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(Information)

COURT OF AUDITORS

SPECIAL REPORT No 5/2004

concerning Phare support to prepare Candidate Countries for managing
the Structural Funds, together with the Commission's replies

(pursuant to Article 248(4), second subparagraph, of the EC Treaty)

(2005/C 15/01)

CONTENTS

	Paragraph	Page
SUMMARY	I-VII	4
INTRODUCTION	1-14	5
Phare assistance to prepare Candidate Countries for managing the Structural Funds	1-10	5
The Court's audit	11-14	7
THE OVERALL APPROACH OF USING THE PHARE PROGRAMME TO PREPARE CANDI- DATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS	15-28	8
The choice of Phare made preparation of Candidate Countries for the ERDF and ESF more difficult	15-17	8
The design of Phare ESC programmes differed from Structural Fund Objective 1 approaches	18-26	9
Constraints affecting strategy of using Phare to prepare for the ERDF and ESF	27-28	11
PHARE PROCEDURES	29-36	11
Delays in establishing Extended Decentralised Implementation System	30-33	11
Multiannual programming not introduced	34-36	12
FUNDING AND IMPLEMENTATION OF PHARE PROGRAMMES TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS	37-55	12
Allocation of funding to most countries was less than foreseen	37-41	12
Difficulties experienced in preparing programmes similar to Structural Fund Objective 1 programmes	42-45	13
Delays in programme implementation	46-55	14
RESULTS OF INSTITUTION-BUILDING PROJECTS TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS	56-62	17
CONCLUSIONS	63-67	18
Difficulties in the overall approach of using the Phare programme to prepare Candidate Countries for managing the Structural Funds	63	18

	<i>Paragraph</i>	<i>Page</i>
Limited progress in moving Phare closer to Structural Funds	64	18
Variable allocations for and delayed implementation of ESC programmes	65	18
Only partial achievement of results of institution-building projects to prepare Candidate Countries for managing the Structural Funds	66	18
Overall conclusion	67	18
RECOMMENDATIONS	68-71	18
The Commission's replies		20

LIST OF ABBREVIATIONS

CBC	Cross Border Cooperation
CSF	Community Support Framework
EAGGF	European Agricultural Guidance and Guarantee Fund
EDIS	Extended Decentralised Implementation System
ERDF	European Regional Development Fund
ESC	Economic and Social Cohesion
ESF	European Social Fund
ISPA	Instrument for Structural Policies for Pre-Accession
NDP	National Development Plan
Phare	The main pre-accession instrument
PNDP	Preliminary National Development Plan
PPF	Project Preparation Facility
Sapard	The pre-accession instrument for measures for agriculture and rural development
SPD	Single Programming Document
SPP	Special Preparatory Programme

SUMMARY

I. The audit examined the effectiveness of the Phare programme, the first of the three pre-accession instruments to be established by the Commission, in helping to prepare Candidate Countries for managing the two main Structural Funds, the European Regional Development Fund (ERDF) and the European Social Fund (ESF). The audit covered the period from 1998, the year from which Phare was reoriented to focus on accession, to 2002 and focused on the 1998 Special Preparatory Programme (SPP) and the Economic and Social Cohesion (ESC) programmes, which were first launched in 2000. The objective of helping to prepare Candidate Countries for the Structural Funds was given an increasingly high priority by the Commission because it wished to ensure that the countries concerned would be able to benefit fully from the very large allocations available to them following accession.

The overall approach of using the Phare programme to prepare Candidate Countries for managing the Structural Funds

II. The fact that a new instrument was not established to help prepare Candidate Countries for the ERDF and ESF made it more difficult to familiarise the Candidate Countries with Structural Funds procedures (see paragraphs 16 and 17). Moreover, the initial approach which the Commission required Candidate Countries to follow in setting up ESC programmes differed from the approach of the Structural Funds (see paragraphs 18 to 24). Not all of the regions eligible for the Structural Funds gained experience in managing ESC programmes prior to accession while the Phare implementation structures did not reflect those of the Structural Funds. The effectiveness of the ESC programmes further suffered from the fact that they also aimed to achieve a cohesion impact and this was not always compatible with the objective of preparing for the Structural Funds (see paragraph 27).

Phare procedures

III. While the Commission had intended that Candidate Countries should learn to manage these programmes on the basis of the Commission only exercising ex-post controls, as would be the case for the management of the Structural Funds, in the end the Extended Decentralised Implementation System (EDIS), which was to make this possible, was not introduced before the accession (see paragraphs 30 to 32). The delays encountered in introducing a system of ex post control also made it more difficult to use grant schemes, the main mechanism for implementing the Structural Funds (see paragraph 33). Very little progress was made in introducing a further procedure employed under the Structural Funds, multiannual programming (see paragraphs 34 and 35).

Allocations for and implementation of programmes to prepare for the Structural Funds

IV. Although overall approximately 35 % of the Phare programme was allocated to ESC programmes, most countries allocated somewhat less than this target figure, mainly due to insufficient absorption capacity and competing priorities (see paragraphs 39 to 41). Thus countries struggled to design programmes and did not devote sufficient funding to preparing future ESC and Structural Fund projects (see paragraphs 43 to 45). They also experienced considerable difficulties in contracting funds before the deadlines (see paragraphs 46 to 52). These problems in absorption capacity largely reflected the inexperience and insufficient institutional development of the ministries responsible for managing the ESC programmes (see paragraphs 54 and 55).

Results of institution-building projects to prepare Candidate Countries for managing the Structural Funds

V. This insufficient institutional development, as well as uncertainty over which bodies would be designated to be future managing and paying authorities, reduced the impact of institution-building projects (see paragraphs 58 and 59). Institution-building at regional level was hindered by the delays in some countries in setting up the regional bodies concerned and changes in the role foreseen for regional bodies in managing the Structural Funds (see paragraphs 60 to 62).

Overall conclusion

VI. While the Commission should be commended for starting as early as 1998 to use the Phare programme to help prepare Candidate Countries for managing the Structural Funds, at the time of the accession the Phare programme had had a more limited impact on preparing the Candidate Countries for the ERDF and ESF than planned in the Commission's policy documents, notably its Phare Review 2000 (see paragraph 67). This was in part due to the inexperience and the insufficient institutional development of the relevant authorities in the Candidate Countries. It was not possible to remedy these shortcomings in the time available.

Recommendations

VII. There is a significant need for more institution-building support in the areas of managing the Structural Funds after the accession (see paragraph 68). Considerable resources should be devoted to the ex-post control of Structural Fund operations in the new Member States (see paragraph 69). A clear strategy should be put in place identifying the different steps that still need to be taken for preparing the current and future Candidate Countries for managing the Structural Funds (see paragraph 70). The Commission should increase its efforts to bring Phare closer to the Structural Funds by giving future managing authorities the status of Phare implementing agencies, providing the assistance necessary to implementing agencies to enable them to implement Phare in the framework of an ex-post control system and introducing multiannual planning based on National Development Plans (see paragraph 71).

INTRODUCTION

Regional Development Fund (ERDF), the European Social Fund (ESF) and the European Agricultural Guidance and Guarantee Fund (EAGGF — Guidance Section) ⁽³⁾. In addition, all the countries concerned will be eligible for the Cohesion Fund ⁽⁴⁾.

Phare assistance to prepare Candidate Countries for managing the Structural Funds

1. A key issue facing the European Union in the context of the 2004 enlargement is the great disparity in average income between the current Member States and the new Member States from central and eastern Europe ⁽¹⁾. Whereas 22 % of the population of the present Union live in regions with less than 75 % of the current average gross domestic product per capita, following the enlargement 93 % of the population of these new Member States will be living in regions where the gross domestic product per capita is less than 75 % of the enlarged EU average. In order to help overcome these disparities nearly all the regions of these new Member States will be eligible for support as 'Objective 1' ⁽²⁾ regions from the three main Structural Funds: the European

2. For the period 2004 to 2006 approximately 13 178 million euro has been allocated to Objective 1 support under the Structural Funds to these countries as well as a further 7 523 million euro for the Cohesion Fund. However, in order to properly

(1) The Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Slovenia and Slovakia.

(2) Objective 1 funding is allocated to EU regions defined as lagging behind in their development by the fact that their gross domestic product per capita is below 75 % of the EU average. Approximately two thirds of Structural Funds are allocated to this objective.

(3) The principal objective of the ERDF is to promote economic and social cohesion within the European Union through the reduction of imbalances between regions or social groups. The ESF is the main financial instrument allowing the Union to realise the strategic objectives of its employment policy. The EAGGF is designed to contribute to the structural reform of the agriculture sector and to the development of rural areas. For the Structural Fund programming period 1994 to 1999, 52 % of funds were implemented through the ERDF, 30 % through the ESF and 16 % through the EAGGF. The remaining 2 % were implemented through the fourth Structural Fund, the Financial Instrument for Fisheries Guidance (FIFG).

(4) The Cohesion Fund finances environment and transport infrastructure projects in countries whose GNP per capita is below 90 % of the EU average (current recipients are Greece, Spain, Ireland and Portugal).

benefit from this funding, new Member States must be able to identify, prepare and implement priority programmes and projects within the timeframes laid down.

3. In March 1997 the Commission proposed a reorientation of the Phare programme in order to fully focus it on preparing Candidate Countries for joining the European Union ⁽⁵⁾ ⁽⁶⁾. Henceforth the Phare budget (approximately 1 500 million per annum) was to be allocated in principle to institution-building (30 %) and investment support (70 %). As far as institution-building was concerned, among the specific areas which the Commission called for funding to be focused on was regional development. Thus it stated that 'there is a need for the introduction, as soon as possible, to the objectives and procedures of the Structural Funds. This is the best way to ensure these countries will be capable, in due course, of applying the rules of the Structural Funds and handling the first payments from them' ⁽⁷⁾.

4. Accordingly a 'Special Preparatory Programme for the preparation of the Candidate Countries for EU Structural Policy' (SPP) covering each Candidate Country was financed from the 1998 Phare programme for a total of 60 million. The programme funded institution-building and small pilot investment projects of the type financed from the Structural Funds to begin to give Candidate Countries operational experience in Objective 1 procedures.

5. The urgency of preparing Candidate Countries for managing the Structural Funds was highlighted by the Berlin Financial Framework of March 1999 which provided for the possibility of six new countries (Czech Republic, Estonia, Hungary, Poland, Slovenia together with Cyprus) joining the European Union as early as 2002 ⁽⁸⁾.

⁽⁵⁾ The new orientation agreed was set out in a Communication to the Commission from Commissioner van den Broek: New Orientations for the Phare Programme in the Context of Pre-Accession Assistance (COM(97) 112/8, Brussels, 18 March 1997).

⁽⁶⁾ As well as the countries referred to in footnote 1, which will join the European Union in May 2004, the Phare programme also provides assistance to Bulgaria and Romania which are foreseen to join the European Union at a later date.

⁽⁷⁾ COM(97) 112/8, Brussels, 18 March 1997.

⁽⁸⁾ The Helsinki Summit of the European Council in December 1999 opened the possibility of accession to a further six countries (Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia). Subsequently the Nice European Council in December 2000 established 2004 as the target date for accession. The Laeken European Council of December 2001 declared that accession was irreversible and that these 10 countries should be ready in 2004.

6. In 2000 two new pre-accession instruments were created. ISPA ⁽⁹⁾ (annual budget: 1 000 million) had similar objectives and procedures to the Cohesion Fund'. Sapard ⁽¹⁰⁾ (annual budget: 500 million) aimed at contributing to the implementation of the *acquis communautaire* in the common agricultural policy and at solving priority and specific problems for the sustainable adaptation of the agricultural sector and rural areas, and, in line with the Sapard Regulation, was implemented with some similarities to the Structural Funds and the EAGGF (see paragraph 17). Although the ERDF and ESF were respectively around three times and two times bigger than the EAGGF Structural Fund ⁽¹¹⁾, no new instruments were established in relation to these two Structural Funds.

7. Instead, the new Phare Guidelines for 2000 to 2006 provided for the setting up in each country of Economic and Social Cohesion (ESC) investment programmes to be funded from Phare ⁽¹²⁾. The ESC programmes would be implemented through measures similar to those financed by these two Structural Funds, in the areas of productive sector investment, human resource development and business related infrastructure. These programmes would be one of the two areas to be funded from the 70 % of Phare funds allocated to investment ⁽¹³⁾. The guidelines also stated that Phare institution-building activities (the remaining 30 % of Phare funds) would particularly reflect the importance of these ESC programmes by addressing weaknesses of the administrations at central, regional and local level which had responsibilities in this area ⁽¹⁴⁾.

8. Further to these guidelines, a Commission review of the Phare programme was issued in October 2000 entitled 'Phare 2000 Review: Strengthening preparations for membership' ⁽¹⁵⁾. The Review concluded that what it termed 'Moving to Structural

⁽⁹⁾ Council Regulation (EC) No 1267/1999 of 21 June 1999 establishing an Instrument for Structural Policies for Pre-Accession (OJ L 161, 26.6.1999, p. 73).

⁽¹⁰⁾ Council Regulation (EC) No 1268/1999 of 21 June 1999 on Community support for pre-accession measures for agriculture and rural development in the applicant countries of central and eastern Europe in the pre-accession period (OJ L 161, 26.6.1999, p. 87).

⁽¹¹⁾ Based on Structural Fund assistance 1994 to 1999: ERDF 75,0 billion; ESF 43,4 billion; EAGGF 23,5 billion.

⁽¹²⁾ 'Guidelines for Phare Programme Implementation in Candidate Countries for the Period 2000 to 2006 in Application of Article 8 of Regulation (EEC) No 3906/89'. Commission Decision: SEC(1999) 1596 final, Brussels, 13 October 1999.

⁽¹³⁾ The second area to be funded under investment was 'Alignment with EU norms and standards' which primarily involved the provision of equipment to key institutions for the monitoring and enforcing of the *acquis*.

⁽¹⁴⁾ See Section 3 'Institution-building' of the 2000 to 2006 guidelines.

⁽¹⁵⁾ Directorate-General Enlargement, C(2000) 3103/2, 27 October 2000.

Funds' was one of two challenges for Phare that the Commission must tackle over the period 2000 to 2006. The Review set out two objectives for Phare in this area:

- (a) 'to prepare for the implementation of the Structural Funds in Candidate Countries by putting in place the necessary administrative and budgetary structures' and to
- (b) 'allow these countries to benefit from a first generation of integrated regional development programmes of a (Structural Fund) Objective 1 type contributing to their economic and social cohesion'.

9. The Review stressed the importance of preparing for the Structural Funds: 'Phare can not only help applicant countries address the wide development disparities that exist between them and existing Member States, but must also familiarise them with the structures and procedures they will need if they are to use Structural Funds efficiently and effectively upon accession'. Indeed, in view of the very limited cohesion impact that Phare ESC programmes could hope to achieve compared with the Structural Funds because of the much smaller budgets available, the internal programming guidelines established in 2000 by Directorate-General Enlargement for drawing up the ESC 2001 programmes stated that: 'the desired impact in economic and social cohesion must be clarified as helping the preparation of the structures and strategies needed to implement the Structural Funds after accession. We can only expect a small impact on reducing general development disparities'.

10. The principal developments envisaged in the Review relevant to the objective of 'moving to Structural Funds' were:

- (a) reinforce progressively Structural Fund approaches and procedures in Phare's ESC support;
- (b) move national Phare programmes to multiannual programming on a differentiated basis for all support, including institution-building;
- (c) extend decentralisation, so familiarising the applicant countries with the joint responsibility principles that underpin the implementation of the Structural Funds;
- (d) reinforce support, alongside Candidate Countries' own efforts, to implementing authorities (i.e. managing authorities in the sense of Article 34 of the Structural Funds Regulation) accepted by the Candidate Country and the Commission in full compliance with the Financial Regulation.

The aim was to devote approximately 35 % of countries' national programmes to investment support for the ESC.

The Court's audit

11. The objective of the Court's audit was to assess how effective the Phare programme was in preparing Candidate Countries for managing the Structural Funds. To do this the Court:

- (a) examined the extent to which the overall approach followed by the Commission provided an effective basis for preparing the Candidate Countries for managing the Structural Funds (see paragraphs 15 to 28);
- (b) examined how far Phare provided adequate preparation for Structural Fund structures and procedures (see paragraphs 29 to 36);
- (c) examined whether Phare funding was allocated as foreseen to this purpose and to what extent this funding was being efficiently implemented (see paragraphs 37 to 55);
- (d) examined the effectiveness of institution-building projects in meeting their objective of preparing beneficiary countries for managing the Structural Funds (see paragraphs 56 to 62).

12. The Court selected this audit in view of the increasing importance attached by the Commission since 1997 to preparing Candidate Countries for managing the Structural Funds, and the significant resources expected to be allocated from the Phare programme to meeting this objective from 2000 onwards in relation to the ERDF and ESF ⁽¹⁶⁾. The audit did not assess the legality and regularity of the expenditure concerned. It also did not undertake an assessment of the capacity of the Candidate Countries to manage the Structural Funds because this is the responsibility of the Commission itself which it carries out through its annual reports on the overall preparedness of Candidate Countries for the accession ⁽¹⁷⁾. The Court's audit rather examines the Phare programme to assess how well the funding available under it was used to assist Candidate Countries to prepare for managing the Structural Funds.

⁽¹⁶⁾ The Court is carrying out a separate audit on the management of the Sapard pre-accession instrument which is linked to the third main Structural Fund, the EAGGF. In addition, the Court examined aspects of the management of ISPA in its Special Report No 5/2003 'Phare and ISPA funding of environmental projects in Candidate Countries', OJ C 167, 17.7.2003

⁽¹⁷⁾ From 1998 to 2003 the Commission issued annually 'Regular Reports' on Candidate Countries' level of preparedness for EU membership. Following completion of the accession negotiations at the end of 2002 with eight of the ten Candidate Countries from central and eastern Europe, the Commission published in November 2003 a 'Comprehensive Monitoring Report' on the extent to which they had taken further steps in preparation for membership.

13. The audit covered the programming and implementation of commitments made over the period 1998 to 2002. It did not cover commitments made in 2003 which could only have had a limited impact before 1 May 2004 given the lead times required to implement commitments. It concentrated on the two main instruments used, the 1998 SPP and the ESC programmes which were launched in 2000. The commitments for each country related to these

programmes are set out in *Table 1* ⁽¹⁸⁾. On-the-spot missions to seven Candidate Countries (Bulgaria, the Czech Republic, Hungary, Latvia, Poland, Romania and Slovakia) were carried out in 2002. In addition, the Supreme Audit Institutions of Lithuania and Slovenia audited this subject in their countries in cooperation with the Court and using its methodology. The findings of these two audits were taken into account when preparing the Court's Special Report.

Table 1

Special Preparatory Programme and Economic and Social Cohesion programme commitments

(million euro)

Country	SPP 1998	ESC 2000	ESC 2001	ESC 2002	Total
Czech Republic	7,0	17,5	13,6	6,3	44,4
Estonia	3,0	10,1	6,0	3,7	22,8
Latvia	3,0	10,5	9,0	4,5	27,0
Lithuania	3,0	14,0	15,6	1,6	34,2
Hungary	7,0	27,0	31,0	41,5	106,5
Poland	9,0	137,0	170,0	197,6	513,6
Slovenia	3,0	5,0	3,0	5,8	16,8
Slovakia	7,0	6,3	18,4	16,5	48,2
Bulgaria	7,0	15,0	37,1	14,0	73,1
Romania	7,0	88,0	109,0	106,6	310,6
Total	56,0	330,4	412,7	398,1	1 197,2

Source: European Court of Auditors.

14. As the ESC programmes funded from the 2000 budget were only contracted towards the end of 2002, the investment projects to be funded from the ESC programme had had virtually no impact yet on the ground by that time. The Court's audit therefore did not cover the second objective of the ESC programmes, that of achieving a cohesion impact (see paragraph 9).

THE OVERALL APPROACH OF USING THE PHARE PROGRAMME TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS

The choice of Phare made preparation of Candidate Countries for the ERDF and ESF more difficult

15. The Phare programme has contributed in two ways to preparing Candidate Countries for managing the Structural Funds:

- (a) financing Twinning projects, where experts in the area of the Structural Funds from the administrations of the Member States work in the relevant ministries of the Candidate Countries. To a lesser degree technical assistance from consultancy firms has also been funded;
- (b) enabling Candidate Countries to 'learn by doing' through familiarising them with procedures, which the Commission intended should increasingly resemble those of the Structural Funds. Funds were directed to investments that pilot-test and demonstrate the instruments and structures to be used after accession.

⁽¹⁸⁾ Most commitments for the ESC included a Twinning component. In a limited number of cases, a separate commitment was made for a Twinning project in relation to ESC. These projects were also examined by the Court and are included in *Table 1*.

16. The support of institution-building for managing the Structural Funds through Twinning and technical assistance reflected what had been the primary role of the Phare programme from its beginnings: the provision of human resource expertise to assist countries in making the transition to functioning market economies and eventual membership of the European Union. However, the use of Phare for the 'learning by doing' approach to institution-building for the Structural Funds was more problematic. The Commission chose not to propose a new instrument and regulation for preparing Candidate Countries for managing the ERDF and ESF. As a result, since Phare differed significantly from the Structural Funds in terms of implementing structures, programming, procedures, implementation mechanisms and control systems, the Phare programme could not be used so effectively to familiarise Candidate Countries with Structural Fund procedures.

17. The approach taken for preparing Candidate Countries for managing the ERDF and ESF was very different from that taken in relation to the Cohesion Fund and the EAGGF. As noted in paragraph 6, the Commission established completely new pre-accession instruments in relation to these Funds, ISPA, managed by Directorate-General Regional Policy, and Sapard, managed by Directorate-General Agriculture. Sapard aims primarily at contributing to the implementation of the *acquis communautaire* in the common agricultural policy and at adaptation of the agricultural sector and rural areas. The Sapard Regulation provides for Structural Fund multiannual programming and EAGGF financial control procedures. The management of Sapard was based, firstly, on multiannual programming and, secondly, on implementation through the decentralisation of functions to the beneficiary countries with only *ex post* controls from the Commission. Phare complemented these new instruments by fulfilling its traditional role of institution-building through funding Twinning expertise from the Member States conversant with the Cohesion Fund and the EAGGF.

The design of Phare ESC programmes differed from Structural Fund Objective 1 approaches

18. Since Phare was the instrument selected for financing Objective 1 type programmes in the Candidate Countries, Directorate-General Enlargement, which manages the Phare programme as a whole, was responsible for these programmes as well as the related institution-building projects. This was despite the fact that expertise for the ERDF and ESF lay primarily with Directorate-General Regional Policy and Directorate-General Employment. In order, therefore, for Phare to be effective in preparing Candidate Countries for managing the Structural

Funds, it was necessary for the Commission to establish a high degree of coordination between Directorate-General Enlargement and these two Directorates-General. However, while there was initially good cooperation between them in setting up the SPP, the approach taken in 1999 to preparing ESC programmes for funding in 2000 differed significantly from the approach favoured by Directorate-General Regional Policy.

19. Thus Directorate-General Enlargement emphasised a 'regional approach' to the Structural Funds, insisting that all Candidate Countries target funds on a small number of regions using regional development plans drawn up for these regions. By concentrating funding in this way, the Directorate-General aimed to increase the impact of the limited Phare funding available. This approach, however, did not take into account two key aspects of Structural Fund implementation mechanisms.

20. In the first place, it did not take into account the specific regional planning framework of the Structural Funds ⁽¹⁹⁾:

- (a) in countries made up of more than one NUTS II region, the Structural Funds are to be implemented through a Community Support Framework ⁽²⁰⁾ involving a number of sectoral and regional programmes, the latter being managed by regional bodies; and
- (b) in countries where the whole country corresponds to one NUTS II region, the Structural Funds are to be implemented through a Single Programming Document (SPD) managed by national ministries. Four of the eight acceding countries from central and eastern Europe fall into this category (Estonia, Latvia, Lithuania and Slovenia).

⁽¹⁹⁾ The 'Nomenclature of Territorial Units for Statistics' (NUTS) divides countries into NUTS I (national), NUTS II (regional) and NUTS III (county) levels. In larger countries with more than one NUTS II region, the NUTS II level is normally the level for which Structural Fund regional operation programmes are established. However, in small countries the whole country may only correspond according to this classification to a NUTS II level.

⁽²⁰⁾ Community Support Frameworks are the strategic documents required by the Structural Fund Regulation and are designed to provide coordination of all Community structural assistance in the regions concerned.

21. By insisting on regionally focused programmes even in smaller countries, lower levels of government were brought into managing Phare funds although they lacked the capacity to do so and would not in any case be required to perform such a function under the Structural Funds after accession. Thus, Directorate-General Regional Policy stated in 2001: 'There has been quite a lot of confusion concerning the role of the regions with regard to the programming and implementation of the Structural Funds. The "target region" approach has contributed to this basic misunderstanding by initiating a process of programming and setting up Regional Development Agencies at sub-regional level' ⁽²¹⁾.

Latvia for the ESC 2000 programme was required by the Commission to concentrate the funds on one or two target regions. The Latvian authorities accordingly decided to focus them on two of Latvia's five county level regions, Latgale and Zemgale. This was despite the weak programming and implementation capacity in both regions. In 2001, the Commission, recognising these weaknesses, and mindful of the urgent need to improve capacity in the central administration, switched to nationally managed sectoral programmes.

22. Secondly, three of the four Member States (Greece, Ireland, and Portugal) which worked through CSFs and were beneficiaries of the Cohesion Fund had largely implemented their Structural Funds allocations over the programming period 1994 to 1999 through sectoral operational programmes rather than regional operational programmes ⁽²²⁾. This led Directorate-General Regional Policy to conclude that a similar sectoral approach should have been adopted for at least Candidate Countries of a similar size to these Member States (Bulgaria, the Czech Republic, Hungary, and Slovakia) which would have CSFs and be beneficiaries of the Cohesion Fund when designing ESC programmes. A sectoral approach was also the most realistic approach to follow given the centralised administrative structure of these countries.

23. In addition, it was clear that any enlargement taking place between 2002 and 2006 would result in a shorter period for the Candidate Countries to programme and implement Structural Funds. This meant that there was a need, particularly given the limited capacity in Candidate Countries, to simplify programming as much as possible. As a result the approach followed by Directorate-General Regional Policy when in 2001 it came to

negotiate with Candidate Countries on the number and type of operational programmes which would be drawn up to implement Objective 1 was that each new Member State should have only one regional operational programme covering the entire country. This was in contrast to the individual regional operational programmes for each eligible area, the assumption on which Directorate-General Enlargement had based its programming of Phare ESC for 2000.

24. It was only in the second half of 2000 in the context of drawing up the 2001 ESC programmes that Directorate-General Enlargement adjusted its annual programming guidelines for ESC investments to better reflect Directorate-General Regional Policy approaches ⁽²³⁾. Nevertheless a significant portion of the funding under 2001 ESC programmes continued to be devoted to programmes which were primarily regional rather than sectoral in character.

25. Since these regional programmes continued to concentrate on a limited number of target regions, although nearly all regions in the Candidate Countries will be eligible for Objective 1 support under the Structural Funds, those regions which did not benefit from such programmes were less well prepared for Structural Funds. Even if the managing authorities in the Candidate Countries for the period 2004 to 2006 will be central ministries, regional bodies will nevertheless still have at least a limited role to play in their implementation as intermediary bodies.

26. At the level of the central ministries, as part of its policy of keeping the number of implementing authorities to a minimum, the Commission encouraged Candidate Countries to have only one implementing agency responsible for managing the ESC programmes. Thus the Phare Review stated that 'the target will be to have (...) one implementing agency for ESC'. One result of this approach was to reduce the possibilities for some central ministries, particularly those that will be responsible for the European Social Fund, to gain experience in managing the ESC programmes and hence preparing for the Structural Funds.

⁽²¹⁾ Synthesis Paper arising from Twinners Seminar, 'Preparations for the Structural Funds in the Candidate Countries' held on 15 and 16 March 2001 in Brussels.

⁽²²⁾ In Ireland for the 1994 to 1999 programming period 100 % of the funds were implemented through sectoral programmes in *industry, economic infrastructure, human resources, environmental services, tourism, transport, agriculture and rural development, local development, fisheries, and technical assistance*. In Portugal 78 % and in Greece 68 % of funds were implemented through sectoral operational programmes. (Source: Report from the Commission: 11 Annual Report on the Structural Funds (1999), Volume II, Annex 7, COM(2000) 698 final, Brussels, 13 November 2000).

⁽²³⁾ In June 2000, the Director-General for Regional Policy wrote to the Directors-General for Enlargement, Employment, Fisheries and Agriculture that: 'Dans la mesure où ces pays sont potentiellement éligibles à l'objectif n° 1 des Fonds structurels, il me paraît nécessaire de mettre l'accent sur la préparation à cette objectif, qui mobilisera des ressources financières importantes dès leur adhésion et nécessitera des adaptations par rapport à l'approche actuelle de Phare.' (Letter of 6 June 2000, ref. D(2000) JFD.A. 1 001 01111).

Constraints affecting strategy of using Phare to prepare for the ERDF and ESF

27. The strategy of using the Phare programme to prepare for the ERDF and ESF suffered from the constraint that the Commission also sought to achieve a cohesion impact from the programmes which it believed could best be achieved by concentrating funds on a limited number of regions (see paragraph 19). This cohesion objective made it difficult to give all the organisations which would be involved in managing the ERDF and ESF experience of the Phare ESC programmes in order to familiarise them with Structural Funds.

28. More generally, the Commission's use of the Phare programme to prepare Candidate Countries for managing the Structural Funds suffered from the lack of a wider strategy identifying both the requirements to be met by Candidate Countries in the field of regional policy prior to accession and the approach to be followed by these countries to Structural Fund management after accession. Such a strategy should have been developed once the decision had been taken to open negotiations with Candidate Countries. On the other hand, the setting of a clear timeframe for such a strategy was rendered difficult because a clear timeframe for accession did not emerge until the end of 2000 (see paragraph 5).

PHARE PROCEDURES

29. While the Commission chose not to set up a new pre-accession instrument in relation to the ERDF and ESF (see paragraph 17), it aimed to move Phare procedures closer to those of the Structural Funds, in particular through making more use of *ex post* controls, introducing more Objective 1 type measures and launching multiannual programming (see paragraph 10).

Delays in establishing Extended Decentralised Implementation System

30. In terms of moving Phare implementation procedures closer to those of the Structural Funds, the largest single step which the Commission could have taken was to further decentralise the financial management of the Phare programme to Candidate Countries as foreseen in the Phare 2000 Review. Stressing that whereas the Structural Funds in the Member States were based on *ex post* control by the Commission, under Phare the Commission controls were *ex ante*, the Phare Review stated: 'As such, Candidate Countries would have great difficulty in moving directly from the current Phare approach to full financial delegation under Structural Funds as new Member States'. Therefore the Review took the view that 'Prior to accession the applicant countries need to have several years experience of full responsibility for implementation'. The Commission therefore planned

to give Candidate Countries operational experience in managing Objective 1 type measures in an *ex post* control environment by introducing what it termed the 'Extended Decentralised Implementation System' (EDIS). Under EDIS the *ex ante* controls carried out by the Commission's Delegations on contracting procedures would be replaced with *ex post* controls. The legal basis for this very significant shift in responsibilities was laid down in the June 1999 Coordinating Regulation ⁽²⁴⁾ for Phare, ISPA and Sapard, which also defined the conditions to be met by Candidate Countries before the new procedures could be introduced. The Phare Review thus planned 'to decentralise implementation responsibility to the Candidate Countries from 2002 where strict conditions are met'. Yet despite the fundamental importance of EDIS in preparing Candidate Countries for managing the Structural Funds, the Commission initially left it to the Candidate Countries to decide whether they wished to take the necessary steps to introduce EDIS or not ⁽²⁵⁾.

31. In practice, the Candidate Countries did not initiate preparations for EDIS, often owing to competing priorities in preparing for accession and because they were content to have the safeguard of the *ex ante* system of checks provided by the Commission Delegations. It was only towards the end of 2001 that the Commission began to apply the necessary pressure on Candidate Countries to set up EDIS before the accession, in particular by establishing in 2002 what were termed 'High-level Working Groups' made up of Commission and national representatives in each beneficiary country to oversee its introduction. The Commission's efforts to introduce EDIS in the framework of Phare were initiated later than for ISPA, while Sapard from the outset was set up on an *ex post* control basis which gave the beneficiary institutions more experience for meeting their responsibilities after the accession.

32. While the 2003 Annual Management Plan for Directorate-General Enlargement still foresaw Commission decisions on the accreditation of countries for the introduction of EDIS in the second half of 2003, EDIS was not introduced for the management of Phare funds into any of the Candidate Countries before the accession on 1 May 2004 ⁽²⁶⁾. It meant that Candidate Countries would become Member States less well prepared for the financial management of the ERDF and the ESF than the Commission had intended in the Phare Review 2000.

⁽²⁴⁾ Council Regulation (EC) No 1266/1999 of 21 June 1999 on coordinating aid to the Applicant Countries in the framework of the pre-accession strategy (OJ L 161, 26.6.1999, p. 68).

⁽²⁵⁾ A circular letter sent by the Directors-General for Enlargement and Regional Policy to National Aid Coordinators in December 2000 stated that 'national preparatory efforts should start as soon as possible in those countries interested in moving to EDIS'.

⁽²⁶⁾ The only exception was Hungary where EDIS was symbolically introduced on 30 April 2004.

33. The delays in the introduction of EDIS also made it more difficult for the Commission to use grant schemes to implement Phare ESC programmes. While the setting up of grant schemes under Phare ESC programmes was an important step towards moving to a more Structural Funds approach to implementation, in an *ex ante* control context there was a limit to the Commission's capacity to supervise them. This was because grant schemes were considered to be a high-risk area involving a large number of small projects. The Commission Delegations therefore had to carry out very time-consuming checks, both on the mechanisms proposed by the beneficiary authorities for implementing each grant scheme and on the evaluation of the project applications submitted for funding. This implied significantly more work for Commission Delegations compared with more traditional Phare implementation mechanisms (essentially works, service and supply contracts).

Multiannual programming not introduced

34. To serve as a basis for introducing multiannual programming along the lines of that used for the Structural Funds, the Commission announced in early 1999 that a preliminary National Development Plan (PNDP) was to be drawn up in draft form by each country for September 1999. Most countries were unfamiliar with this form of planning and were often sceptical of the benefits of planning in view of their experience of planned economies prior to 1989. In any case, countries generally directed their limited human resources in ministries to identifying ESC projects for the annual funding round rather than to longer-term planning. In cases where single ministries were given the overall responsibility for drawing up the plan, they often did not coordinate effectively with other ministries that needed to be consulted. The short time period granted by the Commission for submitting the PNDP also made it very difficult to draw up adequate documentation and made it impossible to establish a proper partnership approach to planning, involving consultation with regional and local authorities and NGOs.

35. The weakness of the PNDPs and subsequent drafts of the NDP was one reason why the Commission did not move to the multiannual programming which was foreseen by the Phare Review to be introduced by 2002. Thus Hungary was the only country which established a programme covering more than one year (2002 to 2003). Nevertheless problems with these planning documents do not provide a full explanation for the lack of

progress in multiannual programming. For example, even in the absence of an overall development plan, under the Phare Cross Border Cooperation (CBC) programme, which is modelled on the Structural Fund Community Initiative 'Interreg', the Commission introduced a multiannual approach as early as 1994, covering the period up to 1998. Indeed, from 2000 such programmes took an increasingly sophisticated form as Phare CBC aligned itself more closely with Interreg practices. Under the Sapard instrument, programmes were established for the Structural Fund programming period 2000 to 2006 in the same way as for Member States.

36. The Phare Review foresaw that the multi-annual programmes to be established would also specify national co-financing and other sources of financing. In the absence of these programmes this key issue of co-financing to accompany European Union funding, which would become all the more important under Structural Funds, was not properly addressed ⁽²⁷⁾.

FUNDING AND IMPLEMENTATION OF PHARE PROGRAMMES TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS

Allocation of funding to most countries was less than foreseen

37. The 1998 Special Preparatory Programme (SPP) was the first programme financed throughout the Phare Candidate Countries to specifically prepare for the management of the Structural Funds. However, no similar programmes were financed by the Commission in 1999 to build on these initial programmes.

38. In 2000 the Commission launched ESC programmes in each Candidate Country. The Phare 2000 Review stated that about 35 % of the funds for Phare national programmes should be devoted to ESC programmes. In global terms the Commission succeeded in meeting this objective, as *Table 2* shows. Thus for the period 2000 to 2002, the average percentage of national programmes committed to these activities was 36,8 %.

⁽²⁷⁾ On the subject of co-financing see also the Court's observations in its Annual Report 2002, paragraphs 8.10 and 8.11 (OJ C 286, 28.11.2003).

Table 2

ESC commitments as a percentage of Phare National Programmes 2000 to 2002

(million euro)

Country	2000		2001		2002		Total (2000 to 2002)	
	ESC commitments	ESC as % of national programme	ESC commitments	ESC as % of national programme	ESC commitments	ESC as % of national programmes	ESC commitments	ESC as % of national programme
Czech Republic	17,5	29,7	13,6	20,8	6,3	7,4	37,4	17,9
Estonia	10,1	42,6	6,0	22,8	3,7	12,2	19,8	24,6
Latvia	10,5	42,4	9,0	28,7	4,5	14,0	24,0	27,2
Lithuania	14,0	36,6	15,6	34,3	1,6	2,6	31,2	21,4
Hungary	27,0	41,5	31,0	34,5	41,5	37,2	99,5	37,3
Poland	137,0	43,8	170,0	41,4	197,6	50,2	504,6	45,1
Slovenia	5,0	31,8	3,0	14,1	5,8	18,5	13,8	20,2
Slovakia	6,3	22,5	18,4	42,3	16,5	28,9	41,2	32,0
Bulgaria	15,0	22,8	37,1	44,8	14,0	14,8	66,1	27,2
Romania	88,0	40,9	109,0	39,8	106,6	40,2	303,6	40,3
Total	330,4	39,0	412,7	37,8	398,1	34,2	1 141,2	36,8

Source: European Court of Auditors.

39. However, this overall average figure was largely attained because of the significantly higher than average percentage of their national programmes committed to ESC by the two largest Phare beneficiary countries, Poland (45,1 %) and Romania (40,3 %) over the period 2000 to 2002 ⁽²⁸⁾. All the other countries, with the exception of Hungary, experienced difficulties in committing the required 35 % of their national programme to this objective.

40. While it would be expected that the percentage of funds committed to ESC would increase from year to year as absorption capacity increased as accession drew nearer, this has not been the case. In four countries (the Czech Republic, Estonia, Latvia and Lithuania) the percentage of the programme allocated to ESC programmes was progressively reduced from 2000 to 2002. The main reason for this was difficulties in absorbing funds committed in 2000. In Bulgaria, a large commitment was made in 2001 despite the significant implementation difficulties with the relatively low commitment made in 2000 programme, but the commitment in 2002 was then reduced to less than that of 2000.

41. The reduced commitments in relation to investment projects in 2002 in part reflected the major emphasis placed by the Commission that year on trying to raise administrative capacity before accession. Prior to this the systematic approach to institution-building for Structural Fund management in all countries, which the Commission initiated in 1998 under the SPP, had not been sustained. Despite the increased importance attached to supporting ESC investment programmes and preparing for the Structural Funds, the Commission did not ensure that Candidate Countries systematically funded Twinning projects in this area in 2000 to support the national structures. Thus the main Twinning projects funded were in Hungary, Poland and Romania but these were largely focused on the regional level, with very few initiatives at national level. Even in 2001 only five of the ten countries had Twinning projects in the area of Structural Fund preparation.

Difficulties experienced in preparing programmes similar to Structural Fund Objective 1 programmes

42. In most countries ESC funding was not programmed in a consistent way from year to year. This largely reflected the shift in the Commission's approach from programmes where allocations were made to different regions in 2000 to programmes

⁽²⁸⁾ The average annual allocation for the Phare national programme over the period 2000 to 2002 for Poland was 373 million euro and Romania 251 million euro. For the eight other countries average annual allocation over the same period was 51 million euro.

which were made on a more sectoral basis starting from 2001. This was followed by a strong emphasis on institution-building projects rather than investment projects in 2002.

43. Countries in most cases experienced difficulties in drawing up project fiches of an acceptable quality for the ESC programmes and had recourse for assistance to the Commission Delegations and consultancy firms. Indeed, a significant portion of the projects which were approved were in fact often not fully prepared and/or suffered from shortcomings in their design, which delayed implementation and hence reduced their impact upon preparation before accession. Although Bulgaria was not due to join the European Union until after other Candidate Countries, the design of its ESC programmes was amongst the most complex of all the Phare ESC programmes, which increased implementation difficulties in that country. More straightforward implementation mechanisms should have been pursued in this country in the first years of ESC.

44. Although infrastructure projects financed under ESC were supposed to be business-related, in Poland in 2000 and 2001, in order to absorb funds, approximately 35 % of funding was allocated to road infrastructure projects with often only tenuous links to business development. In the Czech Republic and Romania, a number of industrial parks were financed without the countries having an overall strategy to prioritise locations and avoid an excess supply of such parks.

Under the ESC 2000 programme, 12,7 % of Poland's allocation was foreseen for a 17,5 million euro access road to Katowice airport, even though all transport and environment infrastructure projects costing more than 5 million euro were to be financed by ISPA. In addition, a further 10 road projects in the beneficiary regions were financed for 28,4 million euro which were not specifically focused on business promotion but most commonly formed part of wider city bypass/ring road projects. This was also the case for the 13 road projects financed under ESC 2001 for a total of 59,3 million euro (34,9 % of budget).

45. While the Commission financed a Project Preparation Facility (PPF) in 1999 of between 2 million and 3 million euro for each Candidate Country to provide technical assistance to improve the pipeline of projects for ESC funding in 2000 and 2001, most countries struggled to make effective use of this instrument. Beneficiaries at both national and local level often did not coordinate sufficiently with the consultants preparing the projects, which in some cases reduced the quality of the projects prepared. Apart from this 1999 PPF, no other horizontal programme covering all countries was established by the Commission for preparing later ESC programmes and, more importantly, developing a pipeline of projects for the Structural Fund financing. Moreover, most Candidate Countries allocated few or no resources to developing project pipelines for the Structural Funds from their national Phare programmes.

Delays in programme implementation

46. All countries have experienced significant delays in implementing ESC programmes compared to the timetables originally foreseen. Although Phare rules allow three years after the commitment of funds for programmes to be fully implemented and disbursed ('n+3' project cycle timeframe), the disbursement rate for the ESC commitments made in 2000 was only 71,7 %, including advance payments, at the end of 2003 (see Table 3). This slowed down efforts to improve administrative capacity in preparation for the ERDF and the ESF. It also highlighted the weaknesses in administrative capacity and the need for more assistance.

47. The Twinning component of the 1998 Special Preparatory Programme only got underway towards the end of 1999 and therefore did not generally have an impact until the first half of 2001. Although twinning had been needed to assist in drawing up the preliminary National Development Plans, in all cases they took up their positions after the September 1999 deadline for the submission of the first draft. These delays were in part due to Twinning being a new instrument as well as weaknesses on the part of the Candidate Countries' administrations. However, the SPP technical assistance contracts in most cases were only signed in the second half of 1999.

Table 3

Implementation of ESC programmes 2000 to 2002 (31.12.2003)

(million euro)

Country	2000		2001		2002		Total (2000 to 2002)	
	ESC commitments	ESC payments	ESC commitments	ESC payments	ESC commitments	ESC payments	ESC commitments	ESC payments
Czech Republic	17,5	13,3	13,6	10,8	6,3	1,7	37,4	25,8
Estonia	10,1	9,7	6,0	2,0	3,7	0,6	19,8	12,3
Latvia	10,5	8,8	9,0	0,6	4,5	—	24,0	9,4
Lithuania	14,0	13,0	15,6	4,4	1,6	—	31,2	17,4
Hungary	27,0	18,5	31,0	7,5	41,5	0,4	99,5	26,4
Poland	137,0	103,7	170,0	32,4	197,6	—	504,6	136,1
Slovenia	5,0	4,5	3,0	0,6	5,8	1,0	13,8	6,1
Slovakia	6,3	6,1	18,4	3,8	16,5	1,3	41,2	11,2
Bulgaria	15,0	5,3	37,1	10,0	14,0	—	66,1	15,3
Romania	88,0	53,9	109,0	26,2	106,6	0,6	303,6	80,7
Total	330,4	236,8	412,7	98,3	398,1	5,6	1 141,2	340,7

Source: European Commission.

48. In the case of the SPP pilot investment projects, implementation was particularly slow because it was only after the SPP had begun that the Commission sought to clarify how far existing Phare procedures for the implementation of these projects could be modified in order to make them more akin to Structural Fund procedures.

49. Most countries only contracted the 1999 Project Preparation Facility shortly before the December 2001 deadline, even though most of the contracts to be funded under the PPF concerned relatively small service and study inputs. Because of delays, in only a few cases was the Facility used for preparing projects under the ESC 2000 programme, it being mainly used for the 2001 and 2002 ESC programmes. Several countries were unable to fully use their allocation before the contracting deadline. In Latvia, the Commission made a significant derogation from tendering procedures to enable funds to be contracted before the deadline. Thus the time for tendering a contract of 2 million euro to provide a number of studies was reduced from the minimum of 50 days to just 28 days. This had a negative effect on the number and quality of the bids received, which also affected subsequent implementation.

50. Notwithstanding the fact that Twinning procedures were not being used for the first time, Twinning projects in the framework of the 2000 and 2001 ESC were subject to considerable delays in both selecting the Member State which would provide the twinning and then drafting the Twinning covenant.

51. The ESC 2000 investment programmes were similarly delayed due to difficulties Candidate Countries had encountered in establishing the operational guidelines governing the implementation of grant schemes. These had to be approved by the Commission before calls for project proposals could be launched and frequently required several drafts before they were of a satisfactory standard. In most countries the great majority of funds were only contracted in the last two months before the contracting deadline, approximately 6 to 12 months later than the implementation timetables set out in the project fiches. In fact the deadline for the beneficiary countries to complete the contracting of the programme had to be extended in Bulgaria and Estonia, as did the disbursement period in Hungary and Poland.

52. The 2001 ESC programmes were also significantly delayed. Although the Commission sought to ensure that only projects should be financed which were sufficiently advanced in their preparation for them to be contracted within six months of the Commission Financing Decision ⁽²⁹⁾, in practice virtually no ESC project fulfilled this criterion.

⁽²⁹⁾ Phare Programming Guide 2001, paragraph 5 (e).

53. The problems encountered by Candidate Countries in programming ESC allocations raise doubts about their capacity to absorb the much greater allocations planned under the Structural Funds (see Table 4), particularly in view of the new tighter timeframe for the

disbursement of Structural Funds introduced for the period 2000 to 2006 (the so-called 'n+2' rule) ⁽³⁰⁾. In fact ESC funding for 2000 to 2002 represented only approximately 6 % of Structural Fund allocations for 2004 to 2006 for Objective 1 ⁽³¹⁾.

Table 4

ESC commitments 2000 to 2002 compared with Structural Fund allocations 2004 to 2006

(million euro)			
Country	ESC 2000 to 2002	SF 2004-2006: Objective 1	ESC as % of SF
Czech Republic	37,4	1 286	2,9 %
Estonia	19,8	329	6,0 %
Latvia	24,0	554	4,3 %
Lithuania	31,2	792	3,9 %
Hungary	99,5	1 765	5,6 %
Poland	504,6	7 321	6,9 %
Slovenia	13,8	210	6,6 %
Slovakia	41,2	921	4,5 %
Total	771,5	13 178	5,9 %

Source: European Court of Auditors.

54. A fundamental cause of the delays for all programmes has been administrative weaknesses in the Candidate Countries. In each country regional policy represents a new field of action and most countries struggled to establish stable structures which were capable of managing even the relatively small amount of funding allocated to the ESC. Moreover, the newness and weakness of the ministries concerned reduced their ability to establish the necessary coordination with other ministries to ensure effective programming and implementation. In addition, the channeling of all funding through a single implementing authority also created bottlenecks which slowed down the overall implementation and, therefore, impact of the programmes (see paragraph 26).

down in January 2001 and its functions transferred to the Ministry of the Interior. Inadequate performance by the Latvian authorities originally managing the ESC programme also led to these responsibilities being moved to the Ministry of Finance in 2002. In Slovakia and Romania, the ministries responsible for regional development only became operational in 2000 and lacked experienced staff. In Bulgaria, the Ministry for Regional Development and Public Works underwent reorganisations and a particularly high level of staff turnover followed changes in political responsibilities. The Ministries of Regional Development in the Czech Republic and Hungary also suffered a loss of key personnel in 2000 for similar reasons.

55. Thus in Poland a Ministry for Regional Development and Construction was established in June 2000 only to be abolished in January 2002 following a change of government. In mid-2002 responsibility for managing ESC infrastructure projects had to be transferred from the Polish ESC implementing authority to another implementing authority because of its inability to carry out this task. Similarly, in Lithuania, the Ministry of Public Administration Reform and Local Authorities was closed

⁽³⁰⁾ The Structural Fund Regulation (EC) No 1260/1999 Article 31.2 foresees that 'the Commission shall automatically decommit any part of a commitment which has not been settled by the payment on account or for which it has not received an acceptable payment application... by the end of the second year following the year of commitment'.

⁽³¹⁾ Notwithstanding the closeness of accession, the Commission's November 2003 'Comprehensive Monitoring Report' pointed to continuing weaknesses in Candidate Countries' capacity for managing the Structural Funds. The countries needed to make what the Commission termed 'enhanced efforts' in their preparations for accession.

RESULTS OF INSTITUTION-BUILDING PROJECTS TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS

56. The 1998 SPP Twinning projects generally allowed some initial progress to be made by mid-2001 in preparing for the Structural Funds. However, the project achievements were very largely not as far-reaching as had been intended at the start of the projects. In the most problematic case, in Bulgaria, the project was abandoned with only approximately 30 % of the funds spent because of the difficult relations between the twinnings and their counterparts. Generally SPP Projects achieved least progress in contributing to drawing up National Development Plans and the setting up of monitoring systems for Structural Funds, mainly because of the complexity of these tasks and the relatively short timeframe of Twinning covenants.

57. The SPP for each country also included a technical assistance institution-building component. However, the respective roles of twinnings and consultants were not always clearly defined which led to a degree of overlap, for example, in contributing to the National Development Plans.

58. Of particular concern is the way the changes in responsibilities between ministries and the internal restructuring of ministries (see paragraph 55), as well as the high turnover of individual staff, reduced the lasting impact of the SPP. Even for ESC programmes in 2000 and 2001 there still existed a similar risk of funds being allocated to ministries which in the end would not be designated to manage the Structural Funds. This problem was only finally resolved in 2002 when Candidate Countries, in the context of their negotiation of Chapter 21 of the Accession Treaty, were obliged to decide on their managing and paying authorities. For the purposes of ensuring more effective preparation, it would have been desirable for the Commission at an earlier stage to have required Candidate Countries to designate these authorities.

59. Even after the managing and paying authorities were designated, the identification of effective institution-building projects was hindered by uncertainty over which departments within ministries would play what role and the fact that the identity and role of intermediate bodies was also not yet clear.

60. The task of Phare concerning institution-building at regional level was particularly difficult. Most countries only started to establish administrative structures at regional level ⁽³²⁾ for the purpose of managing the Structural Funds. Often the boundaries of the newly created regions did not reflect natural historical or geographical boundaries and did not have political bodies as these tended to reside at county level ⁽³³⁾. In several countries, for example Bulgaria, the Czech Republic and Slovakia, regional structures for managing the Structural Funds were only put in place at the end of 2001. This meant Twinning projects could not be set up at regional level in these countries before this time.

In the Czech Republic Twinning assistance to the regions carried out under the SPP was significantly less than had been foreseen. This was in part due to the setting up of new regional structures in the first half of 2001. Under the Twinning covenant financed from the ESC 2000 programme, it was intended during the course of 2001 and 2002 to make up for the limited inputs at regional level made during the 1998 project. However, continuing uncertainty, in particular, over the role of Regional Executive Units and Regional Secretariats ⁽³²⁾ in the implementation of the Structural Funds meant that in this case too the twinnings reduced the amount of time they spent working at regional level.

61. In certain other countries, where regional structures had been established earlier, large Twinning projects were carried out in most or all regions of the country under the ESC 2000 programme. However, in half of the regions in Hungary and Romania, and all the regions supported in Poland, no ESC funding was allocated to ESC investment projects. This reduced the scope for the practical training that could be provided by twinnings on the management of EU funds. Moreover, in Romania, none of the eight Regional Development Agencies ⁽³²⁾ where the twinnings were located had a budget from central government to cover their running costs, which also made the work of the twinnings more difficult. Indeed, uncertainty over future budgets and the agencies' legal status threatened to undermine the long-term impact of Phare institution-building support at regional level in Romania.

62. Under the 2000 Twinning covenants, one of the main tasks both at regional and national level was to assist in drawing up regional operational programmes for each region ⁽³²⁾. The decision in 2001 by Directorate-General Regional Policy to only allow one Regional Operational Programme per country meant that covenants had to be subsequently modified.

⁽³²⁾ NUTS II level.

⁽³³⁾ NUTS III level.

CONCLUSIONS

Difficulties in the overall approach of using the Phare programme to prepare Candidate Countries for managing the Structural Funds

63. There were several difficulties concerning the Commission's overall approach to using the Phare programme for managing the Structural Funds. It was the instrument used in the context of preparing for the ERDF and ESF although it was clear in advance that there were limitations on how far Structural Fund procedures could be replicated under Phare. In the absence of arrangements similar to those under Sapard and ISPA, it was more difficult to gain practical experience in managing and controlling ESF and ERDF type expenditure (see paragraphs 16 and 17). The approach to programming initially followed by Phare did not reflect actual practice in the Structural Funds (see paragraphs 18 to 24). This situation arose in part because of the tension between the two objectives of the Phare ESC programmes: on the one hand to use them to prepare for Structural Funds, and on the other hand to already achieve a cohesion impact through these programmes (see paragraph 27). More generally, the use of the Phare programme was not linked to an overall strategy defining the pre-accession and post-accession needs of the Candidate Countries in terms of preparing for and then utilising the Structural Funds (see paragraph 28).

Limited progress in moving Phare closer to Structural Funds

64. Although an important part of the Commission's strategy for using Phare to prepare Candidate Countries for managing ERDF and ESF was to modify Phare procedures to make them more akin to those of the Structural Funds, only limited progress was made in this respect. In particular, although the introduction of EDIS under Phare was to be a major step in moving towards the Structural Funds, EDIS was not actually introduced before the accession. As a result Candidate Countries will not have gained the experience of managing programmes similar to ERDF and ESF in an *ex post* control environment prior to accession, which is what the Commission originally planned (see paragraphs 30 to 32). Furthermore, delays in introducing EDIS have made it more difficult to channel funding through grant schemes, although these are the main instruments for implementing the Structural Funds (see paragraph 33). In addition, the Commission did not introduce multi-annual programming as foreseen (see paragraphs 34 to 35).

Variable allocations for and delayed implementation of ESC programmes

65. Although for Phare national programmes taken as a whole, the Commission achieved its target of allocating approximately 35 % of funds to the ESC, in most countries the amount of the national programme allocated to this purpose was somewhat less, thus reducing the impact of the Phare programme on contributing to their preparation for the Structural Funds (see paragraphs 38 to 44). Moreover, within the total allocations available insufficient funding has been allocated to preparing future Structural Fund measures (see paragraph 45). Actual programme implementation has been subject to serious delays (see paragraphs 46 to 52). The difficulties encountered largely reflect the administrative weaknesses in the ministries responsible for regional development in the Candidate Countries (see paragraphs 54 and 55).

Only partial achievement of results of institution-building projects to prepare Candidate Countries for managing the Structural Funds

66. The impact of institution-building projects has particularly suffered from the changes in responsibilities for regional development among ministries in beneficiary countries. Delays in designating managing authorities and paying authorities and defining specific roles and responsibilities within them has further hindered institution-building efforts (see paragraphs 58 and 59). Slowness in setting up regional structures has restricted the scope for support to institution-building at this level in some countries (see paragraph 60).

Overall conclusion

67. The Commission should be commended for starting as early as 1998 to use the Phare programme to help prepare Candidate Countries for managing the Structural Funds. However, while Phare continued to provide important support in this area over the period 1998 to 2002, at the time of accession the Phare programme had a more limited impact than expected in preparing the Candidate Countries for the ERDF and ESF to the extent the Commission had planned in its policy documents, notably the Phare Review 2000. This was in part due to the inexperience and the insufficient institutional development of the relevant authorities in the Candidate Countries. It was not possible to remedy these shortcomings in the time available. Making effective use of the Structural Funds will represent a major challenge for new Member States, particularly given the shortened programming and implementation period of 2004 to 2006.

RECOMMENDATIONS

68. There is a significant need for more institution-building support in the area of managing the Structural Funds after the accession.

69. Considerable resources should be devoted to the *ex post* control of Structural Fund operations in the new Member States.

70. A clear strategy should be put in place identifying the different steps that still need to be taken for preparing the current and future Candidate Countries for managing the Structural Funds.

71. The Commission should increase its efforts to bring Phare closer to the Structural Funds by:

- giving future managing authorities the status of Phare implementing agencies,
- providing the assistance necessary to implementing agencies to enable them to implement Phare in the framework of an ex-post control system,
- introducing multiannual planning based on National Development Plans.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 7 and 8 July 2004.

For the Court of Auditors
Juan Manuel FABRA VALLÉS
President

THE COMMISSION'S REPLY

SUMMARY

I. Phare was established in 1989 and assisting Candidate Countries to prepare for Structural Funds was not part of its remit at that time. In 1997 Phare became accession-driven with the objective of preparing Candidate Countries for membership across all 31 chapters of the *acquis communautaire*. The first preparatory projects for Structural Funds and related negotiation chapters were institution building in nature and began in 1998. Only in 2000 did Phare begin with investment projects under the title of Economic and Social Cohesion (ESC) that had a twofold provision: assistance for preparing for Structural Funds and an initial impact on development disparities. The indicative target for Economic and Social Cohesion was 35 % of annual national programmes as of 2001. The timeframe for enlargement and hence the related timeframe for preparation was estimated to be around five to six years.

II. No previous enlargement had such extensive preparations for Structural Funds using three pre-accession instruments. Through Phare, prerequisite planning processes were stimulated and overall planning capacity established and these countries were able to submit draft Structural Funds Development Plans already at the beginning of 2003, thereby ensuring early approval and launch in 2004 of Structural Funds Programming Documents for the 2004 to 2006 period. This has never been achieved before. While not all early ambitions were realised in a timeframe compressed by rapid acceleration in the negotiations, the ESC initiative, among others, had a very significant impact on the negotiations themselves and on institutional developments. As a result the Council was able to close negotiations on the main Structural Funds related chapter (21) in 2002 on the basis of legislative alignment and designation of structures. The second objective of ESC was 'to begin to make an impact on development disparities' through focus and concentration. Any intentionally diffused approach would have been a very poor learning model and this was clearly stated at the outset: 'It is neither feasible nor wise to pilot test all structures and instruments that will be developed...' (Phare 2000 Review).

III. It was foreseen from the outset that extending decentralised management (EDIS) and multiannual programming 'could not start until 2002 at the earliest' (Phare 2000 Review). It transpired that 2002 was the year that negotiation closed and consequently there has been a compression of the timeframe. EDIS is a complex and lengthy process, not a punctual event, and the countries have been working on this process for several years. The

determining factor for moving to *ex post* controls is overwhelmingly the acceding countries 'ownership' of the process to establish their own safe management and control systems. Difficulties encountered in grant schemes were mainly due to the learning curve the countries had to undergo. Hence, they were not related to the type of Commission control (*ex ante* or *ex post*).

IV. Although the objective of allocating approximately 35 % of Phare national programmes to ESC was indicative only 'to be applied with flexibility on a country by country basis', (Phare Guidelines Decision 1999), the 2001 to 2003 figures indicate that the average of around 35 % has been maintained. The insignificant dip in percentage terms in 2002 due to the Action Plans on Administrative and Judicial Capacity was fully compensated in 2003 allocations. In addition there were both investment and institution-building allocations in other horizontal chapters that had an indirect bearing on preparing for managing Structural Funds. In 2003, which was beyond the audit period, there was a deliberate focus on ESC. Several countries devoted well over 35 % of their 2003 funds to investment in ESC. The average was 39 %.

V. The Commission endeavoured to stimulate institutional progress and Phare Twinning and ESC actions were launched considerably ahead of final decisions on requirements for closure of negotiations on Regional Policy e.g. designation of the Paying and Managing Authorities. This process involved prolonged political discussion in the countries and Phare helped accelerate agreements on solutions essential for the eventual success of the negotiations and not least on preparing for Structural Funds.

VI. Even if not all initial ambitions were realised within a timeframe reduced by rapid accelerations in the negotiations, this was primarily due to the inherent difficulties and delays in designation of the future institutions responsible for managing structural funds. In certain instances, insufficient stability of some institutions indeed significantly impeded the impact of preparatory pre-accession assistance. Nevertheless, the evidence to date is that the main objectives were indeed realised as reflected in the negotiations themselves and follow-up monitoring reports and in all subsequent programming developments to an extent never achieved before.

VII. After accession the new Member States will continue to receive a great deal of direct support from the Structural Funds Directorates-General to help them manage programmes effectively, just as they have in framing the programmes and designing their delivery and management systems. The lessons learned are already being taken into account and the Bulgaria and Romania Roadmaps together with the revised 2003 Phare Guidelines already outline the strategy underway. On implementing agencies, in moving to *ex-post* controls, the process is the other way round. Phare agencies, in order not to lose the expertise they

acquired, should become (or be integrated into) the Structural Funds managing and implementing bodies. In most new Member States this is the reality when the structure, or at least the staff, have been transferred to the management and payment agencies. Building on positive pilot experience in 2003 the Phare Guidelines have been revised and the Programming Guide for 2004 has been revised to introduce multiannual planning for the ESC and, where appropriate and feasible, also for institution building.

INTRODUCTION

4. In 1997 and 1998 a Special Preparatory Programme was originally conceived as a horizontal EUR 60 million programme. Subsequently substantial additional funds were made available and implemented under National Programmes, in line with the general policy of moving from multi-country/horizontal programming to national programming.

7. The Phare Guidelines Decision of 1999 stipulated that 'the split of around 30 % for institution building and around 70 % for investment is indicative only. These proportions had to be applied with flexibility on a country-by-country basis, giving priority to the needs arising in the field of institution building'. Consequently this flexibility was established under law.

8. 'Moving to Structural Funds' was also indicated in the 2000 Review as a broad challenge to which all components of Phare would have to contribute. Consequently, the ESC was a significant but only one of the several avenues of approach.

9. The Phare Review (point 5.1.1) set ESC objectives as follows: '(1) to strengthen the countries' programming and administrative capacities through institution-building support across their entire national territories so that they may absorb the Structural Funds upon accession; (2) to use investment in support of institution building and, closely coordinated with it, to begin to make an impact on development disparities and to allow pilot testing of integrated development programmes similar to Objective 1 and Community Initiatives at national and/or regional level (...)' Concerning investment support, the Review and programming documents prescribed focus and concentration in order to ensure impact. While acknowledging the limits on reducing wide development disparities, these documents did not establish a hierarchy of objectives.

10. The Phare Review stated: 'Phare is pushing for maximum impact from its investment support budget in this area...' consequently the aim was to devote approximately 35 % of countries' Phare national programmes to economic and social cohesion support. Thus this aim was directly related to the other 'impact' objective in the Phare Review and not to the objective of 'moving to Structural Funds' as such.

THE OVERALL APPROACH OF USING THE PHARE PROGRAMME TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS

15. Concerning the twofold objective of Phare ESC, see reply to paragraph 9.

As Structural Funds (SF) operate under shared management and Phare under decentralised implementation, legal and financial procedures are different and 'learning by doing' would be thereby constrained. This is why the Phare Review referred specifically to 'pilot testing' of SF-type measures. Thus even if design modalities could be aligned, implementation would still have to comply with external aid Financial Regulation requirements.

16. Outside the limits mentioned in paragraph 15, the use of Phare institution building for Structural Funds preparation was not problematic. Phare is a flexible, general external assistance instrument, within which it is possible to combine investment and institution-building actions as well as partial alignment with other instruments. In the interests of sound financial management it was prudent to remain within the established evolutionary approach of Phare involving gradual and controlled progress from centralised to decentralised with *ex ante* control, to fully decentralised management systems.

17. In the late 1990s the decision to establish only two new pre-accession instruments reflected a complete consensus and was fully endorsed by the European Parliament and the Council. It was evident in 1999 that the scale of the preparations required was enormous and the demands on the administrations of the candidate countries were considerable. They were unable to take on the challenge of a sophisticated multiannual planning exercise coupled with complex implementation arrangements as well as support a second movement to the *ex post* control arrangements as apply in the Structural Funds regulation. Therefore it was prudent to opt for a more phased approach under Phare in order to avoid overloading the limited resources of the candidate countries as well as avoiding a potential interruption of pre-accession assistance delivery.

18. Only the ESC (approximately 35 %) component of Phare National Programmes was deemed to support Objective 1 ERDF and ESF-type projects. Implementation of Phare and coordination of all pre-accession assistance has been the competence of DG Enlargement. However, as provided in the Communication COM(97) 112, since 1998 closer cooperation with Commission services responsible for regional structural policies was established. The involvement of Structural Funds Directorates-General in ESC programming has been substantial. Since inauguration of preliminary National Development Plans (PNDPs), prepared by candidate countries in late 1999, all concerned services contributed to their assessment and implementation. In particular,

the Regional Policy DG was systematically involved in annual ESC programming and in programming missions. A high degree of coordination between all services was ensured in the negotiations on Regional Policy (Chapter 21) and in the context of Council Coordination Regulation of 1999.

19. Concerning the twofold objective of the ESC, see paragraph 9. The method followed aimed at introducing, in a phased manner, effective ESC programming to move progressively towards the full approach used in Objective 1. In this context, the dynamic impact of the negotiations has to be underlined. In 1999, the perspective was to use most of the 2000 to 2006 period to progressively move towards the SF approach. This perspective was changed by the Nice and Laeken European Councils.

20. The Structural Funds Regulation (EC) No 1260/1999 prescribe that Member States, irrespective of their regional structure, shall submit a draft Single Programming Document (SPD) when the Community allocation is less than EUR 1 000 million. For Community allocations above this threshold, the choice between Community Support Framework/Operational Programmes or Single Programming Document is to a large extent left to the Member State. In addition, in 1999 in most applicant countries the NUTS classification was not yet established. And in 1999 no one knew what geographical set-up was going to be implemented for Structural Funds upon accession and when this was going to happen.

21. To facilitate the introduction of ESC and in accordance with the principles of focus, concentration and impact (see reply to paragraph 9), ESC investment support was limited to target regions while institution-building support covered the whole country. This regionally focused approach was implemented only in 2000 (the first year of ESC programming). In the context of the progressive move towards the Objective 1, this approach was widened in 2001 ESC programming (see the Phare Review) where the possibility to have sectoral schemes at national level was introduced. In particular, smaller countries had the option to implement only sectoral schemes at the national level. While the county level regions were likely not to perform Structural Fund managing authority's functions, they would almost certainly perform Structural Fund intermediate body's functions (see paragraph 25). Thus, experience acquired in implementing ESC measures would not be lost.

22. Building on the lessons learned in 1994 to 1999, in the 2000 to 2006 period Member States substantially expanded the share of regional programme versus sectoral (national) programmes. This trend was massive in larger countries with a regionalised structure. Despite their essentially centralised administrative structure, 47 % of the 2000 to 2006 Structural Funds in Portugal are implemented through Regional Programmes and 34 % in Greece. Ireland is a special case. In 1994 to 1999 Ireland had still a fully centralised administrative structure, thus 100 % of Structural

Funds were implemented centrally. For the 2000 to 2006 period two regions were newly created and 31 % of Structural Funds will be implemented through Regional Programmes. Concerning acceding countries, the Commission's approach to recommending sectoral programmes was mainly dictated by the aim of simplifying a very short (less than three-year) Structural Funds programming period (see paragraph 23).

23. Only in 2001, when it became clear that the Structural Funds programming period was going to be very short (three years), did DG Regional Policy propose to the countries not to have individual Regional Operational Programmes (contrary to current practice in Member States) but one integrated Regional OP (IROP) covering all regions. Thus, for example, the IROP in Poland covers all 16 regions. There was eventual agreement with the countries that IROPs be managed centrally, but focusing on measures to be implemented in individual regions by relevant regional authorities.

24. After a first year (2000) where ESC investment was limited to target regions (to facilitate its introduction), as indicated in paragraph 21, DG Enlargement introduced ESC sector schemes at national level for small (NUTS II) countries. For larger 'regionalised' countries, sector schemes could co-exist with the regional approach (see Phare 2000 Review). As indicated in paragraph 21, it was a phased move towards the introduction of an Objective 1 approach.

25. Experience shows that even in the case of centrally managed Operational Programmes, regional bodies still have an implementation role to play. Thus Phare institution building to strengthen programming and administrative capacity was done at both central and regional level. On the other hand (as explained in paragraph 9), the principles of sound financial management (economy, efficiency, effectiveness) required ESC investment support to be focused and concentrated to ensure impact. And as highlighted in the Phare Review, it was neither feasible nor wise to pilot test all regional structures by spreading limited resources across too many programmes.

26. The 1999 Guidelines Decision stipulated that: 'project selection and monitoring remain the responsibility of the ministries/administrations directly benefiting from assistance' and 'as far as possible, of sustainable institutions which will be responsible for management and implementation of Community funds upon accession, particularly the structural funds'. Thus, where capacity existed there was an IA each for Regional Development, ESF, SMEs and CBC (e.g. in Poland). It is also worth mentioning that the Guidelines stipulated 'institution building (IB) activities will be focused on the weaknesses identified at the central, regional, and local level particularly in view of the increased emphasis to be given to economic and social cohesion'.

27. ESC objectives (see paragraph 9) were not conflicting and, as quoted in paragraph 24, the 'target region' approach for investments was followed only in the first year of ESC programming (2000). While institution-building support for preparing for Structural Funds covered the whole country (both at central and regional level), ESC investment support, given its limited resources, had to be concentrated on a few priorities to have an impact as well as to ensure compliance with sound financial management principles. This was an essential lesson for the nascent programming structures and was a vital complement to the preparing for Structural Funds objectives.

28. The preparatory process was not static but dynamic and determined by the wider regional policy negotiations strategy (including common position papers). This strategy included the responsive and evolving policy framework of the progress reports and resulting accession partnership priorities which underpinned the Commission decision to make Phare ESC investment available under conditions of slow designation of managing structures and insufficient institutional stability. However, this approach was justified by the outcome of the negotiations in terms of both actual results and timing.

PHARE PROCEDURES

29. See reply to paragraph 17.

30. The 1999 Coordination Regulation stipulated that the management of pre-accession assistance aims to be gradually decentralised, taking account of management and control capacities. This approach involved first the Decentralised Implementation System (DIS) and then the Extended Decentralised Implementation System (EDIS) which both facilitates the phasing out of Phare as indicated in the 2002 Communication and allows the countries to operate with ex-post controls.

Even though the Coordination Regulation of 1999 did not make the process mandatory for the countries, already in 2000 the Commission elaborated guidelines on preparing for EDIS (see Commission working document Preparing for Extended Decentralisation of the Phare and Ispa Programmes). This Working document, which included checklists on the control standards expected to be attained for EDIS, was distributed to all countries already also in 2000. In 2001, the Roadmap to EDIS for Ispa and Phare was prepared and sent to the countries, giving a step-by-step methodology for realisation of the conditions set out in the Coordination Regulation. Both the Working documents and Roadmap were sent by joint letters from the Regional Policy and Enlargement DGs underpinning the strong coordinated approach maintained for Phare and Ispa programmes. The Phare Review affirmed that 'decentralisation cannot start before 2002 at the earliest' and it will not be implemented 'unless clear preconditions have been met and the necessary financial and human resources are in place'. Thus while earlier EDIS would have indeed been desirable, in the reduced timeframe it proved not to be feasible.

31. In 2001 considerable pressure was brought to bear on the countries on the need to move towards EDIS, culminating in a seminar at ministerial level in February 2002 with both the Commissioner and the Director-General responsible for Enlargement as well as senior management from the Regional Policy and Agriculture DGs. During 2002, after the accession target dates were set at the Laeken European Council, a formal requirement governing EDIS was stipulated in the Act of Accession and actions already initiated were accelerated. High-level Working Groups were only one additional tool for the Commission and the countries. In parallel, continuous guidance was provided in writing as well as during joint seminars organised by the Regional Policy and Enlargement DGs. Consequently, there was no material time difference in initiating extended decentralisation for Phare in comparison to ISPA.

33. The Commission acknowledges that introduction of the new ESC instrument in 2000 resulted in slow but progressive implementation but there is no link between introducing EDIS, due to start 'at the earliest in 2002', and initial difficulties in implementing ESC grant schemes introduced two years earlier. Initial difficulties were mainly due to the inexperienced agencies learning curve with the new 'measure' mechanism. Although grant schemes meant increased work for Delegations (*ex ante* approval of Call for Proposal and Guidelines for Applicants), according to external aid rules (decentralised), evaluation of project applications submitted for funding is not done by Delegations but by national authorities. Delegations give a global endorsement to the evaluation report and the final list of award proposals prepared by national authorities, not an approval to each individual grant contract.

Initial difficulties were mainly due to the learning curve those countries had to undergo with this new 'measure' mechanism.

34. Administrative weaknesses and lack of inter-ministerial coordination were a reality in 1999. Therefore, the requirements for the Preliminary National Development Plan (whose drafts had to be submitted by October 1999), while mirroring the Objective 1 requirements, including the partnership approach, were relatively straightforward. The Preliminary National Development Plan (PNDPs) were conceived as a first step of an on-going process which would develop over time into the type of NDP required for Structural Funds inside the EU. The PNDPs fulfilled a double role of being the key steering documents for programming ESC while at the same time being the forerunners of Structural Funds Development Plans. In late 2000, countries were requested to review and to develop their PNDPs by the end of 2001, to take into account the observations from the Commission on the first generation of PNDPs and to incorporate the lesson learned with the 2000 ESC programming exercise. Revised PNDPs, which were jointly passed by DG Enlargement and Structural Funds DGs, paved the way for the Structural Funds Development Plans and programming documents which were subsequently prepared by acceding countries in the course of 2002 to 2003.

35. The Phare Review identified multi-annual programming (on the basis on strengthened National Programmes for the Adoption of the *Acquis* and PNDPs) as a medium-term task that, under certain conditions, could have been operational from 2002 onwards. A multiannual approach in the context of Phare CBC was easier to implement given the limited scope of the programme and its complementary nature of a programme conceived to work, since its outset, with Interreg (a programme with multiannual programming) at the EU-CC borders. As of 1999, the further alignment with Interreg meant that Joint Programming Documents in a multiannual perspective (although only indicative: for Phare those allocations have to be decided on an annual basis) were adopted to cover the 2000 to 2002 period and revised in 2003.

36. Co-financing requirements are in all Phare investment project fiches since 2000. As preparations for accession imposed a considerable financial burden on candidate countries, both joint and parallel co-financing was permitted under Phare. Even though Phare is bound by annual financing decisions, both co-financing forms clearly require multi-annual budgetary planning of co-financing by the countries.

FUNDING AND IMPLEMENTATION OF PHARE PROGRAMMES TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS

37. The Special Preparatory Programme (SPP) was originally conceived as a horizontal multi-country programme but in 1998, in line with general policy on reducing horizontal actions, it was phased out. As of 1999 SPP-comparable activities were incorporated into the National Programmes, mainly through institution building support.

39. The indicative objective of allocating approximately 35 % of Phare national programmes to ESC was 'to be applied with flexibility on a country-by-country basis' (Phare Guidelines Decision 1999). In 2003 there was a deliberate focus on ESC to compensate for the need to concentrate on building administrative and judicial capacity in 2002. Several countries devoted well over 35 % of their 2003 funds to investment in ESC. The average was 39 %.

40. In Bulgaria the 2000 programme was committed in late 2000 with a contracting deadline of end-2002. Similarly, the 2001 programme was committed in late 2001. By late 2001, little of the 2000 ESC had been contracted as the authorities coped with the new instrument including grant schemes. At this stage the implementation difficulties referred to had not emerged and there was therefore no reason to reduce ESC allocations. When difficulties did emerge in 2002, the Commission acted responsibly by reducing allocations for that year. Despite the difficulties indicated, contracting losses for 2000 and 2001 were

limited. 2000 was the first year of ESC and the total for ESC accounted for 23 % of the National Programme. In 2000 the ESC share of the total rose to 45 %. In 2002 and 2003, given limited capacity, the allocation was reduced to allow earlier commitments to be contracted. The totals were 15 % and 12 % respectively. It is in any case much more meaningful to look on a multi-annual basis, rather than focus on the annual variances. Overall, since introduction of ESC, 23 % of the National Programme has gone to ESC, under the 30 % indicative target, but this is reasonable for a country much further from accession than most other recipients and still developing its capacity.

41. Until 2002, most Structural Funds' national structures were not yet designated. Consequently it was difficult to support them. In 2000 and 2001, the Commission was already pushing for progress by making Phare ESC investment decisions under conditions of acute institutional uncertainty. However, this enterprising approach was in the end vindicated by the outcome of the negotiations in terms of both actual results and timing. As it turned out, the timeframe was approximately halved but nevertheless there was still some time available for actual ESC implementation. However, for institution building such an approach is more difficult and actions were focused on areas where the least uncertainty existed.

42. An evolutionary approach is not an inconsistent one. The programming approach followed in 2000 was evolutionary for the pre-accession period, moving towards the full Structural Funds approach (i.e. thematic and regional programmes covering the whole national territory) as quickly as was feasible. Concerning the regional versus sector approach, see replies to paragraphs 9, 21 and 24. The change in ministries responsible for drafting PNDPs and subsequently NDPs followed the designation of authorities responsible for SFs which took place late in the process (2002).

43. As highlighted in the reply to paragraph 33, the countries were not familiar with ESC projects, and namely with their implementing tool: ESC grant schemes. This required a learning process which, although causing delay in the implementation, was a valuable building block essential for future Structural Funds implementation. In regard to Bulgaria, the Commission agreed with the Court's observations in September 2002 and corrective measures were taken.

44. In keeping with its objective to prepare for Structural Funds, Phare ESC investments closely mirrored ESF and ERDF-type investments. Under the latter, investments in basic economic infrastructure are fully eligible if they help to increase the economic potential of the regions, thus supporting the productive environment. In other words, improving the standard of the infrastructure is a basic pre-condition for any economic and social development.

45. The 1999 Project Preparation Facility (PPF) was the only horizontal multi-country programme of its type. In line with the general policy of moving from horizontal/multi-country programming to national programming, candidate countries were urged to establish PPFs within their national programmes (including for developing a pipeline of projects for the Structural Funds). However, if candidate countries decide that sufficient investment in building up a project pipeline has been done, that is their prerogative.

46. See also replies to paragraphs 33 and 43. The Commission is of the view that initial data indicating a disbursement rate of almost 72 % for 2000, the first year of the new ESC instrument, at the end of 2003 is under the circumstances a good performance. Not surprisingly, start-up difficulties indeed revealed administrative capacity constraints. However, this did not slow down efforts to improve capacity but in fact contributed to speeding them up. This was evident in the 2002 Accession Partnerships priorities and Action Plans for Administrative Capacity, including for ESC institution building, which averaged about 6 % of national programmes. Consequently, during the audit period most countries allocated more of their programmes to institution building.

47. The drafts of the first generation of PNDPs were due to be submitted to the Commission by the end of October 1999 with or without Twinning assistance in order to facilitate ESC programming in 2000. However, Twinning had a significant impact on the revised (second generation) PNDP submitted in 2001 (see paragraph 34).

48. Any impact on implementation of pilot projects of the clarification or modification of procedures was quite marginal in comparison to other fundamental factors identified in the report i.e. institutional uncertainty and weaknesses on the part of the administrations as outlined in observations 51 to 60.

49. Start-up problems are almost inevitable with any new initiative, and this was also the case with the PPF facility. Indeed due to weak administrative capacity in one country, the Head of Delegation decided on derogation from the standard tendering period. However no tendering rules were 'broken' in the sense of an irregularity. The reasons for derogation were justifiable and documented.

50. Twinning delays in a particular selection of Member State partners were invariably due to the slow designation of ministry and implementation agency responsibilities which only took place under the pressure of the negotiations. The Commission could not interfere in the internal political processes of the candidate countries while these issues were being resolved. Both in terms of its ESC investment decisions and institution-building actions, the Commission was pushing the limits of what was feasible and possible.

51. See replies to paragraphs 33 and 43. Commission Delegations played a great role in contributing to improving the quality and soundness of the grant schemes-related documents and procedures, thus contributing to the learning process that candidate countries had inevitably to go through.

52. Given that only the first year of ESC (2000 projects) are finishing implementation, the evidence available makes it difficult to base reasonable doubts on such limited data as well as taking into account the fact that countries had competing priorities in their preparations for accession.

RESULTS OF INSTITUTION-BUILDING PROJECTS TO PREPARE CANDIDATE COUNTRIES FOR MANAGING THE STRUCTURAL FUNDS

56. As was established in the Court's Special Report on Twinning, this instrument improved significantly after its start-up phase and general conclusions cannot be drawn from difficulties in the start-up phase prior to the Commission's own evaluation of the instrument and remedial measures taken.

57. To the limited extent that the respective roles of Twinning pre-accession advisers and consultants were not defined, this was a project management operational problem shared by the country administrations (mainly) and Member State project leaders responsible for these projects (and is addressed in the various replies in the Court's Twinning Reports).

58. Candidate countries were requested repeatedly to designate authorities at earlier dates but internal political constraints prevented them from so doing, which was only resolved in the final stages of the negotiations as the Court indicates in several observations above. However, thanks also to the Phare ESC approach (PNDPs), overall planning capacity was established and allowed candidate countries to submit their draft SF Development plans in early 2003 (in order to assure timely approval and launch in 2004 of CSFs+OPs and SPDs). These plans were also approved in 2003 and this was an unprecedented achievement.

61. As highlighted in replies to paragraphs 9, 25 and 27, IB was used on the whole territory, at central and regional level, for preparing the structures due to manage the ESC, whereas, as the Phare Review stipulated: 'Phare investment support in the ESC must be focused on a few priorities if it is to have an impact. It is neither feasible nor wise to pilot test all structures and instruments that will be developed through IB. This concentration requires a discipline on programming to ensure that resources are not spread too thinly across too many programmes'. This was in accordance with the SFM principles of economy, efficiency and effectiveness.

CONCLUSIONS

63. Given that assisting preparations for Structural Funds was always only one of the ESC objectives and that the Commission has met the aim of delivering around 35 % of total financing for national programmes in the form of investment in the ESC, complemented by considerable related institutional building, results are consistent with the original timeframe. It is questionable as to whether arrangements similar to Sapard and ISPA (effectively a fourth instrument) would have served better. It is also highly doubtful as to whether countries stretched to their limits by accession preparations could have sustained a second full decentralisation process without major disruptions in assistance delivery. Great progress was achieved in the context of a compressed timeframe determined by the pace of the negotiations and not defined at the outset. Overall planning capacity was established and allowed these countries to submit their draft SF Development Plans in early 2003 (and gain approval in 2003). This was never achieved before. The focus, concentration and impact standards of ESC were never at odds with the Structural Funds objective. A more diffused deployment of the limited resources would have provided a bad example of management of Community funds. The Commission considers that an overall evolutionary strategy did exist (Progress Reports and resulting Accession Partnerships) on which the Phare programme including ESC was based. Most of the ESC contribution to this overall strategy continues as most ESC investment is being delivered beyond the audit period.

64. Modified Phare procedures mirrored ERDF and ESF measures to the maximum extent allowed by the external assistance provisions of the Financial Regulations. Progress beyond the legal limits thereby imposed was impossible. On EDIS, the Phare Review stipulated that decentralisation could not start before 2002 at the earliest due to the preparation needed to ensure adequate management and financial control systems were in place and operational. The legal obligation to move to EDIS only arose in the Act of Accession after the timeframe was compressed by the acceleration in the negotiations. In addition there was no legal or other procedural link between the introduction of EDIS

starting at the earliest in 2002 and the initial difficulties encountered in the implementation of grant schemes introduced in 2000. These initial difficulties were mainly due to the learning curve countries had to undergo with this new mechanism similar to ERDF/ESF measures (see also reply to paragraphs 28 to 36).

65. Given the legal flexibility of the Phare Guidelines, allocations were relatively high. In 2001 to 2002, on average, ESC investment accounted for almost 37 % of national programme financing (see 38), in line with the aim in the 2000 Phare Review. The indicative (i.e. suggestive, it was not a minimum requirement) 35 % ESC allocation was 'to be applied with flexibility on a country-by-country basis' (Phare Guidelines Decision 1999). Consequently, seven out of ten countries chose to allocate less than 35 % to the ESC and, as a result, more to other Accession Partnership priorities. Three large countries allocated substantially more to the ESC, thereby raising the average to 37 %. In addition, the ESC institution building has accounted for about 6 % of the entire national programme financing, on average, over the same period, bringing total average allocations to well over 40 % annually. Consequently, it is not clear how ESC allocations have been insufficient in either individual countries or in overall terms.

67. Even if not all initial ambitions were realised within a timeframe reduced by rapid accelerations in the negotiations, this was primarily due to the inherent difficulties and delays in designation of the future institutions responsible for managing structural funds. In certain instances, insufficient stability of some institutions indeed significantly impeded the impact of preparatory pre-accession assistance. Nevertheless, the evidence to date is that the main objectives were indeed realised, as reflected in the negotiations themselves and follow-up monitoring reports and in all subsequent programming developments to an extent never achieved before. Meanwhile, the majority of ESC and related institution building programmes continue to deliver assistance beyond the audit period and the prognosis for the SFs is positive.

RECOMMENDATIONS

68. After accession the new Member States will continue to receive a great deal of direct support from the Structural Funds Directorates-General to help them to manage programmes effectively, just as they have in framing the programmes and designing their delivery and management systems.

69. The new Member States have all set up audit services to fulfil the financial control requirements laid down by Regulation (EC) No 438/2001 and the Commission will ensure that these begin work immediately and will itself monitor and test these systems.

70. The lessons learned are already being taken into account and the Bulgaria and Romania Roadmaps together with the revised Phare Guidelines already outline the strategy underway.

71. Designation of implementation agencies is a sovereign decision for the candidate countries themselves and the Commission has no mandate to dictate such a decision. Actually, in the progression of EDIS accreditation, the process is the other way round. Phare implementing agencies, in order not to lose the experience they acquired, should become (or be integrated into) the SF managing and implementing bodies. In the context of the Roadmaps for Bulgaria and Romania, and in the light of the considerably enhanced amounts that will be available, both countries

were invited (and have agreed) to implement EDIS two years before accession. This will be monitored through the High-level Working Group process and all projects in the 2004 national programmes are being designed for implementation under EDIS. The Phare Guidelines have been revised and the Programming Guide for 2004 has already been revised to introduce multi-annual planning for ESC and, where appropriate and feasible, also for institution building.
