COMMISSION OF THE EUROPEAN COMMUNITIES

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99/0172 (CNS)

Proposal for a

COUNCIL DECISION

modifying Decision 97/787/EC granting exceptional financial assistance to Armenia and Georgia in order to extend it to Tajikistan

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. GENERAL ECONOMIC SITUATION IN TAJIKISTAN

Like Armenia and Georgia, Tajikistan was severely hit by the economic collapse resulting from the breaking up of the command economy and the disintegration of the Former Soviet Union. The crisis reached its height when inter-republican payments and trade virtually ceased, arrears accumulated, and prices increased at hyper-inflationary rates. Furthermore, civil hostilities in the country destroyed infrastructure, disrupted trade, and led to a large number of refugees or displaced persons to other regions. Under such critical circumstances, output sharply dropped, by two-thirds, and living standards of the average population fell below poverty levels.

As a result of the continuing civil hostilities, Tajikistan was among the last NIS countries to initiate reforms. However, after repeated efforts to stabilise the economy and thanks to a peace agreement between the warring parties, Tajikistan recorded a first year of growth in 1997 (1.7 %). Notwithstanding two external shocks (continued fall in world commodity prices - in particular cotton and aluminium - and the financial crisis in Russia), output expanded remarkably by about 5.3 % in 1998, although from a very low base. Despite credit expansion to the cotton sector and a sharp depreciation of the currency against the US$ (by 33 % from August 1998 to mid-March 1999), annual inflation fell below 3 % in December 1998. Fiscal/quasi-fiscal difficulties continued in early 1999, as the Government failed to collect satisfactory revenue levels in January, while the Central Bank continued to provide some direct credits to the illiquid cotton sector. In 1998, the current account deficit expanded from 5.5 % to 15.2 % of GDP (without official transfers), as export revenues declined and remittances from Russia, likely, diminished. At end-1998, gross foreign exchange reserves were equivalent to US$ 65 million only or 1.4 months' imports. Tajikistan's balance of payments position is expected to remain fragile in the medium term.

At the end of 1998, the external debt of Tajikistan was still equivalent to US$ 1,263 million and represented 98 % of GDP. Owing to its external financing needs and insufficient currency reserves, the country has accumulated substantial arrears vis-à-vis its creditors and suppliers, including vis-à-vis the Community (for a global outstanding amount in arrears of some € 74 million including late interest) on commercial credits to finance food and medical imports made available in 1992. However, the Tajik authorities have committed themselves to fully settle their outstanding financial obligations towards the Community and have already secured a minimum servicing of their debts.

Tajikistan is the poorest country among the CIS and one of the least developed countries in the world, with most of the population living below the poverty line. The civil war had caused poverty to intensify and to become widespread and had confronted the Government with the difficult challenge of dealing with refugees, internally displaced persons (700,000) and the

demobilised soldiers. Since August 1998, in addition to the local political problems, the Russian financial crisis has been deeply affecting the population, a large share of which is unable to meet its basic needs. With a possible loss of control of public finances, the temptation to recourse to social arrears might be increased, while budgetary support for the implementation of the yet fragile peace agreement would be weakened.

In order to cover basic needs in recent years, Tajikistan, as Armenia and Georgia, has had recourse to international humanitarian assistance, out of which the Community has provided a substantial share, (in particular, through ECHO). However, technical assistance through TACIS and Food Security assistance already granted have been delayed for security reasons while, in November 1997, the Council postponed decision on an exceptional financial assistance in favour of Tajikistan, pending implementation by the country of an IMF supported macroeconomic stabilisation and structural reform programme.

2. POLITICAL SITUATION

In June 1997, after several years of civil war, a General Peace Agreement was signed between Tajikistan's government and the United Tajik Opposition (UTO). A free and fair constitutional referendum as well as parliamentary and presidential elections foreseen for Autumn 1999 are essential elements of this Peace Agreement.

The implementation of the Agreement has been difficult, since not all armed groupings within Tajikistan are full participants in the process. Violent incidents, some of which targeting foreign personnel, have created problems both for the peace process and for the activities of international donors.

The UN family and the IFIs continue, however, to support the peace process, whose success is important not just for Tajikistan’s future, but for Central Asia as a whole. The EC continues to be present through ECHO and, as from this year, under its rehabilitation programme and intends to normalise its relations with Tajikistan, including through new contractual arrangements. However, the timing of implementation will take into account political progress as regards the overall security situation and the peace process, in particular the holding of the constitutional referendum and the elections under acceptable conditions.

3. STATUS OF IMF PROGRAMME

After two emergency post conflict credits respectively in December 1997 and April 1998, the IMF adopted in June 1998 a three-year ESAF programme in favour of Tajikistan, for an amount equivalent to US$ 128 million, in order to consolidate the stabilisation gains and to achieve sustainable growth. Key elements of the programme include restoring monetary and fiscal discipline, stabilising the exchange rate and interest rates, improving domestic resource mobilisation and increasing international reserves. The structural reforms

emphasise privatisation of industrial and agricultural enterprises, private sector development and reforms of the financial, agricultural and social sectors.

In addition, on 11 December 1998, the IMF and the World Bank took the initiative to convene a Consultative Group (CG) aiming at providing greater access to the financial facilities they implement in favour of Tajikistan and other NIS countries particularly hit by the spill-over effects of the Russian crisis. Since these countries had already high access in relation to their quota, the Fund and the Bank were asking bilateral donors, in particular the European Community, to provide exceptional complementary support.

In December 1998, despite some slippages in the implementation of the ESAF-supported program, the IMF continued to support the authorities' adjustment and reform efforts and recommended the completion of the mid-term review under the first annual ESAF arrangement. Moreover, it endorsed their request for increased access (US$ 6 million) to Fund resources under the ESAF arrangement.

The government of Tajikistan has taken strong measures to respond to the external shocks it faces and policies implemented have brought inflation to fall more rapidly than expected, economic activity to recover and real income to rise. Structural reforms in key areas appear to be proceeding satisfactorily, even if not fully according to the initial time schedule. Progress has also been reported recently in areas where delays had been registered. The conclusions of the recent IMF review mission (May 1999) in the country were encouraging and a positive decision on a second annual programme under the three-year ESAF Facility is expected shortly.

4. THE PROPOSED EXCEPTIONAL FINANCIAL ASSISTANCE TO TAJIKISTAN

The Commission considers Tajikistan's macro-economic programme as being strong and comprehensive. This programme, if fully implemented, should ensure the necessary macro-economic stabilisation and, by the means of structural reforms, establish the core frame of a market economy. However, without additional external assistance, the reform process would be put in jeopardy and the country would be faced with substantial external imbalances in 1999 and, in the medium term, would not be able to meet its international financial obligations.

Tajikistan, as one of the least developed countries in the world, is eligible for World Bank lending at highly concessional IDA (International Development Association) conditions, as well as for IMF ESAF lending, the concessional facility of the Fund.

Owing to the exceptionally harsh social and economic conditions presently faced by Tajikistan and, in particular, to its extreme vulnerability to external shocks, the Commission considers that this country should be supported with concessional assistance and that exceptional support in the form of a mix of a

loan and straight grants is required to underpin the implementation of the country's stabilisation and structural reform programme.

On 17 November 1997, the Council adopted a decision[1] providing exceptional financial assistance to Armenia and Georgia and agreed in principle to consider a similar assistance to Tajikistan once the latter would benefit from an upper credit tranche arrangement with the IMF.

In January 1997, Tajikistan committed to fully servicing its outstanding financial obligations towards the Community and is presently securing a minimum servicing of the Community's outstanding claims. Moreover, the country is now implementing a comprehensive adjustment and reform programme in the context of a three-year ESAF arrangement approved by the IMF in June 1998. Therefore, the necessary preconditions for considering a Community exceptional financial assistance for this country appear now to be met.

In the circumstances, and as already announced in its Communication to the Council and the Parliament of 20 January 1999[2], the Commission intends to propose an increase in the financing made available in favour of Armenia and Georgia in November 1997, so as to make room for exceptional assistance to Tajikistan. The Commission proposes that Council Decision 97/787/EC of 17 November 1997 is adjusted with a view to increasing the present ceilings of long-term loans and grants that can be made available :

– the loans ceiling would be increased by a maximum amount of € 75 million ;

– the grants ceiling would be increased by a maximum amount of € 35 million to be financed by the general budget.

These amounts are consistent with Tajikistan's residual financing needs, taking also into account the financial outflow resulting from the settlement of the country's arrears towards the Community (as of 31 March 1999, € 73 million of arrears, with a monthly increase of some € 200,000 in interest on late payments). The amounts envisaged are, of course, maxima, and effective disbursements would depend on negotiations to be held between the Tajik authorities and the Commission. These negotiations would also have to fix the level and timetable for a net reduction in the country's net debtor position towards the Community, taking into account, as in the cases of Armenia and Georgia, the availability of the grant element of the assistance to be disbursed in successive annual tranches.

The loan component of this assistance would be funded through Community market borrowing with a guarantee by the general budget. The beneficiary country would subsequently borrow from the Community. The borrowing and lending operations would be perfectly matched and without any

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1 97/787/EC, OJ L 322 of 25.11.1997, p. 37

2 The Russian crisis and its impact on the NIS and Mongolia, COM(1999) 8 final, adopted by the Commission on 20 January 1999

commercial risk for the Community. In accordance with the Guarantee Fund mechanism the budgetary implications of a decision to make available loans of up to € 75 million to the beneficiary country would be a maximum of € 10.5 million provisioning of the Fund to be drawn from the 1999 reserve for guarantees relating to external actions.

As for the grant component of this assistance and without prejudice to the competencies of the budgetary authority, the Commission considers that this part of the exceptional assistance would have to be implemented in five equal annual instalments of up to € 7 million from 2000 to 2004, within the limits of Category 4 of the financial perspective for the 2000-2006 period.

In order to ensure coherence with the EC's general policy towards Tajikistan, a decision would be taken after the adoption of this Decision as to whether sufficient progress has been made in the peace process, and in particular the holding of elections, as to justify the immediate implementation of the exceptional financial assistance to Tajikistan.

Accordingly, the Commission requests the Council to adopt the proposed amendments and to allow Tajikistan to benefit from the existing Council Decision 97/787/EC along with Armenia and Georgia.

Proposal for a

COUNCIL DECISION

modifying Decision 97/787/EC granting exceptional financial assistance to Armenia and Georgia in order to extend it to Tajikistan

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 proposals from the Commission[3],

Having regard to the opinion of the European Parliament[4],

(1) Whereas the Council Decision 97/787/EC of 17 November 1997 provides exceptional financial assistance to Armenia and Georgia[5] ;

(2) Whereas, in parallel with its Decision to provide exceptional financial assistance to Armenia and Georgia, the Council agreed to also consider a similar operation for Tajikistan once circumstances allow ;

(3) Whereas Tajikistan is undertaking fundamental political and economic reforms and is making substantial efforts to implement a market economy model ;

(4) Whereas trade, commercial and economic links are expected to develop between the Community and Tajikistan ; whereas Tajikistan is eligible to a Partnership and Cooperation Agreement with the European Communities and their Member States and has formally requested to benefit from such an agreement as soon as possible ;

(5) Whereas Tajikistan agreed with the International Monetary Fund (IMF) in June 1998 on a three-year Enhanced Structural Adjustment Facility (ESAF) ;

(6) Whereas the Tajik authorities have formally undertaken to fully settle their outstanding financial obligations towards the Community and whereas Tajikistan secures a minimum servicing of outstanding Community claims ;

(7) Whereas the Tajik authorities have formally requested exceptional financial support from the Community ;

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3 COM(1997) 24 final (OJ C 95 of 24.3.1997 p. 64) - 1997/0028/CNS and COM(1999) xxx final (OJ C)

4 OJ C

5 97/787/EC, OJ L 322 of 25.11.1997, p. 37

(8) Whereas Tajikistan is a low income country and is facing particularly critical economic, social and political circumstances; whereas this country is eligible to highly concessional loans from the World Bank and the IMF;

(9) Whereas concessional financial assistance from the Community in the form of a mix of a long term loan and straight grants is an appropriate measure to help the beneficiary country at this critical juncture;

(10) Whereas this assistance, both the loan and the grant component, is highly exceptional and therefore in no way constitutes a precedent for the future;

(11) Whereas the inclusion of a grant component in this assistance is without prejudice to the powers of the budgetary authority;

(12) Whereas this assistance should be managed by the Commission;

(13) Whereas in implementing this Decision, the Commission will take due account of progress made in the Inter-Tajik peace process and, in particular, in the holding of elections under acceptable conditions ;

(14) Whereas the Commission consulted the Economic and Financial Committee before submitting its proposal ;

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

HAS DECIDED AS FOLLOWS :

Sole article

Council Decision 97/787/EC of 17 November 1997 is modified as follows :

1. Article 1 is modified as follows :

(i) Paragraphs 1 to 3 are replaced by the following :

"The Community shall make available to Armenia, Georgia and Tajikistan exceptional financial assistance, in the form of long-term loans and straight grants. "

"The total loan component of this assistance shall amount to a maximum principal of € 245 million, with a maximum maturity of 15 years and a grace period of 10 years. To this end, the Commission is empowered to borrow, on behalf of the European Community, the necessary resources that will be placed at the disposal of the beneficiary countries in the form of loans. "

"The grant component of this assistance will consist of an amount of up to € 130 million during the 1997-2004 period, with a maximum of

€ 24 million annually. The grants shall be made available insofar as the net debtor position of the beneficiary countries towards the Community is being substantially reduced. "

2. Article 3 (1) is replaced by the following text :

"1. Subject to the provisions of Article 1 (4) and Article 2, the total amount of the loan offered to each country shall be made available by the Commission in parallel with the first instalments of the grants. The remainder of the grant component of the assistance shall be made available by the Commission in successive instalments, subject to the same provisions."

3. Article 5 (2) is replaced by the following text :

"2. Before 31 December 2004 at the latest, the Council shall examine the application of this Decision to that date on the basis of a comprehensive report by the Commission. "

Done at Brussels,

For the Council
The President

ANNEX

BUDGETARY RESOURCES NECESSARY FOR THE PROVISIONING OF THE GUARANTEE FUND IN 1999 AND MARGIN UNDER THE RESERVE FOR LOANS AND LOAN GUARANTEES IN FAVOUR OF THIRD COUNTRIES

(EUR million)

Operations	Basis of the calculation[6]	Provisioning of the Fund[7]	Reserve Margin
			346.0 [8]
Operations decided			
EIB/New mandates[9]			
CEEC	872.9	122.2	223.8
ALA	218.1	30.5	193.3
South Africa	143.5	20.1	173.2
MED	351.4	49.2	124.0
FYROM	38.5	5.4	118.6
Bosnia	42.0	5.9	112.7
EIB/Old protocols[9]			
Syria	-30	-4.2	116.9
Macro-financial assistance			
Albania III	20	2.8	114.1
Bosnia I	20	2.8	111.3
Operations proposed			
EIB/Turkey[10]	105	14.7	96.6
EIB/Croatia [11]	35	4.9	91.7
Macro-financial assistance			
Bulgaria IV[12]	100	14.0	77.7
Romania IV[12]	200	28.0	49.7
FYROM II[12]	50	7.0	42.7
Tajikistan[12]	75	10.5	32.2

6 The provisioning basis is calculated by applying the relevant guarantee cover rate, namely 70% (EIB loans new mandates), 75% (EIB loans old protocols) or 100% (macro-financial assistance loan).

7 In accordance with the provisioning rules in Council Regulation (EC, Euratom) No 2728/94 of 31 October 1994, the Fund having reached its target amount on 31 December 1997, the provisioning rate has been reduced to 14%.

8 Amount of the Reserve for loans and loan guarantees in favour of third countries for 1999 under the financial perspective.

9 Annual amounts of loans scheduled to be signed in 1999 and correction of amounts already provisioned in the Fund to take account of actual signings at the end of 1998: Transfer 5/99 to the Guarantee Fund.

10 Proposal for a Council Regulation on a special financial cooperation measure for Turkey (COM(95) 389/3).

11 EC/Croatia cooperation agreement (SEC(95) 180/final).

12 Commission proposal.

FINANCIAL STATEMENT

1. TITLE OF OPERATION

Exceptional financial assistance to Tajikistan.

2. BUDGET HEADING INVOLVED

– Grant component of the assistance

Article B7-531 : Exceptional financial assistance to Armenia, Georgia and Tajikistan.

– Loan component of the assistance :

Article B0-213 : European Community guarantee for the borrowing programmes contracted by the Community to provide financial assistance to the countries of the Commonwealth of Independent States.

3. LEGAL BASIS

Article 308 of the Treaty

4. DESCRIPTION OF OPERATION

4.1 General objective

a) Description of the action

Provision of a Community loan (to be financed by Community borrowing in the international capital market) in the amount of up to € 75 million and grant of up to € 35 million (to be financed by the General Budget) to the beneficiary country with a view to supporting its government's reform efforts towards economic progress, to containing the already widespread poverty and strengthening the current peace process.

b) Justification for the action

The sustainability of the beneficiary country's economic reforms heavily depends on external financial assistance from official sources, at concessional terms.

4.2 Period covered and arrangements for renewal

Period 2000-2004 for the grant

Period 1999-2014 for the loan

5. CLASSIFICATION OF EXPENDITURE OR REVENUE

5.1 Compulsory/Non-compulsory expenditure

– *Grant component :* non compulsory.

– *Loan component* : compulsory.

5.2 Differentiated/Non-differentiated appropriations

– *Grant component :* differentiated.

– *Loan component* : differentiated.

6. TYPE OF EXPENDITURE OR REVENUE

– Straight grant (100% subsidy), which would be released in successive instalments.

– Potential activation of budget guarantee for the Community borrowing aimed to fund the loan.

– The Community grant will not be reimbursed. The loan element will be reimbursed.

7. FINANCIAL IMPACT

7.1 Method of calculating total cost of operation (relation between individual and total costs)

a) Method of calculation

The evaluation of the amounts of the assistance deemed necessary is based on the present estimates of the beneficiary country's residual external financing needs.

For the loan component of the assistance, a token entry is proposed given that the amount and timing of any call on this budget line cannot be calculated in advance and because it is expected that the budget guarantee will not be called.

b) Effect of the action on intervention credits

The budget entry corresponding to the grant component of the assistance will be activated subject to compliance with a number of policy conditions to be agreed with the authorities of the beneficiary country.

The budget entry reflecting the budget guarantee for the loan component of the assistance will be activated only in the case of an effective call on the guarantee.

7.2 Itemised breakdown of cost - Schedule of commitment and payment appropriations

(i) *Grants*

The financing of the expenditure will be secured in annual or six-monthly instalments from 2000 onwards within the limits of Category 4 of the new Financial Perspectives for the 2000-2006 period.

The following schedule of appropriations is proposed (in current million €) :

	2000	2001	2002	2003	2004
Commitment appropriations	7	7	7	7	7
Payment appropriations	7	7	7	7	7

(ii) *Eventual call on the budget guarantee*

- Recourse to the Guarantee Fund established by Council Regulation (EC, EURATOM) n° 2728 of 31 October 1994.
- In case the Guarantee Fund did not contain sufficient resources, additional payments would be called up from the budget by transfer :
  - Of any margin remaining in the Reserve for guarantees ;
  - Of any late payments to the budget for which the budget guarantee has been activated (under Article 27 (3) of the Financial Regulation) ;
  - Of any margin available under the ceiling of category 4 of the financial perspectives or redeployment therein.
- In order to fulfil its obligations, the Commission can provisionally ensure the debt service with funds from its Treasury. In that case, Article 12 of the Council Regulation (EC, EURATOM) n° 1552/89 of 29 May 1989 will apply.

8. FRAUD PREVENTION MEASURES

The funds will be paid directly to the Central Bank of the beneficiary country only after verification by the Commission Services, in consultation of the Economic and Financial Committee and in liaison with the IMF and World Bank Services, that the macro-economic policies implemented in this country are satisfactory and that the specific conditions attached to this assistance are fulfilled.

Financial assistance operations under this Decision will be subject to audit by the relevant Commission services and the Court of Auditors, to be carried on the spot whenever and wherever appropriate.

9. ELEMENTS OF COST-EFFECTIVENESS ANALYSIS

9.1 Specific and quantified objectives;

By supporting the beneficiary country's macro-economic reform efforts and complementing financing by the International Community provided to this country in the context of an IMF agreed programme, this assistance would not only underpin the transition towards market economy, but the resulting improved social, economic and financial situation would also be a crucial element for the strengthening of the peace process in the country.

The assistance would also help the country servicing its outstanding external financial obligations, in particular towards the Community. These outstanding financial obligations towards the Community are presently equivalent to euro 74 million (including arrears and late interest).

The present assistance will only be mobilised with the proviso that the beneficiary country will have fully discharged its outstanding financial obligations towards the Community.

9.2 Grounds for the operation

– Higher access for Tajikistan to International Financial Institutions' financial facilities is limited and the country has already high access in relation to its quota.

– Choice of ways and means :

- Owing to its dire social and economic situation and to its extremely vulnerable balance of payments, Tajikistan should be supported with highly concessional assistance.

- A similar assistance package has already been adopted in favour of Armenia and Georgia (97/787/EC)

– Main factors of uncertainty which could affect the specific results of the operation:

- Further negative developments in the economic and financial situation of the whole region and, in particular, of the beneficiary country.

- Resumption of civil hostilities.

9.3 Monitoring and evaluation of the operation

This exceptional assistance is of macro-economic nature and its monitoring and evaluation are based on a satisfactory track record of the IMF supported adjustment and reform programmes that the beneficiary country is implementing.

The monitoring of the action by the Commission services will take place on the basis of a genuine system of macro-economic and structural policy indicators to be agreed with the authorities of the beneficiary country. The Commission services will also remain in close contact with the IMF and World Bank services in order to benefit from their assessment of the recipient country's stabilisation and reform achievements.

An annual report to the European Parliament and to the Council is foreseen in the proposed Council decision, which will include an evaluation of the implementation of this operation

10. ADMINISTRATIVE EXPENDITURE (SECTION III, PART A OF THE BUDGET)

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