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COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 22.12.2008
COM(2008) 880 final

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

**2007 ANNUAL REPORT ON PHARE, TURKEY PRE-ACCESSION, CARDS AND
TRANSITION FACILITY**

{SEC(2008) 3075}

Introduction

Since 2007, EU pre-accession funding has been channelled through a single instrument, the Instrument for Pre-accession Assistance (IPA), designed to deliver focused support to both candidate and potential candidate countries. IPA supersedes five previous EU financial instruments - Phare¹, ISPA², SAPARD³, the Turkey pre-accession instrument⁴ and CARDS⁵.

This report deals with the implementation of Phare, Turkey pre-accession instrument, CARDS and Transition Facility⁶ programmes during the year 2007. It should be noted that as 2006 was the final programming year under Phare, the Turkey pre-accession instrument and CARDS, no new programmes under these instruments were launched in 2007. The 2007 programming for candidate and potential candidates took place under the new instrument IPA, and it will be reported on through the 2007 annual IPA report, as foreseen in the IPA regulation 1085/2006 (Art. 13(6)).

The objectives of Phare pre-accession assistance were: to assist candidate and acceding countries in their efforts to strengthen their public administrations and institutions to function effectively inside the European Union; to promote convergence with the European Community's legislation; to reduce the need for transition periods; and to promote Economic and Social Cohesion (ESC).

The object of the CARDS programme was to support the participation of the countries of the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, the former Yugoslav Republic of Macedonia, Montenegro and Serbia, including Kosovo under UNSCR 1244/99 in the Stabilisation and Association process (SAp). This process seeks to promote stability within the region whilst also facilitating closer association with the European Union.

This report also contains information on the Transition Facility for new Member States which was introduced to allow for the continuation of institution building support with a view to strengthening and consolidating institutional and administrative capacity to implement the *acquis communautaire*.

1. THE YEAR IN REVIEW

1.1. Main evolutions of the Enlargement Process in 2007

In 2007, progress was achieved on the basis of the renewed consensus on enlargement, as defined at the December 2006 European Council. 2007 began with the accession of Bulgaria and Romania. The year also saw a number of important developments in Turkey and the

¹ PHARE, Council Regulation (EEC) No 3906/89 of 18 December 1989

² Instrument for Structural Policies for Pre-Accession (Council Regulation (EC) No 1267/1999 of 21 June 1999)

³ Special Accession Programme for Agriculture and Rural Development (Council Regulation (EC) No 1268/1999 of 21 June 1999)

⁴ Council Regulation (EC) No 2500/2001 of 17 December 2001

⁵ Community Assistance for Reconstruction, Development and Stabilisation (Council Regulation (EC) No 2666/2000 of 5 December 2000)

⁶ Article 31 of the Bulgaria and Romania Accession Treaty

Western Balkans: progress in accession negotiations and the Stabilisation and Association process, the Kosovo status talks, and the launch of the new Instrument for Pre-accession Assistance, IPA.

On 6 November 2007, the Commission presented its annual strategy paper, together with country progress reports and Accession/ European partnership proposals for the candidates and potential candidates⁷ and Kosovo. The Commission's strategy paper confirmed the principles and objectives of the enlargement strategy. It drew attention to a number of significant challenges in the countries concerned. It stated that higher priority will be given from an early stage to basic governance issues, including institution-building, judicial and administrative reform and the prevention of organised crime and corruption. This approach is in line with the recommendations emerging from Directorate General Enlargement's internal evaluation of public administration reform in the enlargement countries.

Accession negotiations with Croatia and Turkey continued to make progress. For Croatia, by December 2007, sixteen chapters had been opened, two of which were provisionally closed. In Turkey's case, six chapters were opened, one of which has been closed. In line with the December 2006 Council conclusions, there are eight negotiation chapters which will not be opened until Turkey implements the Additional Protocol to the Association Agreement. DG Enlargement monitored the implementation of the Association Agreement with Turkey and the Stabilisation and Association Agreements (SAA) with Croatia and the former Yugoslav Republic of Macedonia. None of the three countries had made sufficient progress in addressing the priorities which have been set.

2007 saw progress towards the completion of SAA with the countries of the Western Balkans. Albania continued the implementation of its Interim Agreement. An SAA with Montenegro was signed in October 2007. SAA negotiations with Serbia were resumed in June 2007 and led to the initialling of the SAA in November. An SAA with Bosnia and Herzegovina was initialled in December. The signature of these SAAs was conditional on the fulfilment of the relevant conditions.

Concerning the Western Balkans, the Commission continued to foster the Stabilisation and Association process and coordinate the implementation of the Thessaloniki agenda. By the end of 2007, visa facilitation and readmission agreements had been concluded with Albania, Bosnia and Herzegovina, the former Yugoslav Republic of Macedonia, Montenegro and Serbia. The strategy paper announced the launch of a dialogue on the conditions for visa-free travel and the provision of further higher education scholarships for students from the region.

Kosovo status talks under the auspices of the Special Envoy of the UN Secretary General, Martti Ahtisaari, were concluded in 2007 but did not produce a final status settlement. The subsequent direct Kosovo status talks between the two parties mediated by a EU-US-Russia troika did not result in an agreement. The EU, including the Commission, continued to provide advice and support to this process and to reforms in Kosovo.

At the May summit of the South-East Europe Cooperation Process (SEECP) in Zagreb, the decision was taken to move towards regional ownership of the process of regional co-operation. Since the Stability Pact had largely accomplished its mission, the process of

⁷ Candidates: Croatia, former Yugoslav republic of Macedonia, Turkey.
Potential candidates: Albania, Bosnia and Herzegovina, Montenegro, Serbia, Kosovo under UNSCR 1244

replacing it by a new Regional Cooperation Council (RCC) linked to the SEECP began. A Secretary-General of the RCC was appointed, and Sarajevo was designated as the seat of its secretariat. In July, the new Central European Free Trade Agreement (CEFTA) entered into force.

Communicating enlargement continued to be a priority. For the third anniversary of EU-10 enlargement on 1 May, activities included: a special web section on the EUROPA web-site dedicated to case studies, a facts and figures section and a picture gallery; audiovisual material on Europe by Satellite; visits for journalists to three of the new Member States; and a series of seminars co-organised with Chambers of Commerce in seven Member States.

Moreover, in 2007 the Commission started work on a new civil society facility, which will focus on three areas of intervention: (i) support to local civic initiatives and capacity building; (ii) a people-to-people dialogue programme familiarising all types of stakeholders with EU policies, institutions and bodies, and; (iii) support to (international) partnership actions.

1.2. Main conclusions of the 2007 European Council

The General Affairs and External Relations Council of December 2007 welcomed the enlargement strategy with the following conclusions:

"In line with the enlargement strategy agreed by the December 2006 European Council and the Council conclusions of 11 December 2006, the Council welcomes the Commission's communication on the enlargement strategy and main challenges 2007-2008 of 6 November and takes good note of the analysis and recommendations contained therein. The renewed consensus on enlargement, which is based on consolidation of commitments, fair and rigorous conditionality and better communication, together with the capacity to integrate new members, continues to form the basis of the EU's enlargement strategy. An improved quality of the enlargement process will ensure that enlargement continues to foster peace, democracy and stability throughout the continent and to bring concrete benefits in terms of increased trade, investment and economic growth.

Next year is crucial to further consolidate and implement the EU's enlargement strategy and support the transition process in the Western Balkans. The Council recalls various proposals made on this issue and that the future of the Western Balkans lies in the European Union. Against this background, the consistent implementation of the renewed consensus is more important than ever.

The Council reaffirms that the pace of the negotiations depends notably on the negotiating countries' progress in addressing opening and closing benchmarks as well as the requirements of the Negotiating Frameworks, including the implementation of the Accession Partnerships, currently in course of revision, with each country being judged on its own merits. The Council recalls that chapters for which technical preparations have been completed will be opened in accordance with established procedures, in line with the Negotiating Frameworks. In this context, the Council looks forward to the Intergovernmental Conferences with Turkey and Croatia later this month. It is also essential that the enlargement policy maintains fair and rigorous conditionality at all stages of the negotiations. In this regard the Council welcomes the Commission's intention to continue enhancing the quality of the enlargement process by tackling key priorities in areas of public administration and judicial reform and the fight against corruption at an early stage, by making full use of benchmarks and impact studies, and by bringing more transparency into

the process. This will be instrumental for ensuring broad and sustained public support for the enlargement process."

The subsequent December 2007 European Council then went on to endorse these conclusions:

"The European Council takes note of the communication from the Commission on the Enlargement Strategy and endorses the General Affairs and External Relations Council conclusions of 10 December."

2. PROGRAMMING AND IMPLEMENTATION OF THE PROGRAMMES: GENERAL OVERVIEW

2.1. Phare, Turkey pre-accession and CARDS

With the introduction of IPA in January 2007, there were no new commitments in 2007 under Phare, the Turkey Pre-Accession Instrument or CARDS. The focus on implementation of previous years' programmes, including the reduction of backlogs where necessary.

Detailed information about Phare, Turkey Pre-accession financial assistance and CARDS can be found in the Annex - Part I: Country section - to this report.

2.2. Transition Facility

The Transition Facility for Bulgaria and Romania was established by article 31 of the Act of Accession to fund certain institution building actions to address the continued need for strengthening institutional capacity in certain areas through actions which cannot be financed by Structural Funds or by the Rural Development Fund. As such, this is an extension of the assistance provided before accession under the Phare programme. The implementation of EU assistance available under the Transition Facility is managed by the Memorandum of Understanding on the Implementation of the Transition Facility signed between the Bulgarian authorities and the European Commission on 21 June 2007 and between the Romanian authorities and the European Commission on 5 September 2007.

The amounts allocated to the National programmes for the 2007 Transition Facility are as follows:

Bulgaria	€31.5 million
Romania	€46.5 million

During 2007, the ten new Member States (Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia) which have benefited from the special Transition Facility for institution building created by article 34 of the Act of Accession since 2004, continued the contracting of projects under the 2005 and 2006 Transition Facility programmes and the implementation under the 2004, 2005 and 2006 Transition Facility programmes. This report covers the final year for contracting of the Transition Facility programme for these ten new Member States.

2.3. Moving towards Extended Decentralisation Implementation System (EDIS)

The Commission's objective is to enable the recipient countries of pre-accession assistance to manage Community funds under EDIS in order to acquire, before accession, sufficient practical experience in the management of a fully decentralised system, and thus prepare them to effectively manage Structural Funds upon accession (in a shared management environment). The decision by the Commission to allow the relevant implementing agencies to operate under EDIS will be given upon demonstration of their having appropriate resources, structures and systems in place for the effective and timely management of Community assistance.

The ten new Member States that joined the EU in 2004 have all operated under EDIS since 2005.

With regard to Phare and post-accession Transition Facility assistance, Bulgaria has operated under an Extended Decentralised Implementation System (EDIS) since July 2007. This implies that contracting and implementation of assistance has been, since then, under the full responsibility of the Bulgarian authorities. The assistance still to be implemented (around € 700 million) is managed by four accredited Implementing Agencies⁸.

Though the system as such has been set up and accredited on the basis of commitments taken by the Bulgarian authorities, shortcomings in terms of practical implementation and handling of the assistance remained to be addressed in 2007. The Commission has taken action to ensure that weaknesses highlighted in the accreditation are given the necessary attention by the relevant Bulgarian authorities⁹.

Romania has also operated under EDIS since the beginning of 2007, which means that is fully responsible for both tendering and implementation of the financial assistance programmes. The accredited Implementing Agencies¹⁰ are managing over €1.3 billion, representing Phare 2004/2005 programmes under implementation, and Phare 2006 under contracting and the further support after accession under the Transition Facility.

The Romanian system also showed some deficiencies during its first operating year, with mandatory conditions for its proper operation not being fully met. The Commission has expressed some concerns over the capacity of Romanian agencies to ensure a sound management of EU funds and decided to ask the responsible authorities to address the remaining shortcomings and to provide proof that progress has been reached in ensuring that pre-accession programmes are implemented under a sound extended decentralised implementation system.

As a consequence, substantial action has been taken by the authorities in addressing the remaining key issues. Romania managed to have a very good absorption rate for the 2005 pre-

⁸ CFCU, Ministry for Regional Development and Public Works, the Ministry for Labour and Social Policy, the Ministry of Economy and Energy

⁹ The 2007 Annual Activity Report raised a reservation concerning potential irregularities in management of PHARE funds under extended decentralised management by two Bulgarian Implementing Agencies (Central Finance and Contract Unit and Ministry of Regional Development and Public Works). On 23 July 2008, the accreditation of the two implementing agencies was temporarily withdrawn, see COM(2008)496

¹⁰ CFCU, Ministry of European Integration, Ministry of Labour

accession Phare programme. There is evidence that efforts are being made for the proper management of pre-accession and post-accession funds that still remain to be contracted.

The Commission is closely monitoring the operation of the system, as the capacity of the agencies managing the funds still needs to be strengthened and procedures in place need to be effectively applied in order to ensure that implementation of projects is timely and efficient and that results are effectively achieved.

Concerning the Western Balkans, only Croatia operates under the Decentralised Implementation System (DIS). The Commission decided to confer the management of Phare and CARDS programmes to the Croatian institutions under the authority of the National Authorising Officer on 7 February 2006 while maintaining the ex-ante control requirement for tendering and contracting. A follow-up audit on DIS conducted by DG Enlargement in 2006 highlighted several management deficiencies resulting in weak absorption and administrative capacities that need to be remedied. In light of this, DG Enlargement decided in December 2007 to temporarily suspend the endorsement of contracts under the Phare national programme 2006 until the Commission is satisfied with improvements judged against a set of benchmarks.

A highly critical follow-up audit report on the functioning of DIS in Turkey was finalised at the beginning of June 2007. Through reinforcement of the staffing of the Central Finance and Contracts Unit (CFCU) and the adoption of legislation strengthening the CFCU, the imminent suspension of DIS could be averted. Other critical shortcomings identified for urgent addressing through an Action Plan by Turkey concerned the insufficient supervision of line ministries through the Programme Authorising officer (PAO), a flawed practice of dealing with irregularities, a sub-standard quality control of procurement files through the PAO, as well as late procurement and contracting. Significant progress was achieved in strengthening DIS in the second half of 2007, including an acceleration of contracting, the reinforcement of the CFCU and the assertion of the authority of the PAO over the Senior Programming Officers (SPO) structures in the line ministries.

2.4. Co-ordination of the Community Pre-accession assistance

- SAPARD¹¹ aims to help candidate countries deal with the problems of the structural adjustment in their agricultural sectors and rural areas, as well as in implementing the *acquis communautaire* concerning the Common Agricultural Policy (CAP) and related legislation.
- ISPA¹² is directed mainly towards aligning the applicant countries on Community infrastructure standards. It finances major environmental and transport infrastructure.

Coordination between the different pre-accession instruments was carried out at the programming phase. The last programming exercise for SAPARD and ISPA instruments took place in 2006. As of 2007, all former pre-accession instruments have been replaced by IPA.

¹¹ For general information on SAPARD, we refer to the website of DG Agriculture.

¹² For general information on ISPA, we refer to the website of DG Regional policy.

3. CO-OPERATION WITH THE EIB AND INTERNATIONAL FINANCIAL INSTITUTIONS

The co-operation with the European Investment Bank (EIB) and other IFIs, in particular the European Bank for Reconstruction and Development (EBRD), and the Council of Europe Development Bank (CEB) in association with Kreditanstalt für Wiederaufbau (KfW), are organised under the amended Memorandum of Understanding of 26 April 2006 between the European Commission and participating IFIs for the enlargement countries.

Implementation of horizontal programmes has offered wide possibilities of IFI co-operation by allowing the extension of IFI loans combined with EU grants. These horizontal programmes have complemented the investment projects financed by national programmes.

Four types of programmes have been developed as follows.

The *SME Finance Facility* (SMEFF) has aimed at strengthening the capacities of financial intermediaries (i.e. banks, leasing companies) in beneficiary countries to expand and sustain their financing operations to SMEs. The SMEFF projects include the provision of loans, loan guarantees, and leases for local financial intermediaries in combination with non-reimbursable financial incentives. In turn, financial intermediaries on-lend or lease to individual micro-enterprises or SMEs. Since 2005, the only eligible countries have been Bulgaria, Croatia, Romania and Turkey. At the end of December 2007, the total amount of EU incentives earmarked for projects was EUR 300 million.

The *Municipal Finance Facility* (MFF) has intended to encourage local financial intermediaries to extend loans to the municipalities. The mechanism of the programme is similar to this one of the SMEFF. In 2007, the overall pace of development and signature of new projects was slower than expected owing to the high administrative costs, the delays in regulatory reforms in some countries, and the inexperience of the municipalities to prepare credit files. At the end of December 2007, the total amount of EU incentives committed into projects was €60 million.

As requested by the European Council in Nice in 2002, the EIB and the Commission established a *Municipal Infrastructure Facility* (MIF). The objective of the MIF is to contribute towards the social and economic development of border regions of the EU-15 Member States. To this end, the MIF combines loans from EIB resources with non-reimbursable Phare support to accelerate the completion of small local infrastructure investments. By the end of 2007, the Phare allocation had been fully earmarked for 24 municipal projects.

The *Energy Efficiency Finance Facility* (EEFF) was launched in 2006 to tackle the Climate Change issue. It aims at stimulating the energy efficiency investments in all types of building and in the industry sector by making appropriate financing available to the end-borrowers. The overall results of the programme will be savings in energy and a significant reduction of CO₂ emissions.

The EEFF combines IFI credit lines extended to financial intermediaries with incentives to improve the cost effectiveness of equipment and make the energy investment more attractive, and fees to the benefit of local financial intermediaries to encourage them to lend for the purpose of energy efficiency financing. The implementation of the EEFF started in April 2007 and by December the first projects were approved for a total amount of incentives of EUR 13.65 million.

4. MONITORING AND EVALUATION

The monitoring and evaluation functions aim firstly at monitoring and evaluating the financial support to the beneficiary countries in achieving pre-accession objectives by assessing the programme performance and deriving lessons learned. Secondly, it provides accountability with respect to the value of money and the use of pre-accession funds. A third objective is to support the development of local monitoring and evaluation capacity in beneficiary countries as a means to strengthen their capacity to manage and control pre-accession aid.

4.1. Monitoring and Interim Evaluation

In 2007, the interim evaluation (IE) scheme for Turkey generated one comprehensive country evaluation report for Turkey (TPAER) as well as two sector Interim Evaluation reports.

For Croatia, the IE scheme was introduced in 2007, focusing on the Phare programme. Moreover, an ad hoc evaluation for CARDS Croatia has been completed in 2007.

Specific interim evaluation results are described later on in Part II.3 in the Annex.

4.2. Ex post evaluation

The findings, conclusions and recommendations of the major ex post evaluation of Phare were discussed with the relevant stakeholders including the beneficiary countries at an Evaluation Seminar in April 2007. Another seminar was held specifically following up the ex post evaluation report's findings on Public Administration Reform.

Specific evaluation results are described in Part II.3.

5. OTHER ACTIVITIES

A number of other evaluation activities were undertaken by the Commission services in order to improve the quality of the programmes for the year 2007, as well as to support the development of local monitoring and evaluation capacity. Specific actions are described in Part II.3.