Meta-evaluation of Macro-Financial Assistance Operations (2004 – 2008)

Annex to the Final Report

Specific Tender:

ECFIN/R/3/2008/030

Under Framework Contract No.

DG BUDG No BUDG06/PO/01/LOT 1

ABAC 101931

EPEC

2nd October 2009

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ANNEX I: WORKSHOP NOTES

1 NOTES AND DISCUSSION SUMMARIES FROM WORKSHOP 1 ON DESIGN AND IMPLEMENTATION OF MFAS

1.1 Introduction

This note summarises the key points discussed at the workshop held on 28th May 2009 in Brussels.

The workshop was organised as part of the meta-evaluation of Macro Financial Assistance (MFA) operations. The purpose of this workshop was to discuss:

- The key findings emerging from the meta-evaluation with respect to issues such as relevance, efficiency, effectiveness and impact of MFA operations; and,
- To draw out more general conclusions and recommendations regarding the design and implementation of future MFA operations.

The following discussion paper was circulated to all participants in advance of the workshop:

MFA Workshop 1 - Discussion Paper.pdf

1.2 Structure of this Note

The remainder of the note is structured as follows:

- Section 1.3 summarises the main points made by Mr Antonio de Lecea in his opening remarks and includes a copy of GHK's presentation on the findings of the meta-evaluation;
- Section 1.4 summarises the content of the open discussion that followed the introductory presentations; and,
- Section 1.5 presents a list of workshop participants.

1.3 Presentations

1.3.1 Overview of MFA operations by DG ECFIN

- MFA instrument is devised to help non-EU countries cope with a Balance of Payments (BoP) crisis. It is primarily a crisis instrument; but MFA is also used to support the structural reform process and long term development of recipient countries.
- MFA is used in conjunction with International Financial Institution (IFI) assistance/ operations. EU acts whenever a residual financing gap is identified.

- There are other EU instruments that have been specifically designed to support the long term growth and development efforts of third countries; MFA complements these instruments.

- Given its relatively small size, the MFA instrument cannot be expected to have a crucial or significant impact on the reform process of the recipient country; for example, MFA cannot realistically be used to solve problems such as corruption or have a significant impact on the privatisation process.

- MFA has both economic and political objectives – it is a way of showing that the EU cares about these countries; moreover, instability at its borders is not good for the EU.

- EU provides different levels of assistance via the MFA according to the geographical/ political importance of the recipient country.

- There are a number of institutional constraints that have a bearing on the design of MFAs:

  – Long gestation period due to the need to obtain unanimous Council approval for each MFA operation;

  – MFAs have to be endorsed by institutional structures within recipient countries; and

  – Long period of preparation and discussion.

- Issue of conditionality – it is important to have a common set of conditionalities (for the MFA and IFI operations) and to keep the number of conditionalities to a minimum; however, there are areas where the IFIs don't have a mandate (e.g. trade policy) and MFA's have a clear added value in these areas of reform. But where appropriate, the Commission tries to 'piggy back' on the conditions set by the IFIs.

- Background to the meta-evaluation:

  – The purpose of the meta-evaluation is to look at ex-post evaluation questions (e.g. efficiency, effectiveness, impact) in more detail;

  – MFA has been a relatively dormant instrument in recent years; it is now being revived in the current economic context;

  – The Commission is considering a new batch of MFA operations and does not wish to repeat past mistakes.

- One recurring idea is to introduce an MFA regulation – a regulation would provide a more stable framework for the design and implementation of MFAs, as opposed to the current practice of ad hoc decision making.

- A. de Lecea suggested that it would be of interest to the Commission if the meta-evaluation would also look into:

- The issue of sustainability against the background of crisis: it may be appropriate to look at the success or failure of MFAs in the light of where the recipient countries are today. The economic crisis has affected every country in a globalised world. Are the economies of recipient countries more resilient to shocks or crisis post-MFA?

- The Grant vs. Loan issue: the Commission prefers to use loans; but the grant-loan mix is determined on the basis of the recipient country's debt-sustainability. There is no point in giving loans if the recipient country has limited capacity to repay the loans.

- The monitoring of MFA operations, where the Commission has always tried to keep the requirements to the minimum necessary so as not to over-burden the actors involved.

1.3.2 GHK's presentation:

1.4 Discussion

1.4.1 General discussion

- World Bank (WB) officials kicked-off the discussion by stating that the approach of the Bank to evaluation has shifted in recent times – WB is placing greater emphasis on measuring results.

- The new thinking is that a 'results framework' should be an integral part of the programme/ instrument design and that it is important to think upfront about the outcomes against which the performance of the instrument will be measured.

- Over time the Bank has also realised that the word 'attribution' is a mistake – and that evaluations should sensibly describe the contribution of the instrument. Accordingly, the current evaluation approach is to not spend too much time on establishing the counterfactual; but to focus more on the content of the programme.

- It is hard to evaluate an instrument such as the MFA without a pre-determined results framework. This is a challenge for the evaluation of MFAs which do not have an explicit policy framework clarifying the goals against which the instrument can be evaluated.

- In most cases, MFA is about building political support for the EU. In the MFA evaluations, a lot of effort was spent on assessing the net impact of the instrument on the BoP situation of the recipient country; measurement of economic impact is not necessarily very useful and the evaluations should focus more on the political objectives of the EU.

- WB officials also made the suggestion that the evaluations should consider the donor coordination role of the EU. The major added value of the EU is its role in pulling together a multi-donor package. Speed and coordination are key issues in putting a multi-donor package together and the evaluations should consider these issues.

- DG ECFIN representatives clarified that MFA is specifically implemented to meet a financing gap; so quantitative evaluation is important; Moreover, MFA is an exceptional instrument. There are other EU instruments which are more closely aligned with EU's political/ policy goals.

1.4.2 Key lessons on selection, formulation and implementation of structural conditionalities

- General view is that too many structural conditionalities were attached to MFA instruments (e.g. Serbia); although there were some exceptions (e.g. Albania).

- Structural conditionality is the most controversial aspect of the package as there is typically no consensus on this issue:

  - One view is that the right approach for the EC is to 'piggy-back' on IMF/ WB conditionalities as this approach accelerates reforms within the recipient country;

  - An alternative view is that MFA conditionalities should be radically re-defined.

- IMF has radically re-orientated its approach to conditionality – it is now more focussed on macro conditions; and less focussed on structural conditions. Albert Jaeger (IMF) suggested that MFAs should be re-orientated to reflect this.

- WB: starting point for conditionalities is to select areas of conditionality where you can pick some impact (i.e. in relation to the results framework).

- The lesson is to apply fewer, carefully sequenced and coordinated conditionalities – previous evaluations show that it did help if the three institutions (IMF/WB/EC) applied the same conditions. From the point of view of the country, it needs to be seen as a package. Just looking at conditions at one a given point of time can also be risky; conditions should be looked at from a medium-term perspective.

- However, an issue with conditionality convergence is that EU loses political visibility.

Do different types of conditionalities apply in different economic contexts?

- WB's approach to applying conditionalities: a multi-year package is laid out with built-in flexibility; there are two dominant areas of reform - supporting fiscal adjustments (public finance management) and financial sector reform. A more flexible approach to conditionalities is adopted by building on a government led programme (national ownership). There is a need for technical assistance plus political dialogue to help build consensus within the recipient country.

- DG Enlargement: as regards accession countries, EU is in constant policy dialogue with them, accession conditions are well set-out in action plans. The MFA can be used to lead the countries on the path to EU accession. In addition to the EU accession programme, there is a development agenda. This development agenda will become more and more important in the future. So it is important to bear in mind that there is the accession agenda as well as a development agenda.

- ECFIN officials commented that the MFA is reserved for countries close to the EU (both geographical and political proximity is important); EC is not keen to explicitly include political conditionalities in MFA; but the MFA is clearly an instrument for EU's political objectives.

- IMF conditionality is very short term orientated focusing on the financial and fiscal sector. Sometimes it can be difficult to define appropriate structural benchmarks. For example, in the case of the new operation for Serbia, one component of the conditionality package is for banks to remain adequately capitalised. The structural benchmark is to conduct a stress test on the largest foreign bank.

- It would not be feasible for the EC to piggy back on IMF's short-term conditionalities given the timing and uncertainty associated with the MFA approval process; It may therefore, be more practical for the EC to draw upon WB's medium term conditionalities.

1.4.3 Current economic circumstances and institutional realities

- IMF: even though MFAs have worked well in the past, it doesn't mean that they will work well in the future. MFAs are useful along 3 dimensions:
  - Burden-sharing between IFIs;
  - Useful for financing budgetary gap and linking EU assistance to reforms in public finance management;
  - Important political signalling function as opposed to the technocratic signalling of the IMF/ WB.

- Initially, the MFA operations were implemented in the context of economic/ political transition of the recipient countries. Today's economic context is different –most of the world has adopted one form of capitalism or another; the current economic crisis was triggered by a financial crisis and has spread as a result of globalisation. The nature of the problem has changed. For example, the Western

Balkans haven't faced such shocks in the past i.e. sudden stop in capital inflows that immediately raise external sustainability issues coupled with the more traditional trade shocks (e.g. 30% fall in exports). In this changing context, there is a case to go back to the design of MFAs, particularly the size and flexibility of the instrument needs to be reviewed:

  - There is a case for more flexibility towards budget support;
  - Speed of operations is a clear issue in a fast-moving crisis.

- Burden sharing is more important than ever before – given the scale of the crisis, IMF/ WB/ EC are all cash constrained; the needs of affected countries are much bigger than in the past.

- Albert Jaeger emphasised the role of MFA as a burden sharing and coordination instrument.

- WB can process operations between 3 to 4 months; but WB officials don't have the ability to finance budget support over 3 years. IMF can front-load its assistance to help the recipient country deal with the immediate effects of a crisis; in this context EC support can usefully come in 12 months later.

- EC comments: EC officials don't disagree with the use of MFA for budget support; but there are political/ institutional constraints within which the EC has to operate.

  - Firstly, according to the rules, MFA is not a budget support instrument and the trigger has to be an external financing constraint. This limits the possibility to use MFA for budget support. Budget support can only be provided in the context of a BoP financing constraint/ gap. MFA has to be tied to a BoP crisis;

  - Secondly, there is the issue of timing. IMF/ WB can react more quickly than the EC. There is no political will within EU, even in the context of the crisis, to change the main rules of the instrument i.e. the need for unanimity among Member States for approval.

  These two constraints are strong and important.

- WB: there seems to be a general misunderstanding between budget support and BoP support. The external financing gap resulting from excessive expenditure of public sector is directly linked with the budget deficit. The distinction between BoP and budget support is arcane and no longer made by the WB. While MFA must be triggered by a BoP financing gap, it could still be used to provide general budget support.

- EC officials stated that the Council firmly holds the opinion that the EC is not an IFI and should not seek to play that role. Any proposal for an MFA operation where there is no residual gap (and is presented as purely a budgetary gap) is not approved by the Council.

- WB: the estimates for external financing gap depend on the underlying assumptions; the choice of assumptions clearly influences the results.

- Albert Jaeger: the external financing gap depends on assumptions about the roll-over of debt, FDI inflows, current account flows etc. When an external financing gap is identified, the IMF asks the EC what it can contribute. The burden-sharing dialogue is currently very one-sided.

- This discussion led to the conclusion that early upstream discussions between EC and IMF/WB officials can help clarify the context and design of MFA operations.

1.4.4 Coordination with IMF/ WB

- Coordination to take place much earlier than it did in the past on burden sharing, timing and substance.

- Important for IMF + WB + EC to start discussions very early-on in the process.

- The EC wants conditionalities to converge, a simple agenda and wants strong ownership of conditionalities from national authorities.

1.4.5 Recommendations for the future – how should MFAs be redesigned to address the challenges going forward

- More emphasis in evaluation on programme content / substance.

- EC: MFA co-finances an IMF programme. EC has an agenda of reform with authorities; but it is not an EC programme of reform. Countries of European Neighbourhood Policy have a joint EU action plan. For the new operations (not covered by the meta-evaluations), conditionalities are linked to these action plans.

- Technical assistance + policy dialogue adds to the value of the instrument.

- EC to have more participation in dialogue between IMF/WB and national authorities

- The more coordinated approach; the more ‘packaged’ approach is the right way forward.

- MFA is more relevant and important than ever before, in the context of the current economic crisis; and it needs to be adjusted to reflect this. Coordinating very early on is a key lesson.

1.5 Workshop Participants

S.No.	Title	Name	Organisation
1	Mr.	Antonio de Lecea	DG Economic and Financial Affairs
2	Mr.	Andreas Papadopoulos	DG Economic and Financial Affairs
3	Mr.	Christophe Pavret de la Rochefordière	DG Economic and Financial Affairs
4	Mr.	Dirk Lenaerts	DG Economic and Financial Affairs
5	Mr.	Paul Toulet-Morlanne	DG Economic and Financial Affairs
6	Mr	Jean-Martial Marenne	DG Economic and Financial Affairs
7	Mr.	Vittorio Orsini	DG Economic and Financial Affairs
8	Mr.	Jean-Pierre Raes	DG Economic and Financial Affairs
9	Mr.	Pierre Baut	DG Economic and Financial Affairs
10	Mrs.	Fotini Dionyssopoulou	DG Economic and Financial Affairs
11	Ms.	Olha Nychai	DG Economic and Financial Affairs
12	Ms.	Alexandra Janovskaia	DG Economic and Financial Affairs
13	Mr.	Strlianos Dendrinos	DG Economic and Financial Affairs
14	Mr.	Ronald Albert	DG Economic and Financial Affairs
15	Ms.	Eleni Vossou	DG Enlargement
16	Mr.	Ollivier Bodin	DG Enlargement
17	Mr.	Christian Hiddink	ECORYS
18	Mr.	Ferry Philipsen	ECORYS
19	Mr.	Alberto Bolognini	ECONOMISTI ASSOCIATI
20	Mrs.	Charu Wilkinson	GHK Consulting
21	Mr.	Nick Bozeat	GHK Consulting
22	Mr.	Albert Jaeger	International Monetary Fund
23	Mr.	Borko Handjiski	World Bank
24	Ms.	Erika A. Jorgensen	World Bank
25	Mrs.	Jane Armitage	World Bank
26	Mr.	Manuela V. Ferro	World Bank
27	Mr.	Roland Clarke	World Bank
28	Mr.	Ronald D. Hood	World Bank
29	Ms.	Sandra Bloemenkamp	World Bank

2 NOTES AND DISCUSSION SUMMARIES FROM WORKSHOP 2 ON METHOD OF APPROACH TO EVALUATION OF MFAS

2.1 Introduction

This note summarises the key points discussed at the workshop held on 29th May 2009 in Brussels.

The workshop was organised as part of the meta-evaluation of MFA operations. The purpose of this workshop was to discuss the strengths and weaknesses of the current ex-post evaluation framework for MFAs; and to draw out more general recommendations regarding the method of approach to future evaluations of MFA operations.

The following discussion paper was circulated to all participants in advance of the workshop:

MFA Workshop 2 - Discussion Paper.pdf

2.2 Structure of this Note

The remainder of the note is structured as follows:

- Section 2.3 provides copies of the opening presentations made by DG ECFIN and GHK;
- Section 2.4 summarises the content of the open discussion that followed the introductory presentations; and,
- Section 2.5 presents a list of workshop participants.

2.3 Presentations

2.3.1 DG ECFIN Presentation

2.3.2 GHK Presentation

2.4 Discussion

The following sections summarise the points discussed under each topic.

2.4.1 Scope and focus of MFA evaluations

- The question about European added value needs to be addressed in more detail. However, the notion of EU added value is not very well defined at present.

- Kevin Williams' comments on the suggestion that evaluations should look at programme content and focus on contribution as opposed to attribution:

  - Evaluations should look at contribution where attribution is not feasible/ reasonable.

  - The Commission should consider the scope for a more rigorous approach to contribution analysis.

- Alberto Bolognini: The issue of relevance was not looked at in previous ex-post evaluations as MFA was the only BoP instrument available to the Commission; there were no other alternatives available to the Commission. The evaluations therefore focussed on assessing the relevance of the structural reform package. However, it was found that conditionality package was pragmatically tailored to areas where there was technical assistance on ground to implement reforms.

  Linking the issue of relevance to the distinction between BoP or/and budget support (see discussion workshop 1), he put forward that EU Member States (ECOFIN ministers) are more willing to accept BoP support as this type of support would flow back to the EU through trade flows.

- Kevin Williams: pointed out that the issue of relevance can be considered at a number of levels:

  - Is MFA the right choice of instrument?

  - Is MFA relevant to needs in terms of its scale and design? Was BoP support needed?

- Were the objectives chosen relevant to the needs of the recipient country?

The issue of relevance is most usefully looked at the 'ex-ante' stage and the use of relevance as an evaluation criterion becomes less meaningfull at the ex-post stage.

- There has been a change in Commission thinking over time – evaluation could recognise the changes made to MFAs and highlight the 'learning by doing' aspect. Both the instruments and the evaluation approaches have evolved as a result of new learning.

- Other issues for evaluation to consider are:

  - The lead time for providing emergency support

  - The evaluations should also consider the timing of the operation + political cycle of recipient country. If an MFA is provided towards the end of a cycle, then there is a risk of change in government and this often has a knock-on effect on the reform process.

- National authorities/ ministries often leverage MFAs to gain wider political support for reform and persuade reluctant ministries. MFA helps gain political momentum for reform in the recipient country. The evaluations could consider the incentive effect of MFA in driving reform.

2.4.2 Methods

- The evaluators had three main sources of information for the ex-post evaluations: Delphi, facts (as set out in statistics, documents etc), stakeholder consultations. Delphi technique provided substantial added value in BiH where there were marked differences in the views of the people from RS. The Delphi technique is very useful for divergences of views of interviewees more transparent to the reader when trying to establish scenarios and narratives. The approach used by evaluators was to first collect individual opinions and then test out consensus by showing them the average results.

- Econometric modelling – a key constraint for the use of this method was the lack of time series data to validate the results of the modelling exercise. This was particularly an issue in the case of transition economies.

- Cambridge Econometrics: Modelling approach has intrinsic limitations; should not be used in isolation. The existing evaluations use the model mainly to back up the qualitative analysis which is the right approach. However, the ex-post evaluations could provide greater transparency by adding a technical annex on modelling assumptions and conclusions drawn.

- Methods for measuring the announcement effect of MFA's – in the case of Romania, the evaluators tried to detect if the MFA had an announcement effect on the market by looking at exchange rates, spread etc. However, a notable limitation was that in the case of these countries, the market was dominated by the central bank and hence exchange rate, interest rate spreads etc. could not be used as reliable indicators of 'market sentiment'. The evaluators also looked for credit ratings; but most of the countries were not rated at the time. In future, one possible solution would be to look at credit default swap spreads. Other methods could include investor panels and even sovereign credit ratings in future.

2.4.3 *Scope for joint evaluation*

Possible issues with joint evaluation:

- Other multi-lateral/ bilateral donors may not fully appreciate the complexities of EU policy making; and,

- Joint evaluations may neglect issues such as European added value, political visibility of MFA.

2.4.4 *Aidco's experience*

Aidco recently published an issues paper on evaluation of budget support:

Issues paper-
Evaluation of budget

The recipient countries hardly faced a case of real crisis; the financing gap wasn't always clear. The national authorities were interested in budgetary support and it was dressed as BoP support. Only in the case of Romania was there was a real crisis. If the aim of the MFA is to manage a crisis then the Commission needs to be able to respond quickly. If the MFA is disguised to provide budget support, then it should be evaluated as part of a package.

2.4.5 *Other issues*

- There are some fundamental issues that need to be addressed but are beyond the scope of this workshop. These are to resolve:

  – What is the rationale for MFA instrument? Is it a crisis tool or is it budgetary support. the problem with MFA is that it is a hybrid model.

  – What is the purpose of the evaluation? Is it to provide accountability? Is to learn lessons or is it to demonstrate impact? The scope and focus of the evaluation depends on clarity of evaluation purpose.

  – How can European added value be defined operationally and what benchmarks can be used for assessing it?

2.5 Workshop Participants

S.No.	Title	Name	Organisation
1	Mme	Nelida Ortega Barquero	AIDCO
2	Mr.	Svend Jakobsen	Secretariat General's Evaluation Unit
3	Mr.	Dirk Lenaerts	DG Economic and Financial Affairs
4	Mr.	Paul Toulet-Morlanne	DG Economic and Financial Affairs
5	Mr.	Jean-Pierre Raes	DG Economic and Financial Affairs
7	Mr.	Pierrre Baut	DG Economic and Financial Affairs
8	Ms.	Olha Nychai	DG Economic and Financial Affairs
9	Mr.	Strlianos Dendrinos	DG Economic and Financial Affairs
10	Mr.	Luciovixhas Do Souza	DG Economic and Financial Affairs
11	Mr.	Kevin Williams	Organisation for Economic Cooperation and Development
12	Mr.	Ferrie Pot	ECORYS
13	Mr.	Alberto Bolognini	ECONOMISTI ASSOCIATI
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14	Mr.	Hector Pollitt	Cambridge Econometrics
15	Mrs.	Charu Wilkinson	GHK Consulting
16	Mr.	Nick Bozeat	GHK Consulting

ANNEX II: COUNTRY SUMMARIES

1 ARMENIA (1998 – 2003)

1.1 Background to the EFA

Armenia has faced the usual problems of a former Soviet republic, with a few extra difficulties besides. As a result, Armenian economic policy has had to be geared as much towards fending off the possibility of total economic collapse and starvation as towards attempting to introduce complex reforms to stimulate the growth of market mechanisms. Before economic reform could even begin, the massive earthquake of 1988 devastated large areas of the country. The economy then suffered from collapse of the Soviet Union in 1991 and the disintegration of the rouble zone in 1993. None of this was helped by the war with Azerbaijan, which at the end of 1991 led to the country being largely cut off as a result of Azerbaijani and Turkish blockades, or by the war in Abkhazia which closed the route to Russia through Georgia in August 1992.

As a result of the country's isolation, the loss of markets and the demands of war, the government ran up large fiscal deficits, thereby stoking inflation. Although microeconomic reform in agriculture began early, fiscal reform and stabilisation began only with the replacement of the rouble with a new, local currency, the dram, in November 1993. The government tightened fiscal and monetary policy and in 1994 started a successful IMF-backed stabilisation programme. Despite the government's commitment to stabilisation, structural reform such as privatisation was mishandled and proved to be a vehicle for corruption.

A noticeable trend in the 90's was the government's dependence on external financing to cover the current- and capital- account deficits and for the accumulation of official reserves. Armenia inherited 0.9% of the former Soviet Union's external assets and liabilities, according to the debt allocation treaty signed when the Soviet Union collapsed in 1991. That would have saddled Armenia with an external debt of $603m and a share of largely worthless Soviet assets. But Armenia, like every other former Soviet republic, made no effort to service the debt. Russia then stepped in with the "zero option" in 1992, which Armenia accepted. Under the deal, Armenia renounced its share of Soviet external assets and liabilities in favour of Russia, making Armenia debt-free. By the end of 1992, Armenia's external debt was a mere $41m, according to World Bank figures. That increased to $134m a year later and $371 at the end of 1995. Debt had shot up to $700m by the end of 1997[1]. Multilateral organisations provided most of the loans. Their share of total debt stock was about two-thirds. Armenia's second major creditor was Russia with about 15% of total debt. The EU came third with about 7.5% of total debt

Under the EUR 1,250 million Community trade credit facility made available to the Newly Independent States (NIS) in 1992, Armenia benefited from some EUR 58 million in the form of loans. However, owing to difficult political, economic and financial conditions described above , the country was unable to properly service its external financial obligations including those towards the Community. In order to facilitate the settlement of this debt problem, the Council adopted in November 1997 a Commission

[1] EIU Country Report

proposal to provide Armenia (and Georgia) with exceptional financial assistance in the form of a combination of loans and straight grants.

In December 1998, with Armenia having fully settled its arrears towards the Community (EUR 51 million) and its IMF programme being back on track, the Commission disbursed the first tranche of the EFA (exceptional financial assistance) (EUR 28 million in loan and EUR 8 million in grant). The second tranche (EUR 4 million of grant) under this assistance was disbursed in early December 1999. This tranche was subject to a EUR 5 million reduction by Armenia in its outstanding financial obligations towards the Community (EUR 28 million) and to the country implementing forcefully its macro-economic programme supported by the IMF three year ESAF.

1.2 Stated objectives of the EFA operation

According to the 1997 Decision of the Council, the MFA was targeted to meet the residual financing needs of the country in the context of international donor assistance. The MFA was considered to be highly exceptional in character. According to the MoU of 1998 between the EU and the Armenian government, the MFA's objectives were to support reform efforts of the Armenian government and to alleviate social hardship. The latter objective, however, did not figure in any of the subsequent SMoU.

The implementation of this assistance was subject to Armenia remaining on track with its IMF programme and proceeding with structural reforms in accordance with successive MoU agreed with the Commission. The conditionalities attached to MFA focused on IMF conditionality (macroeconomic performance indicators) and secondly EU specific conditionality (targeted reforms). Structural conditionalities were reformed throughout the process and focused on:

- Public and civil sector reform, including improvements to tax administration and tax collection, reduction in public employment and an effective anti-corruption policy.
- Business climate reform, including the completion of Armenia's accession to the WTO and the promotion of a positive climate for foreign investments.
- Privatisation, including liquidation of non-profitable state-owned enterprises.
- Financial sector reform, including privatisation of major state-owned banks and improved banking regulation.
- Energy sector reform, including privatisation, private management and energy strategies linked to the closure of the nuclear power plant.

The country was also required to proceed with regular principal repayments, so as to reduce the financial exposure of the Community.

1.2.1 Impact of EFA on short term macroeconomic stabilisation of the recipient country

Although Armenia has reported high economic growth since 1998, it seems that the statistics are unreliable and that any in growth in GDP is likely to have benefitted from substantial external sources. The low credibility of reported GDP statistics makes it difficult to assess the direct effect of the MFA. The evaluation report however, concludes that the MFA impact on the macro-economy comes from the fact that the MFA allowed the continuation of IMF/ World Bank activities and more prudent debt management by the Central bank, thus securing price stability. The MFA prevented

Armenia from cutting back its social expenditure or drawing down on its foreign reserves to service its debt.

1.3 Impact of EFA on supporting structural reform in the recipient country in the short to medium term

The evaluation report describes how conditionalities linked to MFA broadly focused on reforming the civil service and reducing public sector employment. In 2000, the focus of civil service reform moved towards addressing corruption, tax and budgetary issues. The anti-corruption strategy programme was drawn up with the support of the international donor community and was adopted by the Armenian government in 2003.

The tax and budgetary reforms however, seem to have had little impact as per the figures presented in the evaluation report. Tax revenues as a proportion of GDP declined from 16% to 14% over 1999 - 2003, even against the background of reportedly high economic growth. Tax administration in Armenia has also been consistently highlighted as being both corrupt and highly discretionary, suggesting that any progress made during the MFA operation in the area of tax administration had limited effects.

Since 1998, the pace of privatisation has slowed and has been less complete than planned, falling significantly short of objectives.

The area in which the reform had most effect was in the energy sector with positive short to medium-term effects on the Armenian economy. Technical, commercial and collection losses declined, the sectoral deficit decreased markedly from 1995 and the collection rate reached almost 100% by the end of 2003. In addition production of nuclear and hydro power increased, while thermal power production declined and so from 1998, imports of gas, petrol and diesel consistently declined.

The evaluation has shown the specific conditionality aiming at the structural reform process in Armenia has produced very limited results. Consequently, this evidence indicates to that while the Armenian economy was going through a period of comparatively strong performance, the structural/ systemic weaknesses persisted and therefore limited the productive capacity of the country.

1.4 Other effects

The ex-post evaluation report does not highlight any unexpected effects of the MFA.

1.5 Impact of EFA on long-term external sustainability

The evaluation report concludes that the EFA prevented a complete or partial suspension of any IMF programme - a ‘no external arrears’ conditionality was attached to the IMF programme which means that the IMF/World Bank would potentially have suspended activities in the country had Armenia not been able to meet its debt obligations towards the EU.

The repayment of the €51 million of debt to the EU in 1998 therefore made a direct contribution to external sustainability by offsetting future debt service costs and consequently the external debt burden in the medium term. In our opinion Armenia could well achieve further goals towards debt sustainability if they experience continued strong export and output growth and achieve diversification of exports. The sustained implementation of appropriate policies and reforms, particularly, in relation to the business environment is critical in order for Armenia to attract foreign direct investment and reduce its reliance on transfers and remittances.

1.6 Design and implementation considerations

The EFA was designed to address the problem of Armenia's debt arrears towards the EC. In terms of alternatives, an explicit bilateral debt restructuring operation would have been the most straightforward way of dealing with the issue. However, this would have had a damaging effect on EC's status as a privileged creditor and the EC was concerned about setting a precedent. The ex-post evaluation report suggests that any repayment with own national funds would have put a heavy burden on Armenia's budget and the government would have made most of the cuts in social expenditure. This is plausible given that the government was running a fiscal deficit throughout the 90's and that it was unlikely to reduce its military expenditure.

Another option for Armenia would have been to use its official reserves to pay EC debt - gross official reserves reached $240m at the end of 1997 covering 3.2 months of imports up from $32m in 1994 covering 0.9 months of imports; but these reserves were built through external financing in the first place and drawing down on reserves would have been a risky strategy.

It is interesting to note that the design of EFA to Armenia represents a significant deviation from *Genval* principles – strictly speaking, it was not undesignated (as Armenia was obliged to clear its outstanding obligations to the EC); furthermore, Armenia is geographically distant from EU; and there is no significant economic or political linkages between the EU and Armenia. In the case of Armenia, MFA was effectively used as a concessional instrument by helping the beneficiary country to meet its financing needs without an excessive burden on its domestic economy.

The evaluation report identifies that the structural conditionalities seemed to cover a broad range of reform areas rather than focusing on specific areas where impact would have been most likely to occur in terms of macroeconomic stability. In addition, in some cases, the objectives and the time frames for the conditionalities were not made explicit. We believe this must be clearly expressed to enable assessment and the benchmarking of progress.

According to the evaluation report, certain aspects of the design of operations in Armenia impinged the effectiveness. For example the evaluation report suggests that the objective of alleviating social hardship was defined without a formalised assessment of how the objective would be achieved through the provision of the assistance, and synergies with other EU policy instruments, more specifically dedicated to achieving this type of objective were not identified at the design phase of the operation. Furthermore we would suggest that additional importance should have been placed on regular policy dialogue with the authorities in charge of implementing the reform measures as this process ensures ownership and would better enable results to be monitored at a local level on the ground. This is in line with the expression in the evaluation and we perceive that a greater presence in the field will also be extremely useful in increasing the impact of future MFA operations.

Table 1.1: Key Economic Indicators (mEUR unless stated otherwise)

	2002	2003	2004	2005	2006	2007
Macro-economic Indicators						
GDP at current prices	2,221	2,273	2,883	4,223	5,550	7,010
Real GDP Growth Rate (%)	13.19	14.00	10.50	13.90	13.30	13.70
Retail prices growth rate (% change)	1.06	4.72	6.96	0.64	2.89	4.41
Exchange Rate (EUR)	613.37	714.86	661.76	531.09	478.73	447.84
Exchange Rate (USD)	584.89	566.00	485.84	450.19	363.50	304.22
Balance of Payments						
Trade Balance	-383	-406	-425	-558	-800	-1,034
Current Account Balance	-138	-153	-16	-45	-102	-436
Direct Investment	106	95	180	197	342	451
Portfolio Investment	1	0	-2	-1	7	-6
Gross Official Reserves	411	397	402	567	814	1,127
Gross Official Reserves* (months)	4.5	4.1	3.4	3.3	4.4	4.9
Public Finance						
Government Revenue and Grants	419	404	438	628	997	1,412
Government Expenditure	428	429	473	717	1,110	1,577
Fiscal Balance	-9	-25	-36	-89	-113	-164
Fiscal Balance (% of GDP)	-0.4	-1.1	-1.2	-2.1	-2.0	-2.3
Relative Importance of MFA						
Debt Indicators						
External Debt of Government Sector	1,321	1,401	1,375	1,577	1,574	
External Debt as % of GDP	59	62	48	37	28	

Source: WDI

2 ROMANIA (2000 – 2005)

2.1 Background to the MFA

At the end of 1998, Romania found itself in an unstable economic environment. The country had already been penalised by the consequences of the Asian financial crisis. In addition, the Kosovo conflict had deteriorated the already delicate regional environment. Due to this conflict, traditional transport routes were closed or endangered and, as a result, important export markets were being lost.

Overall, the internal and external economic situation has deteriorated; and the risk of a full-scale economic and financial crisis had increased, in a context of government instability.

The GDP fell by 5.2% in the first half of 1998, compared with the year-earlier period. Industrial output fell by 18.6% in January-July 1998 compared with the year-earlier period. Manufacturing industry has been hardest hit, with output falling by 19.5%. Output in the extractive industry fell by 16.2% over the same period and that in power generation by 14.5%. The underlying trend of the economy was therefore strongly downwards, whereas inflationary pressures were high, underling the need for fiscal restraint.

Regarding foreign trade and payments, in a setback to the central bank's counter-inflationary, strong exchange rate policy, the external deficits grew during 1998. The current-account deficit widened to USD 1.3bn in the first seven months of 1998 from USD 1.1bn in the year-earlier period. The increase was wholly due to the widening trade deficit. Capital flows were affected by the reduction of foreign direct and portfolio investments.

Thus a large financing gap was created and the country appeared to be on the verge of financial collapse, since it had huge troubles in securing new lines of credit.

In the autumn of 1999, the European Commission (EC) and the World Bank (WB) levered additional financing from donors, in order to fill the financial gap that the IMF estimated to be USD 322 million.

2.2 Stated objectives of the MFA operation

The MFA to Romania was initiated by an EU Council Decision that fixed the objective of "ensuring a sustainable balance of payments situation." The Council Decision and the ensuing Loan and Supplemental Loan agreements did mention as well: (1) easing external financial constraints on Romania (2) and supporting the implementation of the necessary structural reforms.

Several Conditions were attached to the MFA, in terms of restructuring and privatisation, fiscal and financial discipline and improvement of the business environment.

Box 2.1 Summary of the structural conditions attached to the fourth MFA (actually disbursed tranches: 1st tranche and 2nd tranche/ first sub-tranche)

(1) Restructuring and privatisation:

- Privatisation of at least 45 large enterprises and 850 small and medium State owned enterprises, representing at least 9% of the total equity portfolio of the State Ownership Fund
- Liquidation or appointment of liquidators for enterprises generating at least 12% of the losses of the State Ownership Fund
- Effective beginning of the privatisation process for two State banks
- Appointment of the international investment banks in charge of privatisation of five large State owned enterprises.
- Announcing privatisation tenders for two electricity distributors (IMF+WB).

(2) Fiscal and financial discipline

- Reduction of 25% of the accounting losses from operations (including subsidies) of six mining companies.
- Strengthening of the banking supervision department of the National Bank of Romania
- Adoption and implementation of a law converting civil contracts into regular part time employment with a view to extending the social security tax base (IMF).
- Submission to Parliament of a law providing for the unified collection, audit and enforcement of social security contributions (IMF).
- The Romanian government undertakes not to resort to any direct public sector financing by the central bank, pending integration of acquis communautaire in this area (IMF)

(3) Business environment

- Elimination of the import surcharge by end-1999;
- Elimination of the reduced profit tax rate on exports;
- Progress towards reducing delays in VAT refunds (EU specific).

Note: conditionalities attached to the second sub-tranche (of the second tranche), that has never been disbursed, are not mentioned here.

The MFAs was part of a comprehensive and coordinated package of international support whose objective was to ease Romania's short-term external financing constraints and defend its reserves position. Stopping the deterioration of the government's fiscal position, then a result of a combination of expenditure overruns and poor revenue collection, was also in the mind of those who designed the MFA programme.

2.3 Impact of MFA on short term macroeconomic stabilisation of the recipient country

The actual economic developments show a gradually positive trend. After a period of economic decline, the Romanian economy recovered in 2000.

Table 2.1: Key Economic Indicators

	2000	2001	2002	2003	2004	2005
GDP in millions of Euro	40651.3	45356.8	48614.9	52576.5	61063.9	79801.9
Growth rate of GDP volume - percentage change on previous year	2.1	5.7	5.1	5.2	8.5	4.2
Annual average rate of change in HICPS	45.7	34.5	22.5	15.3	11.9	9.1
Balance of the current account (% of GDP)	-3.7	-5.5	-3.3	-5.5	-8.4	-8.6
Balance of international trade in goods (% of GDP)	-4.6	-7.4	-5.7	-7.5	-8.7	-9.8
Balance of international trade in services (% of GDP)	-0.6	-0.3	0	0.1	-0.3	-0.4
Direct investment flows as % of GDP	2.8	2.9	2.5	3.7	8.5	6.5
Public Finance: Annual Deficits (% of GDP)	-4	-3.3	-2.9	-2.65	-2.65	-2.65
MFA IV in millions of Euro	100			50		
MFA as % of GDP	0.24%			0.1%		

Source: Eurostat

As the above table illustrates, between 2000 and 2005 the economy experienced a period of growth and gradual fall in inflation. Other points to note are:

- The current account balance recovered in 1999. From 1999 to 2002 the current account deficit was relatively modest. After that, however the current account deficit increased to record levels.

- After 1999 direct foreign investments and other forms of capital flows increased significantly, especially when Romania regained access to the international capital markets and investors' confidence returned. The developments resulted in large increases in the international reserves.

- Relative low fiscal deficits and a decrease in the quasi-fiscal deficit, achieved by restructuring and privatisation (including initiation of bankruptcy procedure for a couple of heavily indebted companies; reform in the energy sector and utilities price adjustment; and to some extent prudent wage policy in the public enterprises) contributed to macroeconomic stability.

However given the size of the MFA in relation to the GDP, current account balance and fiscal deficit, the net impact of MFA on macroeconomic stabilisation is expected to be negligible.

The ECORYS evaluation concludes that the first tranche had a marginal effect on macroeconomic stabilisation in 1999-2000; yet it is mostly confined to the 'announcement' effect, since the first tranche's effective disbursement took place when Romania was already in a much better situation (in 2000).

Also, market sentiment was most likely to have been affected by the prospects of EU accession than by the existence of the fourth MFA operation. The effect of the second MFA tranche was judged to be "practically non-existent".

Regarding current macroeconomic issues, the former government, headed by the National Liberal Party (NLP - conservative), failed to address the risks posed by lax fiscal policy, wage growth in excess of productivity and the burgeoning current-account deficit, despite warnings from the IMF and the EU Commission that the recent boom was unsustainable. This neglect contributed to rapidly rising inflation and the growth of external deficits. The government, however, has little choice but to adhere to austerity policies in view of the external financing constraints.

It was also, early 2009, negotiating the terms of an external financing package with the EU and the IMF, in a bid to restore confidence in the leu and to meet its balance-of-payments obligations.

2.4 Impact of MFA on supporting structural reform in the recipient country in the short to medium term

In return for the MFA programme, the Finance ministry had agreed, also in conjunction with the IMF, to introduce a global income tax in 2000, designed to bring the tax system more closely into line with international practice, as well as to implement measures to improve the weak budgetary control and lack of surveillance of expenditure (indicative targets had then subsequently been established for monthly revenue and expenditure; expenditure targets had been broken down into more detailed categories in order to restrict spending on State subsidies).

The MFA contributed therefore to reinforce the credibility of the reforms and its insistence, together with the IMF and WB programmes, on privatisation and restructuring of State companies allowed quasi-fiscal losses and arrears to be solved. These in turn contributed to strengthen the long-term prospects of the country. See also *Box 5.1* above, for a summary of the structural reform undertaken.

The country's fiscal and external imbalances posed several systemic and interlinked risks, which would have been compounded without any public spending limitations and restructuring of State enterprises that only structural reform was able to implement decisively. Para-fiscal losses have significantly been reduced, including those in the energy sector, which can be seen as a joint effect of IMF, WB and MFA structural and macroeconomic conditions. However, a distinct MFA effect is not measurable since the conditions of these institutions often overlapped.

Today, the main questions determining relations with the EU with regard to structural reforms are the government's attitude towards judicial reform and the fight against corruption, as well as fiscal policy.

The European Commission's interim report on the reform of the judicial system, released in February 2009[2], argued that Romania had not maintained progress in judicial reform and on the fight against high level corruption. The Romanian government is unlikely to escape punitive sanction in the form of the withdrawal of EU funding, unless it addresses the issues outlined in the report. Therefore, Parliament was expected to approve the required civil and penal codes and procedures by the July 2009 deadline, and has lifted its ban on the prosecution of a former prime minister.

2.5 Other effects

The MFA along with SBA instilled international confidence in the Romanian economy and mitigated the "risk of policy reversals" within Romania.

Also, as said above, the MFA complemented the role of the pre-accession financial instruments in bringing the country closer to the EU. However, it is very difficult to gauge the effectiveness of the MFA as a distinct instrument, to separate its role from that of other parallel processes, such as the implementation of the IMF and WB programmes and progress in EU accession. Nevertheless, to some extent, one could consider that the MFA was part of this last process although originally it had not been conceived as a pre-accession instrument.

Despite the MFA's limited visibility in the media, and even government circles, let alone the general public, the MFA conditionalities have been perceived by the relevant stakeholders as part of a medium to long-term EU strategic effort to support Romanian structural reforms. In that sense, it complemented the role of the pre-accession financial instruments (PHARE, SAPARD, IPSA) in bringing the country closer to the EU.

The MFA operation may have had another possible (negative) unexpected impact on structural reforms. The mention of a deadline for the privatisation in the conditionality documents may have hampered the ability of the privatisation agency to identify the best timing for the best opportunities, hence possibly reducing potential proceeds for the budget, because of the lower quality of investors or lack of competition.

The only really unexpected macro-economic effect, although not directly related, results in the direct consequences on the balance of payments of the abolishment of the EU visa

[2] http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/72&format=

regime for Romanian citizens in 2003, which triggered and almost-immediate rise in remittances and mitigated to a small extent the increase of the trade deficit.

2.6 Impact of MFA on long-term external sustainability

The 1999-2006 period had shown a general improvement in the external financial situation in Romania. Positive developments have been seen in exports and income transfers dynamics, safe levels of official reserves and the increasing inflow of FDIs. External debt service had been falling since 1998 as a share of exports of goods and services, and external debt to GDP ratio remained low over this period. These positive trends are notably reflected in improving foreign currency ratings of Romania until the worsening of the international financial crisis in 2008.

However, following the dramatic worsening of the international financial crisis in September 2008, Romania's economic situation has rapidly deteriorated. Romania's economic problems today are at about the median of those facing the 10 ex-communist states that have joined the EU. Nevertheless, this places Romania at the top of a list that consists of economies facing severe economic problems. Furthermore, there is a substantial risk of contagion, i.e. of investor and saver confidence being undermined if the economic situation in one or several of the EU10 were to deteriorate sharply.

Romania has the lowest ratio of exports to GDP of any of the EU10 countries and is consequently less vulnerable to the recession in the euro zone. The government's public and publicly guaranteed external debt, at EUR 10.7bn, is relatively low by EU10 standards. However, total external debt reached EUR 72.5bn at end-2008; together with Romania's relatively high dependence on intra-group loans to finance current-account deficits, this means that the authorities will face problems in covering current-account deficits over the medium term.

The central bank's foreign-exchange reserves are relatively substantial, and exchange-rate flexibility provides the central bank with more monetary instruments to counteract a downturn in activity and current-account deficits than those EU10 economies that are pegged to the euro.

However, this comes with the downside of increased exchange-rate volatility, which has a direct impact on households and thus expenditure. Hence, there is a need for central bank intervention to prevent excessive or disruptive depreciation of the currency.

Regarding the economic indicators, real GDP growth slowed sharply in the 4th quarter of 2008, resulting in full-year growth of 7.1% year on year in 2008. Inflation has fallen, and a sharp fall in imports cut the external deficit in the 4th quarter of 2008. The annual consolidated budget deficit is estimated at 5.2% of GDP in 2008 (EU methodology), when government spending rose steeply because of the recent election, but will contract a lot in 2009-10 as policy is tightened.

The effects of the global economic crisis and policy tightening will very likely result in a sharp economic contraction in 2009 (estimated to be down -3% to -4% by the IMF, while the EU estimate remains slightly positive at 0% to +0.5%). Average consumer price inflation is expected to fall gradually (from 7.8% in 2008). After reaching an estimated 12.4% of GDP in 2008, the current-account deficit is expected to contract sharply in 2009-10.

The government has recently started talks with the IMF and the EU on a loan package in order in order to restore confidence in the national currency and to solve its external financing problems.

2.7 Design and implementation considerations

The ex-post evaluation points out a number of design considerations, which in summary are:

- While the IMF was seen as more of a short-term instrument, the MFA conditionalities were perceived as part of a long-term EU strategic attempt to prop up structural reforms in Romania. However a balance-of-payment instrument is not supposed to include conditionalities that have a four-year horizon. To some extent, this fundamental ‘legal’ ambiguity was already present in both parties’ negotiating positions and influenced all subsequent efforts to achieve structural conditions.

- Government full support and identification with structural reform efforts is systematically supposed. However conditionalities, which are ‘legally’ at the core of MFA operations, are not enough alone to create the necessary political pressure to implement reforms. They usually produce “managerial pressure”, and hence can help to maintain the pace of reforms through individual actions, but they do not in itself generate political pressure at a high level.

- The EU is not, technically, in a position to monitor the respect of conditionalities. Its controls essentially rely on Government and WB/ IMF sources. This information scarcity as well as the lack of preparatory studies or audits in certain areas has also partially influenced the choice of structural conditions.

3 FYROM (2001 – 2005)

3.1 Background to the MFA

The initial trigger for financial assistance to the Former Yugoslav Republic of Macedonian (FYRoM) was the Kosovo conflict and the security crisis of 2001 (when an estimated 1,500-2,000 ethnic Albanian guerrillas of the National Liberation Army (NLA) engaged in an armed conflict of medium intensity with government forces for six months in 2001), which exerted pressure on macroeconomic stability.

It was expected that the local economy would be severely affected by the crisis because of refugee flows and balance of payments (BoP) financing problems. In 1999, the IMF estimated the BoP financing gap at US$510 million. In addition FYRoM was in a transitional period, moving towards a market economy. MFA was also thought to be a tool to compliment the financing of IFIs in the context of IMF supported economic programmes.

MFA was disbursed to FYRoM in four tranches in the period 2000-2003 and the total disbursement of funds was €98 million. The MFA comprised a loan element of €50million and a grant element of €48 million.

3.2 Stated objectives of the MFA operation

In this context the stated objectives of MFA were to:

- cover the financing gap in order to strengthen the country's reserve position;
- ensure sustainable Balance of Payments; and
- support policy objectives attached to the Government's reform programme.

Additionally, both Council Decisions on MFA to FYRoM (1999/733/EC and 2001/900/EC) mentioned that MFA should help "to alleviate the social consequences of the economic disruptions caused by the conflict in Kosovo". The ECORYS evaluation rightly raises reservations regarding the compatibility of this objective with Genval principles.

The specific conditionalities attached to MFA were very much in accordance with the conditions specified in the agreements with the IMF and the World Bank. The medium-short term structural objectives of the MFA were focused on:

- public finance management (PFM) (including tax reform, strengthening budget
- control and public expenditure management);
- financial sector reform;
- trade policy;
- privatisation (business restructuring);
- private sector development;
- public administration reform.

3.3 Impact of MFA on short term macroeconomic stabilisation of the recipient country

Due to the pressure exerted on the macroeconomic stability by the Kosovo crisis and the security crisis of 2001, in the short term, the fiscal balance deteriorated, inflation increased and there was pressure on the exchange rate. The financing gap was estimated to be US$510 million Nevertheless, the Government was able to recover macroeconomic stability in the medium term through support by donors which allowed financing of the external gap and resulted in a recovery of the level of foreign reserves after 2003.

Without the MFA, the drop in GDP in 2001 would have been larger and the economic recovery would have taken significantly longer. Of the effects detailed in the evaluation report we believe that the most important positive effects of MFA have been on budgetary expenditure (fewer expenditure cuts) and on foreign reserves. The provision of MFA has also resulted in a relaxing of BoP and budgetary constraints and as such has allowed for higher economic growth rates and poverty-reducing expenditure in this period. However, the long-term growth bonus is rather uncertain. Without MFA, we can conclude that the recession in 2001 would have been longer and deeper, however the evaluation report states that overall the direct net impact on the macroeconomic variables was small to moderate.

In addition we would encourage that the indirect impact of MFA disbursements on macroeconomic stabilisation should be considered. Continued EC support sent a clear message to the authorities in Skopje as to EU commitment to closer relations with the country. This would have positively impacted on the conduct of the restrictive macroeconomic policies which maintained stabilisation despite a series of adverse events at the time. Furthermore the close links to IMF programmes and the fact that MFA replicated the objectives of the IMF would have helped to achieve a higher degree of macroeconomic stabilisation as confidence was instilled in the economy

3.4 Impact of MFA on supporting structural reform in the recipient country in the short to medium term

The country's strong interest in EU accession and the EC's monitoring of the reform process gave the Government clear incentives to implement the necessary economic reforms. The evaluation states that reforms focused on areas of public finance management, the financial sector, trade policy, privatisation and liquidation, private sector development, and public administration reform. From studying the evaluation report we can see that the Government has made progress in most reform areas however it would seem to us that disruption of the security crisis meant that reform processes were disrupted and in some cases postponed which would have limited the short-medium positive effects. The evaluation describes how there has been significant progress in the areas of Public Finance Management including tax reform, VAT has been successfully introduced and personal income tax rates reduced. Budget execution has also been improved and the Government has met MFA conditionalities surrounding trade policy reforms. Some progress has also been noted on private sector reform and privatisation, however for most reforms actual outputs have been limited partly due to systemic problems in the judicial sector.

It was also a condition that MFA should contribute to alleviation of the social consequences of the economic disruptions caused by the conflict in Kosovo. However the report suggests to us that the direct effect of MFA on alleviating the social consequences of economic and political disruptions was not significant and MFA objectives regarding alleviation of the social consequences (relating to an increase in employment, real wages and budgetary expenditures) were achieved, partly because of MFA, but also because of complementary support operations from other donors.

To sum up, the overall impact of the MFA on structural reform is estimated to have been positive but relatively limited. However, importantly it seems that there existed a reinforcing effect of MFA conditions on the successful implementation of the IMF and World Bank conditions.

3.5 Other effects

The ECORYS report points to the unexpected effect of the MFA relating to the timing of the disbursement of the first tranche which was initially postponed.

3.6 Impact of MFA on long-term external sustainability

After the political resolution of the security crisis, foreign grants and concessionary loans (including MFA) were of critical importance for sustainability. In 2003 the average inflation rate dropped to 1.2% and GDP grew moderately.

After two years of negotiations the EU and the Former Yugoslav Republic of Macedonia signed a Stabilisation and Association Agreement in 2001. Its political significance was considerable, as it conferred on the country the status of potential candidate, opening up the possibility of future accession to the EU. This suggests to us that FYRoM was therefore of strategic importance due to its potential candidacy for EU accession and the decision to support FYRoM with macro financial assistance was both strategic and political. MFA should be seen as one component of a larger EC support package to improve stability in the region and in the disbursement period 2000-2003 MFA formed up to half of total EC assistance.

We would propose that the overall impact on medium to long-term sustainability has been generally positive and perhaps this could be attributed to the increased confidence that the EC presence bought to the country and the facilitation of the country as candidate for EU accession.

In the last few years, the authorities have stabilised the macroeconomic situation through prudent fiscal and monetary policies. The evaluation report describes how there were no serious threats to the external sustainability of the country in the short-term following the completion of the MFA period. In our opinion the continuation of responsible macroeconomic policies and implementation, together with the potential for EU candidacy should help to further increase confidence in the external financial situation.

However the pace of structural reforms must continue to prevent the external position of the country from becoming unsustainable. There is also a risk to the current account as the export base is narrow and concentrated in a few industries such as metals, textiles and agricultural products. This is coupled with what the evaluation report describes as a low level of penetration of EU markets which exposes the country to increased risk. In addition, the failure to implement supply-side policies directed at improving labour regulations, the functioning of courts and removing impediments to entrepreneurial activity might become the most important threat to external sustainability.

Furthermore we can conclude that at present the global economic crisis could pose significant threat to all MFA eligible countries and could seriously damage the potential for long term sustainability.

3.7 Design and implementation considerations

The prevailing view illustrated in the evaluation was that neither the IMF nor other donors would provide compensation in the event of no MFA funding.

However, the negative effects of the Kosovo crisis were not fully realised and the situation was in fact a lot less drastic than original predictions estimated[3]. Although this may have reduced the relevance of MFA financing; such an outcome could not have been predicted at the time the MFA operation was approved.

[3] The Kosovo crisis was expected to lead to severe budgetary imbalances in the country – the IMF forecast a budget deficit of 7.8% of the GDP for 1999. At the end of the fiscal year, however, the budget showed a surplus because of a faster termination of Kosovo crisis and the generous behaviour of the donors.

In fact, at the beginning of 2001, the country was exposed to a security crisis, with deep and persistent macroeconomic effects which resulted in internally displaced people and higher defence expenditure. With the support of the international community, the crisis ended with the conclusion of the Ohrid Framework Agreement in August 2001. Therefore we can see that the context in which MFA operated was very specific and sensitive and required the designed framework to be flexible to allow for modifications in approach and design as well as redefining expectations and objectives as to what MFA would achieve.

The ex-post evaluation points to a shift in rationale of MFA from residual gap-filling to structural issues and conditions. According to the evaluator's assessment, MFA disbursement was hampered by structural conditions at times when, from an economic point of view, the financial support was most needed – e.g. during the Kosovo conflict and the internal crisis. This issue was not observed in other country contexts and does not reflect a recurrent pattern. It is important that EU assistance is not taken for granted by beneficiary countries; and although MFA support is 'undesignated', the EC has valid reasons to stop or delay disbursements if there is potential for funds to be used for unintended purposes (such as military expenditure).

The ex-post evaluation report highlights two other issues with respect to MFA design that are pertinent:

- In the period 1999-2002, the Government seemed to have significant difficulties in implementing 25 reforms in all 6 areas in a relatively short time frame. In this period, the IMF programmes went off-track and the implementation of reforms was repeatedly postponed. With the benefit of hindsight, a more focused approach with a limited number of conditions might have been more appropriate under such circumstances.

- The topping up of MFA by €18 million of grants in December 2001 softened the average terms of the MFA. This contributed to an increased willingness to implement the IMF reform programmes.

Table 3.1: Key Economic Indicators (mEUR unless indicated otherwise)

	2002	2003	2004	2005	2006	2007
Macro-economic Indicators						
GDP at current prices	3,970	4,059	4,321	4,685	5,082	5,532
Real GDP Growth Rate (%)	0.85	2.82	4.08	4.11	3.95	5.10
Retail prices growth rate (% change)	2.31	1.10	1.05	0.04	3.34	3.54
Exchange Rate (EUR)	61.45	61.95	61.39	61.18	61.17	61.32
Exchange Rate (USD)	58.60	49.05	45.07	51.86	46.45	41.66
Balance of Payments						
Trade Balance	-799	-688	-874	-808	-946	-1,118
Current Account Balance	-375	-131	-334	-66	-19	
Direct Investment	74	76	114	82	266	
Portfolio Investment	1	3	10	200	63	
Gross Official Reserves	753	740	728	1,136	1,435	1,538
Gross Official Reserves* (months)	4.2	4.2	3.5	4.3	5.2	
Public Finance						
Government Revenue and Grants	933	898	1,577	1,649	1,672	1,918
Government Expenditure	1,145	964	1,561	1,638	1,700	1,882
Fiscal Balance	-212	-66	16	11	-28	36
Fiscal Balance (% of GDP)	-5.3	-1.6	0.4	0.2	-0.5	0.6
Debt Indicators						
External Debt of Government Sector	1,585	1,477	1,509	1,901	2,021	
External Debt as % of GDP	40	36	35	41	40	

Source: WDI, IMF Country Reports

4 TAJIKISTAN (2001 – 2006)

4.1 Background to the EFA

The Republic of Tajikistan gained its independence during the breakup of the Union of Soviet Socialist Republics in 1991 and soon fell into a civil war. From 1992 to 1997 internal fighting ensued which had damaging effects on both economic and political spheres leading to a rapid rise in poverty as GDP contracted by 60% on a cumulative basis between 1991 and 1996. Tajikistan experienced exceptional difficulties in the transition from a command economy to a market economy, with hyperinflation and the collapse of industrial production aggravated by a five-year civil war that claimed 50,000 lives, and caused over one tenth of the population to flee the country[1]. This delayed the reforms needed to make the adjustment to a market economy and Tajikistan became the poorest country in post-Soviet Central Asia (and CIS in general), and one of the poorest countries in the world. In addition Tajikistan began transition in 1991-1992 with practically no foreign or domestic debt, however throughout the early 1990s and after 1996, liabilities increased at a rapid rate and ECORYS detail that total nominal government and government-guaranteed debt rose from just below 60 percent of GDP in 1997 to 100-110 percent of GDP in 1998-2000. It was in the post-conflict recovery context from 1998 that substantial external assistance was required to help stabilise the situation and this took place through several donor programmes, including Exceptional Financial Assistance from the European Union (EU).

The EFA consisted of a loan of EUR 60 million and a grant of EUR 35 million and this was in relation to an outstanding debt of EUR 78.771 million. ECORYS detail how EFA assistance was intended for disbursement in five successive equal tranches (EUR 7 million each) during the period 2001-2004, but this was later extended to 2006. Disbursement of the loan and first grant tranche was conditional on settlement of the existing obligations to the European Community. Therefore prior to disbursement, the Tajik Government fully settled the existing arrears with the Community, amounting to EUR 78.771 million. The loan and first grant tranche were released in March 2001. The subsequent four grant tranches (EUR 7 million each) were linked to early repayment (EUR 8million per grant tranche) of the new EFA loan, leading to a net payment of EUR 1 million per tranche. As a result of the repayments the debt to the EC stood at EUR 28 million at the end of the operation in 2006.

The EU is also present in Tajikistan with several other financial instruments which include humanitarian assistance through ECHO, the Food Security Programme and TACIS and human rights and democracy (EIDHR). The figures from the ECORYS report illustrate that MFA comprises a significant part of the total EC assistance. Share of EFA in the total EC assistance is in the range between 28% to 72% during 2001-2004.

4.2 Stated objectives of the EFA operation

The stated general objectives of the EFA programme in Tajikistan were therefore to:

- Encourage the Tajik authorities to implement macroeconomic and structural policies fostering external and fiscal sustainability;
- Help Tajikistan to improve its external financial position by reducing its net debt position towards the Community.

4.3 Impact of EFA on short term macroeconomic stabilisation of the recipient country

The net impact of the EFA operation on macroeconomic stabilisation appears to have been limited. EFA encouraged a small improvement in the economic growth record and lower inflation over the period 2001-2006. The results of quantitative modelling by the evaluators, showed that EFA contributed approximately a cumulative 1.5 percent increase in GDP in the period 2001-2006. However ECORYS also state that the EFA impact on macroeconomic stabilisation should be seen in the context of improving economic conditions in Tajikistan in the period 2001-2006.

Because of (below-mentioned) improvements in the tax administration and collection systems, tax revenue as a percentage of GDP increased, and the overall balance was even positive after 2002. These surpluses facilitated foreign exchange accumulation and supported monetary policy and exchange rate stabilisation[4].

Tajikistan has benefited from exceptional macro-financial assistance from the EC aimed at reducing debt. Outstanding debt to the EC at the end of the EFA period stood at €28 million as opposed to €78 million at its inception which shows to us a positive impact.

However considering the stabilisation and growth of the economy once the country entered post-war recovery stage, it is unclear as to whether Tajikistan would have been in a better position to make these repayments without the intervention of EFA. In terms of macroeconomic and structural impact the ex-post evaluation concluded that EFA's relatively small direct impact on GDP growth (combined with a relatively low identified capacity at initiating structural reform) highlights the fact that EFA provided a positive but only small net impact.

4.4 Impact of EFA on supporting structural reform in the recipient country in the short to medium term

This EFA assistance was based on a set of conditionalities which are outlined in the ECORYS report. The structural conditionalities were mainly based on the conditionalities of the IMF and WB programmes, but also included EC-specific conditionalities. The conditions were grouped into four different areas:

1. system of taxation;
2. public finance and public administration;
3. privatisation and restructuring;
4. banking sector and monetary policy.

The majority of the conditionalities were short-term policy objectives of an operational nature which included implementing the computerisation project at the Tax Committee and conducting an external audit of Tajikgas. However some EFA conditionalities aimed to achieve more structural objectives such as overall improvement of fiscal administration, progress in privatisation of enterprises and strengthening of the banking regulatory environment.

Implementation of the conditionalities has contributed to the realisation of expected structural effects in the four reform areas. ECORYS deduce that reforms in the banking sector have been the most successful. Measures focused on strengthening the banks' capital base led to improved compliance with prudential regulations, and restructuring of the banks, which led to consolidation of the banking sector. The ex-post evaluation suggests that EFA was able to support structural reform as most of the other structural conditionalities have also been successfully fulfilled in Tajikistan. For example it is stated in the ex-post evaluation that fiscal policy performance has improved (thus contributing to macroeconomic stabilisation), and progress has been made in maintaining aggregate fiscal discipline, strengthening public expenditure and debt management. Improvements in the taxation system have been seen, in particular improvements towards the tax administration and collection systems.

4.5 Other effects

The judgement regarding the small size of the net impact, however does not take into account another effect: the confidence that EFA may have conveyed to the wider economy. This, in our opinion this should not be underestimated. Heightened confidence could have led to increased investment, strong leadership and direction of the government in terms of the economy and decreased the level of political unrest. The World Bank noted that the Tajik economy thrived in 2002-07 owing to relatively sound macroeconomic and fiscal management, which induced low inflation, sustainable fiscal balances and increased domestic demand.

If this can partly be attributed to the presence of the EU then the impact would have been more positive than initially deduced. In addition important reforms were initiated in Tajikistan and improvements were made which in turn would have stimulated growth. The willingness of government to continue to work for positive structural change also means that the impact is ongoing.

4.6 Impact of EFA on long-term external sustainability

The EFA was designed and implemented because the EC had no alternative instrument to address the country's unsustainable level of debt arrears towards the EC. ECORYS conclude that in the absence of the EFA operation the EC would not have initiated another arrangement to address the problem of debt arrears, other donors and lenders would have been unlikely to assist arrears repayment, Tajikistan would not have been able to make immediate repayment to clear arrears to the EC and therefore it would have taken significantly longer and potentially threatened the long term sustainability of the economy (Tajikistan would have had to repay debt arrears during the second PRGF arrangement 2002-2006). Given the unstable political background of the country and the size of the outstanding debt coupled with a weak economy and high levels of poverty we would agree that initiating the exceptional financial assistance was, at the time, the most appropriate way to deal with the problem of debt repayment and to improve the country's long-term external sustainability.

The impact of EFA on long-term external sustainability was estimated to be positive but small in the ex post evaluation report - mainly because the two channels where it is relatively easy to identify the direct contribution of EFA appear to play a small part in the long-term sustainability perspective - the debt-relief element of the operation and slightly higher GDP resulting from EFA. In the long term, we think it is likely that issues relating to improved economic governance will become the most important factor for sustainability. As rightly identified in the ex-post evaluation structural reforms including widening the tax base, improving tax collection, strengthening public administration and improving debt management appear to be among the most important achievements for long-term external sustainability prospects. EFA has had some impact on these areas which is therefore why we conclude that strong economic governance providing strategic direction in further implementing the above will become the most important factor moving forward.

Among major risk factors for external sustainability is the possibility of a change in the authorities' attitude to debt financing. ECORYS suggest that abundant global liquidity and in particular the willingness of Chinese creditors to extend loans may potentially create an illusion of 'easy money' among policy-makers which could lead to a return to previous levels of debt owed to foreign parties. Willingness of Chinese creditors to extend loans may potentially create an illusion of 'easy money' among policy-makers which could lead to a return to previous levels of debt owed to foreign parties. However in current economic circumstances this may not prove such an issue as global access to liquidity is strained.

4.7 Design and implementation considerations

It can be questioned as to whether the design of the EFA fully recognised the strengths and weaknesses in government capacity. As mentioned Tajikistan was a country crippled by civil war, poverty and had severely damaged and inadequate physical infrastructure. ECORYS state that the structural agenda was both broad and ambitious and this was coupled with weak institutional influence and force, which led to persistent underperformance in terms of structural conditionalities.

The rationale for EFA was not specific to Tajikistan and in 1997, the EC was considering other countries facing similar problems to Tajikistan, namely Armenia and Georgia. ECORYS highlight that these countries were facing critical economic and social challenges in the context of reforms and transition to market economy but the overarching common feature of these countries was the existence of large external payment arrears to the European Community originating from loans that the Community had extended in the early 1990s. This multi-country approach meant that the basic design of the operation was shared across all three countries and we would agree with ECORYS in that this could have complicated policy discussions at an EU level and made implementation at a ground level increasingly difficult. In our opinion formulating a generic design for countries with a common problem but with prevailing different economic and political conditions will prove less efficient than tailoring to specific needs.

In addition ECORYS cite low EC presence in the different countries which would have made effective selection and monitoring of structural conditionalities difficult and we would recommend that presence and visibility at a local level is increased.

The EC quickly recognised that Tajikistan was not able to meet the original ambitious targets for net debt repayment and as mentioned in the ex-post evaluation, the amount was consequently reduced by mutual agreement. We believe that this decision benefited Tajikistan during the first phase of the EFA operation and meant the country was able to make larger net debt repayments in the second half of the operation when economic growth picked up and budgetary revenues increased as large remittance flows supported the balance of payments. Therefore it would seem to us that the timing of disbursements worked well and the programme was extended until 2006 to ensure that funds were distributed in the most beneficial and effective manner. This flexibility ensured that the programme was able to adapt and react to the requirements of Tajikistan which in our view is a positive trait of the design.

A recommendation we would make would be to formulate a process of assessing structural change that occurs and evaluate how far this is directly linked to EFA/MFA which would be beneficial to EFA/MFA operations and would provide a clearer picture of how efficient the EFA programme has been in Tajikistan.

The main recommendations related to programme design and implementation, highlighted in the ex-post evaluation can be summarised as follows:

- Maintain the flexibility of the MFA instrument to address the real problems in the absence of relevant regular EC instruments.
- Streamline structural conditionality and intensify cooperation with IFIs.
- Avoid reformulations and generalisations of original IFI conditions.
- Secure cooperation among relevant EC Directorates.
- Make use of Operational Assessments as the source of highly relevant EC specific conditionality.

- Discuss MFA programmes on country-by-country basis, even in the case of multi-country operations.

Table 4.1: Key Economic Indicators (mEUR unless stated otherwise)

	2002	2003	2004	2005	2006	2007
Macro-economic Indicators						
GDP at current prices	1,073	1,275	1,489	1,908	2,055	2,506
Real GDP Growth Rate (%)	9.10	10.20	10.60	6.70	7.00	7.80
Retail prices growth rate (% change)	12.25	16.30	7.14	7.09	10.01	13.15
Exchange Rate (EUR)	3.15	3.73	4.14	3.77	4.51	5.10
Exchange Rate (USD)	3.00	2.96	3.04	3.20	3.43	3.46
Balance of Payments						
Trade Balance	-112	-129	-173	-512	-706	-1,138
Current Account Balance	-13	-4	-41	-16	-16	
Direct Investment	34	25	200	46	257	
Portfolio Investment	1	0	4	0	0	
Gross Official Reserves	85	93	126	160	155	
Gross Official Reserves* (months)	1.1	1.2	1.4	1.3	1.0	
Public Finance						
Government Revenue and Grants	178	220	266	383	481	441
Government Expenditure	204	243	302	439	446	741
Fiscal Balance	-27	-23	-36	-55	35	-300
Fiscal Balance (% of GDP)	-2.5	-1.8	-2.4	-2.9	1.7	-12.0
Debt Indicators						
External Debt of Government Sector	1,089	912	729	876	876	
External Debt as % of GDP	101	72	49	46	43	

Source: WDI, IMF Country Reports

5 BOSNIA AND HERZEGOVINA (2002 – 2006)

5.1 Background to the MFA

MFA was provided to Bosnia and Herzegovina (BiH) in the period November 2002 to February 2006[4] in the form of a loan of EUR 20 million and a grant of EUR 40 million.

The MFA was approved in the context of a sharp slow-down in economic growth[5], large trade and current account deficits and falling reserves (the official reserves in months of imports of goods and services reached a low of 1.38 months in 2000[6]). The primary reason for the large trade deficits (about 50% of GDP) was the strong growth in imports fuelled by wage growth and domestic credit expansion.

The MFA was explicitly linked to the IMF Stand-by Arrangement (SBA) which was approved in August 2002 (and successfully completed in February 2004). The first instalment of MFA was released on the approval of SBA and signing of MoU. The second and third instalments were linked to fulfilment of conditionalities set out in the MoU and SMoU.

The MFA was also part of a wider context, in particular the EU Stabilisation and Association Process (SAP) which kicked off in 2003. The EU had been one of the largest donors to BiH, both during and after the war (since 1991, EU assistance to BiH has amounted to more than EUR 2.5 billion), and had focused on advancing political and economic reform and establishing a framework for the eventual integration of BiH into the EU.

5.2 Stated objectives of the MFA operation

The stated objective of MFA was to help ease the country's external financial constraints, support the balance of payments and secure the reserves position. The Council Decision (2002/883/EC) referred to the residual financial gap that remained to be covered after IMF and World Bank financing to support the authorities' reform efforts. It was also considered that financial assistance should be instrumental in bringing Bosnia and Herzegovina closer to the European Community.

The evaluation report suggests that the EC considered financial assistance as instrumental in bringing Bosnia and Herzegovina closer to the European Community. Hence an implicit objective of the MFA was to encourage BiH authorities to incorporate EU principles and norms. The objective of the Commission was also to strengthen State level institutions and to help them prepare for the incorporation of the EU acquis. Hence the features of the distribution of funds among the political entities of BiH: the loan element was shared by FBiH (Croat-Bosnian Federation) (2/3rd) and RS (Republika Srpska) (1/3rd); the grant component was shared between the state government (40%) and the two entities (60%)[7].

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[4] Originally expected to last 15 months from November 2002 until February 2004 in the line with the IMF SBA. In December 2004, the MFA was extended until 30 June 2005. There were delays in disbursement of trances and the loan element of the third and final tranche was released in February 2006.

[5] After a period of strong post war economic recovery (1995 – 1999), growth in real GDP slowed down to an average of 5% over 2000-2006. Over the period 1995 to 1999, annual growth rates oscillated between 10% (1999) to 69% (1996). (Source: EIU, The Economist Intelligence Unit, Country Profile 2001) and averaged around 28% per annum.

[6] Source: The Central Bank of Bosnia and Herzegovina

[7] Bosnia and Hercegovina (BiH) consists of two entities- Republika Srpska (RS) and the Federation of BiH (or Croat-Bosnian Federation) - each with political, legislative and judicial authority, and the Brcko District as a self governing unit under the jurisdiction of the central state.

The other significant feature of the instrument was the relatively large grant component. The ECORYS evaluation report concludes that the "exceptional weight given to the grant component in the BiH operation was fully justified by local conditions". However, the evidence underpinning this statement is not clear.

From the information presented in the evaluation report it seems that the overarching perception of MFA in BiH, is, not as a balance of payment instrument, but rather as a way to support structural reforms through budgetary assistance.

5.3 Impact of MFA on short term macroeconomic stabilisation of the recipient country

Over the period, 2002 to 2006, MFA accounted annually for 2.8% to 5.9% of total financial assistance to BiH and represented over 10% of overall EU assistance (over 2001 to 2006, the main source of EU assistance for BiH was the CARDS programme with over EUR 500 million of financial support in different areas8).

MFA was relatively insignificant in relation to the current account deficit –it is not possible to judge the contribution of MFA to filling the residual financing gap because the ex-post evaluation does not indicate the scale of the residual financing gap.

The evaluation report describes how donor support from 2002-2006 allowed the financing of current account deficits. Together with sustained inflows of remittances from abroad and increased inflows of foreign capital (as banks borrowed from their foreign mother-banks), foreign exchange reserves increased from 3.3 months of imports in 2002 to a projected 4.6 months in 2006 (Table 2.1). The high but decreasing dependence on foreign funds resulted in a downward fiscal adjustment. Public expenditure declined from 56.9% of GDP in 2000 to an estimated 38.8% in 2004. In 2005, this decline was reversed as expenditure increased modestly to 39.6% of GDP. Fiscal surpluses have been recorded since 2003.

Although the key macroeconomic indicators demonstrate a positive trend over the period of MFA operation, as noted above, the direct effects of MFA on macro-economic indicators have been marginal.

The ex-post evaluation describes how the most likely counterfactual scenario would have resulted in a revised IMF programme – i.e. more austere quantitative performance criteria in the SBA and adjustments to the targets set in the macro framework equating to tighter fiscal policy and lower accumulation of international reserves. The net impact of MFA on macroeconomic stabilisation was judged to be "non-negligible" and seen to be arising from the effects of structural reforms, particularly in the areas of indirect tax policy and tax administration (see section 2.4).

The net impact of MFA, as indicated in the ECORYS evaluation, was an overall improvement in macroeconomic stability over the whole period, contributing 18-20% of the overall stabilisation effect. Although a substantial part of these net macroeconomic improvements were attributed to the effects of structural reforms and in particular the indirect tax policy and tax administration reform. The economic modelling results indicated that the direct effects of MFA were small when measured against the main macroeconomic variables such as fiscal balance, international reserves, imports and money supply.

8 http://ec.europa.eu/enlargement/how-does-it-work/financial-assistance/cards/bilateral_cooperation/bosnia-and-herzegovina_en.htm

5.4 Impact of MFA on supporting structural reform in the recipient country in the short to medium term

There were 28 conditionalities covering the following areas:

- public finance reform and administration: treasury system, state border service, excises, customs and tax administration, statistics and public procurement;
- financial sector reform, private sector development: privatisation of banks, banking supervision, insurance
- private sector development and business environment: bankruptcy, privatisation, competition, veterinary office, phytosanitary office.

The net impact of the MFA structural conditionalities on the reforms was judged to be non-uniform by the evaluators:

- Strong structural progress was noted in areas of treasury system reform, customs and indirect tax reform and banking privatisation. In these areas, there was synergy between MFA conditionalities and the reform agenda of the IMF and World Bank and MFA is seen to have made its contribution by politically reinforcing the importance of reforms and accelerating the pace of reform
- Limited progress was noted in areas of competition policy, insurance, supervision, veterinary office and phytosanitary office due to the low relevance attached to these reforms by Bosnian authorities and these conditionalities reflected the reform agenda of EU (and contained no synergies with the IMF/ World bank programmes)
- MFA was seen to have had a negligible net impact on reforms relating to privatisation, banking supervision, bankruptcy and statistics due to lack of ownership by the Bosnian authorities.

The added value of MFA was seen as arising from its role in accelerating structural reforms. For example, it is suggested in the evaluation report that the most visible effect of structural conditionality has been in the area of indirect tax and customs reforms, which led to an increase in indirect tax revenues and have thus contributed to a fiscal surplus. However the evaluation report suggested that the net impact of the MFA structural conditionalities in BiH were not uniform and although several conditionalities have accelerated the structural progress achieved, others have just prepared the ground for future structural progress. In addition, for some conditionalities a distinct net impact could not be identified which makes judgements on the extent of effectiveness of structural reforms extremely difficult.

The evaluation report notes that MFA appears to have been perceived as an instrument that has helped to coordinate policy-making between the two entities and fostered policy dialogue although the report presents no specific examples to illustrate this point.

5.5 Other effects

The ex-post evaluations did not identify any unexpected effects.

5.6 Impact of MFA on long-term external sustainability

5.6.1 Political sustainability

Regarding the contribution of MFA to wider political and foreign policy objectives, it is hard to isolate the effect of MFA from the wider Stabilisation and Association Process (SAP) although the latter has clearly been a driving force in BiH's reform efforts.

BiH signed a Stabilisation and Association Agreement (SAA) with the EU in June 2008, but there are doubts as to whether BiH will be granted EU candidate status, which its government seeks, during 2009-10. BiH's integration with the EU will depend, in part, on the pace of reforms. This came in for criticism in the European Commission's latest annual progress report, published in November 2008, which noted that the reform process had slowed since mid-2008. There is also a question-mark over the EU's own appetite for further enlargement, following the rejection of the Lisbon treaty by Irish voters in June 2008.

5.6.2 External financial sustainability

The external position of BiH remained stable over 2002 – 2004 on account of a steady build-up of reserves – facilitated by sustained flows of FDIs and remittances. The trade balance remained high due to the continuing growth in private consumption and new investment in infrastructure. The Economist Intelligence Unit (EIU) forecasts a deceleration in real GDP growth to 3% in 2009, before it recovers to 4% in 2010[9] - mainly on account of the downturn in BiH's euro zone and regional export markets, higher interest rates on commercial bank loans; and more restricted access to credit, particularly as local subsidiaries of foreign-owned banks are affected by the global financial crisis. There is also expected to be a reduction in workers' remittances from Western European countries, as a result of the economic downturn. The difficulties in accessing external financing will require lower spending to reduce the large current-account deficit.

5.7 Design and implementation considerations

The evaluation report suggests that the BiH authorities' attached low priority to 8 out of the 12 MFA conditionalities. Furthermore, according to some Delphi interviewees, the fragmented allocation of financing between the different entities (the central state, FBiH and RS[10]) weakened the incentives to implement structural reforms as the reform burden fell more on the two entities which received a relatively small amount of money.

The MFA operation in BiH was also affected by delays in implementation - this partly reflected the BiH Government's difficulties in fulfilling conditionalities, but was also resulted from of a series of exceptional operational difficulties with both the EU and BiH legal environments. The evaluation evidence is not conclusive as regards the impact of these delays on macro-economic stabilisation.

Monitoring of MFA in BiH also proved difficult, especially in its early phases due to the lack of secondary sources and the need to consolidate primary data from the political Entities. In addition, as is a common problem in other MFA countries, a lack of resources to enable effective monitoring on the ground and a lack of experience rendered the governments ill-equipped to complete this task. This suggests that they may require further support or guidance on implementing monitoring techniques and programmes.

Internal publicity of the reform agenda also seems to have been inefficient as further down the hierarchical chain civil servants were poorly informed about MFA and its link with the activities under their area of responsibility. This is a problem that should be addressed as the visibility of MFA amongst state officials, civil servants and businesses is useful in increasing a sense of economic and political confidence.

Another criticism of the design is that as many as 100 to 150 structural conditionalities from various sources were provided, including the IMF, different World Bank operations and the EU MFA. This suggests a reform programme that was overly ambitious and wide in scope and points towards a need to simplify and better tailor conditions in the light of a realistic

[9] Real GDP growth in 2008 is estimated at 5.3% (EIU)

[10] Bosnia and Hercegovina (BiH) consists of two entities- Republika Srpska (RS) and the Federation of BiH - each with political, legislative and judicial authority, and the Brcko District as a self governing unit under the jurisdiction of the central state

assessment of capacity for implementation. There also needs to be greater focus if monitoring of the MFA and associated reforms is to have significant effects.

Table 5.1 Key Economic Indicators (mEUR unless indicated otherwise)

	2002	2003	2004	2005	2006	2007
Macro-economic Indicators						
GDP at current prices	6,545	7,401	8,054	8,637	9,756	11,041
Real GDP Growth Rate (%)	5.50	3.00	6.30	3.90	6.70	6.80
Retail prices growth rate (% change)	0.35	0.60	0.40	3.75	6.12	1.50
Exchange Rate (EUR)	1.96	1.96	1.96	1.96	1.96	1.96
Exchange Rate (USD)	2.08	1.73	1.58	1.57	1.56	1.43
Balance of Payments						
Trade Balance	-3,516	-3,663	-3,670	-3,954	-3,398	-4,134
Current Account Balance	-1,249	-1,436	-1,316	-1,552	-815	-1,398
Direct Investment	281	337	564	492	568	1,526
Portfolio Investment			-2	2	0	-1
Gross Official Reserves	1,267	1,425	1,775	2,156	2,782	3,418
Gross Official Reserves* (months)	3.0	3.2	3.7	4.0	5.2	5.4
Public Finances						
Government Revenue and Grants	2,618	3,071	3,254	3,636	4,380	5,017
Government Expenditure	2,625	3,019	3,125	3,420	4,097	4,874
Fiscal Balance	-7	52	129	216	283	142
Fiscal Balance as % of GDP	0%	1%	2%	2%	3%	1%
Relative Importance of MFA						
EU MFA	15	10	10	15	10	
% of GDP	0.23%	0.14%	0.12%	0.17%	0.10%	
% of Current Account deficit	1.20%	0.70%	0.76%	0.97%	1.23%	
% of Public spending	0.57%	0.33%	0.32%	0.44%	0.24%	
Debt Indicators						
External Debt of Government Sector	2,189	2,048	2,057	2,213	2,077	2,021
External Debt as % of GDP	33%	28%	26%	26%	21%	18%

*Months of Imports of goods and services

Source: The Central Bank of Bosnia and Herzegovina

6 SERBIA AND MONTENEGRO (2002 – 2006)

6.1 Background to the MFA

Serbia and Montenegro were late entering the process of economic transition, having to cope simultaneously with the economic consequences of the dismantling of the former socialist federation, the collapse of the command economy, as well as the wars and years of sanctions. In 1999, as a result of the destruction of industry and commerce by the NATO bombing, social product declined in real terms by 21.9% in relation to 1998. Industrial output fell by 23.1%[11]. Although economic growth recovered in 2000, there remained significant structural and systemic weaknesses.

The political situation in Serbia and Montenegro has been volatile and fragile – due to the break-up of Federal Yugoslavia followed by years of ethnic conflict, sanctions, international isolation and the maintenance of a siege economy. Furthermore, the desire of Kosovo to become an independent state has also contributed to political instability. In Serbia, uncertainty was exacerbated in 2003 following the assassination of the Serbian Prime Minister.

Against this general backdrop, on 16 July 2001, the Council approved MFA of up to EUR 300 million in favour of the Federal Republic of Yugoslavia (FRY), comprising a loan facility of up to EUR 225 million and a grant facility of up to EUR 75 million. This assistance was provided in the context of an IMF Stand By Arrangement (SBA) approved in June 2001, covering the period until end-March 2002. In early November 2002, the Council decided to provide Serbia and Montenegro with further MFA (MFA II) of up to €130 million, comprising a €75 million grant and a €55 million loan.

MFA to Serbia and Montenegro consisted thus of two packages (I and II). The ex-post evaluation focuses on the Second Package of MFA. However, both packages are described to provide a fuller picture.

6.2 Stated objectives of the MFA operation

The objective of this assistance was to underpin economic policies in the context of the three-year IMF Extended Arrangement (2002- 2005) and in particular to support the balance of payments.

In addition to the standard MFA objectives (easing the country's external financial constraints, supporting balance of payments and strengthening the reserve position), the Council Decision indicated that "*financial assistance from the Community in the form of a combination of a long-term loan and a straight grant is an appropriate measure to support the sustainability of FRY's external financial position, given its limited borrowing capacity*".

Another major objective that guided the conditionalities of MFA was the establishment of an internal market (for example, the conditionality concerning the agreement by Serbian and Montenegrin authorities to set up a detailed action plan to harmonise custom tariffs and also regarding the modalities to introduce VAT). However, the SMoU relating to the support package agreed in November 2003 did not contain any more conditions supporting the harmonisation of two states' economic systems. Instead the Commission adopted a twin-track approach with separate conditions for Serbia and Montenegro.

[11] EIU Country Report

6.3 Impact of MFA on short term macroeconomic stabilisation of the recipient country

The economic relevance of the MFA is less clear as the size of MFA support was modest in relation to key macroeconomic indicators. The ECORYS evaluation concludes that the direct short-term macro-economic impact of the operation was "very small".

As detailed in the evaluation report, both Serbia and Montenegro achieved economic growth during the MFA period. Curbing inflation has been an important challenge for the authorities but it has declined over time. Serbia's current account deficit worsened gradually since 2000 and reached 11.5% in 2006 whilst Montenegro's current account deficit widened since 2003 and reached about 26% of GDP in 2006. In Serbia, the capital and financial account balances exceeded the current account deficit; resulting in positive net inflows of capital and accumulation of reserves. Foreign direct investments started rising in 2003 and foreign exchange reserves were on a steadily increasing path since 2000. In Montenegro, foreign direct investment was very low in 2001-2004 but increased afterwards due to the one-off transactions related to the sale of state-owned companies; and more recently to the massive inflow of funds for investment in construction. Montenegro's gross international reserves remained modest in the early part of the decade but almost tripled in 2005, reflecting inflows from privatisations. Serbia was successful in balancing central government revenues and expenditures; switching from a deficit into a surplus in 2005 due to tax revenue reforms and improved tax administration. Also in Montenegro, public finances improved over the years due to the buoyant economy and successful tax reforms.

Box 6.1 Statistics relating to Serbia and Montenegro's macroeconomic conditions during the MFA period:

- Since 2000, Serbia has achieved sound economic growth, with rates in the range of 4% to 8% raising the gross domestic product (GDP) in 2007 by over 50% in comparison to 1999.
- In 2001, the inflation rate stood at 99.2%; decreasing to 20.3% in 2002; and to 17% and 12% in 2005 and 2006, respectively. Only in 2007 did it come down to single digit levels.
- The Current account deficit has worsened gradually since 2000, as imports expanded in line with growing demand. In 2002, the Current account deficit stood at -7.9% of GDP and rose to -11.7%)in 2004 and -11.5% in 2006.
- Foreign exchange reserves have been on a steady increasing path since 2000; with a particularly marked acceleration in 2006. Serbia was also successful in balancing central government revenues and expenditures; switching from a deficit into a surplus in 2005.
- In 2002, economic growth in Montenegro was only 1.7% of GDP. Since 2003, economic growth accelerated to reach 8.3% in 2006; and 7.1% in the first three quarters of 2007.
- Inflation declined considerably from 6.8% in 2003 to 3.0% in 2006. Montenegro's Current account deficit widened considerably from 7 to 10% of GDP in the 2003-2005 period; up to 26% in 2006 and to as much as -50% in the first half of 2007.
- Montenegro's gross international reserves remained modest in the early part of the decade, and stood at € 60 million (equivalent to US$ 74 million) at the end of 2004. Reserves almost tripled in 2005, reflecting inflows from privatisations; and increased to €310 million by the end of 2006.

As mentioned previously, the main macroeconomic objectives of Serbia and Montenegro, which were supported by the international community, included the achievement of low inflation with sustainable growth and external viability. These objectives have been achieved but there remains doubt regarding the sustainability in the medium and long term. Moreover reducing inflation in Serbia took more time, and was only achieved after the end of the MFA operation. The MFA operation therefore allowed for a slightly more expansionary macroeconomic policy that marginally improved economic growth performance. However, the direct short-term macroeconomic impact of the operation was deemed small by the evaluation report and it is possible that the MFA assistance could have had a more substantial impact on the medium-term macroeconomic outlook through the acceleration of structural reforms.

The macroeconomic counterfactual portrayed in the evaluation report showed that the direct impact of MFA on economic growth in Serbia was marginally positive in the short term. This was mainly due to the relatively small size of the operation.

6.4 Impact of MFA on supporting structural reform in the recipient country in the short to medium term

The evaluation suggested that the MFA was not considered as the main driver for structural reform by the national authorities. Since accession was high on the policy agenda, the SAP process was identified as the main driver for structural reforms in Serbia and Montenegro. It would have been in the interest of Serbia to implement the reforms in order to qualify at some point for potential EU candidacy. In the case of Montenegro, the authorities would have been keen to display its responsibility and credibility to the international community and the EU in particular; and reduce the negative image associated with Yugoslavia. Therefore, meeting the structural conditionalities was taken seriously as part of the country's international image building.

Also, the evaluation report suggested therefore that without MFA, most reforms related to the conditionalities would have been implemented anyway as structural reform conditionalities were in fact integrated in other IFIs' programmes. Although reforms would most likely have been implemented in the absence of MFA, the overall political reinforcing effect of the EU conditionality was considered to be helpful. Based on the evidence presented in the ECORYS report, it seems that the added-value of MFA was that it speeded up the implementation of reforms regarding the treasury system, tax revenue collection, strengthening of the National Bank, bank privatisation and privatisation of enterprises.

6.5 Other effects

The relevance of the MFA funding was extremely important given the political background of the two entities. The 'political signalling' and 'credibility granting' impact of the MFA is highlighted several times in the ECORYS evaluation.

During the above-described difficult political juncture, the EU gave a strong signal of support for the Serbian authorities by front-loading the MFA disbursements and topping-up the package – MFA II was increased from EUR 130 million to EUR 200 million in November 2003. In this context it is likely that MFA was instrumental in bringing Serbia closer to the Community.

6.6 Impact of MFA on long-term external sustainability

It is possible that the impact of MFA on sustainability would have been substantial if MFA had accelerated structural reforms in the 2002-2005 period as it was these reforms that provided the basis for higher GDP growth rates in the medium term. The most important potential impact of MFA on external sustainability could be due to the pressure on accelerated privatisation of banks and enterprises, as well as their restructuring. Overall it is reasonable to conclude that MFA positively contributed to the medium to long term external sustainability prospects, however as detailed in the evaluation report this net impact was likely to be limited and indirect. The primary channel through which MFA acted appears to be the enforcement of structural reforms and the improved overall macroeconomic management.

The current global economic and financial crisis has already had a negative impact on Serbia, with the dinar coming under pressure in recent months and output growth slowing. Access to external finance has become more difficult and more expensive. The IMF approved a two year stand-by agreement in March 2009, aimed at bolstering external position of the country.

Privatisation has become more urgent, in view of probable financing gaps in the budget. The recent sale of the state oil company to Gazprom will bring in much-needed money. Other priorities include launching the privatisation of the dominant telecommunications operator, Telekom Srbije, and trying again to find a strategic investor for the RTB Bor mine and smelter complex. However, the global financial climate is unlikely to be propitious over the next year or so.

6.7 Design and implementation considerations

As regards design aspects, most conditionalities were considered relevant to the needs of both Serbia and Montenegro (except for the initial conditions relating to the establishment of the internal market where less national ownership existed). MFA conditionalities were closely linked to the IMF Extended Agreement and World Bank programmes thus encouraging local “buy-in”. The MFA operation itself reflected flexibility on part of the Commission – as demonstrated by the front loading and topping-up of assistance in 2003 following the assassination of the Prime Minister; the use of waiver concerning a condition in the area of privatisation; and, the use of a twin-track approach to conditionalities.

The presence of MFA was not widely publicised and therefore the interviewed officials from the national authorities in Serbia were not familiar with the MFA operation. The officials were aware of the conditionalities but related them to IMF or World Bank programmes. There would have been merit in the MFA being visible in beneficiary countries – as the EU can achieve more political leverage if the citizens of the benecifiary country are aware of EU assistance.

However, there were strong and useful synergies between the MFA and the IMF Extended Agreement and World Bank programmes. MFA conditionalities were therefore in line with the overall programmes of the IFIs and thus provided an extra political reinforcing tool in the implementation process.

As well as the MFA objectives which related to the balance of payments and the international reserve position of Serbia and Montenegro, the EU had another objective of relation-building and the national authorities in Serbia appeared to have attached value to the explicit reform support objective. The evaluation report highlighted that in Montenegro, officials emphasised the budget support and the image-building elements. In this MFA operation the interlinking between the explicit short-term objectives and the objective to support reforms of the government(s) was strong. In addition another effective aspect of design was that a number of conditionalities related clearly to ensuring the sustainability of the macro economy through relevant structural reforms.

A strength in the design of MFA that increased efficiency was its flexibility. For example, there was a relatively quick reaction by the EU after the assassination of the Prime Minister and to the use of a waiver concerning a condition in the area of privatisation. Most conditionalities were similar to the conditions in the IMF Extended Arrangement and in World Bank programmes. This coherence can be perceived a design strength and since most conditionalities were similar to the IFI requirements this would have contributed to efficiency. One improvement in efficiency would have been the improved visibility of the MFA instrument to ensure officials and institutions were aware of the conditions.

Table 6.1: Key Economic Indicators – Serbia (mEUR unless stated otherwise)

	2002	2003	2004	2005	2006	2007
Macro-economic Indicators						
GDP at current prices	16,491	16,978	18,138	20,541	26,913	30,729
Real GDP Growth Rate (%)	4.23	2.50	8.42	6.21	5.74	6.55
Retail prices growth rate (% change)	19.49	9.88	11.03	16.12	11.72	6.39
Exchange Rate (EUR)	61.86	69.01	78.91	85.20	78.99	79.09
Exchange Rate (USD)	58.98	54.64	57.94	72.22	59.98	53.73
Balance of Payments						
Trade Balance	-3,227	-3,188	-4,286	-4,539	-5,329	-6,238
Current Account Balance	-1,189	-1,124	-2,114	-1,886	-3,011	
Direct Investment	311	848	585	1,221	3,255	1,362
Portfolio Investment					342	624
Gross Official Reserves	2,173	2,811	3,117	4,952	9,027	9,656
Gross Official Reserves* (months)	4.5	5.2	4.3	5.8	9.4	8.0
Public Finance						
Government Revenue and Grants		6,882	7,511	8,369	10,959	12,651
Government Expenditure		7,418	7,515	8,095	11,374	12,969
Fiscal Balance		-536	-4	273	-415	-317
Fiscal Balance (% of GDP)		-3.2	0.0	1.3	-1.5	-1.0
Debt Indicators						
External Debt of Government Sector	11,023	11,381	10,805	13,812	10,502	
External Debt as % of GDP	67	67	60	67	39	

Source: WDI, IMF Country Reports, National Bank of Serbia

Table 6.2: Key Economic Indicators – Montenegro (mEUR unless stated otherwise)

	2002	2003	2004	2005	2006	2007
Macro-economic Indicators						
GDP at current prices	1,360	1,510	1,670	1,815	2,149	2,599
Real GDP Growth Rate (%)	1.70	2.40	3.70	4.30	8.60	7.50
Retail prices growth rate (% change)	13.40	6.70	3.20	3.30	2.10	
Exchange Rate (EUR)	1.00	1.00	1.00	1.00	1.00	1.00
Exchange Rate (USD)	0.95	0.79	0.73	0.85	0.76	0.68
Balance of Payments						
Trade Balance	-334	-248	-268	-318	-651	-769
Current Account Balance	176	-101	-142	-140	-531	-825
Direct Investment	76	44	52.6	383		
Portfolio Investment						
Gross Official Reserves	55	50	60	173	347	498
Gross Official Reserves* (months)						
Public Finance						
Government Revenue and Grants	304	478	511	579	912	1,340
Government Expenditure	250	514	559	621	862	1,161
Fiscal Balance	54	-36	-48	-42	50	179
Fiscal Balance (% of GDP)	4.0	-2.4	-2.9	-2.3	2.3	6.9
Debt Indicators						
External Debt of Government Sector	1,149	711	742	700	701	737.2
External Debt as % of GDP	84	47	44	39	33	28

Source: WDI, IMF Country Reports, Montenegrin Ministry of Finance

7 ALBANIA (2004 – 2006)

7.1 Background to the MFA

The EU had provided three MFA operations over 1992-2002 to Albania, in order to support the transition to democracy and the related revitalisation and liberalisation of the economy, as well as to facilitate the management of problems created by the influx of refugees from Kosovo.

In July 2002, the IMF approved a second Poverty Reduction and Growth Facility (PRGF) arrangement for the period 2002-2005 and during the July 2003 review identified a residual financing gap for 2004 of US $ 46 million.

At the end of 2003, the Minister of Finance of Albania formally requested MFA to assist in meeting this financing gap and this was approved by the Council in April 2004. The EU then provided EUR 25 million of Macro Financial Assistance (MFA) to Albania, in the form of a loan of EUR 9 million and a grant of EUR 16 million, between April 2004 and July 2006.

The end of the fourth MFA also coincided with the signature of the stability and Association (SAA) with the EU in June 2006, which promoted a set of reforms.

7.2 Stated objectives of the MFA operation

The stated primary objective of the MFA was to cover the residual financing gap remaining after World Bank and IMF funding, and thereby to ease external financing constraints, support the Balance of Payments and secure a stable reserves position.

Support to the institutional and structural reforms included in the IMF/ WB package was stated as a secondary objective but, this assumed increasing importance with the signing of the SAA agreement in June 2006, which promoted essentially the same set of reforms as the ones requested by as IMF/WB.

Moreover, in the Council decision of April 2004 which approved this fourth MFA to Albania (Council Decision 2004/580/EC), it was explicitly agreed that the financial assistance ‘should be instrumental in bringing Albania closer to the Community’.

This objective has been clearly perceived by Albanian commentators. For example, one Delphi respondent in the ECORYS evaluation explicitly stated that the key contribution of the MFA had been in ‘increasing the commitment of the Albanian government vis-à-vis the international community’. Another identified the value added of the MFA ‘as an instrument to build the confidence of the international financial market in Albania’s stability.’

7.3 Impact of MFA on short term macroeconomic stabilisation of the recipient country

Immediately after the Council’s MFA decision of April 2004, Albania’s Balance of Payments position rapidly improved as a result of the proceeds of the Savings Bank privatisation, the consequent FDI inflow of EUR 103 million being more than sufficient to fill the residual financing gap (of US $ 46 million). MFA disbursements were therefore postponed until 2005 when a new financing gap was identified.

In 2006, the MFA accounted for about 15 % of total financial assistance to Albania and some 32% of EU assistance for that year but its significance for the Balance of Payments was dwarfed by that of remittances (15% of GDP) and FDI flows and it also accounted for only a small percentage of total public spending. In 2006, the MFA would have accounted for slightly over half of the estimated residual financing gap, which was itself only US $ 41 million – a modest level of BoP financing, even for a small economy such as Albania's. In practice both remittances and FDI flows were underestimated, so with the benefit of hindsight the MFA may not have been required to meet the external financing gap.

The question might then be asked whether the MFA financing was needed at all? Additional foreign exchange financing was not in the end necessary but given the potential volatility of an external position financed predominantly by remittances and FDI flows, it is understandable that the IMF and the Government of Albania should have adopted a prudent approach to the calculation of external financing requirements. In this context, the MFA provided a type of insurance against foreign exchange shortages. Its small scale was consistent with this role and with the desire to avoid excessive appreciation of the exchange rate in the event of higher than planned foreign exchange inflows.

Thus, in summary, the Albania MFA had a modest supporting and reinforcing effect in terms of short term macroeconomic stabilisation only as an additional insurance against foreign exchange shortfalls. The continuing flows of remittances, FDI and alternative official flows meant that there were indeed no urgent BoP financing needs to be met. Thus, the BoP impact of the MFA was limited to ensuring a marginally stronger reserves position and a marginally stronger exchange rate to the Euro than would otherwise have been the case.

Within such a context, a small scale MFA was appropriate - to provide BoP 'insurance' without risking 'Dutch disease effects' from excessive foreign exchange inflows. A more substantial effect was simply not necessary, given the nature of macroeconomic developments, the level of maturity of the reform programme and the existing level of commitment to this programme.

7.4 Impact of MFA on supporting structural reform in the recipient country in the short to medium term

The ECORYS evaluation explains that even in the absence of the MFA, the twelve structural reforms required (in the following areas: a) Public Finance Management; b) Public Administration Reform and the fight against corruption; c) Financial Sector Reform; and d) the Business Environment) would have been implemented.

However, for three of these reforms (plus two prior actions linked to the first tranche, related to the formalisation of practices within the Albanian Treasury – i.e. segregation of duties and the use of double signatures), the ECORYS evaluation identifies an operational reinforcing effect of the MFA inducing a 'verifiable speeding up of reform implementation'.

Several Albanian commentators also identified this general 'reinforcing effect' of the MFA with regard to the implementation of structural reforms. In large part, this was the consequence of the fact that the MFA conditions were included as priority actions in the National Action Plan for the Approximation of Legislation and SAA implementation (NPL-SAA). The inclusion in both the MFA and the NPL-SAA of actions related to new banking legislation and to proposed legislation on judicial delays was said, by Government observers, to have been employed to strengthen the case for their inclusion in the policy agenda, despite some opposition.

This more general 'reinforcing effect' upon structural reforms attributed to the MFA almost certainly derives from the powerful signal provided by the MFA as a sign of the rapprochement of Albania with the EU and of the increasing international confidence in the political and economic stability of Albania.

The 'low profile approach' to structural reform conditions was also appropriate, aiming to reinforce established conditions and commitments rather than to "raise the bar" through inclusion of additional conditions and more ambitious targets.

As a conclusion, the MFA operation had a modest, supporting and reinforcing effect in relation to the implementation of short to medium term structural reforms (as well as to macroeconomic stabilisation). A more substantial effect was simply not necessary, given the nature of macroeconomic developments, the level of maturity of the Albanian reform programme and the existing level of commitment to this reform programme.

7.5 Other effects

The overall macroeconomic effect of the MFA operation derived both from its direct contribution to the budget and from its indirect effect upon the availability of domestic credit. In this regard, the operational 'reinforcing effect' of the MFA was most noticeable in relation to the channelling of public sector wages through the banking system, where the EU explicitly argued for a higher target coverage, which in turn impacted positively on the availability of private credit by raising the level of deposits in the domestic banking system. ECORYS estimated the cumulative effect of the MFA upon GDP growth over 2004-2008 to have been between 0.1 and 0.6 percent of GDP.

The impact of the MFA in promoting increased international confidence in the Albanian economy was not explicitly assessed in the ECORYS evaluation; nor was its impact upon Albanian political and public opinion regarding the association with the EU. However, it is reasonable to judge that the MFA operation has been effective in contributing to the wider political and foreign affairs objectives of the EU (NB: in the Council Decision 2004/580/EC of April 2004 which approved this fourth MFA to Albania, it was explicitly agreed that the financial assistance 'should be instrumental in bringing Albania closer to the Community').

Notably, the responses of the Albanian commentators to the Delphi questionnaire give an indication of significant, positive effects with regard to this political objective. Also highly relevant is the fact that the Stability and Accession Agreement was signed during the period of implementation of the MFA, with steady progress being subsequently achieved in its implementation.

Of course, in this respect, it is exceedingly difficult to disentangle the relative effects of the MFA and of other EC and Government of Albania initiatives. However, the 'signalling role' of the MFA is clearly important here and this is not an effect which can easily be generated by other EU instruments, such as project investments or provision of technical cooperation.

7.6 Impact of MFA on long-term external sustainability

The external financial position of Albania remained sustainable in the period 2004-2007, with public debt and foreign currency-denominated debt-to-GDP ratios both declining. Moreover, IMF projections up to 2010 do not signal any significant problems.

Clearly, the world recession will impact on remittances and may also impact upon exports but to an extent this will be tempered by (generally) declining food and energy prices. As with almost any country in the post-credit crunch world, some problems should be expected but overall, the Albanian economy is considerably less vulnerable than it was in the late 1990s.

The more significant question is whether this return to a broadly sustainable external financial position should be attributed in any way to the MFA operation? Clearly, it is primarily the result of a sustained process of domestically-driven reforms supported by a variety of international financial institutions but the confidence-building effects of the MFA may also have been significant, even if in financial and policy terms its direct contribution would have been small or negligible.

7.7 Design and implementation considerations

7.7.1 Design

The design of the programme, based on a balance of 2/3 grant and 1/3 loan financing for the MFA, appears to be a standard split for this region. The grant component of the first tranche (EUR 3 million) was released in November 2005 and the loan component (EUR 9 million) in March 2006. The second tranche (a grant of EUR 13 million) was released in July 2006 after the MoU conditions were deemed to have been fulfilled.

Clearly, the Government would have favoured a higher level of grant financing but given the highly concessional terms available for the loan financing, and Albania's relatively favourable external debt position, it is unlikely that the specifics of the loan/grant split were of much significance. The ECORYS evaluation report suggests that the fact the second tranche was predominantly grant financing may have represented an additional incentive for faster fulfilment of the conditions for disbursement. This conclusion could be contested both because of the modest scale of the MFA operation and because the majority of the disbursement conditions related to reform actions to which the Government were already firmly committed: no extra financial incentive was necessarily required.

The other significant feature of the design relates to the choice of the structural reform conditions included within the MoU for the MFA. The MFA operation included a total of 14 conditions. Of these, as mentioned above, two were prior actions linked to the first tranche, which were drawn from the Operational Assessment, and related to the formalisation (in administrative regulations) of practices already well established within the Albanian Treasury, regarding the segregation of duties and the use of double signatures. It is not clear that these conditions had any real operational significance.

The other twelve conditions related to structural reforms in the areas of a) Public Finance Management; b) Public Administration Reform and the fight against corruption; c) Financial Sector Reform; and d) the Business Environment. All of these conditions represented actions to which the Government had expressed its strong commitment and which were the subject of agreements with either the IMF or the World Bank.

7.7.2 Implementation/ utilisation

The principal use made of the MFA was as budget support. In particular, the evaluation report suggests (in its specification of the counterfactual) that the MFA flows allowed a higher level of expenditure on infrastructure projects and on the land compensation fund being built up for future land acquisitions for public infrastructure development. This seems appropriate in developmental terms, whilst also representing a fiscally prudent use of one-off resources, with a relatively unpredictable disbursement pattern.

As untied and undesignated foreign exchange resources, neither the MFA financing agreement nor the MoU specified an agreed use for the MFA funds but it would perhaps have been wise for the evolution of BoP financing and of the pattern of public spending (not just the aggregate fiscal balances) to have been formally included as agreed areas for discussion and monitoring in the annual programme reviews.

7.7.3 Relevance and appropriateness of design and implementation

The design and mode of implementation of the Albania MFA was appropriate to its implicit objectives but less so to its stated objectives. Effective financial support to the Balance of Payments (one of the key stated objectives) requires rapid and timely disbursements.

Although the disbursement of the Albania MFA was reasonably prompt (taking account of the deliberate decision to delay the disbursements initially scheduled for 2005), it is clear that the combined bureaucratic delays deriving from the nature of the MFA legal instrument and the Albanian requirement (common to many countries) for external loans to be approved by Parliament would have been a hindrance if a fast disbursing operation had genuinely been required.

Similarly, the selection of a limited number of structural conditions (14), of which 12 were already the subject of internal Government commitments and agreements with the IMF and the World Bank would not be consistent with the objective of having a significant, independent impact upon the policy reform agenda. However, empirical research suggests that the scope for external influence upon domestic policy processes is limited and subject to quickly diminishing marginal returns. In this context, the selection of conditions for the MFA MoU was in fact highly appropriate and contributed to a harmonised set of disbursement conditions, which were clearly “owned“ by the Albanian authorities.

There remains a suspicion that, however appropriate the end result may have been, these were not all deliberate design decisions. For example, the ‘low profile approach’ to the selection of structural reform conditions may perhaps have been a simple operational response to internal capacity limitations.

Hence, although it can be argued that the MFA operation was highly relevant it was in large part for reasons which were prominent neither in the stated MFA objectives nor in the MoU nor, indeed, in the ECORYS evaluation report.

If these were deliberate design decisions, then they deserve to be better documented both to facilitate evaluation and to serve as clearer examples of the sort of approach that might be appropriate in similar operations elsewhere. Similarly, if a key contribution of the MFA was the ‘confidence-building effect’ or political ‘signalling role’ of the MFA as a declaration of confidence by the EU in the Albanian political and economic situation, then this also deserved to be highlighted more in the formal objectives of the operation and in the various communiqués issued during the process of monitoring.

In the same vein, some adaptation of the evaluation methodology may be necessary in order to permit the assessment of impacts upon Albanian political/ business and public opinion.

Table 7.1 Key Indicators (mEUR unless indicated otherwise)

	2000	2001	2002	2003	2004	2005	2006	2007
Macro-economic Indicators								
GDP at current prices	3,939	4,539	4,702	5,048	5,879	6,550	7,244	7,951
Inflation Rate								
Interest Rate								
Exchange Rate (EUR)	132.79	128.51	132.43	137.5	127.7	124.4	123	123.6
Exchange Rate (USD)	143.71	143.48	140.16	121.9	102.8	99.9	98.5	90.4
Balance of Payments								
Trade Balance	-897	-1,149	-1,218	-1,177	-1,277	-1,477	-1,659	-2,104
Current Account Balance	-185	-316	-444	-350	-340	-589	-471	-832
Direct Investment	157	231	141	157	267	209	250	466
Portfolio Investment	-29	-26	-40	-21	5	-2	27	19
Change in Reserve Assets	-142	-146	-103	-148	-276	-47	159	99
Public Finances								
Government Revenue and Grants	950	1,083	1,167	1,216	1,444	1,641	1,865	
Government Expenditure	1,276	1,445	1,454	1,463	1,742	1,868	2,104	
Fiscal Balance	-326	-363	-286	-247	-298	-226	-239	
Fiscal Balance as % of GDP	-8%	-8%	-6%	-5%	-5%	-3%	-3%	
Relative Importance of MFA								
EU MFA						3	22	
% of GDP						0.05%	0.30%	
% of Current Account deficit						0.51%	4.67%	
% of Public spending						0.16%	1.05%	
Debt Indicators								
Net Foreign Debt (Stock)	4,646	5,429	7,397	8,730	10,885	10,922	12,587	14,364
Net Foreign Debt as % of GDP	118%	120%	157%	173%	185%	167%	174%	181%
Domestic Debt Stock	1,702	1,877	1,969	2,042	2,312	2,539	2,837	2,990
Internal Debt as % of GDP	43%	41%	42%	40%	39%	39%	39%	38%

Source: Bank of Albania, Ministry of Finance, IMF, International Finance Statistics

ANNEX III: REVIEW OF ECONOMETRIC MODELLING

1. Introduction

This section presents Cambridge Econometrics' evaluation of the counterfactual modelling carried out as part of the Macro-Financial Assistance (MFA) analysis. The main sources of information used for this evaluation are the final reports available on the website of the European Commission's Directorate General for Economic and Financial Affairs[12]. Specifically these are the national reports for:

- Macedonia (FYROM) and Romania (July 2006)
- Tajikistan (March 2007)
- Bosnia & Herzegovina (May 2007)
- Albania and Serbia & Montenegro (March 2008)

In one country, Romania, an additional quarterly model was also applied. This is discussed briefly in Section 1.3.

For each country and counterfactual scenario, the most important modelling assumptions are laid out in the Section 1.6.

There was also a report for Armenia which used a different modelling approach; this is discussed in Section 1.7.

Counterfactual modelling

The project team's original proposal referred to this task as a review of "econometric" models, but it is not clear that the models that were used are based on an econometric foundation. The project reports use the term "counterfactual modelling", meaning an analysis of what could have happened in the past, if policy decisions had been different (or analysis of previous impacts). We shall use the same terminology.

Why is a review necessary?

When interpreting the results of any modelling exercise, it is important to be aware of the underlying assumptions on which the model and/or counterfactual is based. In the most extreme cases these assumptions may be the primary driver of results. In this analysis the authors frequently note that quantitative results should be treated with caution but:

- these warnings are often ignored
- it could be possible to derive a model that produced a particular set of results

It should be noted that it is sometimes preferable to produce no modelling results at all than ones that are potentially misleading.

The remainder of this chapter focuses on some of the key aspects in the modelling process, namely basic structure, equations, data inputs and estimation of parameters. Finally we consider if the model has been applied appropriately and look at the design of the counterfactual scenarios (as scenario design can be the most difficult part of the modelling exercise). Particular attention will be paid to any factors that are likely to lead to systematic bias of results.

[12] See http://ec.europa.eu/economy_finance/multiannual_eval_prg/multiannual_eval12403_en.htm

Model versions

The basic model was further developed for the later studies, although the main structure remains the same. This document generally describes the most recent version, with references made to earlier versions where appropriate and where the information is available.

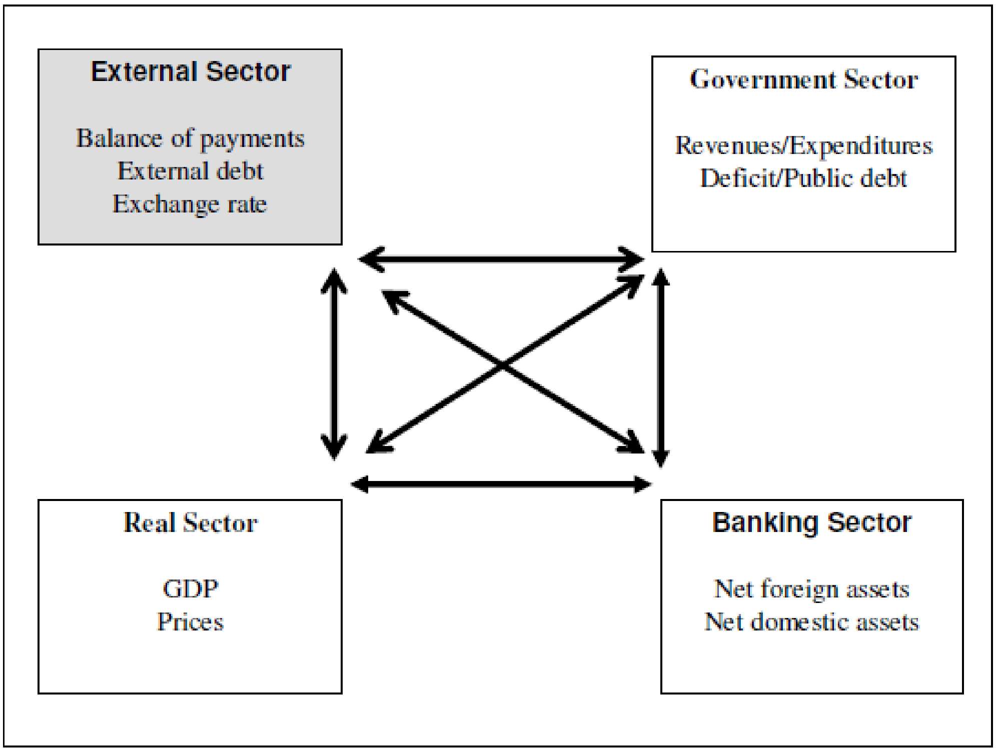
2. Model structure

Basic structure

The basic model is made up of four sectors:

- External Sector
- Government Sector
- Real Sector
- Banking Sector

Figure 1: Basic Model Structure



These are shown in Figure 1, which is taken from the report for the evaluation of the Former Yugoslav Republic of Macedonia, but also appears in the other national reports. The arrows in this diagram suggest that there are direct, two-way linkages between all four modules. This is backed up by the equation specification.

Follow-up question

It is not clear why the arrows into and out of the banking sector are different to the others but the distinction should not be regarded as important.

Difference from base

The model operates using differences from base, either in actual levels (identity relationships) or as percentages (behavioural relationships). This is a sensible design and side steps some definitional problems and problems with units, but it does assume that the overall size of the economy does not have any effect on any of the behavioural relationships. This assumption may be questionable, but it is not easy to see how such a factor could be incorporated into the modelling framework.

The method of using differences from base raises the question of the baseline that was used. Usually, modelling studies are carried out ex-ante, meaning that they results are based on a prediction of the future. However, in this case, most of the analysis is carried out ex-post, with the counterfactual scenarios (see Section 1.1) giving an indication of what would have happened in the absence of MFA (ie the analysis is not actually on the impacts of MFA, it is on what the outcomes would have been *without* MFA). The baseline is therefore mostly formed from historical data and is not an issue of contention in these studies.

Where a forecast element was required for the final years when data were not available, the studies used published IMF forecasts that were consistent with historical data. This would have been the best approach available.

Static relationships

For short-term analysis a dynamic framework would usually be applied, meaning that developments in one year would affect developments in subsequent years. In these studies this has not been the case, mainly due to problems with data and estimating parameters. It is difficult to see how the modelling team would have been able to get around this. The model is solved annually, meaning the implication is that, in the modelling results, MFA has no impact on flow variables (eg GDP growth, government) beyond the year it is applied.

This is particularly relevant where infrastructure spending has been highlighted as a difference between base and counterfactual scenarios, as this would be expected to increase activity in the real economy in subsequent years. There is no capital stock in the model.

3. Model equations

The model documentation does not describe all of the equations that are in the model, but focuses on the most important ones. These are described in the sections below. As would be expected, the model consists of both identity and behavioural relationships.

Identity relationships

The identity relationships on their own are non-controversial; these are constructed to be consistent with standard accounting conventions. The main possible issues are if terms have been left out (ie changes are assumed to be zero); this is discussed for each of the equations below.

Balance of payments

The model documentation shows a “stylised” version of the equation used for the balance of payments. It is based on the standard identity plus foreign exchange reserves and essentially states that change in reserves is equal to the change in the current accounts (including MFA grants) plus the change in the capital account (including MFA loans).

This in itself is perfectly acceptable. However, the behavioural relationships attached are to it subject to major assumptions. This is key to the modelling results as the identity relationship states that there must be direct impacts on one of the items if MFA (an item of the capital account) changes. The assumptions that were used are specific to each individual case and are generally made explicit (see Section 1.6), although the thinking behind these assumptions is not always made clear.

Generally in modelling exercises, the closer the assumption is to the initial shock, the greater the size of its likely impact, so these assumptions should be regarded as important.

Budget identity

The government budget identity is straight-forward with change in debt equalling the difference between change in revenues and change in expenditure. It is important to note that MFA grants and MFA loans appear in different places here.

Similar to the balance of payments this is a standard relationship but again a judgment must be made to balance the identity when MFA is removed. This is also shown in Section 1.6. This case is possibly less controversial, as government behaviour at the time could be observed (and officials were often consulted), so it was easier to link the assumptions to actual behaviour. It would almost certainly not have been possible to estimate relationships, using econometric techniques. However, the arbitrary nature of the relationships suggests that model outcomes should also be treated as approximations.

A possible improvement, discussed below, would be to split government expenditure into transfer payments, a component of income, and final demands, a component of GDP.

Money supply

The banking sector identity splits changes in money supply to changes in net foreign assets, government credit and other domestic assets. This is presumably designed to fit within the other sectors in the model. The exact definition of the money supply could be M1, M2 or M3, depending on what is included in the other domestic assets category. However, as the model is based on differences this is not important and, in the countries considered, differences between the definitions are likely to be small anyway. Likewise money held outside banks is assumed to remain unchanged but in these countries this seems a reasonable assumption.

Behavioural relationships

The documentation on the behavioural relationships differs between the country reports, although all use the same heading “Real sector behavioural equations”. It is not always clear if it has been the model or the documentation that has been updated. Later reports present a larger group of equations, reflecting developments to the model but do not give values for any of the parameters. We cover as much of the material as is available in the reports.

Banking sector

The first equation for the banking sector states that deposits are a function of wages and (assumed gross) savings rates. It is not clear what the treatment of business accounts is. It is also not clear what the assumptions about the savings rates are and whether these would be expected to change in the counterfactual scenarios. This is quite a significant omission.

The second equation determines banks' total domestic lending (banking sector claims on the private sector), based on their deposits and behavioural patterns. In normal times these rates could probably be assumed to remain constant although, as the recent financial crisis has shown, banks will change rates of lending in times of trouble.

It is not clear from the reports if this lending is assumed to be only to households or also to business but, as it affects both private consumption and business investment it is assumed to be both. This implicitly assumes that the ratio between lending to households and lending to businesses remains unchanged.

Components of GDP

Private consumption is a function of incomes with saving and lending taken into account, ie real wages corrected for net saving. Usually in a static model this relationship would be taken as one-to-one but this may not the case here, because the incomes variable also includes lending to business. Given the size of private consumption in GDP this is a key parameter for results in the Real Sector.

The other factor that is missing from this function is non-wage income; it is not clear how this is accounted for, but in many countries it does make up a significant share of total household incomes.

Changes in gross fixed capital formation are defined as a function of changes in bank lending. Again it would be reasonable to suggest a one-to-one relationship. Relative prices, rates of interest and the level of uncertainty would also be expected to influence investment decisions, but this is not a key equation so the specification seems adequate.

Changes in imports are modelled as a function of changes in final demand, ie consumption and investment. These are treated separately so the model may take into account the fact that different shares of consumption goods and investment goods are imported (although again no parameters are given). In addition, no provision is made for imports that are intermediate goods, ie are required by businesses as an input to the production process. The implicit assumption is that these imports increase at the same rate as those for consumption plus investment. However, some of these imports will be used to produce exports, which are assumed to remain unchanged. The implication is that imports could be increasing by more than would be expected.

It should also be noted that exchange rates respond directly to imports and not vice versa, and there is no reaction in import shares to changes in relative prices. This is an omission in a model that includes inflation and wages.

GDP is defined as a behavioural, rather than identity, relationship. This is curious. Possibly in the earlier versions of the model private consumption was not defined so there was implicitly a behavioural aspect (in relation to net household incomes) in the function but the later versions included all the required components of GDP except exports, stock building and final government demand (currently only included in a more aggregate variable).

However, with aggregate data for all these almost certainly available (although not for Serbia and Montenegro), it would not have been difficult to add them and to calculate GDP directly from its component parts. Nevertheless, as long as the "parameters" in this function are correct (i.e. share of each component in GDP) this treatment will make little difference for the small changes in GDP we are considering.

Inflation

The method for modelling inflation is simple but appropriate for a static model. Inflation is assumed to be a function of the difference between money supply and real GDP growth. This seems sufficient for the purpose.

Exchange rates

The documentation is unclear on exchange rates and it looks like there are errors in the text. The assumed methodology is that exchange rates are a function of GDP, inflation and imports. As exports are fixed this effectively means exchange rates are a function of the current account, but it is surprising there is no direct link between the capital and financial accounts and exchange rates.

Otherwise this approach to modelling exchange rates is reasonable but it should be noted that the variations are likely to be large in comparison to day-to-day fluctuations.

One point worth noting here is that exports appear to be held as fixed, even if there is a change in the exchange rate (or indeed relative prices). This would have implications for the balance of payments and real economy.

Missing relationships

The most obvious factor that is missing from the model structure is a treatment of the labour market. Wages play an important role in determining factors in the Banking Sector and (indirectly) the real economy. No explicit function for wage determination is given so it is assumed that the share of wages in GDP remains constant. However, the implicit assumption is that this is through higher wage rates rather than higher employment rates (consistent with equilibrium-based modelling approaches). There would be a difference on the government balance through changes in benefit claims. Currently there is no link between the government sector and wages.

Follow-up question

After contacting the original modelling team it was confirmed that a simple specification was used for determining wages (presumably from GDP). Given the scale of the changes and level of aggregation this seems adequate.

As mentioned above, the missing link between price changes and changes in import volumes is surprising, as is the apparent lack of influence of the capital account on exchange rates.

Quarterly model

In the study for Romania a separate quarterly model was constructed. This was consistent with the annual model and used the same data sources. The model was designed to add detail to the balance of payments identity by allowing the costs of external borrowing to vary over the year (Romania was the only country where external borrowing was directly changed).

As the factors this model was supposed to account for (ie mainly market sentiment) are highly uncertain, model parameters are only ever going to be approximations at best and this is acknowledged. The conclusions drawn from this model, representing one sentence in the report, are consistent with this. In summary, the model was fairly crude but was used in an appropriate manner.

4. Data quality

All modelling exercises are dependent on the data that are fed into them so this is an aspect that cannot be ignored. Clearly in the countries that were examined there are issues of data quality. The choice of annual macro-economic data is not surprising; although a certain amount of detail is lost, as this was much more likely to be available and of reasonable quality.

The model requires data for the years it is solved for. If any econometric estimation was carried out (see below), data for previous years would also have been required.

The main data sources in all the studies are various IMF publications which would have been the most reliable available. Use of these also gives a consistent definition to the more complex (eg financial) variables.

If there are gaps remaining then data are taken from central banks and national statistical agencies. It is unlikely that any alternative would have been available.

In summary, it is difficult to argue against the modelling team's choice of data sources and dimensions.

5. Parameter estimation and sensitivity testing

The model documentation repeatedly urges caution about the nature of the elasticities. While noting that parameters may be estimated, calibrated or entered by assumption, the available data mean that most of the parameters were entered by assumption.

In most cases it would not be possible to estimate elasticities using econometric methods as time-series data would be required (cross-sectional estimation would not be possible in analysis for a single country). However, only short time series would have been available, probably of poor quality, based on a period of transition, and the number of structural breaks would most likely invalidate the estimated elasticities. Calibration would be an option for some of the behavioural parameters but this also requires more data and a more formal specification of some of the relationships that are in the model.

Therefore it seems reasonable that many of the parameters have been entered by assumption. However, from a technical perspective the detail is unfortunately lacking in the reports. The only reference is a fairly vague one in some of the reports to "available evidence from [country of question] and other similar economies" (for example, p124 of the Albanian report). As the reader does not know the values of the parameters, or how they were obtained, it is difficult to make a judgment on their suitability.

Linear relationships

One property that does seem to be clear in the model (and many more complex economic and financial models) is the linear or log-linear nature of its responses to a given set of inputs. This means that, for example, a doubling in MFA would lead to a response twice the size. This is usually considered reasonable for the relatively small changes in these studies, but would become less appropriate in a crisis, when high levels of uncertainty tend to lead to non-linear responses. Effectively this is saying that, by modelling assumption, removing the MFA will not lead to a financial crisis.

Sensitivity analysis

Sensitivity analysis is a key aspect of any modelling exercise. The model results provide a single point value but there is a range of uncertainty around that value, for example relating to parameters and data. Sensitivity analysis tries to identify the scale of the uncertainty and provide a likely range of results.

This is particularly important in these studies as there is a lot of uncertainty, especially with the respect to the model's parameter estimates. It is encouraging that an exercise was carried out but this is important enough to warrant more than a single paragraph in each report. In particular it is not clear how the sensitivity analysis was carried out; for example adjusting one parameter at a time may not have much impact on results, but if there was a systematic bias in model parameters results could be significantly different.

Follow-up question

After contacting the original modelling team, it is understood that the sensitivity analysis did adjust more than one variable at a time, using a step-by-step process. This seems a reasonable approach and supports the conclusions in the report.

Conclusions

As far as there is information available, the approach seems sound, but there is surprisingly little detail about the nature of the model's parameters, both in terms of size and methodological underpinning. The modelling team's own assessment through sensitivity analysis is similarly lacking in documentation. Again this is surprising as it likely constituted a significant amount of work.

6. Model applications

Just as important as the model design is the way it is applied for analysis. If the scenarios violate key modelling assumptions then results would most probably be biased. In this case, however, the model has been designed for the particular purpose of analysing the macro-economic impacts of MFA. The structure seems suitable for this purpose in that it is able to incorporate the direct effects and the most major indirect effects of MFA.

The design of the scenarios is also important in that they include the main aspects of MFA, both beneficial and negative. An important distinction is made between grants and loans. The scenario inputs to the balance of payments and budget identities are clearly documented and are compatible with the model structure and its parameters.

One key issue is that the changes are expected to be relatively small in nature, so the linear assumption of the parameters is appropriate. The model would not be suitable for application in a crisis or period of uncertainty. In the final reports, results are presented in an aggregate form to one decimal place and the degree of precision is not exaggerated in any way.

A dynamic model would be better-suited to this sort of short-term analysis, for example to take lagged effects into account but given the available data and difficulty obtaining model parameters, the approach seems reasonable.

Input assumptions

The following two tables show the assumptions that were used to maintain the two main identities in the modelling. Table 1 shows the assumptions made in the balance of payments identity when MFA is removed. Table 2 shows the assumed changes in government receipts (i.e. higher taxes) and cuts in expenditures.

TABLE 1: MAIN INPUT ASSUMPTIONS: BALANCE OF PAYMENTS

Country	Year	Component that was adjusted
Romania	2000	Two thirds foreign reserves, one third imports
	2003	Foreign debt
FYROM	2000-03	Half foreign reserves, half imports
Tajikistan	2001-06	60% foreign reserves, 40% imports
Bosnia and Herzegovina	2003-06	Half reserves, half imports
Albania	2004-06	Imports
Serbia and Montenegro	2002-06	Two thirds foreign reserves, one third imports

Source(s) : National reports.

TABLE 2: MAIN INPUT ASSUMPTIONS: GOVERNMENT EXPENDITURE

Country	Year	Component that was adjusted
Romania	2000	Two thirds expenditure, one third receipts
	2003	External borrowing
FYROM	2000-03	Expenditure (MFA grant), borrowing (MFA loan)
Tajikistan	2001-06	80% expenditure, 20% borrowing
Bosnia and Herzegovina	2003-06	Expenditure (2003-04), borrowing (2005-06)
Albania	2004-06	Expenditure (on investment)
Serbia and Montenegro	2002-06	Expenditures (see report)

Source(s) : National reports.

Delphi technique

In the cases of Bosnia & Herzegovina, Albania and Serbia and Montenegro, the modelling was complemented by additional analysis. This was designed to compensate for necessary limitations in the model due to data quality and parameter estimation. It is based on a system of iterative questionnaires and attempts to form a qualitative view. Strictly speaking it is not part of the modelling process but it is worth noting that alternatives to pure modelling approaches were considered.

7. Modelling in Armenia

The role of the modelling in Armenia was different to the other countries. The focus was on whether interventions might be required in the future as part of the assessment of "External Stability" in Part IV of the report. It was therefore ex-ante in nature.

Basic structure

The details presented here are taken from page 54 onwards of the report. In a similar vein to the analysis carried out for the other countries the authors note that a general economic framework would have been preferable but was not possible in this case. The analysis is therefore based around a single equation, the balance of payments identity:

$$\Delta D_t = (MGS_t - XGS_t - INC_t - CT_t) - (FDI_t + KT_t)$$

where the first set of brackets represents the current account (imports and exports of goods and services, net income and net current transfers) and the second the capital account (Foreign Direct Investment and net capital transfers). Each of these components is projected forwards to form two forecasts, with positive and more negative outlooks.

Using a single equation means that there are no feedback effects but this is less important when the model is used for forecasting than when it is used for counterfactual analysis.

Model parameters and input assumptions

As this equation is an identity relationship there are no explicit parameters. However, parameters are implicitly used to determine the impacts of external shocks on each component. As with the other countries, a lack of data mean that these parameters cannot be estimated or calibrated so are given values in a more ad hoc way based on "past developments and economic common sense" (page 55 of the report). While there are no other options available, it would have been preferable if the values used were available in the final report.

The input assumptions used for forming the forecasts are well documented in a qualitative sense with key inputs shown in tables for each of the scenarios. Unlike the ex-post counterfactual analysis used for the other countries, a baseline forecast is required, which is formed from these inputs. As the final results are presented as levels (or growth rates over time) rather than differences from baseline, the input assumptions are critical and this is acknowledged in the report.

Context of analysis

The conclusions that are drawn from the analysis relate to the current situation and likely outcomes in the short-term future. As there are many other factors affecting this, the report correctly does not draw any specific conclusions about the effects of MFA, while noting that the generally positive outcome may be partially due to previous loans.

Summary

Although the role of modelling was different for Armenia than for the other countries, the evaluation comes up with the same broad conclusions, discussed in Section 1.8. Like the models used for the other countries, the one that provided the analysis for Armenia was simplistic, due to data constraints, but suitable for the task. The application of the model, and the conclusions drawn from this, are appropriate for presenting the broad overview that is provided and do not attempt to go into a high level of detail.

The input assumptions are well documented, as is the ad-hoc methodology used for producing the model parameters. However, transparency would be greatly improved if these parameters were made available.

8. Overall conclusions

Basic structure

In the review of the MFA operations the macro-economic modelling played a relatively small role and was used mainly to back up the qualitative analysis. A fairly simplistic model was set up, which was developed further for the later studies. There are several advantages to using a simpler approach:

- development time is less
- data requirements are lower
- the model and, by implication, results are easier to interpret

However, an overly simplistic model may produce bias in results. This review finds that, in general, the structure of the model was adequate for the purpose it was built for. The main structural issues we find are:

- changes in imports may be biased upwards as possible links to exported goods are ignored
- imports are not affected by changes in the price level or exchange rate
- exports are assumed to be exogenous but would be affected by some model variables
- the capital account does not seem to affect the exchange rate, although the current account does

We would also recommend that government expenditure is split into final demands and transfer payments as these have different implications for the banking and real sectors. If possible, some treatment of the labour market should be included, although this is probably a more major development.

Model inputs and outputs

The choice of data for the model is logical and makes the best use of what are available. The modelling team create a set of model parameters using a mixture of estimation techniques and personal judgment (and possible calibration). There is no reason to doubt that they did not make the best use of the information available, for example conducting interviews with policy makers. However, it is more difficult to justify this approach when there is so little documentation of the methods used, or the final value of the parameters (or even the structure of some equations).

The rough-and-ready nature of the model is acknowledged, with results (generally very small changes) being shown at the macro-economic level to a sensible level of precision, and the importance of particular results is not overplayed. The main scenario assumptions are laid out clearly for each of the studies, although reasons are not always given for the choice of inputs. The sensitivity of results to key parameter assumptions has been tested.

The main criticism we have is not with the model itself, but with the level of documentation that is publicly available. The quality of the information that is available is good and reasonably easy to understand but more information is required. For example, only a single diagram has ever been used to explain how the various components of the model fit together. Some of the key relationships, such as wage formation, are not explained at all and almost none of the parameter values are given. The validation of results with respect to the sensitivity analysis is not discussed in a quantitative manner.

The lack of documentation is possibly due to the small role the modelling played in the studies but a much greater level of transparency is required if results are to be fully understood. Perhaps the best solution would be to produce a separate document outlining the model in more detail; this could be supplemented by tables of main parameters in each of the country studies.

ANNEX IV: HISTORICAL OVERVIEW OF IMF ARRANGEMENTS AND MFA OPERATIONS

Table 1 Historical Overview of IMF Arrangements and MFA Operations

Country	IMF Lending Arrangements				MFA Operations					Notes
	Facility	Year	Million SDR	Million €	Operation	Year of Approval	Loan Million €	Grant Million €	Total Million €	
Albania	Standby Arrangement	1992	20.00	21.96	I	1992		70	70	
	PRGF Commitments	1998	45.04	49.46	II	1994		35	35	
	PRGF Commitments	1998	45.04	49.46	III	1999	20		20	1
	PRGF Commitments	2002	28.00	30.75	IV	2004	9	16	25	
	Extended Fund Facility	2006	8.52	9.36						
	PRGF Commitments	2006	8.52	9.36						
	Total		**155.13**	**170.34**			**29**	**121**	**150**	
Armenia	Standby Arrangement	1995	43.88	48.18						
	Extended Fund Facility	1996	109.35	120.07	I	1997	28	30	58	
	PRGF Commitments	2001	69.00	75.77						
	PRGF Commitments	2005	23.00	25.26						
	PRGF Commitments	2008	9.20	10.10						
	Standby Arrangement	2009	368.00	404.09						
	Total		**622.43**	**683.46**			**28**	**30**	**58**	
Tajikistan	Standby Arrangement	1996	15.00	16.47						
	PRGF Commitments	1998	100.30	110.14	I	1997	60	35	95	
	PRGF Commitments	2002	65.00	71.37						
	PRGF Commitments	2009	78.30	85.98						
	Total		**258.60**	**283.96**			**60**	**35**	**95**	
Bosnia and Herzegovina	Standby Arrangement	1998	94.42	103.68	I	1999	20	40	60	
	Standby Arrangement	2002	67.60	74.23	II	2002	20	40	60	
		2009	11,443.00	12,565.05						
	Total		**11,605.02**	**12,743.05**			**40**	**80**	**120**	
Serbia and Montenegro	Standby Arrangement	2001	200.00	219.61	I	2000	225	120	345	2
	Extended Fund Facility	2002	650.00	713.74	II	2002	120	80	200	3
	Standby Arrangement	2009	2,619.12	2,875.96						
	Total		**3,469.12**	**3,809.31**			**345**	**200**	**545**	
Romania	Standby Arrangement	1991	380.50	417.81	I	1991	375		375	
	Standby Arrangement	1992	314.04	344.84	II	1992	80		80	
	Standby Arrangement	1994	320.50	351.92	III	1994	125		125	
	Standby Arrangement	1997	301.50	331.07						

Country	IMF Lending Arrangements				MFA Operations					Notes
	Facility	Year	Million SDR	Million €	Operation	Year of Approval	Loan Million €	Grant Million €	Total Million €	
	Standby Arrangement	1999	400.00	439.23	IV	1999	200		200	
	Standby Arrangement	2001	300.00	329.42						
	Standby Arrangement	2004	250.00	274.52						
	Standby Arrangement	2009	11,443.00	12,565.14						
	Total		**13,709.54**	**15,053.94**			**780**	**0**	**780**	
FyRoM	Standby Arrangement	1995	22.30	24.49						
	PRGF Commitments	1997	54.56	59.91	I	1997	40		40	
	Extended Fund Facility	2000	24.12	26.48	II	1999	50	48	98	4
	PRGF Commitments	2000	10.34	11.35						
	Standby Arrangement	2003	20.00	21.96						
	Standby Arrangement	2005	51.68	56.74						
	Total		**182.99**	**200.93**			**90**	**48**	**138**	
Grand Total			**30,002.81**	**32,945.00**			**1,332**	**554**	**1,886**	

Source: IMF Statistics, MFA Annual Reports
Notes:

1. The macro-financial assistance of up to EUR 20 million decided by the Council in April 1999 was not implemented because of the reticence of the Albanian authorities to increase non-concessional borrowing under a relatively comfortable Net International Reserve (NIR) position. As a result, this assistance was deprogrammed.

2. On 10 December 2001, the Council approved a revision of its July decision increasing the grant element of the assistance from 75 million to EUR 120 million

3. On 25 November 2003 the Council approved a revision of its earlier decision increasing the grant element of the assistance by EUR 45 million and loan component by EUR 25 million.

4. On 10 December 2001, the Council approved an additional macro-financial assistance in the form of a EUR 18 million grant in favour of the fYRoM.

Table 2 Timeline of IMF Arrangements and MFA Operations

Albania	MFA Operations			70		35					20					25						150	4
	IMF Arrangements			21.96 Standby Arrangement						98.92 PRGF Commitments				30.75 PRGF Commitments				18.72 Extended Fund Facility and PRGF Commitments				170	4
Romania	MFA Operations		375	80		125					200											780	4
	IMF Arrangements		418 Standby Arrangement	344 Standby Arrangement		351 Standby Arrangement			331 Standby Arrangement		439 Standby Arrangement		329 Standby Arrangement			275 Standby Arrangement					12,565 Standby Arrangement	15,052	8
Armenia (EFA)	MFA Operations								58													58	1
	IMF Arrangements						48 Standby Arrangement	120 Extended Fund Facility					76 PRGF Commitments				25 PRGF Commitments			10 PRGF Commitments	404 Standby Arrangement	683	6
Tajikistan (EFA)	MFA Operations											95										95	1
	IMF Arrangements							16 Standby Arrangement		110 PRGF Commitments				71 PRGF Commitments							86 PRGF Commitments	284	4
Bosnia and Herzegovina	MFA Operations										60			60								120	2
	IMF Arrangements									104 Standby Arrangement				74 Standby Arrangement							12,565 Standby Arrangement	12,743	3
[illegible]	MFA Operations								[illegible]		[illegible]		[illegible]									[illegible]	3
	IMF Arrangements						[illegible] Standby Arrangement		[illegible] PRGF Commitments			[illegible] PRGF Commitments and Extended Fund Facility			[illegible] Standby Arrangement		[illegible] Standby Arrangement					[illegible]	5
Serbia and Montenegro	MFA Operations												[illegible]	[illegible]	[illegible]							[illegible]	3
	IMF Arrangements												[illegible] Standby Arrangement	[illegible] Extended Fund Facility							[illegible] Standby Arrangement	[illegible]	3
No. of Operations Approved / Approved Amount	MFA Operations	0	1 / [illegible]	2 / [illegible]	0	2 / [illegible]	0	0	2 / [illegible]	0	4 / [illegible]	1 / [illegible]	2 / [illegible]	2 / [illegible]	1 / [illegible]	1 / [illegible]	0	0	0	0	0	[illegible]	[illegible]
No. of Operations Approved / Approved Amount	IMF Arrangements	0	1 / [illegible]	2 / [illegible]	0	1 / [illegible]	2 / [illegible]	2 / [illegible]	2 / [illegible]	3 / [illegible]	1 / [illegible]	1 / [illegible]	3 / [illegible]	4 / [illegible]	1 / [illegible]	1 / [illegible]	2 / [illegible]	1 / [illegible]	0	1 / [illegible]	5 / [illegible]	[illegible]	[illegible]

Source: MFA Annual Reports — MFA Operation covered by the meta-evaluation

Source: IMF Statistics, MFA Annual Reports

ANNEX V: IFI APPROACH TO CONDITIONALITY

1. IMF's approach to conditionality

Within the context of the IMF, conditionality refers to policies a member must adopt to secure access to Fund's resources. These policies are intended to help the member country overcome its external payments problem and thus be in a position to repay the Fund in a timely manner, thereby ultimately assuring the "revolving character" of Fund resources.

Structural reforms in Fund-supported programs are frequently divided into two broad groups:

- One group covers policies designed to underpin **macroeconomic stabilisation** by enhancing the functioning of macroeconomic policy instruments. Such policies include measures to improve the tax structure, tax administration, or public expenditure management to make fiscal adjustment more durable; changes in the operational framework of monetary policy to enhance its efficacy; and reforms in the foreign exchange and trade system to facilitate exchange rate policy.

- The other group of structural reforms covers policies aiming more generally at **improvements in the economy's underlying structure, its efficiency and flexibility** to foster growth and facilitate adjustment to exogenous shocks. Such reforms may include trade liberalisation, pricing policies in certain sectors such as energy or agriculture, as well as institutional and regulatory changes in the financial and corporate sectors and the labour market.

Until the mid 1980s, structural reforms in Fund-supported programmes were typically confined to the exchange and trade system. In addition, programmes occasionally addressed selected fiscal and financial sector issues, or general pricing policies. In the late 1980s, programmes began to cover an increasing variety of structural measures. For example, between 1987-99, most conditions extended to the fiscal sector: of these, 40 percent referred to tax systems and tax administration (e.g. the introduction of a value added tax or implementation of excise taxes on all cigarettes). Expenditures and public sector management accounted for 30 percent of fiscal sector conditions. Other areas covered were civil service reform and debt management. During the Asian crisis, conditions relating to the financial sector gained importance. They accounted for almost 24 percent of the Fund's structural conditions between 1997-99. Of these, 20 percent focused on the monetary policy framework (e.g. on changes in the system of reserve requirements and the introduction or modification of central bank laws to give the central bank more autonomy); 50 percent of the financial conditions referred to banking regulations and supervision (a typical condition in this area would be the liquidation of a certain bank at a certain time); and financial liberalisation amounted to about 10 percent of financial conditionality.

Structural conditions related to reforms in the fiscal and financial sectors, the exchange and trade system, and economic statistics areas are considered to be at the very core of the Fund's involvement in member countries. However, structural conditions related to the restructuring of public enterprises, privatisation, and the reform of the social security have also gained importance since 1987. While these reforms were outside the Fund's core areas of expertise, they were motivated not only by efficiency considerations and the need to scale back extensive quasi-fiscal operations, but also by budgetary considerations more directly. They were thus often linked to fiscal adjustment, which plays a critical role in nearly all Fund-supported programmes. The importance of other areas (such as trade sector), on the other hand, has declined over time. Public enterprises and reform of the exchange system have also lost importance[13.]

The number of conditionalities in IMF programmes, however, has continuously increased over time. This increase in the number of conditions has been heavily criticised, as has the concept – and the specific content – of IMF conditionality. Criticisms point out the ineffectiveness of IMF conditions to overcome the dependence of a range of low income countries on IMF money. In fact, the IMF became an almost continuous provider of aid to a number of developing countries and emerging market economies[14]. Regarding the content it has been argued that the Fund has focussed too narrowly on reducing demand, so jeopardising growth[15].

Developing countries protested that the increasing intrusiveness of conditionality could not be justified by the relatively small amounts of money provided and that IMF conditions were not tailored to individual countries circumstances and that industrialised countries received its loans merely without conditionality. Their protests led to a review of IMF conditionality in 1979. It was agreed that individual country's priorities and characteristics should weigh more heavily in IMF programmes.

In 2000, the IMF concluded another extensive review of conditionality[16.] This review led to the adoption of the revised guidelines on conditionality by the IMF's Board in September 2002. These guidelines were aimed at improving the effectiveness of conditionality by recognising the central importance of:

- National ownership of programmes
- Parsimony in the application of conditions
- Tailoring the programme to member's circumstances
- Clarity as to what essential aspects of the programme must be complied with

In 2007, the IMF's Independent Evaluation Office (IEO) completed an assessment of structural conditionality in IMF-supported programs. In light of the IEO's finding that the number of structural conditions has not declined and that some conditions were not critical for the achievement of program goals, the IMF's Executive Board called for strengthened efforts to achieve parsimony by focusing on criticality and providing rigorous justification for conditions. The management implementation plan in response to the Board-endorsed IEO recommendations called for sharpening the application of the 2002 Guidelines on Conditionality by requiring better justification of criticality, establishing explicit links between goals, strategies and conditionality, and enhancing programme documents.

In March 2009, the IMF modernised its conditionality framework in the context of a comprehensive reform to strengthen its capacity to prevent and resolve crises. The new

[13] For a detailed description of IMF conditionality see Dreher, Axel (2002) *The Development and Implementation of IMF and World bank Conditionality* and IMF (2001) *Structural Conditionality in Fund-Supported Programs*

[14] Independent Evaluation Office of the IMF (2004) *Evaluation of the Prolonged use of Fund Resources*

International Financial Institution Advisory Commission, IFIAC (2000) *Report of the International Financial Institution Advisory Commission*

[15] Allen, Mark (1984) *The Link between Structural Reform and Stabilization Policies: An Overview*

[16] IMF (2001) *Conditionality in Fund-Supported Programs - Policy Issues*

IMF (2001) *Streamlining Structural Conditionality – review of Experience* framework aims to ensure that conditions linked to IMF loan disbursements are focused and adequately tailored to the varying strengths of countries' policies and fundamentals. The key features of the new approach are:

- First, the IMF will rely more on pre-set qualification criteria (ex-ante conditionality) where appropriate rather than on traditional (ex post) conditionality as the basis for providing countries access to Fund resources.

- Second, implementation of structural policies in IMF-supported programmes will from now on be monitored in the context of programme reviews, rather than through the use of structural performance criteria[17], which will be discontinued in all Fund arrangements, including those with low-income countries.

In effect, starting May 2009, structural performance criteria have been discontinued for all IMF loans, including for programmes with low-income countries. Structural reforms will continue to be part of IMF-supported programs, but only when they are seen as critical to a country's recovery. And the monitoring of these policies will be done in a way that reduces stigma, because countries will no longer need formal waivers if they fail to implement an agreed measure by a specific date.

The new IMF-supported programmes have been tailored to individual country circumstances and focus on the most immediate issues to resolve the crisis. For example:

- The November 2008 Fund-supported programme in Iceland allows for a high fiscal deficit in 2009 to avoid exacerbating the ongoing collapse of economic activity, while taking measures to stabilise the exchange rate and restructure the banking sector.

- The September 2008 IMF-supported programme in Costa Rica uses expansionary fiscal policy to mitigate the adverse effects of the drop in private demand during 2009, including increases in the wage bill and infrastructure spending.

- The April 2008 IMF-supported programme in Guatemala seeks a moderate fiscal stimulus to support domestic demand, financed with substantial external resources from multilateral institutions, and includes a refocusing of public expenditures towards social spending and labour-intensive public works.

- In Hungary, the October 2008 IMF-supported program was recently modified in response to worse than anticipated global economic growth and global financial market conditions. The changes seek the right balance between preserving creditor confidence in Hungary's fiscal and balance of payments positions while avoiding measures that would further deepen the recession. Measures include a small rise in the 2009 budget deficit relative to the original program, along with additional emphasis on measures to safeguard essential social spending.

Conditionality is now more tightly focused on core objectives. The number of structural conditions has decreased in many programmes, and has been increasingly limited to the most critical measures, in particular urgent public financial management reforms. For example:

[17] These are the main structural conditions such as measures to improve financial sector operations, reform social security systems, or restructure key sectors such as energy

- Senegal: 12 structural reforms when the Policy Support Instrument (PSI) was approved (November 2007); reduced to 7 reforms by June 2009.

- Zambia: Its three successive PRGFs have had 12, 11, and 9 structural conditions, successively. The strongest level of conditionality (prior actions and structural performance criteria) has been cut from 5 in the first two programs to 2 in the latest PRGF.

2. World Bank's approach to conditionality

Conditionality in the World Bank context is defined as the set of conditions that, in line with the Bank's Operational Policy (OP) 8.60, para. 13, must be satisfied for the Bank to make disbursements in a development policy operation. These conditions are (a) maintenance of an adequate macroeconomic policy framework, (b) implementation of the overall programme in a manner satisfactory to the Bank, and (c) implementation of the policy and institutional actions that are deemed critical for the implementation and expected results of the supported program.

The World Bank uses conditionality for two reasons: to ensure that the assistance it provides contributes to the country's development objectives (development effectiveness rationale), and to ensure that the resources are used for the purposes intended (fiduciary rationale).

The Bank's approach to conditionality has also been subject to the same criticisms as IMF – the steady increase in number of conditions and its intrusiveness. Stiglitz (1999) argued that the Bank's conditionality has been flawed and may have undermined democracy in recipient countries.

Over the past two decades, the content of the Bank's conditionality in policy-based lending has broadly moved away from its traditional focus on short-term macroeconomic adjustment and removing major economic distortions toward support for medium-term institutional changes that are complex and often inherently unpredictable. To some extent these shifts reflect a changing focus of many countries' policy agendas. For example, trade policy issues are of lesser importance following the significant reduction of trade barriers across the world. In recent years, the content of conditionality has strongly emphasised improvements in public sector governance: support for government efforts to strengthen public financial management, fiduciary arrangements, public expenditures, and public sector reforms now account for the largest share of conditionality. The use of conditionality has increased in the social sectors and declined in the areas of environment, rural development, and urban development, as well as in trade and economic management. However, reforms in the financial sector and private sector development continue to be important areas of Bank engagement, but with a focus on improving business environments rather than on privatisation.

In particularly sensitive policy areas, conditionality has declined and now focuses more on long-term institutional issues[18]:

- The emphasis on privatisation has strongly declined since the 1990s. The shift away from privatisation is related to the increased attention to the quality of the investment climate as a whole. In non-competitive sectors, independent of the ownership structure, the institutional framework has become central to the design of reforms.

[18] The World Bank (2005) *Review of World Bank Conditionality*

- Conditionality on user fees is extremely limited. Conditions on user fees figure more prominently in the power sector (Eastern Europe and Latin America). There are virtually no such conditions in basic health, education, and water; and when such conditions are used they may actually call for the removal of user fees or the design of targeted schemes to improve access for the poor.

- Conditionality on trade has declined significantly since the mid-1980s with the increasing importance of international bodies, notably the World Trade Organisation, in the trade area. The focus of remaining conditions is on institutional issues, such as the performance of customs agencies, product quality, and certification, rather than tariff rates or trade liberalisation.

In 2007, the World Bank reviewed its latest experience with conditionality in development policy lending based on a comprehensive review of all operations approved during its 2007 fiscal year. The resulting report[19] gives evidence for government ownership of Bank-supported programs, including where they support sensitive reforms, and for the use of analytic work to address poverty and social impacts of policies . Progress has also been made in other areas: (a) sensitive reforms are rarely used in fragile environments and only when there is sufficiently strong evidence of ownership; (b) use of process conditions is rare; (c) matrix sizes have been sharply reduced, and a further reduction may not be possible without harming harmonization efforts; (d) in many countries the Bank is working closely with financial partners in harmonizing support around government budget cycles; (e) the Bank maintains a strong record of predictability of its budget support; and (f) results frameworks have been strengthened through the more systematic use of baseline indicators.

[19] The World Bank (2007) *Conditionality in Development Policy Lending*