discussing the key findings emerging from the meta-evaluation with respect to issues such as the relevance, efficiency, effectiveness and impact of MFA operations, this workshop provided

[1] Out of total commitments of assistance of EUR 7.4 billion.

[2] "Meta-evaluation of Macro-Financial Assistance Operations, 2004-2008. Final Report", GHK Consulting, October 2009. The executive summary of this report is reproduced in Annex 1 of this document. The full report is available at: http://ec.europa.eu/economy_finance/evaluation/pdf/final_report_meta_annex_en.pdf.

input for the design and implementation of future MFA operations. The final evaluation report underlined the usefulness of this financial instrument, while putting forward some recommendations aimed at strengthening its effectiveness (see Section 3.7.1).

Although MFA has made a valuable contribution to macroeconomic stability in the EU's neighbourhood, with positive spill-over effects on the EU economy, some of its features tend to reduce its effectiveness and transparency. In particular, MFA is currently subject to case-by-case legislative decisions. Before the entry into force of the Lisbon Treaty, these decisions were taken by the Council, following a non-binding consultation of the Parliament, on the basis of Article 308 of the EC Treaty (the predecessor of Article 352 TFEU) since no specific provisions had been foreseen by the Treaty. Under the Lisbon Treaty, these decisions have been taken jointly by the Parliament and the Council through the ordinary legislative procedure (co-decision) under Article 212 TFEU governing economic and financial cooperation with third countries, which now forms the regular legal basis for MFA.

The process of adoption of an individual legislative decision for each MFA operation has tended to result in significant delays, harming the effectiveness of an instrument meant to be used in the context of critical balance of payments situations that normally require an expeditious response. Thus, the above-mentioned meta-evaluation described the delays encountered in the decision-making process as an important shortcoming of the MFA instrument, notably when compared with interventions of the international financial institutions (IFIs). This is further evidenced by the fact that the decision-making process between the Commission's proposal and its adoption by the Council has lasted on average about three months since 2000 (see Section 3.8). This contributes to produce a significant lag between the disbursement of funds under IMF financial arrangements and the disbursement of funds under related MFA operations, which, as stressed by the meta-evaluation, lowers the political visibility of this EU assistance and reduces the EU's capacity to influence the formulation of the conditionality in IMF programmes.

Moreover, MFA operations have de facto been based on a number of principles and criteria defined by the Council, the so-called Genval criteria, which have not been sufficiently formalised. These criteria were last stated in the conclusions of the ECOFIN Council of 8 October 2002 and an informal letter from the Council to the Commission (see Section 3.4). There is therefore a need to clarify and formalise these criteria in a legislative act, in order to strengthen the legal force, transparency and predictability of the rules applicable to MFA.

2.2. The new institutional and operational context calls for streamlining of decision-making and formalising the principles guiding MFA

The entry into force of the Lisbon Treaty has underlined the need to address the shortcomings above. First, some features of the co-decision procedure, combined with the need to allow for at least eight weeks for the national parliaments to use their right of scrutiny of new legislation, could result in a lengthening of the decision-making process. Second, with the Parliament now sharing with the Council the capacity to legislate on the MFA instrument, this instrument can no longer be based only on a set of Council conclusions. The Genval criteria must be transformed into a formal legal act endorsed by both co-legislators. Third, the Lisbon Treaty (Article 212 TFEU) aligns MFA with other external cooperation instruments and extends the implementing powers of the Commission (Article 291 TFEU). This underlines the anomaly of the lack of a Framework Regulation for MFA. Since the EU overhauled and streamlined its external assistance framework in 2006, framework regulations were adopted for all key external financial instruments (the Instrument for Pre-Accession, the European Neighbourhood and Partnership Instrument, the Development Cooperation Instrument, the Instrument for Stability, the Instrument for Nuclear Safety Cooperation and Humanitarian Aid). These cover the period of the 2007-13 financial perspectives and grant strong implementation powers to the Commission.

These shortcomings can be overcome through the adoption of an appropriate Framework Regulation streamlining the decision-making process and formalising the applicable rules. Moreover, the global crisis of 2008-09 has further highlighted the need for the EU of endowing itself with solid crisis prevention and crisis management systems, including appropriate financial facilities. MFA can contribute to economic and financial stability in the countries in the EU neighbourhood. In order for MFA to play this role effectively, it is essential to make its decision-making process more efficient and timely.

2.3. The proposed Framework Regulation has a two-fold objective: making MFA more efficient while providing a transparent legal basis

The main objectives of the proposed Framework Regulation are:

- Making MFA more efficient by streamlining its decision-making process

  As highlighted by the global financial crisis, dealing effectively with emergency situations requires an expeditious decision-making process avoiding long procedures and delays. This ensures that the response instrument can better help to shield beneficiary countries from short-term financial pressures – which can entail sudden, disorderly adjustments with high economic and social costs – thereby giving them the breathing space to adopt policy measures designed to restore a sustainable balance-of-payments position. A swift reaction can therefore clearly increase the effectiveness of an instrument such as MFA. It should also increase its complementarity with the relatively quick disbursement financial facilities of the IMF and the policy-based facilities of the World Bank.

- Clarity, certainty and stability of the legal basis

  The proposed Framework Regulation will not change the substance of the MFA instrument, which will remain based on existing principles formulated in conclusions of the Council and broadly shared by the Parliament (the Genval criteria). However, the Framework Regulation provides the opportunity to the legislators to consolidate, clarify and update, where necessary, the instrument's key principles. This should reinforce its transparency and predictability, as all the criteria will be established clearly and more formally in advance. Finally, it will provide a permanent legal basis to the instrument instead of case-by-case legislative decisions.

3. THE EXPERIENCE WITH MFA

3.1. Definition and purpose of MFA

MFA is exceptional financial assistance of a macroeconomic nature designed to help countries in dealing with serious, but short-term, balance of payments difficulties. It complements financing provided in the context of an IMF-supported adjustment and reform programme. This is in recognition of the fact that, within the global economic architecture, the provision of balance-of-payments support is primarily the role of the IMF, which is endowed by its members, including EU Member States, with the resources needed to do so. EU MFA is provided only to countries with a residual external financing gap after taking into account any programmed IMF assistance; it is to be discontinued once the country's balance-of-payments situation has been brought back onto a sustainable path and its external financing needs can be met through other sources.

MFA, which can take the form of grants or medium- to long-term loans, underpins the implementation of strong adjustment and structural reform measures designed to help remedy the country's balance-of-payments problems. It is therefore released only if economic and financial policy measures, to be agreed between the EU and the beneficiary country in a Memorandum of Understanding, are being implemented.

3.2. A historical perspective

Since 1990, 55 MFA decisions have been approved, with total commitments amounting to EUR 7.4 billion and effective disbursements to EUR 5.4 billion (see Chart 1 and Table 1), in the form of grants and loans. Twenty-three countries have benefited from this assistance. The size of individual MFA operations has ranged from EUR 15 million (Moldova, 1996, 2000, 2002) to EUR 870 million (Hungary, 1990) (see Annex 2 for more details)[3].

Initially, MFA operations focused on supporting macroeconomic stabilisation and structural reforms in countries of Central and Eastern Europe. Between 1990 and 1999, the MFA disbursed to these countries amounted to EUR 2.6 billion, or about two thirds of the total MFA support provided during this period. These operations generally took place within the G-24 donor coordination framework, which reflected a strong consensus within the international community to help Central and Eastern European countries overcome the difficult economic and political challenges they were confronted with at the start of the transition process.

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[3] For more information on the implementation of past MFA operations, see the Commission's Annual Reports on the Implementation of Macro-Financial Assistance to Third Countries, which can be consulted at: http://ec.europa.eu/economy_finance/financial_operations/market/third_countries/index_en.htm.

Table 1: Summary of MFA approvals, 1990-2010 (EUR million)

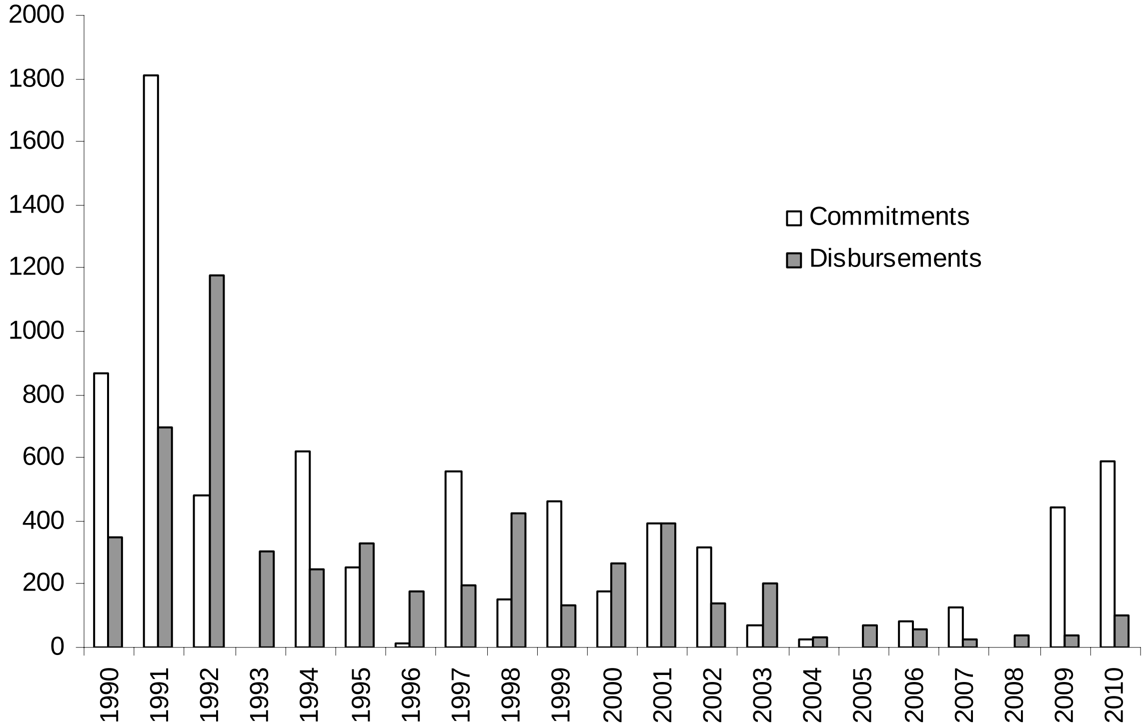
	Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total	Number of operations
New Member States	**Bulgaria**		290	110					250		100												750	4
	Czech & Slovak Fed. Rep.		375																				375	1
	Estonia			40																			40	1
	Hungary	870	180																				1050	2
	Latvia			80																			80	1
	Lithuania			100																			100	1
	Romania		375	80		125					200												780	4
	Slovakia					130																	130	1
Med	**Algeria**		400			200																	600	2
	Israel		187.5																				188	1
	Lebanon																		80				80	1
NIS	**Armenia+**								58												100		158	2
	Belarus						55																55	1
	Georgia+								175									33.5			46		254.5	3
	Moldova					45		15				15		15					45			90	225	6
	Tajikistan+											95											95	1
	Ukraine					85	200			150				110								500	1045	5
Western Balkans	**Albania**			70		35					20					25							150	4
	Bosnia & Herzegovina										60			60							100		220	3
	Kosovo (UNSCR 1244)+											35	30					50					115	3
	Macedonia (FYR)								40		80		18										138	3
	Montenegro+											20											20	1
	Serbia																				200		200	1
	Serbia & Montenegro												345	130	70								545	3
	Amount approved	870	1808	480	0	620	255	15	555*	150	460	180*	393	315	70	25	0	83.5	125	0	446	590	7440	
	No. of operations approved	1	6	6	0	6	2	1	4	1	5	4	3	4	1	1	0	2	2	0	4	2		55

Source: European Commission, Annual Reports on Macro-Financial Assistance

* Decision 97/787/EC of 17.11.1997 made available an overall amount of MFA of EUR 265 million to Armenia and Georgia. This Decision was modified by Decision 00/244/EC of 28.03.2000, which added Tajikistan to the list of beneficiary countries and increased the total combined amount to EUR 375 million. EUR 47 million of this combined amount was never allocated to any of the three eligible countries and therefore does not appear in the country rows. However, it is included in the column totals.

+ The figures for Armenia, Georgia, Tajikistan, Kosovo (under UNSCR 1244) and Montenegro include exceptional financial assistance.

Chart 1: Annual commitments and disbursements, 1990-2010 (EUR million)



Source: European Commission, Annual Reports on Macro-Financial Assistance

During the first five years of existence of the MFA instrument, the Council also approved three operations for the Mediterranean countries, namely Algeria (1991 and 1994) and Israel (1991), as well as Albania.

Over the years, the number of countries to which the Community extended MFA expanded, as a growing number of countries neighbouring the EU faced balance of payments difficulties and committed themselves to programmes of economic reform. This led to a change in the geographic balance of MFA compared to its early years.

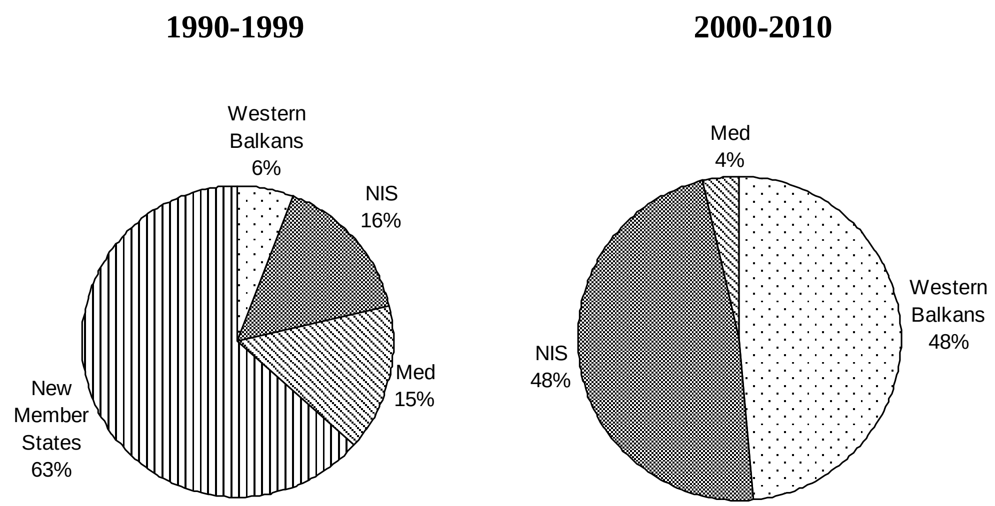
Thus, starting in the middle of the 1990s, a number of MFA operations were approved for the European countries of the former Soviet Union (Belarus, Moldova and Ukraine). Then, at the end of the 1990s, the focus of MFA operations spread to the Western Balkans (the Former Yugoslav Republic of Macedonia, Bosnia and Herzegovina, Albania, Kosovo, Serbia and Montenegro) in response to the regional economic instability resulting from the conflict and political realignment in the former Yugoslavia. Since 2000, 13 MFA decisions have been approved for the Western Balkan countries (excluding three decisions that only extended the maximum duration of existing operations), committing a total of EUR 1,083 million. This represents 49% of total MFA commitments during the period (see Chart 2).

In 1997, the Council decided to provide MFA to Armenia and Georgia in the form of a combination of loans and grants, in the context of the difficulties these countries were experiencing in servicing the debt to the Community stemming from the EUR 1,250 million credit facility made available to the new independent states of the former Soviet Union in

1992 to help them import food and medical products. This Council decision was amended in 2000 to extend it to Tajikistan.

Following the establishment of the European Neighbourhood Policy (ENP) in 2004, support for the Eastern ENP economies has risen, accounting for around two-thirds of new MFA committed since then. By contrast, new operations in the Mediterranean neighbours were limited to the one for Lebanon approved in 2007. This partly reflected the relative resilience of the Mediterranean region to the global crisis of 2008-09 and the fact that these countries did not in general have recourse to financial support from the IMF.

Chart 2: Regional distribution of commitments, 1990-2010



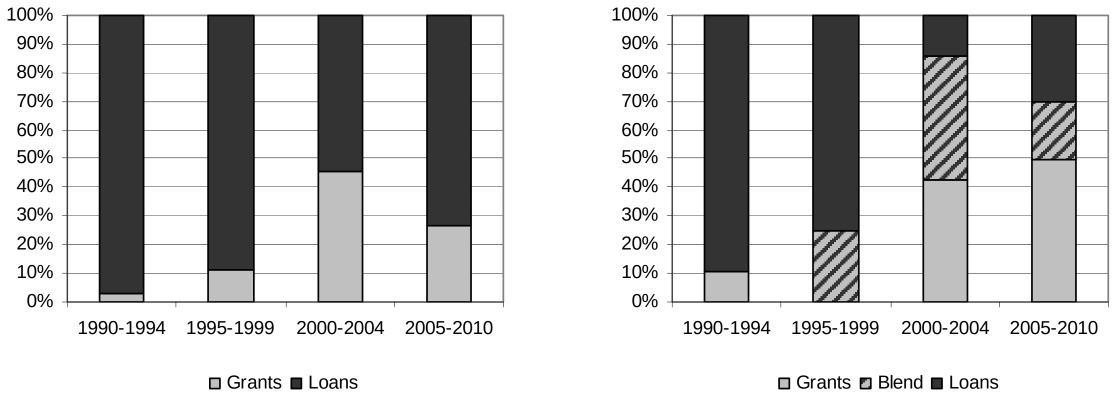
Source: European Commission, Annual Reports on Macro-financial assistance

While only a modest amount of MFA assistance was approved between 2004 and 2008 (EUR 234 million), reflecting a relatively benign global economic climate, the global crisis has resulted in a resurgence of assistance to Eastern neighbours and Western Balkan countries, which have been particularly hard hit by the crisis. As countries have run into balance of payments difficulties, the amount of new MFA committed rose to EUR 446 million in 2009 and EUR 590 million in 2010, underlining its continued importance as a crisis instrument. The operations approved in 2010 include a EUR 500 million loan for the Ukraine, the largest operation since 1990, to help the country overcome the impact of the crisis and bolster structural reform efforts.

In terms of its financial composition, during the 1990s, around 95% of MFA support was in the form of loans, while between 2000 and 2004 nearly half of all support was in grants (see Chart 3). This shift reflected in part the increased number of operations in the Balkans, where many countries had a very weak repayment capacity. During the recent resurgence in MFA support, resulting from the global economic crisis and its aftermath, loan financing has risen again, in particular as a proportion of all MFA commitments.[4] This includes substantial loans to Balkan countries (Serbia and Bosnia-Herzegovina), whose debt servicing capacity has strengthened significantly since the initial MFA operations in the region.

[4] The recovery in loan financing is less pronounced when measured as a percentage of the number of MFA operations, reflecting the fact that grant operations have tended to be smaller in volume.

Chart 3: Percentage of loans and grants, 1990-2010
by volume and number of operations (commitments)



Source: European Commission, Annual Reports on Macro-Financial Assistance

3.3. The legal basis for MFA

3.3.1. Before the entry into force of the Lisbon Treaty

Before the entry into force of the Lisbon Treaty, MFA was granted on a case-by-case basis through individual decisions of the Council on proposals by the Commission, after a non-binding consultation of the European Parliament. While Article 181a, introduced to the EC Treaty by the Treaty of Nice, gave competence to the Council – through qualified majority on a proposal by the Commission and after consulting the European Parliament – to adopt decisions necessary for carrying out "economic, financial and technical cooperation measures with third countries", balance-of-payments assistance such as MFA was explicitly excluded from the scope of this article by Declaration No. 10 of Member States' governments annexed to the treaty.

Instead, Article 308 of the EC Treaty served as a legal basis for the Community's MFA decisions prior to the Lisbon Treaty. This article enabled the EU institutions to act in all those areas for which the treaties did not confer specific powers on them, but in which there was a need to act in order to attain one of the objectives of the Community. The main practical difference between the use of Article 308 as opposed to Article 181a was the requirement of unanimity in the Council under Article 308 (both articles conferred only a consultative function on the European Parliament).

Prior to the entry into force of the Lisbon Treaty, the Economic and Financial Committee (EFC), which reports to the Ecofin Council, played an advisory role to the Commission in the preparation of MFA operations, as well as in their implementation. In particular, it was consulted by the Commission on the draft Memorandum of Understanding including the policy conditionality of operations and on their disbursements.

3.3.2. Changes introduced by the Lisbon Treaty

Since the entry into force of the Treaty on the Functioning of the European Union (Lisbon Treaty; TFEU) on 1 December 2009, the legal basis for MFA has changed. In particular, the use of Article 352 TFEU (which replaces the old Article 308) is no longer necessary or possible, as the Lisbon Treaty amended the preceding treaties in such a way that MFA is now specifically covered. The following articles are of relevance in this context:

- Article 212 TFEU foresees that economic, financial and technical cooperation measures are adopted by the Council and the Parliament on a proposal from the Commission, in accordance with the ordinary legislative procedure (co-decision, as per Article 294 TFEU). More specifically, this Article 212 TFEU (which is the successor to the old Article 181a) includes an explicit reference to financial assistance to third countries other than developing countries[5].

- Article 213 TFEU states that "When the situation in a third country requires urgent financial assistance from the Union, the Council shall adopt the necessary decisions on a proposal from the Commission." Council decisions on the basis of Article 213 TFEU are adopted by qualified majority (Article 293 TFEU), except where the Council decides to amend the Commission's original proposal, in which case unanimity is required. The procedure does not involve the Parliament in co-decision. However, the legal services of both the Council and the Commission[6] concur in their view that Article 213 TFEU should not be used as the regular legal basis for MFA, even though MFA is by its nature an instrument of urgency. Its use must be exceptional and fully justified in an objective manner with reference to the situation in the beneficiary country concerned.

Once approved by the co-legislators, MFA decisions belong to the category of legally binding acts that need to be implemented uniformly and hence centrally since they use financing from the EU budget. In accordance with Article 291 TFEU, Paragraph 2, the power to implement MFA operations should therefore be conferred on the Commission, albeit with the co-legislators laying down in advance the mechanisms for control by Member States of the Commission's implementation. A regulation setting the general principles for conferring such implementing powers on the Commission under Article 291 TFEU was adopted by the European Parliament and the Council on 14 February 2011 and entered into force on 1 March 2011.[7] Prior to this date, the comitology rules as per Council Decision 1999/468/EC of 28 June 1999[8], laying down the procedures for the exercise of implementing powers conferred on the Commission, governed the oversight of the Commission's implementation of MFA decisions.

Since the entry into force of the Lisbon Treaty, two MFA decisions have been approved (for Ukraine and Moldova) – both of them before the entry into force of the new comitology rules.

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5 The basis for the Union's development cooperation is laid down in Articles 208-211 TFEU. Thus, Article 209 may serve as the legal basis for MFA when a developing country is the beneficiary. However, it should be noted that the treaty does not provide a definition as to which countries should count as developing countries.

6 "Macro-Financial Assistance to Third Countries – Legal Basis", Opinion of the Legal Service of the Council of the European Union to the Financial Counsellors Working Party, 5703/10, 3 February 2010; and "Analysis of the legal basis of macro-financial assistance following the entry into force of the Lisbon Treaty", Commission's staff working document of 19 February 2010 (see Annex 3).

7 Regulation (EU) 182/2011 of the European Parliament and of the Council laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (OJ L 55, 28.2.2011, p. 13), which replaces Council Decision 1999/468/EC.

8 As amended by Council Decision 2006/512/EC.

In both cases, co-legislators agreed to use the advisory procedure[9] for the adoption of the Memorandum of Understanding (MoU) laying down the policy measures to be taken by the beneficiary country. However, the Council declared that, in the context of the general review of comitology rules, its acceptance of the advisory procedure for MoU should not be seen as setting a precedent for future legislative proposals on MFA.

3.4. The Genval criteria

The "Genval criteria" originate from the conclusions of the informal ECOFIN Council of 9 October 1993 regarding the principles that should govern EU balance-of-payments assistance to third countries. They were revised on 6 April 1995 and on 8 October 2002, when they were adopted as formal ECOFIN Council conclusions, accompanied by a letter from the President of the Council to the President of the Commission concerning notably MFA's geographical delimitation. They were last reviewed in March 2006, when the EFC prepared a report to EU Finance Ministers, which re-affirmed the Genval criteria while clarifying some aspects of them.

The Genval criteria have provided the political framework that has guided MFA proposals by the Commission and the corresponding ECOFIN deliberations. However, they are not legally binding rules formally constraining the Commission's right of initiative or the Budgetary Authority with regard to individual MFA decisions.

The Genval criteria, as contained in the Council conclusions and the aforementioned letter of the Presidency of 2002, are described below.[10]

Exceptionality

MFA is exceptional in nature. It is mobilised on a case-by-case basis to help the recipient country deal with serious short-term balance-of-payments or budget difficulties in conjunction with, and as a complement to, financial support for the country from the IFIs. The assistance underpins the implementation of strong adjustment and structural reform measures in the recipient country designed to remedy these short-term difficulties. It is to be discontinued once the external financial situation of the country has returned to a sustainable path to the extent that the beneficiary can rely solely on capital inflows from the IFIs and/or private sources. At this point, regular EU cooperation and assistance instruments are meant to take over.

Thus, unlike other EU financial instruments with macroeconomic objectives (notably the direct budget support provided under the Instrument for Pre-Accession, the European Neighbourhood and Partnership Instrument and the Development Cooperation Instrument), MFA neither provides regular financial support, nor has as its primary aim to support the economic and social development of the recipient countries. For this reason, MFA does not feature among the regular instruments of EU financial cooperation with third countries, but it is one of three crisis instruments (alongside Humanitarian Aid and the Instrument for Stability).

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9 In practice, Member States have tended to appoint as representatives for the advisory committee their EFC Alternates, who have expertise in MFA operations.

10 Both documents are shown in full in Annex 4.

Geographical delimitation

MFA is in principle reserved for third countries with close political and economic links to the EU, taking into account especially their geographical proximity and the EU's economic, commercial and political interests.

According to the letter from the President of the Council to the President of the Commission dated 8 October 2002, this is meant to cover two groups of countries:

- The first group includes both *candidate countries*[11] and *potential candidate countries*[12] (countries with which an EU Stabilisation and Association Agreement is in force or expected to come into force).

- The second group includes the *European countries of the CIS*[13] and the countries concerned by the Barcelona process (i.e. countries that have signed, or are expected to sign, Euro-Mediterranean Association Agreements)[14].

Other third countries not covered by this second group may in exceptional and duly justified circumstances also become eligible on comparable terms. This has happened already a number of operations have been approved in favour of countries in the Southern Caucasus and Central Asia.

Political pre-conditions

In addition to being geographically close to the EU, a potential recipient country must, in order to be eligible for MFA, fulfil certain political pre-conditions in line with the EU's fundamental values. In particular, it must have in place effective democratic institutions and mechanisms, including multi-party parliamentary systems, and respect human rights and the rule of law.

Complementarity and burden sharing

MFA operations are contingent on the existence of an IMF-supported programme in the recipient country entailing the use of IMF funds. Furthermore, the satisfactory implementation of the IMF programme is a prerequisite for each MFA disbursement. This recognises the role assigned to the IMF as the main provider of macroeconomic assistance to countries undergoing serious balance-of-payments difficulties.

Complementarity is also included in the Genval criteria with a view to ensuring an appropriate financial burden sharing between the EU and other donors. In the letter of 2002 to the Commission, the Council defined a ceiling for the EU's contribution of 60% of the

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11 Currently: Croatia, Iceland, the Former Yugoslav Republic of Macedonia, Montenegro and Turkey.

12 Currently: Albania, Bosnia and Herzegovina, Kosovo (under United Nations Security Council Resolution No. 1244) and Serbia.

13 Belarus, Moldova and Ukraine.

14 The Barcelona process, launched by the EU in 1995, included 11 non-EU countries (Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia and Turkey, some of which were at the time also eligible for MFA by virtue of being EU candidate countries) and the Occupied Palestinian Territories. In 2008, the Barcelona process was replaced by the Union for the Mediterranean initiative.

country's residual external financing gap (i.e. after the support expected from the IFIs) for candidate and potential candidate countries and of one-third of the residual external financing gap for other countries.

Finally, complementarity helps to ensure the consistency of approach towards the recipient country by the international community. The IMF programme, along with any programmes of other IFIs (notably those of the World Bank's policy-based loans), provides a framework for the adjustment path that is being supported by external financing from official donors or creditors, including the EU.

Conditionality

As noted, the launch of any MFA operation is conditional on the country having an IMF-supported programme in place that entails the use of IMF funds. In addition, the Commission, on behalf of the EU, agrees with the recipient country on a separate set of conditions. These conditions are laid down in a Memorandum of Understanding (MoU). In this context, coordination between the EU and the IFIs on their respective conditions helps to avoid overlaps (or outright contradictions) between the performance criteria of the different donors or creditors; instead, the conditions of the different donors are designed to reinforce each other. By avoiding overlaps, coordination also contributes to reducing the administrative burden on the recipient's authorities in implementing their adjustment programme and drawing on the available external support.

Compliance by the beneficiary country with the conditions laid down in its MoU with the EU is verified by the Commission ahead of the release of each tranche of the assistance. In case of failure to comply, the disbursement can be suspended until the conditions are met.

Financial discipline

When MFA takes the form of a grant, the funds come from the EU budget. The amounts provided as MFA have to be consistent with the ceilings established for the relevant budget appropriations in the EU's multi-annual Financial Perspectives.

When it takes the form of a loan, the Commission, on behalf of the EU, issues a bond in the capital markets that matches the financial terms agreed with the beneficiary country and on-lends the proceeds immediately. In order to cover the EU budget against risks related to default or payment delays on MFA loans by beneficiary countries, the EU bond is guaranteed by the Guarantee Fund established in 1994 (Council Regulation 2728/94 of 31 October 1994[15]). The level of provisioning currently in force stands at 9% of the outstanding amount, reflecting the likelihood of default across the whole portfolio of loans covered by the Fund.

The Fund is provisioned from the corresponding EU budget line. The amounts provided in the form of MFA loans therefore have to be consistent with the ceilings established within the multi-annual Financial Perspectives (Category 4) for the reserve for guarantees for external

[15] This regulation was subsequently amended several times. Its amendments were eventually codified in Regulation 480/2009, which repealed Council Regulation 2728/94.

actions[16]. In the Financial Perspective 2007-2013, an annual amount of up to EUR 200 million has been foreseen for the provisioning of the Fund.

3.5. The experience with policy conditionality

Design of MFA conditionality

MFA conditionality consists of a set of economic policy measures agreed between the Commission, on behalf of the EU, and the beneficiary country, laid down in a MoU. These policy measures aim at contributing to one or several of the following overarching objectives:

- restoring balance of payments and fiscal sustainability;
- raising the rate of potential growth over the medium term;
- fostering economic and financial integration and regulatory convergence with the EU, notably by supporting the economic priorities of the pre-accession agreements and the ENP Action Plans; and
- improving economic governance, in particular by strengthening public finance management (PFM).

The policy measures contained in the MoU complement those included in the IMF and World Bank policy-based operations. In particular, the existence of an IMF-supported reform programme enables the EU to focus its conditions on areas relevant to EU priorities, rather than having to cover the whole range of macroeconomic performance criteria. In practice, the EU has thus tended to focus on structural reform measures aimed at increasing sustainable growth, restoring a sound balance of payments position and improving economic governance, as well as on developing a closer economic and financial integration between the beneficiary country and the EU, in line with ENP Action Plans, existing bilateral trade and partnership or association agreements, and relevant EU cooperation activities in the country.

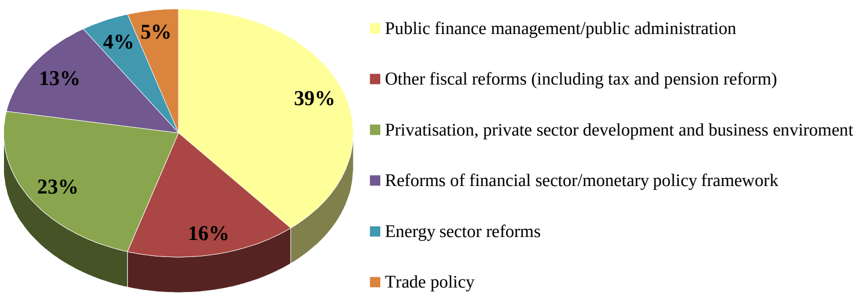
By contributing to create an appropriate overall framework for macroeconomic stability and structural reform, MFA conditionality can improve the effectiveness of the programmes supported by other EU external financial instruments, in particular projects financed under the IPA and the ENPI. At the same time, some of the policy measures included in the Memoranda of Understanding of MFA operations are often supported by technical assistance provided by the EU through its regular cooperation assistance instruments, as well as by the sectoral actions identified under direct budgetary support operations. It should also be noted that the policy conditions in the area of PFM draw on the recommendations made in the context of the Operational Assessments of financial and administrative circuits conducted by the Commission prior to each MFA operation (see next section).

[16] The ceilings apply to all the operations guaranteed by the Guarantee Fund, which also include the loans granted by the EIB under its external lending mandate and the EURATOM loans outside the EU. Only part of the EU budget's reserve for guarantees for external actions is therefore available for MFA loans.

Conditionality by type

The policy conditions agreed between the Commission and beneficiary countries in the context of MFA operations have tended to cover reforms in the fiscal area, including PFM, reforms of the financial sector and monetary policy framework; privatisation and private sector development. Measures in the area of trade and energy sector reform have also been relatively frequent, though less so. Chart 5 summarises the composition of policy conditionality by main area in the MFA operations implemented during the period 2000-09.

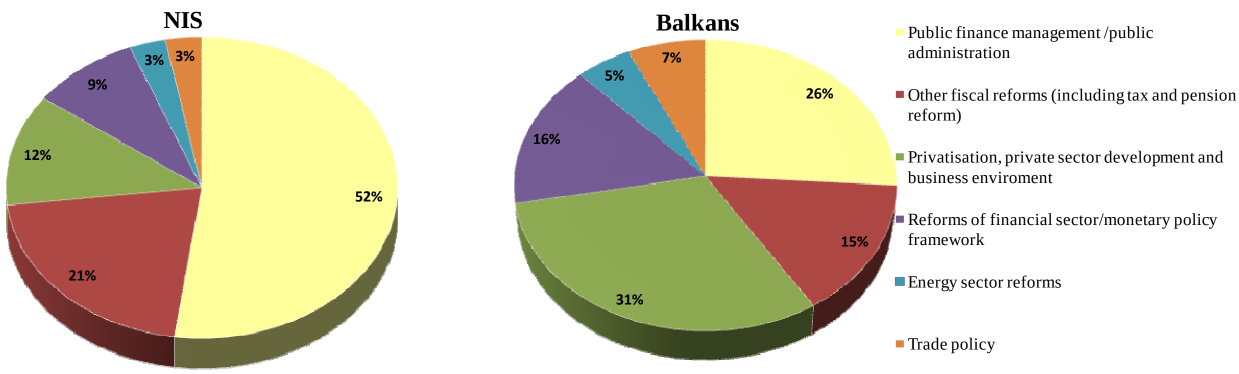
Chart 5: Conditionality MFA operations by type, 2000-2009



Source: Commission staff estimates based on ex-post evaluation of the MFA operations

Conditionality has tended to vary depending on the institutional ties of the recipient country with the EU. Candidate and potential candidate countries had a larger share of private sector development related measures. They have also tended to have longer-term oriented conditionality. This reflected the longer horizon of the EU involvement with them and the perspective of their potential EU membership, which should provide an opportunity to continue the implementation of structural measures. This is especially true for certain legal reforms (which cut across different areas of conditionality) in the Balkan countries, which have to be completed on the way to EU membership anyway. By contrast, MFA conditionality for the Newly Independent States (NIS) was dominated by operational PFM measures, many of which could be implemented within a shorter period of time. This also reflected the significant weaknesses in PFM detected in many of the NIS.

Chart 6: Conditionality in MFA operations by region and type, 2000-2009



Source: Commission staff estimates based on ex-post evaluation of the MFA operations

Evolution of MFA conditionality over the last decade

Over the last decade, the number of policy conditions has been somewhat trimmed down in order to increase the focus on priority measures and reduce the implementation burden on the recipient country. Chart 7 shows the evolution of the average number of policy conditions included in MFA operations since 1999, distinguishing the candidate and potential candidate countries from the NIS countries. It shows that the average number of conditions has been approximately halved and is now limited to about ten in new MFA operations. It also shows that conditionality has tended to be more detailed for the candidate and potential candidate countries, partly reflecting the more ambitious approach related to the EU accession perspective.

This trend towards streamlining conditionality has also been evident in the IMF and World Bank programmes. This process was reinforced by the global recession, because IFIs had to concentrate on helping countries to deal with the most pressing issues, rather than embarking on complex structural reforms. The IMF in particular has tried to limit its involvement in structural conditionality in an effort to go back to its traditional macroeconomic stabilisation focus.

A second trend observed in the conditionality of MFA is an increased emphasis on PFM-related conditions. This reflects the increased importance attached to economic governance in the structural reform strategy supported by the EU, as well as the need to ensure adequate fiduciary and administrative circuits so as to limit the risk of a misuse of the assistance, as recommended by the European Court of Auditors (ECA) in its Special Report of 2002 on MFA (see Section 3.7.1). It also reflects the increased share of operations in countries (notably among the NIS countries) with significant weaknesses in PFM. Since 2004, the key recommendations of the Operational Assessments of financial and administrative circuits of beneficiary countries conducted by the Commission (see Section 3.6) have been included in the conditionality of MFA operations.

Effectiveness and implementation of MFA conditionality

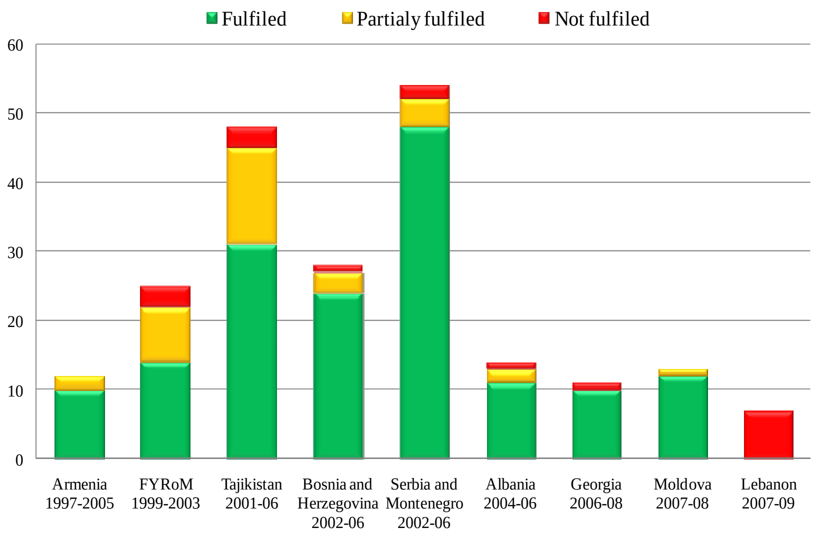
The formal implementation of conditionality by the recipient countries has been relatively strong. Almost 80% of all conditions included in the MoU of the MFA operations for which ex-post evaluations were conducted between 2004 and 2008 were formally implemented[17]. Out of 186 policy conditions reviewed by these ex-post evaluations, only 15 were not fulfilled and 26 were partially fulfilled. On the other hand, and as noted in the meta-evaluation of MFA of 2009, actual progress with the targeted structural reform processes has not always been as foreseen even when the policy conditions were formally satisfied.

There is evidence that MFA conditionality linked to PFM, public administration reform and financial sector reform had led to the most tangible progress. This may in part reflect the fact that these reforms tend to be politically easier to implement than other reforms that have direct effects on the population at large (such as tax or pension reforms). Also, MFA implementation analysis showed that MFA conditionality tended to be more effective when: (i) it was consistent with IMF conditionality; (ii) secured strong ownership of the recipient

[17] See “Meta-Evaluation of Macro-Financial Assistance Operations, 2004-2008, Final Report”, *op. cit.*

country; (iii) was aligned with the other EU programs implemented in the country; and (iv) was supported by technical assistance and advice[18].

Chart 7: Fulfilment of the MFA conditionality criteria (in numbers)



Source: Commission staff estimates based on ex-post evaluation of the MFA operations

3.6. The Operational Assessments

Since 2004, the Commission carries out so-called Operational Assessments to obtain reasonable assurances on the functioning of administrative procedures and financial circuits of the recipient countries before disbursing EU funds in the context of MFA operations.[19] Such assurances are required by the Financial Regulation related to the EU budget. They were also emphasized in the recommendations issued by the European Court of Auditors in its Special Report of 2002 on MFA (see Section 3.7.2). In addition, the Commission's Operational Assessments play a supportive role in the area of PFM reform in the recipient country, notably in the fields of public internal financial control and external audit.

The most critical recommendations made in the Operational Assessments are considered as prior actions that have to be fulfilled before disbursement can be made. Some of the key weaknesses detected in Operational Assessments are reflected in the policy conditionality of MFA operations. Selective follow-up inspections are undertaken to assess the improvements implemented by the national administrations. Operational Assessment typically focus on the organisation of the central bank and more specifically on the management of accounts receiving EU funds. Also, the existing procedures of the ministries of finance are assessed in areas such as budgetary processes, the functioning of the treasury and accounting departments, internal audit and financial control, human resources and IT units. In addition, Operational Assessments check whether the country has an independent and capable external audit office. In the most recent Operational Assessments, an analysis of existing procedures in the public procurement agencies was also undertaken. The conclusions of the Operational

18 "Meta-Evaluation of Macro-Financial Assistance Operations, 2004-2008, Final Report", *op. cit.*

19 Since 2004, a total of nine operational assessments were completed in countries benefiting from MFA and follow-up missions have been undertaken in most of them.

Assessments are communicated to the national authorities, who have the opportunity to comment on the analysis and recommendations contained in the reports.

The complementary fiduciary information available in reports already issued by the IFIs is also taken in to account. These include, in particular: the Public Expenditure and Financial Accountability (PEFA) studies, developed by the World Bank in cooperation with the Commission and bilateral donors, which focus, as the Commission's Operational Assessments, on PFM issues.[20]

3.7. Overall Assessment of Results

3.7.1. Findings of ex-post evaluations

To assess the impact of MFA, the Commission conducts ex-post evaluations. Since 2004, ten evaluations have been carried out by external consultants. In addition to the country specific evaluations, a meta-evaluation of MFA operations was also carried out in 2009, which reviewed the previous seven individual evaluations of individual MFA operations conducted between 2004 and 2008 and drew some general conclusions[21].

All country-specific evaluations use a methodology that describes the objectives of the MFA, identifies its overall effects on short-term macroeconomic stabilisation and structural reform, and compares the results with a counterfactual scenario that assumes the absence of the MFA in question. The longer-term effects on the sustainability of the recipient country's external financial situation are also assessed. The evaluators base their work on a variety of methods, including document analysis, interviews with key officials and macroeconomic and econometric analysis.

<u>Meta-evaluation</u>

The meta-evaluation carried out in 2009 found that in general MFA operations had a positive (though not uniform) impact on the implementation of structural reforms in beneficiary countries, particularly for public finance and financial sector reforms. In addition to a positive operational effect on the reform process, a political reinforcing effect was detected, particularly in the countries participating in the EU Stabilisation and Association Process, i.e. the Western Balkans. The structural reforms which were implemented in connection to MFA were also found to have had a positive impact on long-term potential growth. In addition to meeting immediate objectives, MFA operations brought certain indirect benefits. For example, fiscal reforms helped raise tax revenue, financial sector reforms increased the capitalisation of banking institutions and market reforms contributed to greater business activity. The meta-evaluation also found that, in some cases, MFA operations enabled social expenditure to be maintained by helping to reduce the cost of foreign debt servicing.

On the other hand, it was found that, due to the modest scale of MFA operations (notably when compared with those of the Bretton Woods institutions), relative to the size of the economy of beneficiary countries, the impact of all MFA operations on macroeconomic

[20] Other relevant assessments produced by the IFIs include Reports on the Observance of Standards and Codes (ROSCs) produced by the World Bank and the IMF, and the World Bank's Country Financial Accountability Assessments (CFAA).

[21] "Meta-Evaluation of Macro-Financial Assistance Operations (2004-2008). Final Report", *op. cit.*

stability was less significant. The fact that several beneficiary countries had to request again international support packages during the 2008-2009 global financial crisis suggested that the positive effect of MFA on balance of payments sustainability may have not been sufficiently durable. At the same time, the meta- evaluation argued that in the absence of MFA support the impact of the global financial crisis on beneficiary countries would have been more severe. Also, it found that a significant benefit of MFA had been the increased political involvement of the EU.

In sum, MFA has had a positive impact on the advance of reforms in beneficiary countries, but its macroeconomic impact has been less tangible, also because MFA is most of the time part of a wider assistance package including the multilateral finance institutions.

Furthermore, the meta-evaluation pointed at the frequent delays in the decision-making process of MFA, which it described as an important shortcoming of the instrument, notably when compared with the interventions of the IFIs. It found that, on average, there is a time lag of 12 to 18 months between the onset of a crisis and the first MFA disbursement. IMF programmes, by contrast, can become operational just in a couple of months. The time lag of MFA has to be minimised to make MFA more efficient as an instrument for alleviating balance of payments distress.

Therefore, the meta-evaluation recommended creating appropriate procedures and guidelines to ensure that the EU provides MFA quickly, especially where circumstances call for immediate action. In this respect, the adoption of a Framework Regulation for MFA was identified as a key recommendation.

3.7.2. Reports or opinions from other institutions

2002 Special Report of the European Court of Auditors on MFA

In 2002, the ECA produced a special report on MFA and the Structural Adjustment Facilities (SAF) used at the time by the EU in the Mediterranean countries.[22] The main conclusions of this report called on the Commission to provide a clearer definition of the value added of the EU contribution and additional conditionality vis-à-vis those of the IFIs. They also pointed at the priority that should be given to carrying out ex-post evaluations of MFA. Finally, they stressed the need to strengthen and closely monitor the financial management capacities of the beneficiary countries. In response, an action plan was formulated by the Commission that included the following elements: (i) systematic implementation of ex-ante evaluation for each MFA operation to assess the residual financial needs of the beneficiary countries and the complementarity aspects with programmes of the Bretton Woods Institutions; (ii) systematic ex-post evaluation of MFA operations (carried out since 2004) in the context of a framework contract with external consultants; and (iii) completion of Operational Assessments of the reliability of the relevant financial circuits and procedures in the beneficiary countries before any MFA disbursement[23]. In addition, provisions on fraud prevention are now included in

[22] Special Report No 1/2002 of 8 March 2002 concerning macro-financial assistance (MFA) to third countries and structural adjustment facilities (SAF) in the Mediterranean countries.

[23] The main features of the Operational Assessment and ex-post evaluation processes have already been discussed above.

each Commission proposal for Council decision and the MoU attached to each MFA operation now contains an audit and recovery clause.

2003 Resolution of the European Parliament on MFA

In June 2003, the European Parliament adopted a resolution on MFA (Belder report).[24] The resolution stressed as the main shortcomings of the MFA instrument its lengthy decision-making process and the lack of a transparent legal basis. The resolution regretted the decision-making procedure based on ad hoc decisions taken by the Council on a Commission proposal after consultation of the Parliament, noting that "from the date of the inception of MFA to the first disbursement it usually takes six months and final disbursement possibly two years".

At the same time, the resolution acknowledged that "macro-financial assistance has become an important emergency instrument", underlining that "lending operations to third countries can be an effective instrument with limited cost to the general budget of the Community" while "the amount of defaults has been relative low in comparison to the overall lending capacity".

The Parliament called on the Commission to consider submitting a proposal for an appropriate legal instrument for MFA. While it considered that the Council conclusions of 8 October 2002 on MFA (the Genval criteria) were useful and proper and could be stated as key criteria for granting MFA to third countries, it called for certain modifications or clarifications in the context of a framework regulation for MFA.

Discussions at the Council

As noted above, the EFC has reviewed the Genval criteria and the working of MFA more generally on a number of occasions since the first version of the Genval criteria were adopted in 1993, without fundamentally changing the nature of the instrument. In its 2002 conclusions on MFA, the ECOFIN Council considered that the existing decision-making procedures were broadly appropriate. At the same time, it acknowledged that the procedures for MFA "are relatively lengthy and normally several months elapse from the Commission proposal until the final disbursement".

3.8. A slow decision-making process

An analysis of the 20 MFA operations approved between 2000 and 2009 (see Annex 5), shows that between the official request for MFA of a beneficiary country and the adoption of the decision of the Council an average of more than one year elapsed, with this decision-making gap having ranged between 118 days and about three years.[25]

This decision-making gap can be divided into two components:

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[24] OJ C 68 E/86, 18/03/2004. The Resolution is reproduced as Annex 6 of this document.

[25] The two operations adopted in 2010 under the co-decision procedure introduced by the Lisbon Treaty (for Ukraine and Moldova) have not been included in the sample. The implications of the introduction of the Lisbon Treaty for the decision making gap are discussed in the following section.

(i) First, there is *the time that elapses between the reception of the request for assistance from the beneficiary country and the adoption of the decision by the Commission*. This entails, first of all, the technical assessment by the Commission of the request, including the estimation, in cooperation with the IMF, of the residual financing gap, and the determination of other donors' contributions. During this period, the Commission also consults the EFC on the proposal. The period can further be influenced by the time taken by the country's government to reach agreement with the IMF on an adjustment programme or the organisation of international donors' conferences. For the sample of operations examined, this preparatory phase, which concludes with the formal adoption of the proposal by Commission, lasted on average 294 days (just under 10 months).

(ii) Second, there is *the time required by the legislative decision-making process*, i.e. the time that elapses between the adoption of an MFA proposal by the Commission and its final adoption by the legislator. Annex 5 shows that this phase of MFA decisions lasted, for the operations examined, on average 106 days (about 3.5 months).

This lengthy decision-making process has also contributed to lags between the approval of the IMF financial arrangement that the EU's MFA was meant to complement and the approval of the MFA itself, which has somewhat complicated coordination with the IMF, has tended to limit the EU's influence in the design of IMF programmes and, overall, has been detrimental to the effectiveness of MFA operations.

The application of the ordinary legislative process under the TFEU of co-decision by the Parliament and the Council is likely to result in a further lengthening of the decision-making process because it involves the intervention of the two co-legislators – each with its specific procedures – for each individual MFA operation. For example, a decision to grant MFA to a country may require lengthy negotiations between the two co-legislators, e.g. two readings by Parliament and a conciliation procedure. There is a risk that the procedure under the Lisbon Treaty may further lengthen the decision-making process.

A factor that may further lengthen the decision-making process is the *scrutiny period for national parliaments* for all EU draft legislative acts as stipulated in the Lisbon Treaty. Pursuant to Article 6 of Protocol No. 2 to the TFEU (Application of the Principles of Subsidiarity and Proportionality), any national parliament or any chamber of a national parliament may, within eight weeks from the date of transmission of a draft legislative act, send to the Presidents of the European Parliament, the Council and the Commission a reasoned opinion stating why it considers that the draft in question does not comply with the principle of subsidiarity.

4. KEY FEATURES OF THE PROPOSED FRAMEWORK REGULATION

Section 3 has shown that, although the MFA instrument has proved useful in promoting macroeconomic stability and reforms in the EU's neighbourhood, its effectiveness has been hampered by its slow decision-making procedures. There is also a case for making its rules more transparent by enshrining them in a legal act, while updating and clarifying some of them. This section describes the main elements of the proposed Framework Regulation for MFA, which is aimed at addressing these shortcomings.

4.1. A more efficient decision-making process: the role of the examination committee

Under the proposed Framework Regulation for MFA, the Commission would be able to adopt country-specific MFA decisions under the supervision of a committee consisting of Member State representatives and chaired by the Commission ("the Committee" hereafter). MFA decisions would be implementing acts in the sense of Article 291 TFEU. As MFA decisions have substantial budgetary implications, the Committee would act in accordance with the examination procedure, as established by the new comitology rules.[26] The procedure for adopting MFA decisions would be as follows:

The Commission would submit to the Committee draft Commission decisions granting MFA to a third country. In case of a positive opinion by the Committee (adopted by a qualified majority of the representatives of the Member States[27]) on the proposed decisions, the Commission would adopt them. In case of a negative opinion of the Committee, the Commission would not adopt them, although it could refer them to the appeal committee or present amended drafts. Finally, if no opinion was delivered (e.g. because a qualified majority could not be found either in favour or against), the Commission could still adopt the draft decisions, unless a simple majority of the Committee's members opposed them.

The Parliament and the Council would have access to the documents concerning the proceedings of the Committee through the register's procedure and would have the right to challenge draft implementing acts submitted by the Commission on the grounds that these go beyond the implementing powers provided for in the Framework Regulation.

This procedure for the approval of decisions, based on the conferral of decision-making powers on the Commission under the control of an examination committee, would allow for a swifter decision-making process compared to the case-by-case approach applied in the past. It is similar to the procedure already existing for other external financing instruments. The proposed Framework Regulation would therefore align the decision-making process for MFA with that applicable to other external instruments.

4.2. Implementation of MFA

The decision to provide MFA, taken on the basis of the implementing powers stemming from Article 291 TFEU, would continue to mention the availability period and the general conditions attached to the EU's assistance, including the existence of an operational IMF programme involving the use of IMF resources. The decision would also specify the maximum amount of the grant or loan and the maximum number of instalments and, for a loan, its maximum maturity.

Following the approval of the decision granting MFA, the Commission would implement the MFA operation. In particular, akin to the existing practice, the Commission would be authorised to negotiate with the beneficiary country a Memorandum of Understanding (MoU) laying down the policy measures associated with the assistance, which must be consistent with the beneficiary country's existing EU partnership, cooperation or association agreements

[26] Regulation (EU) 182/2011, *op. cit.*

[27] The Commission (chair) does not have the right to vote.

and with its IMF programme. Following agreement with the authorities of the beneficiary country on a MoU, the Commission could adopt it subject to the opinion of a committee of Member State representatives. Unlike for the adoption of the decision to provide MFA, this committee would now act in accordance with the advisory procedure (rather than the examination procedure), since the Memorandum of Understanding has no budgetary implications for the EU beyond those of the basic act, while its implications for the beneficiary country would be in line with those of programmes previously agreed with the EU, such as within the framework of the European Neighbourhood Policy and the Stabilisation and Accession Process. Information and scrutiny rights of the Parliament and the Council would be the same as for the committee proceedings under the examination procedure.

The Commission would also be empowered to agree with the beneficiary country on the financial terms of the operation, to be specified in a Loan or Grant Agreement. Furthermore, it would inform the European Parliament and the Council of developments in country-specific assistance and provide them with the relevant documents.

As it is currently the case, once a Memorandum of Understanding has been adopted and – along with the accompanying Loan or Grant Agreement – entered into force, the assistance would be implemented by the Commission under direct centralised management, with the support of the delegations of the EU. This would include verification of compliance with the policy conditions by the beneficiary country and the ensuing release of disbursements, as well as appropriate fraud proofing provisions to protect the EU's financial interests. Budget commitments would be made on the basis of decisions taken by the Commission. In cases when these extend over a number of financial years, they could be split into annual instalments.

MFA would continue to be disbursed to the central bank of the beneficiary country in successive instalments, conditional upon the fulfilment of the conditions referred to in the Memorandum of Understanding and which the Commission would verify at regular intervals. The European Parliament and the Council would be kept informed of any developments related to the disbursement of the assistance.

Consistent with the current practice, operational assessments of the financial circuits and procedures in the bodies in charge of managing the assistance in the beneficiary countries would be conducted prior to the first disbursement. Detailed ex-post evaluations of MFA operations would continue to be provided within two years after their closing date. In addition, the Commission would continue to submit to the Parliament and the Council an annual report on the implementation of all ongoing MFA operations, including an evaluation of the implementation of each decision in the previous year.

4.3. Reaffirming and updating the Genval criteria

As presented in Section 3.4, the Genval criteria set by the ECOFIN Council in October 2002 spell out five principles on which MFA operations should be based. In addition, the letter from the President of the Council to the President of the Commission accompanying the Council conclusions provides more detailed guidelines regarding certain aspects of the instrument, notably its geographical scope. It is proposed to reaffirm and formalise the Genval criteria in the Framework Regulation. Where necessary, the proposed Regulation updates or clarifies certain criteria, but the scope of these changes is limited. The following section presents the proposed amendments, which concern the criteria on geographical delimitation, complementarity and financial discipline. The criteria on exceptionality, political pre-conditions and conditionality would remain unchanged.

Geographic delimitation

Two main groups of countries will continue to be eligible for MFA: the candidate and potential candidate countries remain priority countries for the assistance, while the countries and territories covered by the ENP[28] would also be eligible. The latter would now formally include Armenia, Azerbaijan and Georgia, two of which have already benefited from EU MFA. Making these countries eligible for MFA is motivated by the EU's overarching political, economic and strategic interests in stabilising the South Caucasus, which is also reflected in the inclusion of the region in the ENP. Other third countries could become eligible in exceptional and duly justified circumstances. These countries should be geographically close to the EU and entertain close political and economic links with it.

Complementarity and burden sharing

A prerequisite for the mobilisation of MFA will remain the existence of a significant residual external financing gap, identified in cooperation with the IMF and other multilateral financial institutions, over and above the resources provided by them in support of economic stabilisation and reform programmes. The amounts of the EU assistance will continue being decided, case-by-case, taking into account the estimated residual external financing gap, the intensity of EU relations with the beneficiary country, as well as the maximum potential contributions available from the IFIs and contributions from other donors and creditors – with a view to fair burden sharing.

However, it is proposed not to introduce explicit ceilings, as defined by the Council in 2002, for the share of the EU contribution to covering the residual financing gap. This reflects the Commission's past experience with these ceilings, which have been in some cases difficult to apply for two main reasons:

- the absence, or reduced scale, of participation of the main non-EU bilateral donors (notably the US and Japan) in covering the residual financing gaps in countries increasingly seen as the EU's "backyard";

- the technical difficulties in calculating residual financing gaps in an unambiguous way, in particular when there are significant differences in the reference periods used by the IMF on the one hand and the Commission on the other, as may be the case when some time has elapsed between the approval of the IMF programme and hat of the EU's MFA operation. There is also a considerable margin for error in forecasting balance-of-payments developments in general and private capital flows in particular, sometimes exacerbated by a lack of availability or reliability of recent and historical data.

Complementarity and synergies between MFA and other EU instruments of external financial support operating in the beneficiary countries will continue to be emphasised.

[28] Algeria, Armenia, Azerbaijan, Belarus, Egypt, Georgia, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, Occupied Palestinian Territories, Syria, Tunisia and Ukraine.

Financial discipline

As foreseen in the Genval criteria and in line with a discussion on the matter in the EFC in January 2011, it is proposed that MFA will, in principle, take the form of a medium/long-term loan, but can also take the form of a grant or a combination of loan and grant. In determining the appropriate form, the Commission will take into consideration various indicators covering the same two main areas of concern that the World Bank and the IMF emphasise when determining eligibility to their concessional arms (IDA and PRGT, respectively), namely:

- *The level of economic development of the beneficiary country*. In line with international practice, the main measure for this will be per capita income.[29] However, poverty ratios should also feature, as a way to take due account of the distribution of income in a country and its developmental and social challenges.[30]

- *The beneficiary country's debt burden and debt dynamics, as indicators also of its capacity for debt repayment.* The Commission will use a number of debt and debt service indicators (for both external and public debt). It will also draw on the Debt Sustainability Analyses (DSA) conducted jointly by the IMF and the Wold Bank, which are available on a systematic basis for low-income countries.[31]

When proposing a choice between grants and loans, or a combination of the two, the Commission will assess the beneficiary country against the different criteria presented above[32]. It will also take into account the treatment of the country by the IFIs, notably the classification of the country by the World Bank as IDA only, IBRD only or blend country and its eligibility or not for concessional IMF financing under the PRGT.

5. SUMMARY AND CONCLUSIONS

The purpose of the MFA instrument is to help countries resolve short-term balance of payments problems and stabilise public finances, and to encourage their implementation of structural reforms. MFA is provided on an exceptional and temporary basis, and based on strict conditionality. It is tied to adjustment and reform efforts to ensure that the economies of recipient countries are brought back to a sustainable path and improve their resilience to future macroeconomic shocks. MFA operations complement IMF adjustment programmes. These programmes must be on track, and the additional measures agreed between the EU and beneficiary countries must be implemented, for MFA funds to be disbursed. The assistance is ended as soon as a country's economy has been stabilised and placed on a sustainable path.

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[29] In particular, gross national income expressed in purchasing power parities or converted to US dollars through the World Bank's Atlas method, which is also used by the IMF and the OECD's Development Assistance Committee.

[30] For example, the countries of the South Caucasus (except oil-exporting Azerbaijan) feature a relatively high level of absolute poverty, even though they are lower middle income countries (rather than low income countries).

[31] The IMF also addresses the issue of debt sustainability in its reports on Article IV consultations for countries with capital market access; in doing so, it follows a slightly different methodological framework than in its DSA for low income countries.

[32] Annex 7 summarises how the countries that are in principle eligible for MFA are positioned in terms of some of these indicators.

Since the instrument was created in 1990, it has been used to assist 23 countries mainly bordering the EU. The experience with the instrument has been broadly positive. It has helped to bring stability to the recipient economies, proving also a useful instrument to foster their integration and regulatory convergence with the EU. Evaluations by external experts have detected a particularly positive effect in promoting public finance and financial sector reforms, although the impact on balance of payments and fiscal sustainability has been more modest.

However, the effectiveness of the instrument is constrained by its slow decision-making process. In contrast with other external financial instruments of the EU, MFA still lacks a Framework Regulation conferring implementing powers on the Commission. This has tended to result in long lags between the requests for MFA and the adoption of Decisions by the Council and between the approval of IMF programmes and that of the associated MFA operations. Moreover, the rules guiding MFA operations (the so-called Genval criteria), while useful, lack transparency and a formal, legally-binding status. Also, some of them need to be updated or clarified. The entry into force of the Lisbon Treaty, which puts MFA decisions under the ordinary legislative procedure (co-decision), risks lengthening further the decision-making lag. It also underlines the need to give to the Parliament, as co-legislator, ownership of the MFA rules by enshrining them in a basic legal instrument approved by both legislators.

In order to address these shortcomings, and following repeated requests by the European Parliament, as well as the results of the recent meta-evaluation of MFA operations, the European Commission is proposing the adoption of a Framework Regulation for MFA. The proposed Regulation involves an alternative, lighter, legislative procedure, which should help strengthen the responsiveness of the MFA instrument while ensuring that MFA operations meet all legal requirements. It makes the decision-making procedure for MFA comparable to that of other external relations instruments, in which the Commission is responsible for adopting individual financing decisions under the supervision of a committee of Member State representatives. This approach should considerably reduce the procedural burden associated with MFA operations and enable a swifter response in support of eligible countries with serious balance of payments problems, consistent with the emergency nature of MFA.

The proposed Framework Regulation also consolidates the Genval criteria in a formal legal instrument, while refining and updating some of them. This is consistent with the calls by the European Parliament to clarify these criteria and make them more transparent.

Ultimately, a more expeditious MFA instrument, with more transparent and better defined rules, should help increase its effectiveness. This should strengthen its contribution to creating a more stable EU neighbourhood and promoting economic reforms and integration with the EU in those countries. By improving the timeliness of MFA, it should also facilitate its coordination with, and the EU’s influence on, the programmes of multilateral financial institutions that it is meant to supplement. Finally, by supporting appropriate macroeconomic and reform frameworks, a more responsive and effective MFA instrument should contribute to the effectiveness of other EU financial instruments used in those countries.