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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT,
THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE
AND THE COMMITTEE OF THE REGIONS**

SAPARD ANNUAL REPORT – Year 2005

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1. INTRODUCTION

Beginning in 2000, the EU reinforced its pre-accession assistance for the rural development of ten candidate countries of eastern and central Europe by creating Sapard, the Special Accession Programme for Agriculture and Rural Development. For its implementation a unique approach was chosen: the national authorities in the applicant countries assumed the entire responsibility through fully "decentralised management" thus enabling the realisation of Sapard. One objective is to implement numerous small scale rural development projects and the other to create structures capable of applying the *acquis communautaire* upon accession. Detailed information regarding the implementation and management systems of Sapard can be found in the 2000 Annual Report.

2. MAIN RESULTS OF IMPLEMENTATION¹

From 2000 to 2005, a total of €2 663,9 million was allocated to the beneficiary countries for the improvement of their rural and agricultural sectors, of which €1 334,2 million was allocated to the eight new Member States (nMS) eligible for Sapard support² and €1 329,7 million to Bulgaria (BG) and Romania (RO). During this period €1 803,0 million³ was actually paid to the beneficiaries, representing 94,4% of all available appropriations under the Annual Financing Agreements (AFAs) 2000–2003 for the nMS and 40,9% of AFAs 2000–2005 for BG and RO.

In 2005 the European Commission (EC) committed €250,3 million to BG and RO and paid a total of €811,9 million to all beneficiary countries of which €557,5 million to the nMS and €254,4 million to BG and RO. The payments made in 2005 represent 82% of the payments made during 2000–2004. This indicates a significant increase in the absorption of the EU funds and is mainly due to the fact that besides LV and HU all nMS reached the 95% threshold at which the EC stops reimbursement payments until the final balance can be paid. LV (94,6%) and HU (91,3%) were close to it.

In 2005, the nMS continued to pay contracts concluded under Sapard. At the end of 2005 only the CZ had officially stopped Sapard spending and submitted the final payment claim so that this programme could be closed in 2006.

In all nMS the commitments made to the beneficiaries went well beyond the 100% available under Sapard. More than 34 000 projects were committed, amounting to €1 492 million of Community contribution.

As a result, the nMS were able to rapidly start the implementation of the post-accession rural development programmes.

¹ See Annex A.

² Czech Republic (CZ), Estonia (EE), Hungary (HU), Latvia (LV), Lithuania (LT), Poland (PL), Slovakia (SK), Slovenia (SI).

³ Pre-financing and reimbursement payments.

The total amount of public funds spent under Sapard at the end of 2005 was €2 334,9 million⁴. Large shares of the investments made under Sapard are revenue generating investments supported by up to 50% from public sources. The overall direct impact of support under Sapard (total eligible costs) amounts to a total of €4 287,1 million in investments and services provided. Consequently, each €1 provided by the Community under Sapard results in an overall investment of €2,4.

3. ASSESSMENT OF ACHIEVEMENT OF OBJECTIVES⁵

Now that the implementation of Sapard is coming to an end in the nMS it is possible to assess the overall impact of the country programmes.

The report focuses on the implementation results as compared to the Sapard objectives. It assesses the state of implementation of the investment measures for farms and the food industry, which contribute, in particular, to the attainment of EU standards. It also assesses the other two investment measures for diversification of economic activities and rural infrastructure which mainly contribute to sustainable economic development and the creation of job opportunities in rural areas. These measures account for 93% of the total Sapard allocation⁶.

A horizontal assessment based on all indicators set out in the Sapard programmes will be done in the framework of the *ex-post* evaluation of the eight nMS' programmes.

As regards BG and RO, this report will focus on the progress made throughout 2005.

3.1 New Member States

Already by the end of 2004, all eight nMS had managed to contract the total amount of EU funds allocated to them and to prepare a pipeline of projects eligible under the post-accession programmes.

Investments in farms and the food industry, which are the most essential sectors in terms of adoption of *acquis* standards, represent 53% of the total Sapard allocation to the nMS, of which 24% was spent for investments in farms and 29% in the food industry.

Under the farm investments measure, the share of animal production and products reached 41% of the overall amount contracted in the eight nMS. Investments in the wine, fruit and vegetables sectors are to a large extent related to adaptation to *acquis* standards. These sectors represent ca. 10% of the total investments under this measure.

At the same time, investments in the arable crops sector represent 17%. Although the crops sector in some countries is important in the overall agricultural production, the relatively high level of investments in the crops sector is also partly a result of economic difficulties in the cost intensive animal production and products sectors which, in addition to the lack of rural credit finance, lead to a lower uptake in the live sectors and consequently a higher share of support for the arable crop sector. This was for instance the case in the 3 Baltic States, where the share of investments in the crops sector corresponded to 45% in LV, to 47% in LT and to 70% in EE.

⁴ Including national co-financing and payments by the nMS beyond the 95% ceiling.

⁵ Annexes B and C contain a horizontal overview.

⁶ Annex C.1.

As regards food processing and marketing, investments in meat and milk and dairy products, the two key sectors in terms of adjustment to *acquis* standards, have reached 52% and 21% respectively. The monitoring data suggest that investments to meet *acquis* standards represent the largest share of the investments. For example in PL, the largest Sapard beneficiary, investments aimed at adapting to EU sanitary and veterinary standards represent about 87% of the total investments in the meat and 72% of the investments in the dairy sector⁷.

Moreover, investments in first stage processing, improving quality controls and rendering were substantial in certain countries. For example, in CZ investments in improving the structures for quality control in processing plants amounted to €23 million of which 99% was used to introduce the HACCP systems in dairy and meat establishments.

These results suggest that investments under these two measures have contributed to achieving the Sapard objectives.

Investments in rural infrastructure and diversification of economic activities represent 40% of the total Sapard allocation to the nMS, of which 31% was allocated to investments in rural infrastructure and 9% to investments in diversification of economic activities.

Investments in rural infrastructure were concentrated on investments in waste management (39%), water supply (19%) and local access roads (35%). The relatively high level of rural infrastructure investments is in particular due to their high level in PL (47%) while other nMS have allocated substantially lower amounts to this measure.

As regards diversification of economic activities in rural areas, the main area of investment has been rural tourism (27%) while investments in the development of basic services represent 11% of the allocation to this measure in the nMS.

Investments under these two measures improved the basic infrastructure and supported sustainable development of economic activities in the rural areas.

3.2 Bulgaria⁸

In 2005, the EU committed €75,1 million to BG under the AFA 2005. This brought the total of EU funds committed for BG under the AFAs 2000–2005 up to €362,3 million. At the same time the EC paid €67,2 million to BG and cumulated EU payments 2000–2005 amounted to €158,2 million (43% of available EU funds) at 31.12.2005.

By the same date, the Sapard Agency had approved 1 921 projects under all measures (except for agri–environmental and irrigation), accounting for €286,5 million of EU contribution (79% of the AFAs 2000–2005). However, following the temporary freeze of projects approved under the so called "limited time procedure" only 1 721 projects were approved in 2005 accounting for € 251,8 million of EU contribution (70% of the EU allocation 2000–2005)⁹. The application of this procedure by the Agency considerably delayed the implementation of the Programme.

⁷ Annual Implementation Report PL, 2005.

⁸ Annex C.3.9 gives an overview of the distribution of Sapard funds between measures for BG.

⁹ The "limited time procedure", through the application of which projects were approved temporarily before the final eligibility check to speed up the implementation, had been applied by the Sapard Agency since July 2004. However, it turned out to be contested at national and EC level. As a result, the implementation of the Sapard Programme was delayed by a temporary suspension of projects until a final decision on the conformity of the procedure is taken.

In 2005 only 12 projects were approved due to the exhaustion of funds under the AFAs 2000 – 2004 and the relatively late ratification of the AFA 2005. As a consequence, the call for applications was suspended for all measures except “Vocational training”, “Setting up producer groups”, “Forestry”, afforestation” and “Technical Assistance” for which limited funds had remained available.

By the end of 2005, 1 378 projects have been completed corresponding to 72% of approved projects to that date, of which 536 have been completed during 2005. The EC contribution in the reimbursed subsidies was €159,1 million, corresponding to 54% of the amount under the AFA 2000–2004.

The measures with the highest allocation are “Investments in Agricultural Holdings” and “Processing and Marketing” covering respectively 32% and 34% of available funds. With as much as 81% of the funds approved for 1 324 projects, “Investments in Agricultural Holdings” has been the most successful measure; of these projects 998 have been completed (391 in 2005). Under the second most popular measure “Processing and Marketing” 238 projects were approved (55 in 2005) covering 59% of all funds available. Under “Investments in Agricultural Holdings” the share of the arable crops, fruit and vegetables sectors still remains very high (77%) which is to a certain extent justified by the substantial need for rationalisation and mechanisation, partly a result of economic difficulties in the livestock sectors and weak rural credit services. Under “Processing and Marketing”, investments in the processing and marketing of meat, fish, milk and dairy products represent a 53% share of all approved projects.

The contracting level under “Diversification of Economic Activities” has also increased with 291 approved projects covering 50% of the amount available for the entire programming period. 190 projects have been completed (88 in 2005). The key activities under this measure are related to investments in rural tourism (43%) and investments in timber, carpentry and bio-fuels (33%).

With regard to the measures “Rural Infrastructure” and “Renovation of Villages” the contracting levels reached 60% and 50% respectively of the amount available for the period 2000–2005 with 17 and 30 projects completed respectively by the end of 2005. Under “Rural Infrastructure”, 83% of the funds were used for building roads.

3.3 Romania¹⁰

In 2005 the EU committed €175,2 million to RO under the AFA 2005. This brought the total of EU funds committed for RO under the AFAs 2000–2005 up to €967,4 million. In 2005 the EC paid €187,2 million to RO and the cumulated EU payments 2000–2005 amounted to €385,4 million (39,8% of EU funds) at 31.12.2005.

By the end of 2005, the Sapard Agency had approved 1 928 projects amounting to €534,8 million of EU funds (55% of the Sapard allocation for 2000–2005). Considering that the EC should pay €792,2 million¹¹ to RO by the end of 2006 to avoid de-commitment of funds, and only €385,4 million was paid by the end of the year 2005, RO risks losing substantial EU funds if the implementation does not accelerate considerably during 2006.

¹⁰ Annex C.3.10 gives an overview of the distribution of Sapard funds between measures for RO.

¹¹ The deadline for de-commitment of funds was extended by one year for AFA's 2004 and 2005 by Regulation (EC) No 1052/2006 of 11 July 2006 (OJ L 183, 12.7.2006, p. 3).

The implementation of Sapard started only mid-2002 and faced serious difficulties, mainly related to the lack of administrative capacity and credits for farms or rural businesses. Furthermore, the floods which affected RO in 2005 hampered the execution of the Programme.

Considering the scope of damages (estimated at €1,6 billion and 3,4% of the 2003 GDP) affecting almost every county during April-September 2005, the EC agreed to re-allocate substantial funds to the measure "Rural Infrastructures" for rehabilitation in the affected areas. Moreover, it agreed to use the related provisions of MAFA (Multi Annual Financing Agreement) in case of natural disasters allowing to apply a higher EU co-financing rate (85% instead of 75%) and a higher public aid rate (75% instead of 50% for private beneficiaries) under some measures. In addition, a new sub-measure for investments in flood prevention was created.

In general, the Programme is characterised by a strong emphasis on rehabilitation of rural infrastructure while the *acquis* related measures have only recently started to absorb funds to a larger extent. Therefore, one of the main objectives of the Programme, to help RO meet the requirements of the EU *acquis*, has not yet been attained.

The largest share of EU funds has been allocated to "Rural infrastructure". However, no new projects were contracted during 2005 since the contracting level reached 100% of the funds already in 2004 (49% for roads, 35% for drinking water facilities, 16% for sewerage systems). The "Rural Infrastructure" measure has been subject to allegations of low project quality and irregularities in the tender procedures. RO has made efforts to reinforce controls of the implementation and therefore none of the alleged irregularities have led to financial corrections so far. Many completed projects were moreover seriously damaged during the 2005 floods.

The EU *acquis* related measure "Processing and Marketing" which has been allocated the second largest share of funds is facing serious absorption problems. The level of contracting reached only 54% of the funds available for the period 2000-2005. Out of the amount allocated to this area the meat products sector received 52% and the dairy sector 19%.

"Investments in Agricultural Holdings" is the third most important measure. Contracting under this measure however only reached 28% of the available funds (59% for field crops, 20% for milk, 12% for meat). In the run up to accession, attention is given to enhance implementation in the livestock sectors.

The level of contracting under "Diversification of Economic Activities" has reached only 23% of the funds allocated for 2000-2005 by the end of 2005, of which 86% relate to rural tourism.

4. PROGRAMME IMPLEMENTATION AND MANAGEMENT

4.1 Monitoring of programme implementation

During 2005 the EC continued to work closely with the beneficiaries on running the monitoring and evaluation systems. In addition to the ongoing monitoring, the 14 Monitoring Committees held during 2005 focused on programme modifications. 11 EC Decisions amending the Sapard programmes of nine countries (all except PL) were adopted in 2005, of which eight were taken for the nMS and three for BG and RO (Annex D).

For the nMS, who stopped contracting projects in 2004, amendments mainly concerned the preparation of final payments.

The main objective of the amendments adopted for BG and RO was to better focus the programmes to accession and to improve the absorption capacity. Furthermore, a programme amendment was approved allowing for the application of special provisions with regard to natural disasters and to re-allocate funds for the rehabilitation of the infrastructure affected by the floods in RO.

4.2 Update on mid-term evaluations

According to MAFA, the mid-term evaluations should be updated where and whenever appropriate. Based on this, it was decided to carry out such updates for BG and RO by 31.12.2005. As neither of the countries had submitted the evaluation by that date, the reports will be reviewed by the EC during 2006.

4.3 Rural Credit

The PHARE Small and Medium Finance Facility (SMEFF) combines resources of the EBRD, the CEB/KfW with PHARE grants in order to provide financial intermediaries in the candidate countries with incentives to

- expand their offer of finance to SMEs including farms and rural business,
- enhance their capacity to assess and monitor the related risks and
- manage their risk exposure.

The Rural Sub Window (RSW) aims at strengthening the financial sector's capacity to increase access to finance for farmers and rural businesses.

By the end of 2005, EBRD had signed 6 RSW projects with financial intermediaries in BG, PL, SK, SI and CZ amounting to a total of €47 million of credit lines and €6,6 million of EU incentives. The CEB/KfW has signed 2 projects with financial intermediaries in SK (€5 million) and RO (€30 million) and a total amount of EU incentives of € 3,5 million.

4.4 Croatia

The Croatian (HR) programme was adopted by the EC on 8.2.2006. With a financial allocation of €25 million for 2006 it defines 3 priorities to be implemented through four measures: 20% of EU funds will be allocated to "farm investments", 39% to the improvement of "processing and marketing of agricultural and fishery products" and a further 40% will be devoted to the improvement of "rural infrastructure" with the remaining 1% to be used for technical assistance.

The HR MAFA was adopted on 6.12.2005 and signed on 29.12.2005. The MAFA lays down the Community management and control rules for Sapard.

As Sapard is managed under the full responsibility of the country, HR is required to set up and accredit a Sapard Agency to which the EC will subsequently confer the management of aid.

5. ACTIVITIES IN RELATION TO CONFERRAL OF MANAGEMENT, AUDITS AND CONTROLS

5.1 Update on Conferral of Management of Aid and monitoring missions¹²

In 2005 only one conferral audit mission has been carried out to RO covering four measures. The EC Decision was not issued in 2005 as the RO authorities were due to amend and complete some of the Sapard procedures in order to comply with the MAFA requirements.

Moreover, several fact-finding audit missions were carried out to the candidate countries Croatia (HR) and Turkey (TK). For HR the objective was to follow up the progress made by the National Fund and the Sapard Agency towards accreditation, whereas for TK the objective was to kick-start the accreditation process under the new Instrument for Pre-accession Assistance (IPA) available from January 2007 and to provide advice and information on the tasks and responsibilities involved.

5.2 Clearance of accounts decision

The annual accounts 2004 for 10 countries (CZ, EE, HU, LV, LT, PL, SK, SI, BG and RO) were cleared by the EC Decision C(2005) 3656 of 30 September 2005.

The annual accounts for the financial year 2003 regarding BG, RO and PL were not covered by the EC Decision of 28 September 2004. Therefore, two certification audit missions were conducted during 2005 to RO and PL and additional information was requested from BG. The EC Decisions relating to these 3 countries will be taken during 2006.

5.3 Conformity Clearance decision

After its start in September 2003, the compliance audit enquiry was continued during 2004 and 2005. In 2005, 5 conformity missions were carried out. In CZ, HU, LT and PL the audits concentrated on the implementation of corrective measures to address the recommendations made during the first enquiries carried out in 2003 and 2004. In RO, a second audit was carried out to cover the expenditure declared during 2005 and to perform an overall verification of the implemented procedures for a new measure.

During these audits, selected samples of payment files were examined and some final beneficiaries were inspected on the spot. The weaknesses detected were addressed to the authorities concerned. The application of possible financial corrections to the expenditure affected will be evaluated at the end of the clearance of accounts procedures linked to the present enquiry according to MAFA.

A Conformity Clearance Decision C(2005)3702 was adopted on 6.10.2005 excluding from Community financing certain expenditure incurred by BG under Sapard due to unacceptable conflicts of interests between the beneficiaries and their consultants for two projects and, in one case, for non compliance with private tendering rules established by the Community legislation and by the MAFA.

¹² See Annex E.

5.4 Work carried out in relation to the European Court of Auditors (ECA)

In the framework of the DAS 2004 the ECA checked the EC's handling of the Sapard Annual Implementation Reports focusing on the documentation of the EC's analysis of the reports and on the respect of the deadlines as laid down in the MAFAs. The comments made were duly taken into account by the EC services.

Moreover, in the framework of its 2004 annual report the ECA carried out audits in HU and SI. The EC services examined these reports as well as the replies from the MS, and followed up on some of the issues raised during the national audits in both countries. After this examination the EC considers that there is no evidence of widespread errors or system weaknesses.

In its conclusions for the 2004 financial year the ECA notes that, for the pre-accession funds in general, risks of varying degrees existed at the level of the implementing organisations in the candidate countries. For Sapard in particular the ECA noted that certain weaknesses had been identified but with minor financial impact. Overall it concluded that, for Sapard, "the systems included the key concepts, procedures are well documented and the systems as described and accredited were generally working in practise ... On the basis of the audit work performed and excepted the court reiterates the opinion that the Sapard supervisory and control systems generally worked in practise."

5.5 Information on irregularities

In 2005, 151 new cases of irregularities were brought to the attention of OLAF: 87 in RO, 21 in HU, 19 in PL, 9 in BG, 4 in LV, 3 each in EE and SI, 2 each in LT and CZ and 1 in SK. The number of cases reported from the nMS is clearly decreasing whereas the majority of new cases brought to OLAF's attention came from the accession countries where Sapard expenditure rose. Some countries, in particular RO, have communicated irregularities for an amount below €4 000 with the consequence that the number of irregularities reported from those countries was quite high.

The majority of irregularities reported arose from the incorrect application of procurement rules, the irregularity of accounting, the ineligibility of certain expenses and forged documents. Inadequate staffing, lack of training, the importance of rotation as well as the desire to commit Sapard funds before the accession related deadline is reached, are considered as the risk factors.

6. FUTURE DEVELOPMENT

6.1 Instrument for Pre-accession Assistance (IPA)

In 2005, the EC prepared the legal basis to follow up on the reform of the external aid policies proposed in the Financial Perspective 2007–2013¹³ which resulted in the elaboration of the new instrument IPA replacing the 5 former instruments PHARE, ISPA, Sapard, CARDS and the TK pre-accession assistance. Moreover, implementing rules for IPA including the Rural Development Component of the instrument (IPARD) were prepared and the preparatory work for the implementation of IPARD in the candidate countries concerned (HR, TK, fYRoM) was initiated.

¹³ COM(2004) 101.

6.2 Croatia

Preparatory work for the IPARD component which will apply from 2007 has accelerated during the year 2005.

The IPARD programme will be based on the Sapard programme. It will include additional measures such as “Development and Diversification of Rural Economic Activities”, “Agricultural Production Methods Designed to Protect the Environment and Maintain the Countryside” and a “Leader-type Measure”. Croatia envisages submitting an IPARD plan for EC approval during 2006.

6.3 Turkey

During 3 preparatory missions to Ankara in April, July and December 2005, the TK authorities confirmed their intention to start with the implementation of an IPARD Programme for TK as early as possible and no later than during the first half of 2008, while the EC provided advice on the key steps to be taken.

Detailed sector analysis involving independent expertise will become a requirement for all sectors included in IPARD programmes. Upon request of the TK authorities, the FAO has started to carry out a study of the dairy sector in autumn 2005 to be finalised in 2006.

With regard to rural credit finance the EC has stressed the importance of well functioning financing facilities for the absorption of IPARD funds.

6.4 Co-operation with International Organisations

The EC has increasingly developed cooperation with International Financing Institutions (IFIs) in the field of pre-accession assistance to rural development in recent years. The result has been a better understanding of the functioning of Sapard as well as IPARD and the potential areas of collaboration between the IFIs and the EC services in this field.

Close coordination and cooperation with the World Bank (WB) started in HR soon after it was awarded candidate status by the EU. The WB Agricultural *Acquis* Cohesion Facility for HR (€25,5 million) was designed to build up capacities within the HR Ministry for Agriculture, including support for the establishment of an Sapard/IPARD Agency and the preparation of Sapard/IPARD measures.

Under the Agriculture Reform Implementation Project (ARIP), the WB is supporting IPARD-type measures in TK.

The EC has also been in close contact with other international donors, such as the UNDP and the USAID, to better coordinate the respective rural development activities. The EC is furthermore a member of the East-Agri group which is a network of agricultural and agri-business institutions working in the region of Central and Eastern Europe under FAO coordination.