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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on the implementation of macro-financial assistance to third countries in 2022

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on the implementation of macro-financial assistance to third countries in 2022 ([1])

1 INTRODUCTION

Macro-financial assistance, or MFA, is an EU financial instrument ([2]) extended to partner countries experiencing a balance-of-payments crisis. Since its inception in 1990, MFA has helped to improve macroeconomic and financial stability in countries neighbouring or geographically close to the EU, while encouraging structural reforms. It usually complements and is conditional on a non-precautionary credit arrangement agreed with the International Monetary Fund (IMF), but an exception from this preconditon was made in the set-up of the exceptional support provided to Ukraine following Russia's full-scale invasion in February 2022. Relieving the partner country of some pressure to address balance of payment problems allows it to increase its fiscal space, improve its debt sustainability and focus on driving needed reforms. By smoothening the macroeconomic adjustment path, MFA operations can have positive social impacts, giving the country more time and scope to address the root causes of its crisis.

MFA most often takes the form of loans, whose funding the Commission borrows on capital markets and lends on to the beneficiary country on the same terms. In some cases, it takes the form of grants financed by the EU budget. Sometimes, it can be a combination of loans and grants.

MFA is released in instalments and only if all the specific structural reform criteria - agreed with the country - are fulfilled. This underpins the implementation of strong adjustment and reform measures aimed at addressing the root causes of the underlying crisis, strengthening public finance systems and supporting sustainable and inclusive growth and employment creation. Moreover, a precondition for granting MFA is the beneficiary country's adherence to effective democratic mechanisms, which includes having a multi-party parliamentary system and observing the rule of law, and the country's respect of human rights. In this way, MFA complements regular EU cooperation assistance and contributes to the wider goal of preserving stability and promoting prosperity and EU core values beyond its borders. MFA has been widely recognised as an effective instrument to respond to crises, enabling the EU to intervene in a visible and flexible manner and with policy leverage ([3]). This is supported by the

[1] This report is based on information available up to April 2023.

[2] The legal basis for macro-financial assistance to non-EU countries other than developing countries is Article 212 of the Treaty on the Functioning of the European Union (TFEU). Article 213 TFEU may be used as a legal basis when the third country requires urgent financial assistance.

[3] MFA also complements other EU external actions or instruments for the Neighbourhood and the Western Balkans, including budget support for which a total of EUR 1 384 million in grants was provided to the regions in 2022. The latest budget support report is available at: https://international-partnerships.ec.europa.eu/system/files/2022-10/budget-support-trends-and-results-2022_en.pdf

findings of several independent evaluations of completed MFA operations ([4]) as well as the recent meta-evaluation of the last decade of operations ([5]).

Following the onset of Russia's unjustified war of aggression against Ukraine, 2022 proved to be an exceptional year for MFA, in that it forcefully demonstrated its continued relevance and flexibility in allowing the EU to extend sizeable short-term financial support to Ukraine under extraordinary circumstances, while also supporting other countries in the EU Neighbourhood that have been strongly affected by the economic fallout of this war. These operations and their budgetary implications are therefore among the key issues reported on in this annual report.

The 2022 report is prepared in accordance with the Commission's information obligations as laid down in the various decisions by the European Parliament and the Council concerning MFA operations ([6]). It is accompanied by a Commission staff working document, which provides a more detailed analysis of the macroeconomic context and the implementation of individual MFA operations.

2 MACROECONOMIC DEVELOPMENTS IN PARTNER COUNTRIES

In 2022, the economic developments in the EU Neighbourhood and enlargement countries were directly and indirectly impacted by Russia's war of aggression against Ukraine. While the Eastern Partnership (EaP) countries were most directly affected by the resulting spillovers, the repercussions were also felt in the EU Southern Neighbourhood and in the Western Balkans.

In the EaP countries, the Russian war of aggression against Ukraine led to a currency depreciation and strong pressures on food and energy prices. Consumer and business confidence has also been heavily affected, and significant migration flows in the region have reinforced inflationary pressures in some countries The Republic of Moldova was most negativey affected as inflation surged (beyond the levels in Ukraine), while consumer and business confidence took a hit. In contrast, Armenia and Georgia benefited from the sizeable flows of Russian citizens and the associated financial transfers as well as the change in transport routes due to the war.

In the Southern Neighbourhood, despite overall low trade exposure, pressure took the form of rising food prices and decreasing food security (some countries rely heavily on Russia and Ukraine for their wheat imports, a critical and highly subsidised staple) and of rising (though often highly subsidised) energy prices. Nonetheless, all Southern Neighbourhood countries - except for Lebanon - continued an economic expansion in 2022.

In the Western Balkans, sustained increases in energy, food and transport prices fuelled a further acceleration in inflation, reducing households' real disposable income and private consumption. Disruptions in international supply chains and reduced demand due to the lower growth prospects of major trading partners, including the EU, have further

[4] All evaluations are available on the Commission's website: https://ec.europa.eu/info/evaluation-reports-economic-and-financial-affairs-policies-and-spending-activities_en

[5] COM(2023) 0016, final; Commission Staff Working document Evaluation of Macro financial assistance to third countries (Meta-evaluation of operations for 2010-2020).

[6] Decision (EU) 2022/313; Decision (EU) 2022/1201; Decision (EU) 2022/1628; Decision (EU) 2022/2463; Decision (EU) 2022/563; Decision (EU) 2020/701; Decision (EU) 2020/33.

burdened the economic outlook for all three regions, including for exports and foreign direct investment, thus exacerbating existing external imbalances.

This section examines the regional challenges faced by the EU Neighbourhood countries and the Western Balkans, while their economic performance is further assessed on a country-by-country basis in the accompanying staff working document.

2.1 Eastern Partnership

In 2022, economic developments in all Eastern Partnership countries were shaped by Russia's war against Ukraine, while the effects of the pandemic gradually faded. Economic developments diverged strongly between these countries, however. On the one hand, economic output collapsed (by around -30% in Ukraine) or contracted considerably (a 4.7% drop in GDP in Belarus and a 5.9% drop in Moldova). These countries were affected either directly (Ukraine suffering from Russia's brutal war of aggression and its devastating humanitarian, social and economic consequences, including via a massive loss of physical capital and infrastructure destruction as well as a significant amount of international and internal refugees) or through spillover effects that dented consumer and investor confidence. On the other hand, economic activity in the three Caucasus countries reached impressive heights. For Armenia and Georgia, with GDP growth of 12.6% and 10.1% respectively, this reflected an inflow of Russian citizens and businesses following the start of the Russian war of aggression and an accompanying surge in financial transfers. Azerbaijan (GDP growth of 4.6%) also benefited from higher financial flows from Russia and positive terms-of-trade effects on higher energy prices, as well as from the ongoing post-pandemic recovery.

High inflation, in many cases at levels not seen in decades, remained a common characteristic of the Eastern Partnership in 2022. Consumer price growth reached its peak (reaching double digits in all countries) in the middle of the year as a result of the price shock (namely in relation to food and energy) associated with the Russian war of aggression against Ukraine and the weakening of the local currencies in the immediate aftermath of the conflict. The significant migration flows in the region also reinforced inflationary pressures in some of the countries. To tame inflation, central banks continued their monetary tightening efforts in 2022 even if the pace of rate hikes eased considerably as of mid-year, following the stabilisation of global commodity prices and local currencies.

Benefiting from the robust economic activity, the three Caucasus countries reported strong fiscal outcomes in 2022 as the budget deficits came in below targets, while the public debt-to-GDP ratios decreased considerably. In contrast, amid steep increases - notably in defence spending - and a collapse of revenues from the war-stricken domestic economy, Ukraine recorded a huge budget deficit that was mainly financed by international partners, notably the EU. On the external front, there were diverging trends as well. The three Caucasus countries recorded strong growth in trade, partly related to changes in transport routes triggered by the war and, in the case of Azerbaijan, the surge of global energy prices. In contrast, trade collapsed in Ukraine due to the destruction of capital stock by Russia and blockades of key trade routes, notably the Black Sea, by Russia. The comprehensive Western sanctions against Belarus contributed to the decline in the country's trade. On the positive side, remittances to the Eastern neighbours remained surprisingly resilient to the war and contributed to narrowing the current account deficits, thus supporting - along with official financing - the ongoing build-up of international reserves in most of the countries in the region.

The short-term outlook for the region is that it will likely continue to be shaped by Russia's war of aggression in Ukraine. Another key factor is a potential weakening of global external demand due to the ongoing monetary tightening by key central banks. This could be partly offset by slightly more accomodative fiscal and monetary policies in the Eastern neighbours as inflation has started to gradually slow down.

2.2 Southern Neighbourhood

Despite the repercussions of Russia's war of aggression against Ukraine in terms of higher commodity prices and inflation causing a tightening of financing conditions, all Southern Neighbourhood countries - except for Lebanon - continued to see an economic expansion in 2022. Despite the economic impact of the pandemic tapering off, economic growth slowed and stood below pre-war expectations, in particular in the quarter following the outbreak of the war. Preliminary data suggest that real GDP growth reached between 2.0% in Morocco and 7.7% in Israel in the first half of 2022.

Economic growth was driven by the continued recovery of the service sector, in particular tourism, hospitality, restaurant and transport services. Energy exporters' expansion benefited in particular from robust demand and high international energy prices following Russia's war against Ukraine and (Western) sanctions against Russia. Unemployment levelled off to pre-pandemic levels in most countries, on the back of recovering economic activity. Consumer price inflation accelerated in all countries, driven by international energy and food prices. In response to the rise in inflation, central banks tightened the monetary stance by hiking interest rates in particular in Q2-2022, after having maintained their accommodative policy stance in 2021 and early 2022.

After the strong deterioration of fiscal balances during the pandemic in 2020, fiscal deficits narrowed in all countries. Revenues, in particular tax income, increased with the recovery of economic activity and on the back of rising inflation, while expenditures, notably on the social and health sectors, generally decreased from their 2020 peaks. This was partly offset by pressures on fiscal expenditures from the fallout of the Russia's war against Ukraine, as most southern neighbours subsidise wheat and/or fuel. In addition, public debt remained at record levels as a consequence of substantial financing needs during the pandemic. Current account dynamics vary strongly across the Southern Neighbourhood, given the wide differences in economic structures and trade profiles. Driven by global commodity price increases following Russia's war against Ukraine, price hikes for fuel and gas have put pressure on the current accounts of all energy importers. The recovery of the tourism sector and remittances had mitigating effects for most countries. The region also continued to benefit from external support from international institutional lenders.

Russia's war of aggression against Ukraine also impacts the outlook of the Southern Neighbourhood, albeit to a lesser degree than in the EaP. Its fallout implies significant downside risks to the ongoing recovery, as the southern neighbours continue to be affected by higher food, energy and other commodity prices in particular, which drive up inflation and hit domestic consumption while adding to the pressure on public budgets. Disruptions of supply chains and trade flows have already put huge pressure on markets, public finances, producers and consumers across the region, in particular on the countries depended on the grain export from Ukraine and Russia, such as Egypt, Jordan, Lebanon, Libya, Morocco and Tunisia.

2.3 Western Balkans

The economic rebound in the Western Balkans moderated significantly in 2022 due to the fallout from Russia's war of aggression against Ukraine, the induced energy crisis and ensuing high inflation. Despite the reopening of the economies after the COVID-19 pandemic and a rebound in tourism, output growth slowed further in the third quarter of 2022, with the region's GDP growing by 2.1% y-o-y, compared to 4.3% in the previous three months. Private consumption and exports remained the key growth drivers across the region while investment showed a mixed performance, with year-on-year declines recorded in some of the countries. Public consumption contracted in some countries, partly reflecting the gradual withdrawal of pandemic-related support measures.

Job growth turned marginally negative in the Western Balkans in Q3-2022 compared with the previous year. Despite this, unemployment rates fell or remained unchanged, reflecting a decrease in labour force participation in some countries. Strong increases in energy, food and transport prices fuelled a significant acceleration of consumer price inflation in all Western Balkan countries in 2022, which prompted the region's central banks with monetary autonomy to raise their key policy rates. Helped by decelerating food and energy prices, headline inflation levelled out somewhat in most countries in the last months of 2022.

The continued economic recovery and high inflation supported the growth of budget revenues, and fiscal balances increased further across the Western Balkans in the first 11 months of 2022. In parallel, the public debt-to-GDP ratio decreased in all countries compared to end-2021, partly reflecting the rise in nominal GDP. Between September 2021 and September 2022, the region's current account deficit stood at 6.8% of GDP, the second-highest level since Q3-2020. This was mainly due to the energy-balance-driven increase in merchandise trade deficits which outweighed the strong rebound noted in exports of services and the higher remittances inflows.

There are significant downside risks to the Western Balkans' economic outlook due to Russia's continued war of aggression against Ukraine, mainly through the impact of high inflation on real disposable income and consumption, as well as tighter financial conditions.

3 MACRO-FINANCIAL ASSISTANCE OPERATIONS IN 2022

In the spring of 2022, the two remaining MFA operations under the COVID-19 MFA package ([7]) were completed. While Tunisia received the disbursement of the final instalment on 25 May 2022, the second instalment for Bosnia and Herzegovina was cancelled, due to seven out of nine policy conditions being unfulfilled.

With the completion of the COVID-19 MFA package, in 2022 the focus shifted to finding ways of providing new financial assistance to Ukraine, given Russia's continued war of aggression, in a reasonably safe manner (recognising the exceptional uncertainty surrounding the operations and given that the usual precondition of the MFA operation being backed by a disbursing fully-fledged IMF programme was not fulfilled). Following the onset of the war, on 28 February 2022, the European Parliament and the Council adopted a decision to provide emergency macro-financial assistance to Ukraine for up to

[7] Decision (EU) 2020/701 providing EUR 3 billion in MFA loans to 10 enlargement and neighbourhood countries.

EUR 1.2 billion in loans, thereby authorising the sixth MFA operation in Ukraine since 2014.

In a situation of intensified and acute funding needs for Ukraine, in the second half of 2022, the EU adopted two additional exceptional MFA operations, which authorised the disbursement of a further EUR 6 billion to the country by December 2022. For the two exceptional MFA operations, the provisioning rate was increased from 9%, as stipulated by the Neighbourhood, Development and International Cooperation Instrument - ‘Global Europe’ Regulation (NDICI Regulation), to 70% (at least temporarily, with the adequacy of the provisioning rate to be reviewed bi-annually in view of the uncertainty surrounding the economic situation and outlook in Ukraine as long as the war is ongoing).

Less than 2 months following the request from the European Council on 20-21 October to establish a more structural solution for providing assistance to Ukraine in 2023, the ‘MFA+’ Regulation entered into force on 17 December. This new instrument will ensure more predictable, continuous, orderly and timely financing to enable Ukraine to cover a good part of its immediate funding needs, the rehabilitation of critical infrastructure and initial support towards post-war reconstruction, with a view to supporting the country on its path towards European integration.

Moreover, as reflected in the name ‘MFA+’, this new instrument introduces certain changes to standard MFA practices to adapt it to the extraordinary circumstances of providing support to a country at war, notably to high uncertainty, risks and flexibility needs. Changes include increased concessionality of the loans (higher maturity of up to 35 years with a ten-year grace period and interest rate subsidy), flexibility with the strucutral policy conditionality (satisfactory progress towards implementation required only, for all disbursements bar the last), continued de-linking from a disbursing IMF programme and enhanced reporting requirements. These elements are explained in more detail in Section 3.1 below and in the accompanying staff working document. The 20 targeted policy conditions underpinning this operation have been carefully designed to ensure their relevance and feasibility in the current situation. They cover the four areas of macro-financial stability, structural reforms and good governance, rule of law, and energy.

In November 2021, following a gas crisis in Moldova, which heavily impacted the economy and fuelled its financing needs, the authorities submitted a request for a new MFA. In response, the EU agreed on a new operation for Moldova of EUR 150 million, including EUR 120 million in loans and EUR 30 million in grants. The operation is underpinned by an economic reform programme covering 15 actions on the rule of law and the fight against corruption, public finance management and financial sector governance, improving the business environment and energy sector reforms. The first and second instalment were successfully released in July 2022 and March 2023.

The Moldovan economy has been particularly heavily impacted by Russia’s war of aggression against Ukraine, which has contributed to its higher financing needs, further amplified by the ongoing energy crisis. In light of this, the authorities requested further international support. On 10 November 2022, President von der Leyen announced an additional financial support package for Moldova of EUR 250 million, to be partly provided via MFA. On 24 January 2023, the Commission adopted a proposal to increase the ongoing MFA support by EUR 145 million, including EUR 100 million in loans on concessional terms, and EUR 45 million in grants.

Besides the financial assistance provided for the COVID-19 pandemic recovery and the Russian war of aggression against Ukraine, in 2022 a third regular MFA for Jordan was also put in place. Following the fulfilment of all but one of the 14 outstanding policy reforms, with the condition on amendments to the Illicit Enrichment Law waived in agreement with the Member State committee on MFA, the third and final instalment was released on 31 March 2023.

The implementation status of MFA operations in 2022 (by region):

3.1 Eastern Partnership

- **Moldova: new MFA operation**

In November 2021, following the outbreak of an energy crisis reflecting the country's still strong energy dependency on Russia, despite a post-pandemic economic recovery, Moldova officially requested a new MFA operation. After careful assessment of the financing needs, the Commission prepared a proposal for support of up to EUR 150 million, including EUR 120 million in loans and EUR 30 million in grants. The decision to provide additional MFA to Moldova was adopted by the European Parliament and the Council on 6 April 2022. Following ratification by the Moldovan Parliament, the MFA entered into force on 18 July 2022. After fulfilling the policy conditions agreed in the Memorandum of Understanding (MoU), the first instalment was released in July 2022 and the second instalment in March 2023, both of EUR 50 million in loans and grants. Under the current operation, Moldova still has EUR 50 million available to be disbursed in one instalment. Moreover, on 24 January 2023, the Commission adopted a proposal to increase the ongoing MFA support by EUR 145 million. The additional MFA is part of a larger support package by the Commission to Moldova in light of the country's worsening external position due to the severe energy crisis in autumn/winter 2022/2023. Following adoption by the Council and the Parliament, it is expected that the additional MFA will be disbursed in two instalments in the second half of 2023, when the corresponding policy actions have been fulfilled.

The regular MFA operation as well as the proposed increase remains subject to a positive track record of the IMF programme for Moldova of the Extended Credit Facility/Extended Fund Facility, adopted in December 2021 and augmented in May 2022. After the increase, the Fund's programme amounts to USD 815 million. In January 2023, the IMF successfully concluded its second review, assessing the overall progress on the programme as positive.

- **Ukraine: emergency MFA**

The European Union's financial support to Ukraine in response to Russia's war of agression increased progressively, in step with the difficult situation developing on the ground and based on an assessment of Ukraine's funding needs. This step-by-step approach resulted in the provision of three MFA operations to Ukraine in 2022, where the high uncertainty and extraordinary circumstances called for novel and exceptional elements of increased flexibility, but also for higher provisioning, as further detailed below and in the attached staff working document. An emergency MFA operation of up to EUR 1.2 billion was followed by an exceptional MFA package consisting of two operations for up to EUR 1 and 5 billion, respectively.

In the context of the escalating geopolitical tensions preceding Russia's war of agression against Ukraine, and in response to an official request by Ukraine of 16 November 2021 for a longer-term MFA operation of EUR 2.5 billion, on 1 February 2022 the European Commission adopted a proposal on providing a new emergency MFA to Ukraine for up to EUR 1.2 billion in loans, to be disbursed in two equal instalments. The European Parliament and the Council promptly adopted the Decision on 28 February 2022, thereby authorising the sixth MFA operation in Ukraine since 2014. The Commission and Ukraine signed the related MoU on 3 March, which enabled the very swift disbursement of the first instalment of EUR 600 million in two tranches on 11 and 18 March 2022. Moreover, the war circumstances constitute an event of *force majeure* that impeded the effective completion of the structural policy measures - a precondition of the disbursement of the second instalment of the MFA, even though the authorities had taken steps to address all of them. As an exceptional response to the acute financing needs of Ukraine, and since the conditionality agreed in the MoU could not be achieved at that stage for reasons of *force majeure*, the Commission decided, having consulted the Member States Committee for MFA, to proceed with the disbursement of the second instalment of EUR 600 million in May, as a matter of urgency.

- **Ukraine: exceptional MFA**

The financing situation became increasingly acute over the summer 2022 with Ukraine increasingly having to print money and draw down reserves. As a part of the EU's extraordinary support to Ukraine, the Commission proposed on 1 July 2022 a new EUR 1 billion MFA operation for Ukraine in the form of a highly concessional and longer-term loan (compared to usual conditions - see below). This proposal was the first part of the exceptional MFA support of up to EUR 9 billion announced in the Commission's Communication on Ukraine Relief and Reconstruction of 18 May 2022 and endorsed by the European Council of 23-24 June 2022. The exceptional MFA aimed to provide immediate financial assistance in a situation of acute funding needs and to ensure the continued functioning of the most critical functions of the Ukrainian state. The European Parliament and the Council adopted the Decision on 12 July 2022, using all available procedural flexibilities to adopt it at record speed. The Commission and Ukraine signed the related MoU on 19 July, which enabled a disbursement of the whole amount of this MFA in two tranches in early August 2022.

On 7 September 2022, the Commission proposed a new MFA operation of EUR 5 billion in loans as a second part of the exceptional MFA package. The MFA Decision was adopted very swiftly by the European Parliament and the Council on 20 September 2022, again making use of all available procedural flexibilities to speed up the process. After the entry into force of the MoU on 4 October, a first instalment of EUR 2 billion was disbursed to Ukraine on 18 October. The second disbursement of EUR 2.5 billion followed on 22 November 2022. The third and last payment of EUR 500 million was released on 14 December 2022. The exceptional MFA operations, which brought the EU's immediate financial support to Ukraine since the beginning of the full-scale Russian invasion to a total of EUR 7.2 billion, were vital to maintain macroeconomic stability in the country.

Given the extraordinary circumstances in Ukraine due to Russia's war of aggression against the country, these exceptional MFA operations introduced some novelties, which should not be considered a precedent for future MFA operations ([8]). An overall average maturity of up to 25 years, compared to the traditional 15 years, and the possibility for the EU budget to cover interest rate costs and administrative fee payments strengthened the concessional nature of the assistance. To enhance flexibility in the extraordinary war situation, and unlike regular MFA operations, the exceptional MFA had no formal link to a disbursing IMF programme. Policy conditionality, which has proven to be a key value added of macro-financial assistance, was limited to relevant conditions that were deemed feasible and which could be expected to be implemented swiftly with a reasonably high degree of certainty. Finally, a system of reporting requirements was introduced aimed at ensuring that funds received were spent in an efficient, transparent, and accountable manner.

The Ukrainian authorities committed to provide monthly reports on revenues and expenditures of the state budget for the major expenditure headings and including details on the administrative and financial management measures in place and the internal controls. In addition, the backing of these operations has been increased through a provisioning rate of 70% instead of the usual 9% as stipulated by the NDICI Regulation. The standard 9% remains in the form of pad-in provisioning and 61% in the form of a second-loss guarantee by Member States. This was covered by the EU budget for the first operation, in line the regular operational procedures, whereas for the second part, it was backed by guarantees by Member States (see Box 1).

These novel and exceptional elements, in terms of e.g. increased concessionality, flexibility and enhanced reporting also inspired the design of the MFA+ instrument that provides financial assistance to Ukraine for 2023.

- **Ukraine: MFA+**

Within a month after the request of the European Council of 20-21 October to establish a more structured approach to providing assistance to Ukraine for 2023, the European Commission adopted a proposal to provide EUR 18 billion of support inthe form of highly concessional loans to Ukraine for 2023 through a new MFA+ instrument. This new instrument ensures a more predictable, continuous, orderly and timely financing to make a sizeable contribution to Ukraine's immediate funding needs, rehabilitation of critical infrastructure and initial support for post-war reconstruction, with a view to supporting the country on its path towards European integration.

The MFA+ instrument, in addition to integrating the novel elements introduced by the exceptional MFA package, e.g. strenghtened concessionality through longer loan maturities and interest rate subsidy, continued delinking from a disbursing IMF programme, increased flexibility with the structural policy conditionality and enhanced reporting requirements, allows for the channeling of third-party bilateral contributions towards the reconstruction of critical infrastructure in Ukraine ([9]). Following another swift process using all procedural flexibilities, the European Parliament and the Council adopted the Regulation setting up the MFA+ on 14 December 2022. The 20 targeted policy conditions underpinning this operation have again been carefully designed to

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[8] From a budgetary perspective, the major novelty is the introduction of an overall 70% coverage rate of the exceptional MFA loans to Ukraine, whereby the traditional 9% provisioning rate under the EU budget is topped up by bilateral national guarantees for the remaining 61% of the coverage.

[9] From a budgetary perspective, the major novelty of the MFA+ instrument is the coverage of the MFA+ loan exposures by the headroom of the EUR budget, thereby having no immediate implications for remaining availability of budget allocations under the current MFF period.

ensure their relevance and feasibility in the current situation. They cover the four areas of macro-financial stability - structural reforms and good governance, rule of law, and energy. Building on the experience with the exceptional MFA package and recognising the impact of the continuing extraordinary situation, due to Russia's war of aggression, on the authorities' capacity to implement reforms, satisfactory progress on policy implementation is required to enable the disbursement of instalments, except for the final disbursement which is conditional on full implementation. The possibility for a midterm review of the Memorandum of Understanding (MoU) provides for additional flexibility to test the feasability of these conditions given Russia's ongoing war of aggression against Ukraine.

The Commission and Ukraine signed the MoU and the Loan Facility Agreement (LFA) on 16 January 2023, both of which entered into force on the same day. The first instalment of EUR 3 billion in loans was disbursed on 17 January 2023, with the second payment of EUR 1.5 billion following 2 months later on 21 March. Pending compliance with the political precondition, the strengthened reporting requirements on the use of funds and further satisfactory progress in implementing the agreed structural policy conditionality, the MFA+ instrument is meant to provide Ukraine with assistance to the tune of EUR 1.5 billion per month until the end of 2023 (and which have enabled such disbursement on 25 April).

3.2 Southern Neighbourhood

- **Jordan: MFA-III**

After the third MFA to Jordan of EUR 500 million in loans entered into force in January 2020, the Jordanian authorities requested additional assistance in April 2020 in the context of the COVID-19 pandemic, and the EU agreed on a 'top-up' MFA of EUR 200 million in loans. The MFA's policy conditionality focuses primarily on improving public finance management, fighting corruption, and on reforms in the utilities sector, social and labour market policy, and on governance.

The first instalment (EUR 100 million, plus EUR 150 million from the COVID-19-related top-up) was disbursed on 25 November 2020. The second and third instalments are subject to the specific policy conditionality agreed between Jordan and the EU in the MoU. The second instalment (EUR 200 million and a top-up of EUR 50 million) was disbursed on 20 July 2021, sucessfully concluding the COVID-19-related part of the assistance. The third instalment of EUR 200 million was released on 31 March 2023, following a positive assessment of the related policy conditionality.

These MFA operations are provided in conjunction with the resources from international financial institutions and bilateral donors, including the IMF. On 25 March 2020, the IMF approved a four-year Extended Fund Facility programme with Jordan of initially roughly USD 1.3 billion (270% of its quota), which was augmented twice in 2021/2022 to about USD 1.49 billion (334% of its quota) to step up support to help the country cope with the impact of the pandemic on the population, while hosting 1.3 million Syrian refugees. The IMF approved the fifth review of the EFF in December 2022, making about USD 343 million immediately available. This brings the total amount of IMF disbursements to Jordan since the start of 2020 to about USD 1.7 billion, which includes around EUR 366 million in emergency assistance under the Rapid Financing Instrument in May 2020 to help the country deal with the impact of the pandemic. While Jordan's public debt remained high at 113.2% of GDP in 2022, it was assessed as sustainable by the IMF in December 2022.

- **Tunisia: COVID-19 MFA**

As part of the COVID-19 MFA package adopted in May 2020, the EU agreed on a EUR 600 million MFA in loans for Tunisia. Reflecting lengthy procedures in the partner country it became the penultimate COVID-19-related operation to enter into force: the MoU and the LFA were signed on 24 November 2020, ratified by the Tunisian Parliament on 15 April 2021 and entered into force on 11 May 2021 upon publication in the Tunisian Official Gazette. The 12-month availability period therefore ran until May 2022. The MFA's policy conditionality focused primarily on four thematic areas, namely public finance management and civil sector reform, reforms in state-owned enterprises, social protection and investment climate.

The MFA was provided in two instalments of EUR 300 million each. The first instalment was subject to the general political preconditions for MFA and was disbursed on 1 June 2021. The policy reforms required for the disbursement of the second tranche were either fulfilled or broadly fulfilled during 2022. Despite concerns on the political preconditions following the deterioration in the political situation since mid-2021, and after a careful assessment of the situation and a letter from the authorities providing assurances and setting out commitments on a political calendar, the second instalment was disbursed on 25 May 2022.

The assistance complemented resources made available by other donors, including the IMF, under its EUR 685 million Rapid Financing Facility programme for Tunisia, approved on 10 April 2020.

3.3 Western Balkans

- **Bosnia and Herzegovina MFA-COVID-19**

Following an official request for MFA from Bosnia and Herzegovina on 14 April 2020 to address the COVID-19 pandemic, EUR 250 million in loans was included for Bosnia and Herzegovina in the COVID-19 MFA package. The MoU and the LFA were signed on 15 January 2021 and entered into force on 9 June 2021, making this the last of the COVID-19-related operations to enter into force. This substantial delay was caused by the lengthy decision-making processes of the country. The MFA's policy conditions for the second instalment aimed to address some of the weaknesses in economic governance and institution building, as well as financial sector stability and transparency, and to support the fight against corruption and a better functioning of the labour market.

The MFA was to be provided in two instalments of EUR 125 million each. The first instalment was disbursed on 7 October 2021 unconditionally, while the second tranche was not disbursed due to insufficient implementation of the agreed policy conditions within the availability period of the MFA, with seven out of nine reforms not having been completed.

The assistance complemented resources made available by other donors, including the IMF, under its EUR 330 million Rapid Financing Facility (RFI) programme for Bosnia and Herzegovina, approved on 20 April 2020.

4 ENSURING THE PROPER USE OF MFA FUNDS: OPERATIONAL ASSESSMENTS, EVALUATIONS AND AUDITS

4.1 Operational assessments

In line with the EU Financial Regulation, the Commission carries out operational assessments with the help of external consultants to obtain reasonable assurances on the functioning of administrative procedures and financial circuits in beneficiary countries.

Operational assessments focus on public financial management systems, in particular how finance ministries and central banks are organised and what procedures they implement, and - more specifically - on how accounts receiving EU funds are managed. Special attention is also paid to the functioning, independence and work programmes of external audit institutions, and how effective their controls are. Public procurement procedures at central level are also examined.

In 2022, a new operational assessment of Ukraine was initiated in the context of the MFA+ operation. The external consultants concluded that, despite the Russia's war of aggression, the financial circuits and procedures of the country are deemed sufficiently appropriate for the purposes of MFA. They confirmed that Ukraine's public financial management systems and other financial circuits improved considerably in the years following the 2018 operational assessment and that the Ukrainian government remains committed to improving systems and processes, with ample evidence to suggest that several crucial reforms had taken place or were ongoing before being abruptly interrupted by the Russian full-scale invasion.

4.2 Evaluations

In line with the EU Financial Regulation and the corresponding MFA decisions, the Commission conducts evaluations ([10]) after the completion of MFA operations to assess their impact. The two main objectives of these evaluations are to:

i. analyse the impact of MFA on the beneficiary country's economy, and in particular on the sustainability of its external position; and

ii. assess the added value of the EU action.

In September 2022, following the completion of the external study in 2021, the Commission published a staff working document setting out the results of the joint evaluation of the operations with Tunisia and Jordan.

In addition and going beyond the legal obligations, the Commission completed a meta-evaluation of all MFA operations over 2010-2020 already presented in last year's report, while taking into account the recommendations of the Regulatory Scrutiny Board. The meta-evaluation assessed the principles and characteristics governing the MFA instrument and aimed to provide input on how to improve its relevance, effectiveness, efficiency, value added and its ability to respond to the EU's external action priorities. The accompanying staff working document was published in January 2023.

- **Tunisia and Jordan**: the evaluation covered the MFA operation to Tunisia in 2017-2019 and to Jordan in 2017-2019, which was in each case the second such support package to the country. It found that the size, form and timing of the operations were relevant and appropriate to the countries' financing needs,

[10] All evaluations are available on the Commission's website: https://ec.europa.eu/info/evaluation-reports-economic-and-financial-affairs-policies-and-spending-activities_en

providing EU added value. In both countries, the MFA had a positive impact on debt sustainability and played a positive role in promoting macroeconomic stabilisation. The conditionality was relevant and focused on key reform areas. The operations supported positive change in some reform areas, despite mixed progress on some other specific reforms. This was the first time that two operations, given regional similarities, overlapping implementation timeframes and comparable conditionality, were grouped into a single evaluation in order to draw conclusions going beyond the specific operation. From a regional perspective, the positive impact and spillovers on the Middle East and North Africa (MENA) region of the two MFAs was less measurable given the relatively small size of the supported economies and low intraregional integration, possible positive impacts were mostly related to the confidence effect. Both operations were found to be consistent with the overall EU policy framework, aligned with the authorities' reform agenda and other donors' programmes. Given the overall positive experience with grouping the two operations into a single evaluation, it is planned to proceed in the same way for the next ones, notably on the 2017-2020 operations in the EaP and for the COVID-19 package, respectively, where this approach appears particularly relevant and promising given the common shock underlying the need for support.

- **The meta-evaluation of MFA operations 2010-2020**: the evaluation covered 15 MFA operations with the EaP countries, the Southern Neighbourhood countries, pre-accession and other countries; complemented by more recent experiences with the COVID-19 package and the 2022 MFA operations with Ukraine. It found that these operations were efficient, relevant, coherent, and that they generated EU added value. Moreover, the MFA instrument was effective in helping restore external sustainability and promoting structural reforms. The effectiveness of MFA was notably supported by (i) the focus on countries in the EU's direct vicinity and the strong ties with those countries, (ii) by the preference for loans and the standard availabilty period of 2.5 years which is long enough to incentivise reforms and their implementation, and (iii) the fact that policy conditions (which were found to be relevant and rightly sequenced) ensured a comprehensive reform effort. The evaluation also confirmed that the objectives, design and implementation of MFA operations were largely complementary and consistent with other EU initiatives and IMF operations. However, the evaluation also pointed to some limitations. The procedures to adopt MFA operations were assessed as lengthy for a crisis instrument, somewhat undermining their effectiveness. This was the case especially for standard decision-making procedures, and the recent experiences with the COVID-19 package and the 2022 MFA support to Ukraine showed that using all available procedural flexibilities helped significantly. The MoU's lack of flexibility also appeared to have reduced the effectiveness of MFA in times of profound changes. The evaluation also indicated the need to strengthen the visibility of the MFA in beneficiary countries. From a methodological perspective, the MFA evaluations were found to be carried out to a high standard, especially after the 2015 Better Regulation Guidelines came into effect.

Additional information on the two evaluations is provided in the staff working document accompanying this report.

5 GENERAL DEVELOPMENTS RELATED TO THE MFA INSTRUMENT

5.1 Functioning of the MFA instrument

The 2013 Joint Declaration of the European Parliament and the Council on MFA ([11]) frames the assistance as being of a macroeconomic and financial nature and clearly states that its aim is ‘to restore a sustainable external finance situation for eligible countries and territories facing external financing difficulties.’ For MFA to be successful as an ‘emergency’ instrument, it is therefore important to mobilise it effectively and in time. At the same time, it has been noted by both the European Court of Auditors and in the above-mentioned meta-evaluation of MFA operations (2010-2020) that delays in adopting MFA decisions by the European Parliament and the Council within the ordinary legislative procedure can be a major shortcoming for an instrument that is meant to respond to a balance-of-payments crisis, and as a consequence ‘The Commission should explore with its co-legislators the available options to accelerate the approval procedures of subsequent MFA programmes, particularly for emergency funding ([12]).

However, the Commission notes that the experiences with the COVID-19 MFA package and the 2022 MFA operations to Ukraine (emergency MFA, exceptional MFA, MFA+) showed that the current set-up of MFA can allow for a very swift adoption, if all institutions agree to make full use of the available procedural flexibilities. In these cases, the Commission worked with the Parliament and the Council to agree on the use of existing urgency procedures which allowed for the corresponding assistance to be adopted within 1 month of the Commission’s respective proposals by both co-legislators. The European Parliament invoked a specific clause (Rule 163) in their Rules of Procedure, which permitted it to immediately adopt the Decision in Plenary, without having to go through the International Trade (INTA) Committee, as is the regular practice. This fast adoption process was the result of a shared sense of urgency by all institutions in these extraordinarily challenging times.

Thus, the Rules of Procedure of both the Council and the European Parliament provide for an accelerated procedure necessary for swift adoption in urgent situations. By having timely, constructive contacts, it proved possible to have a faster adoption process under the ordinary legislative procedure, with the full involvement of the European Parliament, which would not have been the case if the Commission had proposed measures on the basis of Article 213 TFEU (applicable for cases where urgent financial assistance is required and by only the Council adopting the MFA operation).

5.2 MFA in the 2021-2027 multiannual financial framework

As the EU’s Neighbourhood and Enlargement remain exposed to high geopolitical uncertainty and continues to experience economic instability, further exacerbated by Russia’s war of aggression against Ukraine, the need for the EU to consider providing MFA is likely to remain high in the years to come. It is therefore important to make sure that the budgetary backing conditions for this are in place.

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[11] Joint Declaration by the European Parliament and the Council adopted together with the decision providing further macro-financial assistance to Georgia (Decision (EU) 2013/778 of 12 August 2013). Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013D0778&from=EN

[12] European Court of Auditors Special Report (No 03/2017) available at: https://www.eca.europa.eu/Lists/ECADocuments/SR17_3/SR_TUNISIA_EN.pdf.

MFA loans are guaranteed by the External Action Guarantee that was created by the NDICI Regulation, at a provisioning rate of 9% as was the case under previous MFFs ([13]). In view of the extraordinary support needs since the start of the MFF and notably the EU's sizeable support to Ukraine via MFA in 2022, much of the available provisioning has already been used. Box 1 provides some detail on the budgetary treatment of the support to Ukraine in 2022.

1. Box – budgetary treatment of support to Ukraine in 2022

The EU's financial support to Ukraine in response to the Russian war of agression evolved progressively, reflecting its funding needs. This step-by-step approach resulted in the provision of three MFA operations in 2022, with the introduction of several novel exceptional budgetary arrangements as compared to regular MFA operations.

First, the emergency MFA to Ukraine of up to EUR 1.2 billion in loans adopted on 28 February 2022 followed the regular pattern of MFA operations, and was provisioned at 9% of the nominal value of the loan, in accordance with the NDICI Regulation.

Second, in view of the extraordinary situation in Ukraine, namely to finance the immediate funding needs following the unprovoked and unjustified aggression by Russia, it was decided that the loans to Ukraine under the exceptional MFA (EUR 6 billion in two operations of respectively 1 and 5 billion), given their higher risk in the war context, would be covered for 70% of their value ([14]). Given the limited budgetary availability under the MFA, this translates into paid-in provisions under the EU's budget at the traditional 9% provisioning rate and additional callable bilateral national guarantees by the Member States for the remaining 61% of the amounts.

Finally, given the persistence and escalation of the war, the co-legislators adopted further and more structured support for the year 2023 of EUR 18 billion in loans in the form of a new MFA +. To limit the crowding out effect of the sizeable support to Ukraine on future MFA operations in other partners countries, it was decided that the risks associated with this lending would be covered in a different manner. More precisely, the corresponding financial liability is guaranteed by the available margin under the 'own resources' ceiling (i.e. the 'headroom'). This relates to the flexibility afforded by the fact that ressources can be mobilised over and above the MFF ceilings and up to the limits of the ceilings of the EU's own resources. This arrangement allows the lending to take place without the provisioning that the NDICI Regulation usually stipulates.

Recent developments have therefore left a significant hole in the MFA budget for loans because of the size and nature of the support to Ukraine. More than 60% of the budget allocated to cover for the provisioning of MFA loans under the current MFF has been used so far, only 2 years after the entry into force of the current MFF. With MFA being a crisis instrument, needs are not programmable and are difficult to predict, but are likely to remain sizeable in the current context of high geopolitical uncertainty and the economic fallout from the Russian war of aggression against Ukraine adding to existing

[13] The NDICI - 'Global Europe' instrument entered into force in June 2021, after its formal adoption by the Council and the Parliament. While the Regulation therefore plays an important role in the budgetary set-up of MFA, the instrument as such remains separate from NDICI-Global Europe, and specific MFA operations continue to be activated, as needed, by separate ad-hoc decisions on the basis of the applicable Treaty legal basis.

[14] The Regulation also includes a review clause of the provisioning rate, every 6 months, given the exceptional uncertainty given the current war.

macro-fiscal imbalances in many partner countries. It would appear important to ensure that sufficient resources are available so that eligible requests can be considered and possibly responded to in a favourable manner in a way that is consistent across countries and over time.

The External Action Guarantee is being managed through the Common Provisioning Fund. In the context of the EU's exposure to Ukraine and the region, the Commission has embarked on an assessment of the risks involved.

6 LOOKING AHEAD - MFA OPERATIONS AND BUDGETARY SITUATION IN 2023

The Moldovan economy has been heavily impacted by Russia's full-scale invasion of Ukraine, which contributed to higher financing needs, further amplified by the ongoing energy crisis. In light of this, the authorities requested further international support. Thus, on 10 November 2022, the Commission President announced an additional financial support package for Moldova of EUR 250 million, to be partly disbursed via the MFA instrument. On 24 January 2023, the Commission adopted a proposal to increase the ongoing MFA operation by up to EUR 145 million, including up to EUR 100 million in loans on concessional terms and up to EUR 45 million in grants. The increase is to be disbursed in two additional instalments, tentatively foreseen for Q3/Q4-2023, subject to new policy conditions being added to the existing Memorandum of Understanding (MoU). The adoption of the proposal by the European Parliament and the Council took place in May 2023.

On 6 February 2023, the Commission adopted a proposal to provide MFA to North Macedonia of up to EUR 100 million following a deterioration in the country's economic situation and outlook since its first request in April 2022. The MFA is expected to be disbursed in two instalments, tentatively foreseen for Q3-2023 and Q1-2024, respectively. The release of each instalment will be conditional on progress being made with the implementation of a number of policy measures to be agreed between the Commission and the authorities and listed in a MoU, as well as satisfactory track record in the implementation of the IMF programme with the IMF Executive Board adopting a 24-month precautionary and liquidity line (PLL) for North Macedonia of up to EUR 530 million on 22 November 2022. The MFA proposal to North Macedonia was adopted by the European Parliament and the Council in June 2023.

Tunisia requested additional EU macro-financial assistance of EUR 1.2 billion in November 2022 to support its financing needs in the context of a slow post-pandemic recovery and the economic fallout of Russia's war of aggression in Ukraine. This followed the staff-level agreement reached with the IMF for a new Extended Fund Facility (4 years, USD 1.9 billion) in October 2022. However, the IMF has not yet adopted the programme due to the need for additional financing assurances and for completing prior actions. Due to the escalating crisis, Tunisia's external residual financing gap is growing and the implementation of reforms to address the country's vulnerabilities has become even more urgent. Based on a careful assessment of MFA preconditions and Tunisia's external financing needs, the Commission is preparing a proposal for a new MFA to be adopted in 2023 once the IMF programme is in place.

The Commission stands ready to consider any other forthcoming requests for MFA, and if appropriate, will propose new and/or follow-up MFA operations to eligible partners.

Table 1 provides an overview of commitments and payments of MFA grants and the disbursement of MFA loans for 2020, 2021, 2022 and (provisionally) 2023.

Table 1: Commitments and payments for MFA grants and disbursements of MFA loans 2020-2023 (EUR) ([15])

	2020	2021	2022	2023
Commitment appropriations for grants in the budget	20 000 000	227 200	30 114 460	56 710 579
Operational assessments, *Ex post* evaluations	293 900	227 200	114 460	350 000
Other possible MFA operations	-	-	30 000 000	45 000 000
Commitments, total	293 900	227 200	30 114 460	45 350 000
Uncommitted budget allocations	19 706 100			TBD
Payment appropriations for grants in the budget	27 000 000	362 400	20 868 187	55 350 000
Operational assessments, *Ex post* evaluations	284 600	362 400	-	350 000
MFA Georgia III (completed)	5 000 000	-	-	-
MFA Moldova (completed)	10 000 000	-	-	-
MFA Moldova	-	-	15 000 000	55 000 000
Other possible MFA operations	-	-	-	-
Payments, total	15 284 600	362 400	-	55 350 000
Unused allocations for grants payments	11 715 400		5 868 187	
Disbursements of MFA loans				
MFA Georgia III (completed)	20 000 000	-	-	-
MFA Moldova (completed)	20 000 000	-	-	-
MFA Ukraine IV (completed)	500 000 000	-	-	-
MFA Jordan II (completed)	-	-	-	-
MFA Jordan III (completed)	100 000 000	200 000 000	-	200 000 000
MFA Tunisia II (completed)	-	-	-	-
MFA Moldova	-	-	35 000 000	35 000 000
Emergency MFA Ukraine	-	-	1 200 000 000	-
Exceptional MFA Ukraine	-	-	6 000 000 000	-
MFA Moldova top-up	-	-	-	140 000 000
MFA+ Ukraine	-	-	-	18 000 000 000
Disbursements of MFA loans, total	**640 000 000**	**200 000 000**	**7 235 000 000**	**18 375 000 000**
COVID-19 MFA operations:				
MFA Georgia (partially disb.)	75 000 000	-	-	-
MFA Moldova (completed)	50 000 000	50 000 000	-	-
MFA Ukraine (completed)	600 000 000	600 000 000	-	-
MFA Jordan (completed)	150 000 000	50 000 000	-	-
MFA Tunisia (completed)	-	300 000 000	300 000 000	-
MFA Albania (completed)	-	180 000 000	-	-
MFA Bosnia and Herzegovina (partially disb.)	-	125 000 000	-	-
MFA Kosovo (completed)	50 000 000	50 000 000	-	-
MFA Montenegro (completed)	30 000 000	30 000 000	-	-
MFA North Macedonia (completed)	80 000 000	80 000 000	-	-
Disbursements of COVID-19 MFA loans, total	**1 035 000 000**	**1 465 000 000**	**300 000 000**	-
Disbursements of all MFA loans, total	**1 675 000 000**	**1 665 000 000**	**7 535 000 000**	**18 375 000 000**

[15] The table does not take into account any proposal for new MFA operations after April 2023.