COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 14.11.2005
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2005/0224(CNS)

Proposal for a

COUNCIL DECISION

providing macro-financial assistance to Georgia

(SEC(2005)1449)

(presented by the Commission)

EXPLANATORY MEMORANDUM

1) CONTEXT OF THE PROPOSAL

- **Grounds for and objectives of the proposal**

The Commission proposes to provide macro-financial assistance to Georgia in the form of a grant with a view to supporting the government's economic reform programme and helping the country reduce external indebtedness, thereby improving external and fiscal sustainability over the medium-term.

The proposed macro-financial assistance will be limited in time, complement support from the Bretton Woods Institutions, bilateral donors and the Paris Club, and will be conditional, in particular, on progress in the implementation of the IMF-supported PRGF arrangement. This operation will take place at a time when EU-Georgia relations are entering a phase of deeper integration through the inclusion of Georgia in the European Neighbourhood Policy.

- **General context**

Following the Rose Revolution of November 2003 a comprehensive economic reform process has been launched in Georgia, aimed at reviving growth, improving the business environment and reducing poverty. Significant emphasis has been put on fighting corruption and strengthening the rule of law.

Despite the progress made so far, Georgia continues to face a significant current account deficit and a high debt-to-GDP ratio, which, albeit declining gradually, represent a heavy burden on the budget. The current account deficit is projected to widen in 2005 to about 12 percent of GDP (7.6 percent in 2004), owing to robust import demand in the pipeline construction and other investment projects, before easing to around 7 percent in 2006. Anticipated privatisation deals could bring about a significant boost to private capital inflows to finance the wider current account deficit. External public and publicly guaranteed debt remains fairly stable in nominal terms at around USD 1.85 billion, equivalent to 36 percent of GDP at end-2004. Domestic public debt, consisting of Treasury bills and debt to the National Bank of Georgia, amounted to about 9 percent of GDP in 2004. Interest payments and amortisation represented some 13 percent of general government expenditure in 2004, corresponding to 2.5 percent of GDP. Domestic expenditure arrears, which totalled nearly 5 percent of GDP before the Rose Revolution, are expected to be fully repaid by end-2006.

Real GDP grew by 6.2 percent in 2004 and is projected to grow by 8.5 percent in 2005 (GDP growth was 6.8 percent year-on-year in the first half of 2005). As the current stimulus from oil and gas pipeline construction will tend to wane over time, adherence to structural reforms is needed to support robust growth in the economy. The 12-month inflation has been increasing somewhat, reaching 7.5 percent at end-2004. For 2005, the authorities aim to achieve an end-year inflation rate of 7 percent. This will require careful management of the government's discretionary spending in addition to the National Bank's commitment to an appropriately tight monetary stance.

Fiscal performance improved significantly in 2004, but a more expansionary stance has

been decided for 2005. In 2004, the government managed to increase tax revenues by an impressive four percentage points of GDP (from 14.5 to 18.2 percent of GDP) which highlights the Georgian authorities' remarkable anti-corruption drive. As a result, the general government posted a surplus of 2.3 percent of GDP on a commitment basis, while on a cash basis the payment of expenditure arrears led to a deficit of 0.2 percent. In 2005 large increases in expenditure are planned against the backdrop of anticipated privatisation revenues. The general government deficit is projected to increase to 4.8 percent of GDP on a cash basis. Supported by a rebound in investor confidence, yields on Treasury bills have declined to approximately 10 percent from over 50 percent at late 2003.

Structural reforms focus on improving the business climate, reducing the energy sector quasi-fiscal deficit and fighting poverty. The new streamlined tax code which took effect in January 2005 was one of the first major reforms of the new government aimed at improving the business climate. A new customs code is under preparation and an overhaul of the licence system is also underway. The civil service has been downsized substantially in the early stages of the reinvigorated reform process, paving the way for higher salaries in the public sector. Privatisation has been resumed on a wide scale, including land and remaining large-scale industrial assets. Restoring the technical and financial viability of the energy sector remains perhaps the most difficult area still to be tackled. Quasi-fiscal losses of the power sector are estimated at around 4.5 percent of GDP. Given that the share of population living under the minimum subsistence level is hardly changed at 52.5 percent, poverty reduction is at the heart of the government's reform programmes in social protection, health and education, building on improved economic fundamentals. The Georgian poverty reduction strategy (the Economic Development and Poverty Reduction Program EDPRP) was presented by the previous government to the Executive Boards of IDA and the IMF in September 2003.

In the context of the European Neighbourhood Policy, EU-Georgia relations are bound to deepen through closer economic integration. The European Neighbourhood Action Plan, to be agreed between the EU and Georgia, is expected to include macroeconomic stability, measures to improve the investment climate as well as legislative and regulatory approximation with the EU among the priority areas.

The Executive Board of the International Monetary Fund approved in June 2004 a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in an amount of SDR 98 million. Thereafter, the Paris Club creditors agreed in July 2004 to a restructuring of Georgia's bilateral official debt on the Houston terms. This Paris Club agreement consolidates about USD 160 million due on bilateral official debts contracted by Georgia before November 1999, consisting of arrears and maturities falling due from June 2004 to December 2006. The new Government of Georgia received strong support from the international community also at the donors' conference co-chaired by the European Commission and the World Bank in June 2004. At the donors' conference, the Commission pledged a total assistance amount of EUR 125 million, including an indicative amount of EUR 33.5 million in the form of macro-financial assistance for 2005/2006 subject to agreement by the EU Member States.

In the period 1998-2004, the Community made available to Georgia exceptional financial assistance consisting of a loan of EUR 110 million (disbursed in July 1998 after Georgia had settled arrears of EUR 131 million to the Community) and a total grant of EUR 65 million (of which only EUR 31.5 million was committed and paid by

end-2004). For most of this period the Georgian authorities did not have a working financing arrangement with the IMF or they did not meet all specific EC conditions on structural reforms when the IMF-supported program was on track. The political situation remained unfavorable to reforms until the Rose Revolution of November 2003. As a result, the Commission was not in a position to release the grant component of the assistance as planned and, accordingly, Georgia's outstanding debt towards the Community (EUR 85.5 million) remains well above the targets set at the time of the preparation of the exceptional financial assistance.

Following the political regime change in late 2003, the new government embarked on a strong adjustment and reform programme. The main components of the government's economic policy agenda include fiscal consolidation and sound public finance management, restructuring and reform of the public administration, reinvigoration of privatisation and rehabilitation of the energy sector. Decisive action has been undertaken to fight against corruption and tax evasion. A new liberal tax code has been effective since January 2005 and further measures to improve the business climate are on the government agenda. Macroeconomic stability has been maintained with robust growth and subdued inflation. This reform drive bodes well for the implementation of the poverty reduction strategy. Given these commendable improvements in the overall economic policy environment, the Commission deems appropriate to make available to Georgia macro-financial assistance in the form of grants through re-programming of the uncommitted grant amount of EUR 33.5 million.

- **Existing provisions in the area of the proposal**

Council Decision of 17 November 1997 providing exceptional financial assistance for Armenia and Georgia (97/787/EC).

Council Decision of 20 March 2000 amending Decision 97/787/EC providing exceptional financial assistance for Armenia and Georgia in order to extend it to Tajikistan (2000/244/EC).

The present proposal for a new legal basis for macro-financial assistance to Georgia entails reprogramming of the uncommitted and undisbursed grant amount of EUR 33.5 million out of EUR 65 million which had been earmarked for Georgia under the total ceiling of EUR 130 million (Article 1(3) as amended by Decision 2000/244/EC).

- **Consistency with other policies and objectives of the Union**

EU-Georgia relations are entering a phase of deeper integration through the inclusion of Georgia in the European Neighbourhood Policy. The Community's assistance to Georgia through the macro-financial assistance instrument would contribute to the strengthening of the bilateral relations at a time when a European Neighbourhood Action Plan, currently under negotiation, will be entering the implementation phase. It is envisaged that from 2007 onwards the European Neighbourhood and Partnership Instrument will become available to Georgia, allowing assistance also in the form of budget support, whereas the macro-financial assistance instrument will be deployed in the interim period, aiming at improving medium-term debt sustainability and

supporting the government's reform programme.

2) CONSULTATION OF INTERESTED PARTIES AND IMPACT ASSESSMENT

- **Consultation of interested parties**

The Georgian authorities requested further macro-financial assistance from the EC in 2004. The Commission services have been in contact with the authorities and the International Monetary Fund during the preparation of the present Commission proposal to discuss the modalities of the assistance. The Commission has consulted the Economic and Financial Committee before submitting its proposal. Following the adoption of the Council Decision, the Commission services will negotiate a Memorandum of Understanding with the Georgian authorities to lay down in detail the implementation modalities of the assistance.

- **Collection and use of expertise**

There was no need for external expertise.

- **Impact assessment**

Because the macro-financial assistance is a policy-based instrument, it is particularly well-suited to support the efforts of the Georgian government to improve the external and fiscal debt sustainability in the short-to-medium run.

By providing further macro-financial assistance in the form of grants, the Community will continue supporting Georgia's economic reform programmes. In the short-run, the macro-financial assistance will help the authorities to improve the external financial position of Georgia through a reduction in the country's net debtor position towards the Community. In the medium-run, the macro-financial assistance will foster external and fiscal debt sustainability by encouraging the authorities to implement appropriate macro-economic and structural policies.

3) LEGAL ELEMENTS OF THE PROPOSAL

- **Summary of the proposed action**

The Community shall make available to Georgia macro-financial assistance in the form of grants over a two-year period. The assistance will be made available in at least two instalments over the period 2006-2007 conditional on (i) the implementation of a set of measures to be jointly agreed with the government and (ii) a satisfactory implementation by Georgia of the IMF-supported economic programme. The grant payments are also linked to early debt repayments by Georgia of its outstanding debt towards the Community. The assistance is managed by the Commission which shall agree with the authorities the specific economic policy and financial conditions attached to the payment of the grant instalments. Specific provisions on the prevention of fraud and other irregularities, consistent with the Financial Regulation, will be duly taken into account.

- **Legal basis**

Article 308 of the Treaty

- **Subsidiarity principle**

The proposal falls under the exclusive competence of the Community. The subsidiarity principle therefore does not apply.

- **Proportionality principle**

The proposal complies with the proportionality principle for the following reason(s):

The assistance will be fully consistent with the macroeconomic targets already set in the IMF supported PRGF arrangement. As regards specific conditions attached to the disbursement of the grant instalments, the Commission intends to focus on a limited number of areas, including in particular public finance management.

The amount of the assistance is reprogrammed following the expiry of the implementation period of the exceptional financial assistance to Georgia and therefore remains within the ceiling provided for in the previous legal basis. This is deemed an appropriate level of burden sharing for the Community, given the assistance provided to Georgia by bilateral creditors and the international donor community in general.

- **Choice of instruments**

Proposed instruments: other.

Other means would not be adequate for the following reason(s):

In the absence of a framework regulation for the macro-financial assistance instrument, ad hoc Council decisions under Article 308 of the Treaty are the only available legal instrument for this assistance.

4) BUDGETARY IMPLICATION

EUR 33.5 million to be committed under budget line 01 03 02 01 "Macroeconomic assistance for partner countries of eastern Europe and central Asia".

5) ADDITIONAL INFORMATION

- **Review/revision/sunset clause**

The proposal includes a sunset clause.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 308 thereof,

Having regard to the proposal from the Commission[1],

Having regard to the opinion of the European Parliament[2],

Whereas:

(1) Council Decision 97/787/EC[3] provides for exceptional financial assistance to Armenia and Georgia in the form of long-term loans and grants.

(2) Council Decision 2000/244/EC[4] amending Council Decision 97/787/EC provides for exceptional financial assistance to Tajikistan and extends the implementation period of the assistance to Armenia and Georgia until 2004.

(3) In case of Georgia, the objectives of the assistance have not been fully met, owing to an unsatisfactory economic policy environment in the country during most part of the implementation period.

(4) Therefore, only EUR 31.5 million of the total grant allocation of EUR 65 million to Georgia was committed and paid under the exceptional financial assistance.

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1 OJ C […], […], p. […].
2 OJ C […], […], p. […].
3 OJ L 322, 25.11.1997, p. 37.
4 OJ L 77, 28.3.2000, p. 11.

(5) The present authorities of Georgia are committed to economic stabilisation and structural reforms, supported by the International Monetary Fund (IMF) through a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) which was approved on 4 June 2004 in a total amount of SDR 98 million. Thereafter, the Paris Club creditors agreed on 21 July 2004 to a restructuring of Georgia's bilateral official debt on the Houston terms.

(6) The new Government of Georgia received strong support from the international community also at the donors' conference held in Brussels on 16 June 2004.

(7) The World Bank approved in June 2004 a USD 24 million Reform Support Credit (RSC), and will continue its assistance to Georgia under a new Country Partnership Strategy in the form of Poverty Reduction Support Operations (PRSO).

(8) Georgian authorities have expressed their intention to pursue early debt repayments to the Community with a view to improving debt sustainability.

(9) As EU-Georgia relations are developing within the framework of the European Neighbourhood Policy, which is expected to lead to deeper economic integration, Community support to the government's economic reform programme is considered appropriate.

(10) Making available an amount equivalent to the uncommitted grant amount of the exceptional financial assistance, which would support the country's economic reforms and help reduce external indebtedness, is an appropriate contribution by the Community to the implementation of poverty reduction and growth strategies in Georgia.

(11) In order to ensure efficient protection of the Community's financial interests linked to the present macro-financial assistance, it is necessary to provide for appropriate measures by Georgia related to the prevention of and to the fight against fraud, corruption and any other irregularities linked to this assistance, as well as for controls by the Commission and audits by the Court of Auditors.

(12) The Commission services, with the support of duly mandated external experts, carried out in October 2004 an operational assessment of the financial circuits and administrative procedures at the Ministry of Finance of Georgia and the National Bank of Georgia to ascertain the existence of a framework for sound financial management.

(13) The release of this grant assistance is without prejudice to the powers of the budgetary authority.

(14) The Commission has consulted the Economic and Financial Committee before submitting its proposal.

(15) The Treaty does not provide for the adoption of this Decision powers other than those of Article 308,

HAS DECIDED AS FOLLOWS:

Article 1

1. The Community shall make available to Georgia macro-financial assistance in the form of straight grants to a maximum amount of EUR 33.5 million with a view to supporting economic reforms and helping the country improve debt sustainability.

2. This Community financial assistance shall be managed by the Commission in consultation with the Economic and Financial Committee and in a manner fully consistent with the agreements reached between the IMF and Georgia.

3. The Community financial assistance shall be made available for two years starting from the first day after the entry into force of this decision. However, if circumstances so require, the Commission, after consultation of the Economic and Financial Committee, may decide to extend the availability period by a maximum of one year.

Article 2

1. The Commission is empowered to agree with the authorities of Georgia, after consultation with the Economic and Financial Committee, the economic policy and financial conditions attached to this assistance, to be laid down in a Memorandum of Understanding. These conditions shall be consistent with the agreements referred to in Article 1(2).

2. During the implementation of the Community assistance, the Commission shall monitor the soundness of Georgia's financial circuits, administrative procedures and internal and external control mechanisms which are relevant for this Community macro-financial assistance.

3. The Commission shall verify at regular intervals that the government's economic policies are in accordance with the objectives of this assistance and that the agreed economic policy and financial conditions are being fulfilled.

4. The grant amount shall be made available to Georgia in at least two instalments insofar as the net debtor position of the beneficiary towards the Community has been reduced, as a rule, by at least a similar amount.

Article 3

1. Subject to Article 2(4), the first grant instalment shall be released on the basis of a satisfactory implementation of the economic programme supported by the IMF under the Poverty Reduction and Growth Facility; the second and any further instalments shall be released on the basis of a satisfactory implementation of the IMF-supported economic programme and any other measures agreed with the Commission as set out in Article 2(1), and not before one quarter after the release of the previous instalment.

2. The funds shall be paid to the National Bank of Georgia. The final recipient of the funds will be the Ministry of Finance of Georgia.

Article 4

The implementation of this assistance shall take place in accordance with the provisions of the Financial Regulation applicable to the General Budget of the European Communities and its implementing rules. In particular, the Memorandum of Understanding to be agreed with the authorities of Georgia shall provide for appropriate measures by Georgia related to the prevention of and to the fight against fraud, corruption and any other irregularities linked to this assistance. It will also provide for controls by the Commission, including the European Anti-Fraud Office (OLAF), with the right to perform on-the-spot checks and inspections, and for audits by the Court of Auditors, where appropriate, to be carried out on the spot.

Article 5

At least once a year, before September, the Commission shall submit to the European parliament and to the Council a report, which will include an evaluation on the implementation of this Decision in the previous year.

Article 6

This Decision shall take effect on the day of its publication in the *Official Journal of the European Union.*

Done at Brussels,

For the Council
The President

LEGISLATIVE FINANCIAL STATEMENT

Policy area: Title 01 – Economic and Financial Affairs

Activity: 03 – International economic and financial affairs

TITLE OF ACTION: MACRO-FINANCIAL ASSISTANCE TO GEORGIA

1. BUDGET LINE(S) + HEADING(S)

01 03 02 01 "Macroeconomic assistance for the partner countries of eastern Europe and central Asia"

2. OVERALL FIGURES

2.1. Total allocation for action (Part B): € million for commitment

€ 42.050 million (2005); this amount includes the initial budget (€ 24.200 million) and an internal transfer which is under preparation (€ 17.850 million)

2.2. Period of application:

Start year: 2005, expiry year: 2007

2.3. Overall multiannual estimate of expenditure:

(a) Schedule of commitment appropriations/payment appropriations (financial intervention) *(see point 6.1.1)*

€ Million (*to three decimal places)*

	2005	2006	2007			Total
Commitments	33.500					33.500
Payments		19.000	14.500			33.500

(b) Technical and administrative assistance and support expenditure *(see point 6.1.2)*

Commitments		0.050	0.050			0.100
Payments		0.050	0.050			0.100

Subtotal a+b						
Commitments	33.500	0.050	0.050			33.600
Payments		19.050	14.550			33.600

(c) Overall financial impact of human resources and other administrative expenditure *(see points 7.2 and 7.3)*

Commitments/ payments		0.165	0.165			0.330

TOTAL a+b+c						
Commitments	33.500	0.215	0.215			33.930
Payments		19.215	14.715			33.930

2.4. Compatibility with financial programming and financial perspective

The proposal is compatible with existing financial programming

2.5. Financial impact on revenue

The proposal has no financial implications on revenues

3. BUDGET CHARACTERISTICS

Type of expenditure		**New**	**EFTA contribution**	**Contributions from applicant countries**	**Heading in financial perspective**
Non-compulsory	Differen-tiated	NO	NO	NO	**No 4**

4. LEGAL BASIS

Article 308 of the Treaty

5. DESCRIPTION AND GROUNDS

5.1. Need for Community intervention [5]

5.1.1. Objectives pursued

The proposed assistance aims at supporting economic reforms and helping Georgia to further reduce its net debtor position towards the Community, thereby improving debt ratios and fiscal sustainability over the medium-term. This assistance is complementary to the resources provided by the International Financial Institutions and by bilateral donors.

[5] For further information, see separate explanatory note.

5.1.2. Measures taken in connection with ex ante *evaluation*

An ex ante evaluation was carried out by Commission services in September 2004 and updated in July 2005.

5.1.3. Measures taken following ex post *evaluation*

No ex-post evaluation of the Community macro-financial assistance to Georgia has been carried out yet. A recent evaluation of a similar assistance to Armenia indicates that notwithstanding the short-term positive impact of the assistance on debt sustainability, the longer term impact on structural reforms is less evident. These conclusions point to the need to focus the EC policy conditionality on a smaller number of key reforms, on which adequate monitoring and close policy dialogue is maintained throughout the implementation period.

5.2. Action envisaged and budget intervention arrangements

This assistance will take the form of a straight grant of up to € 33.5 million (financed from the General Budget), to be released in at least two instalments. The disbursements will be conditional upon a satisfactory track record in the implementation of the present three-year arrangement agreed between Georgia and the IMF under the Poverty Reduction and Growth Facility (PRGF). Before the release of each instalment, the Commission services, in co-operation with the national authorities and the IMF staff, shall verify that the said arrangement is on track.

In addition, the Commission shall agree with the Georgian authorities on a number of specific policy conditions which have to be met before the release of the second and any further instalments. These conditions shall be consistent with agreements reached by Georgia with the IMF.

The grant instalments would be released only insofar as Georgia has made early debt repayments on its outstanding debt to the Community. The exact amounts of debt repayments, to be agreed with the authorities in a Memorandum of Understanding, would, as a rule, be at least the same as the amounts of the grant instalments.

5.3. Methods of implementation

This assistance will be implemented in the form of centralised direct management by the Commission using regular staff.

6. FINANCIAL IMPACT

6.1. Total financial impact on Part B - (over the entire programming period)

The total grant amount corresponds to the uncommitted part of the exceptional financial assistance to Georgia under Council Decisions 97/787/EC and 2000/244/EC. Therefore, the overall ceiling stipulated in the previous legal basis is not exceeded by the present proposal.

6.1.1. Financial intervention

Commitments (in € million to three decimal places)

Breakdown	2005	2006	2007				Total
Grant instalments to Georgia	33.500						33.500
TOTAL	33.500						33.500

6.1.2. Technical and administrative assistance, support expenditure and IT expenditure (commitment appropriations)

	2005	2006	2007				Total
1) Technical and administrative assistance							
2) Support expenditure							
a) Studies (Operational Assessments)		0.050	0.050				0.100
b) Meetings of experts							
c) Information and publications							
TOTAL		0.050	0.050				0.100

7. IMPACT ON STAFF AND ADMINISTRATIVE EXPENDITURE

7.1. Impact on human resources

The tasks related to the management of the assistance will be carried out through staff redeployment, where necessary, and will not involve an increase in the number of Commission staff.

Types of post		Staff to be assigned to management of the action using existing and/or additional resources		Total	Description of tasks deriving from the action
		Number of permanent posts	Number of temporary posts		
Officials or temporary staff	A B C	1/3		1/3	E.g. prepare memoranda of understanding/grant agreements, liaise with authorities and IFIs, liaise with external experts for operational assessments, conduct review missions, prepare Commission staff reports, Commission procedures related to the management of the assistance
Other human resources					
Total		1/3		1/3	

7.2. Overall financial impact of human resources

Type of human resources	Amount (€)	Method of calculation *
Officials Temporary staff	30,500	1/3 x average annual expenditure for an A*5 – A*12 grade official
Other human resources (specify budget line)		
Total	30,500	

The amounts are total expenditure for twelve months.

7.3. Other administrative expenditure deriving from the action

Budget line (number and heading)	Amount €	Method of calculation
Overall allocation (Title A7)		
A0701 – Missions	10,000	Two missions per year for two persons
A07030 – Meetings	125,000	Estimated total expenditure of €250,000 for the service contract
A07031 – Compulsory committees [1]		
A07032 – Non-compulsory committees [1]		
A07040 – Conferences		
A0705 – Studies and consultations		
Other expenditure (specify)		
- An ex-post evaluation		
Information systems (A-5001/A-4300)		
Other expenditure - Part A (specify)		
Total	135,000	

The amounts are total expenditure for twelve months.

[1] Specify the type of committee and the group to which it belongs.

I.	Annual total (7.2 + 7.3)	€ 165,500
II.	Duration of action	2 years
III.	Total cost of action (I x II)	€ 331,000

8. FOLLOW-UP AND EVALUATION

8.1. Follow-up arrangements

This assistance is of macro-economic nature and its design is consistent with the IMF-supported economic programme. The monitoring will take place on the basis of progress in the implementation of the PRGF arrangement and specific reform measures to be agreed in a Memorandum of Understanding. The authorities will be required to report on a set of indicators on a regular basis.

The Commission services will continue to monitor public finance management, following the operational assessment of the financial circuits and administrative procedures carried out in preparation of this proposal. The Delegation of the European Commission to Georgia will provide regular reporting on issues relevant for the monitoring of the assistance. The Commission services will remain in close contact with the IMF and the World Bank.

8.2. Arrangements and schedule for the planned evaluation

An annual report to the European Parliament and to the Council is foreseen in the proposed Council decision, comprising an assessment of the implementation of this operation. Furthermore, an independent ex-post evaluation of the assistance by the Commission or its duly authorised representatives is planned to be carried out after the expiry of the implementation period.

9. ANTI-FRAUD MEASURES

The Commission services have put in place an on-going programme of Operational Assessments of the financial circuits and administrative procedures in all third countries benefiting from the Community macro-financial assistance in order to fulfil requirements of the Financial Regulation applicable to the General Budget of the European Communities. All available conclusions of the relevant reports of the IMF and the World Bank are also taken into consideration.

In Georgia, the Commission services, with the support of duly mandated external experts, carried out in October 2004 an operational assessment of the financial circuits and administrative procedures at the Ministry of Finance and the National Bank of Georgia. This review covered areas such as management structure and organisation, management and control of funds, security of IT systems, internal and external audit capacity as well as the independence of the central bank. It concluded that the framework for sound financial management of the Ministry of Finance is effective with regard to budgetary control, but needs to be strengthened and developed with regard to internal control within budget organisations and internal and external audit. The framework for sound financial management within the National Bank of Georgia is effective.

The proposed legal basis for macro-financial assistance to Georgia includes a provision on fraud prevention measures. These measures will be elaborated further in a Memorandum of Understanding. It is envisaged that specific policy conditions aimed at strengthening efficiency, transparency and accountability will be attached to the assistance.

The macro-financial assistance will be liable to verification, control and auditing procedures under the responsibility of the Commission, including the European Antifraud Office (OLAF), and by the European Court of Auditors.