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(Information)

COURT OF AUDITORS

SPECIAL REPORT No 1/2002

concerning macrofinancial assistance (MFA) to third countries and structural adjustment facilities (SAF) in the Mediterranean countries, together with the Commission's replies

(pursuant to Article 248(4), second subparagraph, EC)

(2002/C 121/01)

CONTENTS

ABBREVIATIONS

ACP	African, Caribbean and Pacific States
BWI	the Bretton Woods Institutions (the International Monetary Fund and the World Bank)
DG	Directorate-General
DG ECFIN	Directorate-General for Economic and Financial Affairs
DG RELEX	Directorate-General for External Relations
Ecofin Council	Council Economic and Financial Affairs
EU	European Union
EDF	European Development Funds
FYROM	former Yugoslav Republic of Macedonia
GNP	gross national product
IMF	International Monetary Fund
MFA	macrofinancial assistance
OJ	Official Journal of the European Communities
SAF	structural adjustment facility
VAT	value added taxation

SUMMARY

Programme overview

I. The European Union helps third countries not only through specific programme and project assistance but also by supporting general economic transition and structural reform processes with assistance at a macroeconomic level. Such assistance is called 'macrofinancial assistance' (MFA) for third countries such as the EU accession countries, the western Balkans and the new independent States (1) and 'structural adjustment facilities' (SAF) (2) for the Mediterranean (MEDA) non-member countries.

Framework and legal basis

II. In the absence of a framework regulation, the MFA interventions are based on individual Council decisions. MFA is mainly given as loans. It is considered to be an exceptional instrument and is managed by DG ECFIN. The legal basis for SAF actions is the 1996 MEDA Regulation. SAF are given as grants, are not considered to be an exceptional instrument and were managed by DG RELEX, until 2001, when EuropeAid took over the management of SAF (see paragraphs 1 to 5).

Design of structural adjustment facilities

III. In relation to SAF, the Commission does not document the basis for decisions on the global amount of the programme nor the timing and amount of instalments. Therefore, the rationale for these decisions is not clear. In general, the amount of the support is not based on the specific cost of the associated reform programme (see paragraph 20). The programmes' conditions have focused on the presentation of legislation, action plans etc, which represent intentions rather than being based on results. Generally, the Financing Agreements do not clearly indicate which conditions are shared with the Bretton Woods Institutions (BWI) (3), and which are the Commission's alone. Many of the specific conditions relate to the social sector. However, structural adjustment specialists may lack a comprehensive view of social sectors and technical experts are not systematically consulted (see paragraphs 23 to 27).

Design of macrofinancial assistance

IV. EU MFA does not always respect the five principles (4) that the Ecofin Council agreed in 1995, which should govern the policy of MFA to third countries. For example, the assistance is in some cases regular and continuous rather than exceptional. The political preconditions (5) are not always fulfilled. So far, MFA has

(1) These regions are receiving MFA. In the past, Israel (1991) and Algeria (1991 and 1994) were also beneficiary countries.
(2) The EU also provides structural adjustment assistance to the African, Caribbean and Pacific States (ACP) (see paragraph 7).
(3) The International Monetary Fund (IMF) and the World Bank.
(4) Exceptional character, political preconditions, complementarity, conditionality and financial discipline.
(5) Geographical proximity to EU, full respect of human rights and rule of law.

developed primarily as an economic instrument (see paragraphs 34 and 35). The examination of complementarity between EU MFA and other EU assistance revealed problems of coordination within the Commission (see paragraphs 36 to 41). Although the principle of including conditions relating to political and economic reforms is always respected, many of these do not define clear and measurable performance criteria, and are not easily verifiable. Furthermore the principle of macroeconomic conditionality has been watered down when urgent and political constraints have been taken into account for a payment decision (see paragraphs 42 to 45).

Assessment of partner government's budgetary and accounting processes

V. In budgetary support operations, whether loans or grants, as the money goes directly into the partner country's budgetary system and its use cannot be distinguished from the rest of the budget, it is important that the budgetary and accounting processes in the country are reliable. The Commission has not made comprehensive specific assessments of the reliability of these processes in the countries to which it has provided support (see paragraphs 47 to 50).

Monitoring

VI. There are no job descriptions, no internal rules, and no specific tools in the Commission units responsible for monitoring setting out how to verify whether the reform policy in the beneficiary countries is satisfactory and whether the specific conditions are fulfilled. The Commission monitors its assistance in close contact with the IMF and the World Bank, and in many cases relies largely on work carried out by these financial institutions. In practice, the Commission does not require that all of the conditions are fulfilled in order for the country to receive a positive progress assessment and for the money to be disbursed. The decision to disburse may be influenced by many other factors and the Commission should explicitly justify its decision (see paragraphs 51 to 60).

Reporting and evaluation

VII. The annual report on MFA is comprehensive, however, the explanations concerning macroeconomic performance and structural reforms do not establish links and causalities with the assistance. The absence of evaluations (MFA) or their limited scope (SAF) means that the Commission has not yet fully implemented its general policy for the evaluation of Community expenditure programmes (see paragraphs 61 to 65).

Conclusions and recommendations

VIII. While the instruments certainly encouraged general economic transition and structural adjustment reform processes, there is considerable room for improvement. It is recommended that (see paragraphs 66 to 78):

— the added value of the European Union's interventions in comparison to the World Bank and the IMF should be more clearly established,

— consideration should be given to creating a more harmonised approach between, on the one hand, MFA for the EU accession countries, the western Balkans and the new independent States, and, on the other, SAF for the Mediterranean non-member countries, so that countries in similar situations are dealt with in a similar manner. Lessons learned from experience in ACP States should also be taken into consideration,

— the Commission should make its decision making for the various phases of the management of macroeconomic assistance more transparent, in particular on the considerations and criteria for the content of the financing agreement and for disbursements of the instalments,

— the Commission should document its justification for waiving conditions,

— the Commission's monitoring of the quality of financial management in beneficiary countries should be considerably improved and involve all relevant DGs,

— more priority should be given to carrying out evaluations.

INTRODUCTION

1. The European Union helps third countries not only through specific programme and project assistance but also by supporting general economic transition and structural reform processes with assistance at a macroeconomic level. Such assistance is called 'macrofinancial assistance' (MFA) for third countries such as the EU accession countries, the western Balkans and the new independent States and 'structural adjustment facilities' (SAF) for the Mediterranean non-member countries.

2. The instrument of MFA was initially created for intra-Community balance-of-payment support. Since 1990 MFA has been extended to third countries with a view to supporting their political and economic reform efforts. The Council decides MFA actions on a proposal from the Commission after consultation of its Economic and Financial Committee and of the European Parliament (see paragraph 28). The Commission (DG ECFIN) implements this assistance in consultation with the Economic and Financial Committee of the Council.

3. Since the mid-1980s, many of the south and east Mediterranean countries have carried out structural adjustment reforms in agreement with the BWI. The reforms focused on the reduction of budgetary and external deficits. As the macroeconomic situations in most Mediterranean partner countries improved, macroeconomic stabilisation objectives have become less important and programmes concentrate more on structural reforms. The Commission has supported these reforms through the provision of SAF.

4. The instruments have certain similarities. For both, the proceeds are as a rule disbursed in instalments to the central bank of the beneficiary country in order to strengthen its balance-of-payments situation or help finance the budget. The assistance is not allocated to specific categories of expenditure. There are no specific accounting requirements for the money disbursed. The assistance is generally released in successive instalments, the disbursement of each of them being conditional upon the fulfilment of agreed macroeconomic performance and structural adjustment criteria, based on the programmes of the beneficiary countries.

5. The Court noted three main differences in the design and implementation of MFA for third countries and SAF for the Mediterranean non-member countries:

(a) MFA is not seen as a permanent but as an exceptional instrument whereas SAF is considered to be a normal, even essential instrument. As a consequence there is no framework regulation for MFA ([1]) whereas SAF is governed by the MEDA Regulation ([2]);

(b) whereas SAF is always given as a grant, MFA generally takes the form of loans and only in some special cases are grants given;

(c) MFA is mainly managed by DG ECFIN, whereas the lead DG for SAF was DG RELEX. From 2001 EuropeAid took over responsibility for the management of SAF.

6. Given these differences, where appropriate, the Court makes separate audit observations for MFA and SAF. Otherwise comments are valid for both areas.

7. The EU also provides structural adjustment assistance to the African, Caribbean and Pacific States through the European Development Fund. Until recently, this aid was given in the form of targeted support to the budget channelled through so-called counterpart funds. The utilisation of these counterpart funds has been the subject of a recent special report of the Court ([3]).

([1]) However, according to its work programme DG ECFIN intends to elaborate a proposal for a Council decision on a framework agreement for MFA.

([2]) Council Regulation (EC) No 1488/96 of 23 July 1996, on financial and technical measures to accompany the reform of economic and social structures in the framework of the Euro-Mediterranean partnership (MEDA 1) (OJ L 189, 30.7.1996), modified by Regulation (EC) No 2698/2000 (MEDA 2) (OJ L 311, 12.12.2000).

([3]) Special Report No 5/2001 (OJ C 252, 14.9.2001).

FINANCIAL AND BUDGETARY SIGNIFICANCE

SAF in the Mediterranean countries

8. In total 955 million euro has been committed to the Mediterranean countries as SAF between 1992 and 2000, of which 600 million euro under the MEDA programme between 1996 and 2000 (1) (see the tables in *Annex I*). Payments made under the MEDA programme between 1996 and 2000 amounted to 470 million euro. Five countries benefited from these programmes: Algeria, Jordan, Morocco, Tunisia and Lebanon. Thirty-four per cent of all the funds committed for these countries under the MEDA programme were in the form of SAF. Jordan and Tunisia were the largest recipients of funds as SAF under the MEDA programme.

MFA to third countries

9. The disbursements for MFA for the years 1998, 1999 and 2000 amounted to 822 million euro, of which 704 million euro was given in the form of loans (85,6 %) and 118 million euro in the form of grants (14,4 %) (see *Annex II*). Nine countries/provinces benefited from these disbursements during this period: Bulgaria and Romania (EU accession countries), Bosnia and Herzegovina, former Yugoslav Republic of Macedonia (FYROM), Montenegro and Kosovo (western Balkans) and Armenia, Georgia and Ukraine (new independent States). For Tajikistan, Moldavia and Albania decisions were made, but no payments were executed during 1998 to 2000.

10. MFA to third countries given in the form of grants is covered by specific budget headings in the general budget of the European Union (2). In the case of loans the effect on the general budget (3) is limited to contributions to a Guarantee Fund (4). This fund is used should the debtor default (see paragraph 46).

THE COURT'S AUDIT

11. The main audit objectives were to assess:

(a) the rationale of the design of the instruments;

(b) the quality of the Commission's payment approval and monitoring process;

(c) whether the Commission fulfilled satisfactorily its reporting duty and made comprehensive evaluations.

12. Concerning MFA the Court reviewed all 23 disbursement operations for 1998 to 2000, including the underlying decisions (see *Annex II*). Bulgaria, as the largest beneficiary country for loans, was visited. The Court also visited the United Nations Interim Administration Mission in Kosovo on the occasion of an audit of the European Agency of Reconstruction.

13. For SAF the audit work included desk reviews in Brussels of the six programmes relating to Lebanon, Jordan, and Tunisia covering the period 1996 to 2000 (5) representing a total commitment of 450 million euro (see *Annex I*). In addition, a more detailed audit, including a visit to the delegation and to representatives of the national authorities, was carried out for the programmes in Jordan and Tunisia.

14. Information was also obtained from the World Bank and the IMF on the implementation of MFA and SAF.

DESIGN OF PROGRAMMES

SAF in the Mediterranean countries

Background

15. Initially the SAF programmes were governed by the fourth Protocol (6). This Community support consisted mostly of import support programmes, with the domestic counterpart value of the foreign exchange (the so-called counterpart funds) spent, in agreement with the Commission, on specified items or activities within the government's budget. The Court examined structural adjustment programmes in Mediterranean non-member countries in 1994 (7).

(1) The budget heading concerned is B7-4 1 0 MEDA (Measures to accompany the reforms to the economic and social structures in the Mediterranean non-member countries).

(2) An MFA budget heading for grants was introduced for the first time in the general budget of the European Union for the financial year 1998 (Article B7-5 3 1 'Exceptional financial assistance to Armenia, Georgia and Tajikistan'). The 1999 budget introduced a further Article (B7-5 3 2): 'MFA to the countries of the western Balkan region'.

(3) In the form of a p.m. entry in Chapter B0-2 1 (Guarantees for borrowing and lending operations to promote development in third countries).

(4) A Guarantee Fund for external action was established in 1994. Any defaults on repayments are covered by this fund within the limit of the amount available.

(5) In both Jordan and Tunisia there was one completed SAF and one ongoing SAF. In the case of Tunisia, there was also a health sectoral programme. In Lebanon, there was one ongoing SAF. All six SAFs examined were under the MEDA programme.

(6) Consisting of country Protocols signed (depending on the country) between 20 June and 18 September 1991, covering the period 1 November 1991 to 31 October 1996.

(7) See Court's Annual Report concerning the financial year 1994, paragraphs 11.9 to 11.81 (OJ C 303, 14.11.1995).

16. A Council resolution in June 1995 [1] introduced more flexibility to the management of the structural adjustment instrument. This included the possibility of direct budget support for countries with a freely convertible currency and of less earmarking of the counterpart funds, in cases where control instruments, and budget programming and execution had become more effective. As the macroeconomic situations in most Mediterranean partner countries have improved, macroeconomic stabilisation objectives have become less important and programmes concentrate more on structural reforms.

Framework

17. Following the Barcelona Declaration of 1995 [2], economic transition and the creation of a free trade area between the EU and its Mediterranean partners [3], and among the Mediterranean partners themselves, were the principal goals of EU financial cooperation with the Mediterranean region. The MEDA programme is the principal financial instrument of the European Union for the implementation of this Euro-Mediterranean Partnership. Its legal basis is the 1996 MEDA Regulation. It provides structural adjustment support as direct budgetary aid, without specific earmarking.

18. The MEDA Regulation states that operations in support of structural adjustment programmes should satisfy the following eligibility criteria:

(a) the country concerned must undertake a reform programme approved by the BWI or implement programmes recognised as analogous, in coordination with those institutions;

(b) account must be taken of the economic situation of the country, and particularly its level of indebtedness and its debt-servicing burden, the state of its balance of payments and the availability of currency, the budget situation, the monetary situation, the level of per capital GNP and the unemployment level.

19. The Commission has not provided adequate training for staff covering the evaluation of these criteria and their impact on the programme design. This poses particular risks given the major organisational changes that have taken place in the Commission in recent years, especially as responsibility for the implementation of SAF was transferred in 2001 from DG RELEX to EuropeAid. However, the Court notes that the Commission is now in the process of preparing a procedures manual.

Rationale of Financing Agreements

20. The amounts allocated to the beneficiary countries as SAF are the result of many factors and considerations such as the specific needs of the country in question, the amounts available in the EU budget and the country's capacity to carry out reforms. However, the Commission does not document the basis for decisions on the global amount of a programme, nor the timing and amount of the instalments. Therefore, the rationale for these decisions is not clear. The amount of the support is also not justified by linking it to the social or other costs of the reform programme. Some progress was made in this respect in the sectoral programme Tunisia Santé. Its financing proposal [4] includes an annex where the cost of the reform has been evaluated, but not linked to the amount of the programme either.

21. Although the adjustments or reforms to be carried out under the SAF are generally not of a short-term nature, SAF have so far been planned and approved on a stand-alone basis, without a long-term commitment for continuity in the programming.

Conditionality

22. SAF follows the principle of conditionality, which means that disbursement is conditional upon compliance with mutually agreed criteria.

23. The programmes' conditions have so far focused on the presentation of legislation, action plans, budgets etc, which represents intentions rather than actual results to be obtained. Thus the monitoring does not follow up whether the legislation is actually adopted and the reform actions ultimately carried out. For example, in Jordan, SAF I contained a condition that a competition law

(1) Recueil Vol. 2, 06/95-11/97.
(2) The Conference of EU and Mediterranean foreign ministers in Barcelona (27 to 28 November 1995).
(3) The 12 Mediterranean partners, situated in the Southern and Eastern Mediterranean are Morocco, Algeria, Tunisia (Maghreb); Egypt, Israel, Jordan, the Palestinian Authority, Lebanon, Syria (Mashrek); Turkey, Cyprus and Malta.

(4) Under MEDA 1, financing proposals of over 2 000 000 euro were submitted to a Committee (the MED Committee) of representatives of EU Member States which advises the European Commission in implementing the MEDA programme. The Committee gave its opinion on the proposals.

would be approved by the Cabinet. Although the Cabinet approved the law, it was not adopted by the Parliament. In Lebanon, two conditions for disbursement of the second instalment were formulated in terms of certain targets to be included in the Budget Law 2000 [1]. This implies that the Commission needs to follow up conditions systematically even after disbursement, given the need to take them into account when setting up new programmes. Given the human resources currently allocated by the Commission to the management of SAF, this is difficult, especially as monitoring is largely focused on ensuring conditions have been met before disbursement (see paragraph 53).

24. In Lebanon, the Commission decided to carry out its financing programme while the World Bank postponed its programme because of Lebanon's alarming macroeconomic situation at the time. In the absence of a World Bank financing programme, on whose appraisal mission the Commission could rely, a condition was added at a late stage, stating that 'the disbursement of the first instalment would take into consideration the examination of the IMF staff report for the 2000 Article IV consultation' [2]. At the moment that the first disbursement was planned to be made no IMF report was yet available. The disbursement was finally made after an Exchange of Letters between the Commission and the IMF. Although the IMF gave a rather mixed picture of the macroeconomic situation in Lebanon, the Commission, nevertheless, decided to proceed with disbursement as it considered that the conditions of the first tranche as defined by the financing agreement had been sufficiently met.

25. In order to be eligible to receive SAF support, Annex II to the MEDA Regulation requires that a country undertake a reform programme, approved by the BWI, or implement a programme, recognised as analogous, in coordination with those institutions. Generally, the Financing Agreements do not clearly indicate which conditions are shared with the BWI, and which are the Commission's alone.

26. The Commission has introduced specific sectoral conditions, usually relating to the social sector, in a general SAF. For example, Tunisia SAF II contained conditions relating to the reduction of State involvement and to the macroeconomic framework, as well as conditions relating to reforms to basic and higher education. Jordan SAF I contained conditions relating to population strategy and a birth-spacing programme. However, the effectiveness of the specific sector conditions is not ensured as for the preparation and appraisal of social sector conditions technical experts in the Commission are not systematically consulted and as structural adjustment specialists may lack a comprehensive view of social sectors.

27. In Jordan's and Tunisia's SAF I some conditions for the second instalment were left open at the time of signature of the Financing Agreement. It is clear that it can be difficult when negotiating a SAF to know in advance all the conditions that should be met by the second instalment, given that circumstances can change. However, leaving conditions open leads to uncertainty over how much is still open for negotiation. A contract like a Financing Agreement should not have such gaps and should at least lay down properly the criteria and the procedures for conditions to be negotiated at a later stage.

MFA to third countries

Framework

28. The legal basis for MFA to third countries has so far been provided by individual Council decisions taken on the basis of Article 308, EC [3] (former Article 235). There is no framework regulation defining the overall strategy and objectives, as MFA was not seen as a permanent but as an exceptional instrument. However, the Ecofin Council [4] agreed in 1995 on five principles which should govern the policy of MFA. The Commission indicated in its 2000 report on the implementation of MFA [5], that Community operations have continued to incorporate these principles, which are:

(a) exceptional character;

(b) political pre-conditions;

(1) i.e. reduction of budget deficit and increase in wages bill.

(2) Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

(3) Article 308, EC: 'If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures'.

(4) Conclusions of the Ecofin Council of 20 March 1995 on principles of MFA to third countries, which updated the Genval Ecofin conclusions of 9 October 1993 on MFA (the so-called revised Genval guidelines).

(5) Report from the Commission to the European Parliament and to the Council on the implementation of MFA to third countries in 2000 (COM(2001) 288 final of 1 June 2001).

(c) complementarity;

(d) conditionality;

(e) financial discipline.

29. The respect of these principles in the design of the programmes is analysed in paragraphs 30 to 46.

Principle of exceptional character

30. The first agreed principle is that MFA to third countries should remain exceptional in nature, as the Community is not an international financial institution like the World Bank or the IMF, considered to be the primary institutions to do such financing. Following proposals by the Commission, the Council made 10 decisions which were implemented during the three years examined, 1998 to 2000. In each case the Commission provided the Economic and Financial Committee with an information note, including an explanatory memorandum and a financial statement. These preparatory documents do not always clearly indicate why an exceptional character is considered to exist nor whether there is any added value to the European Union's contribution in comparison to the international financial institutions. Thus it is not made explicit whether the European Union follows the same objectives as the World Bank and the IMF or whether it has additional distinct objectives for its own action.

31. The number of countries/provinces considered to be eligible to receive exceptional assistance (19 at the end of 2000) is increasing steadily. The notion of exceptional character has developed in recent years in particular concerning the MFA given to Armenia, Georgia and Tajikistan, which is marked as 'highly exceptional'. In addition to the usual loans given, a grant is included in this assistance. The grant is made available only in so far as the net debtor position of the beneficiary countries towards the Commission is reduced by at least a similar amount ([1]).

32. The MFA given to Kosovo and Montenegro has a different exceptional aspect: not being sovereign States they cannot benefit from conventional IMF- or World Bank-supported programmes.

33. In a number of cases the MFA has become regular and continuous rather than exceptional. In November 1999 Bulgaria and Romania were promised assistance for the fourth time since 1991. Three other countries have received MFA three times.

Political preconditions

34. The second principle is that MFA should only be given to third countries which fulfil certain political preconditions: close political and economic links with the European Union, geographical proximity, full respect for effective democratic mechanisms including multiparty parliamentary systems, the rule of law and guarantees of human rights.

35. In practice, assistance is also provided to third countries in which these political preconditions are only partially met. Regarding geographical proximity, Armenia, Georgia and Tajikistan were not considered eligible according to Genval criteria (see footnote 4, page 8) as they do not fulfil this precondition. Regarding human rights, the Council and the Commission expressed their concerns ([2]), particularly as far as minorities are concerned, in some beneficiary countries. Nevertheless, the dialogue with the countries in question on the MFA support might provide political leverage to improve democratic mechanisms, the rule of law and to ensure human rights.

Complementarity

36. Complementarity between EU MFA and the assistance provided by other multilateral or bilateral donors constitutes the third agreed principle. EU assistance should be limited to a maximum of 60 % (for EU accession countries) or to one third (other countries) of total bilateral support ([3]), in order to ensure an adequate burden-sharing. The principle of complementarity has a second aspect: complementarity is also to be sought between EU macro-financial assistance and other EU assistance, which requires internal coordination.

37. In general, MFA is only mobilised if there is a significant residual external financing gap ([4]), over and above the resources

([1]) Under the 1 250 million euro Community credit facility made available to the new independent States in 1992 to import food and medical products, Armenia and Georgia benefited respectively from 58 million euro and 113 million euro in the form of loans. They were unable to comply with the time limits for repayment of the loan capital or interest. In order to facilitate the settlement of this debt problem, the Council decided in November 1997 to provide Armenia and Georgia with exceptional financial assistance in the form of a combination of loans and grants. This Council decision was amended in March 2000 in order to extend it to Tajikistan.

([2]) European Union Annual Report on human rights 2001, Council of the European Union, 8 October 2001.
European Initiative for Democracy and Human rights, Compendium 2000, programme financed by the European Commission

([3]) Support given by individual countries (not by multilateral institutions).

([4]) The Commission distinguishes between the remaining financing needs which exclude financial support from the IMF and the World Bank, and the residual financing needs, which take into account support from these institutions.

provided by the IMF and the World Bank, which is identified in common with them. Thus there is usually a close coordination with the IMF and the World Bank already at the planning stage. However, problems were encountered in cases where considerable time lags occurred between the planning of an operation and its implementation.

38. Concerning the fourth loan to Bulgaria decided in 1999 (100 million euro), more than one year passed between the first estimate of the residual financing needs and the actual disbursement to cover these needs. The Commission's original calculation of the assistance was based on an IMF estimate of the financing needs from September 1998. However, the residual financing needs estimated for 1999 diminished considerably ([1]). Therefore, the Commission's services considered that Bulgaria did not need to receive a disbursement in 1999. Nevertheless the first instalment of the loan was disbursed in December 1999 ([2]).

39. Concerning the disbursement of the second instalment of the loan to Bulgaria in September 2000 (60 million euro), there is no evidence that paragraph 9 of the Memorandum of Understanding between the Commission and the Bulgarian authorities was applied before the proposal for disbursement: 'The amount of the second instalment will be decided following a Commission review of Bulgaria's residual external financing requirements. Due account will also be taken of the effective mobilisation of financial assistance to Bulgaria by other bilateral donors …' In the absence of such a review at that time, it was not possible to establish if there were any residual financing needs for 2000 nor was it possible to establish whether the Community assistance to Bulgaria represented less than 60 % of total bilateral support given in 1999 and 2000 and therefore remained within the maximum limit for EU accession countries, which was set to ensure an adequate burden-sharing.

40. As far as complementarity and coordination between EU macrofinancial assistance and other EU assistance is concerned, the approach in Kosovo was not always harmonised between the different Commission services. The European Agency for Reconstruction, situated in Pristina and responsible for commitments of about 400 million euro in 2000, was critical of the efficiency of the United Nations Interim Administration (UNMIK). The UNMIK did not supply the reports on the utilisation of EU funds managed by the Agency despite several reminders, including a letter from the Commission in Brussels, pointing out that UNMIK was putting further payments at risk. At the same time the Commission's service responsible for MFA decided to disburse quickly the second instalment of the 35 million euro commitment relating to the Kosovo budget managed by UNMIK (see *Annex III, paragraph 1)*.

41. In the case of Albania in April 1999 the Council decided on MFA of up to 20 million euro in the form of a loan. However, there was still no payment by the time of the Court's audit (February 2001) because Albania benefited from a large inflow of other EU assistance, mainly in the form of grants (emergency budgetary assistance for costs related to refugees under the Food Security programme). As other countries are receiving MFA in the form of grants, Albania no longer seems willing to take loans. A cancellation of the loan agreement would seem to be appropriate.

Conditionality

42. Macroeconomic conditionality was agreed as the fourth principle. The assistance should generally be released in successive instalments, their disbursement being conditional upon the fulfilment of macroeconomic performance and structural adjustment criteria, based on the economic programmes of the beneficiary countries, as agreed in standby agreements with the IMF. The conditions should also take into account progress on opening mutual markets, in the context of the Community's external policy.

43. The review of all operations in 1998 to 2000 showed that this principle of conditionality has been taken into account throughout the period. However, some of the conditions do not define clear and measurable performance criteria, but are formulated in a general way with the result that they are not easily verifiable (e.g. Kosovo: 'take the appropriate measures to develop the necessary regulatory framework for the various priority sectors'; FYROM: 'the government will have made significant progress on the establishment of a merit system for civil servants').

44. The rationale behind the conditions is not always clear, because the relationship to overall objectives is not indicated. In the case of Romania, the design of the conditions is fragmented, and their relevance to the Accession process is not specified.

45. In general the assistance is disbursed in two or three instalments. Most of the schemes foresee a minimum period of three months between the first and the second instalment. For Montenegro this minimum period was fixed for only two months. Such planning creates expectations in the beneficiary State that the total amount of assistance will be disbursed quickly. However significant measurable macroeconomic progress is not normally

([1]) From USD 205 million in September 1998 to USD 71 million in September 1999.
([2]) This was reduced from 50 million euro to 40 million euro.

achieved over such a short period. In the case of Montenegro payments were made in January 2001 (i.e. after four and a half months), and this only after having softened the conditions for disbursement (see *Annex III(6)*).

Financial discipline

46. The fifth principle agreed by the Ecofin Council is the respect of financial discipline. This means that the amounts of the assistance should comply with the annual budget ceilings established by the Community's financial perspective, as well as with the rules and the agreed ceilings of the Guarantee Fund mechanism for external actions [1]. The Court audits the mechanism of the Guarantee Fund annually [2]. The Court has not noted any instances of non-respect of the principle of financial discipline.

ASSESSMENT OF PARTNER GOVERNMENT'S BUDGETARY AND ACCOUNTING PROCESSES

47. Recognising the fungible nature of funds provided under SAF the Commission made these available as untied budget support. Consequently, all provisions for the audit of SAF-related expenditure have disappeared from the Financing Agreements. However this has not been replaced by any more global control. In budgetary support operations, whether loans or grants, as the money goes directly into the partner country's budgetary system and its use cannot be distinguished from the rest of the budget, it is important that the budgetary and accounting processes in the country be reliable. A high degree of transparency, accountability and external control in the management of public resources is vital for ensuring good governance and in helping to combat fraud and corruption. The Commission should document its own assessment of these processes in the countries of the Mediterranean region, including the extent to which they have relied on work carried out by the international financial institutions. So far, no evidence was found that the Commission had made such an assessment.

48. An attempt was made by the Commission to raise the question of the reliability of the Government's budgetary and accounting processes as an element in the Financing Agreement for the Tunisian Education SAF but as this was done very late in the process this aspect was finally not included in the Financing Agreement. The introduction of this important issue was, however, not part of a general policy decision by the Commission applicable to all countries, but was rather started on an ad hoc basis.

49. A review of the reliability of the management of public resources was also largely lacking in countries receiving MFA support. A specific monitoring exercise was only carried out, to a very limited extent, by external technical assistance, in the case of Montenegro (see *Annex III(6)*). In ACP States a start has been made to coordinate action in this direction with the World Bank. The Court in its recent report has recommended that the Commission concentrate on monitoring closely the quality of the management of public finances [3]. Such a recommendation applies equally to all countries receiving budgetary support.

50. Lessons learned from the Commission's experience with these instruments should be taken into consideration by all DGs involved in budgetary support. For example, the Internal Audit Service of the Commission has also recently carried out an analysis of budgetary support given to ACP States [4]. This internal report makes a number of observations that are applicable to all countries receiving budgetary support. In particular, it stresses the importance of financial management issues at the level of the administrative capacity and accountability system of the beneficiary countries.

MONITORING OF MFA AND SAF

General observations

51. The Commission has the task of verifying whether the economic policies in the beneficiary countries are in accordance with the general objectives of such assistance and whether the conditions laid down are being fulfilled. However, there are no internal rules defining responsibilities, no job descriptions and no monitoring tools (e.g. checklists, operational framework, guidelines) in the units responsible for monitoring.

52. Programmes are mainly managed and monitored from Brussels. Before payments are made the Commission usually visits the

(1) The Guarantee Fund was established on 31 October 1994 by Council Regulation (EC, Euratom) 2728/94, and is drawn on if the beneficiary of a loan granted or guaranteed by the Community to or in a third country defaults. Article 14 of Council Decision 94/729/EC on budgetary discipline states that each year a reserve relating to loans and loan guarantees is entered in the general budget as a provision to cover the requirements of the Guarantee Fund. When submitting a new proposal for MFA in the form of loans the Commission provides information about the budgetary implications of the operation. Thus the required contribution to the Guarantee Fund is indicated as well as the consequences in case of a call on the budget guarantee.

(2) Court's Annual Report concerning the financial year 2000, Chapter 8 (OJ C 359, 15.12.2001).

(3) Special Report No 5/2001, paragraphs 40 to 44.

(4) Report on the managing, monitoring and control arrangements governing the use of counterpart funds and budgetary support in development aid (internal document, Brussels, 4.7.2001).

country concerned. The role of the delegation varies from one country to another. In many cases, the Commission's monitoring largely relies on work of the IMF and the World Bank, as many of the conditions are common.

53. The Commission's monitoring is rather intermittent, due to limited human resources. It is focused on the need to verify the fulfilment of conditions in order to approve the disbursement of the funds rather than a permanent monitoring of the economic and political conditions of each country.

54. In the process of monitoring the Mediterranean countries DG ECFIN, despite its specific expertise, is not closely involved and its role in this context is not clearly defined.

55. Overall coordination between the World Bank and the Commission was generally very good, particularly at the design stage. At the monitoring stage, the quality of coordination varied between countries, as regular close cooperation had not been systematically established but depended largely on individual personal contacts.

Approval of SAF payments

56. SAF under the first MEDA programme were supposed to be quick disbursing instruments. Although the Commission may have succeeded in making payments more quickly than for traditional projects, approval of payments and the consequent disbursements were still rarely made in line with the timetable indicated in the Financing Agreements. However, predictability of disbursements is important, once the conditions are fulfilled. It is essential for countries to know when the funds are going to arrive, particularly when they include the funds in their budgets. Otherwise negative effects on the reform process are to be expected. The IMF also underlined that coordination over the timing of funding is an important issue.

57. For the first SAF carried out under the MEDA programme delays in the approval of payment procedures were due to a lack of clarity in the division of responsibilities between the different DGs concerned. Coordination was not always good, resulting in divergent plans (for instance for the organisation of supervision missions).

58. For Jordan's SAF I there were delays in the payment as the competition law was not approved. Delay between February and July 1997 can be attributed largely to the Jordanian authorities which did not provide the Commission with the information considered necessary. However, delays were also caused because DG Competition was involved late in the process. In the end DG Competition's involvement was not used to best effect as DG RELEX decided to make the payment, based on the Jordanians' assertion that the changes DG Competition had proposed would be incorporated into law, without waiting for the results of a DG Competition mission to Jordan which was taking place at the time the payment was being processed. In the end the law concerned was not adopted by the Jordanian parliament.

Fulfilment of conditions

59. According to the Council decisions in the case of MFA, or the individual Financing Agreements in the case of SAF, the agreed conditions have to be fulfilled before payments can be made. Generally disbursements take place if there is a consensus view between the Commission and the World Bank and IMF on whether the beneficiary country has made enough progress towards the agreed reform agenda. In cases however where the World Bank and IMF do not have programmes (e.g. Lebanon and Montenegro) and also where the Commission has laid down its own specific conditions, it has to rely on its own judgement. In practice the Commission uses a certain margin of manoeuvre in judging the successful completion of the economic policy conditions. Emergency situations and political constraints are also taken into account when the Commission proposes a disbursement (see *Annex III*).

60. This approach means that in practice a country may receive a positive progress assessment and the money may be disbursed even though not all of the conditions have been fulfilled [1]. Whereas the need to have a margin of judgement is inherent to an instrument like SAF or MFA, the Commission has not always established clearly enough whether or not certain conditions had been fulfilled. In those cases, the justification for waiving conditions was not sufficiently documented.

REPORTING AND EVALUATION

SAF in the Mediterranean countries

61. In 2000 the Commission published an evaluation for the ACP States and Mediterranean countries receiving Community support for economic reform programmes and structural

(1) A similar point was made for ACP States. Court's Annual Report concerning the financial year 1999: report on the activities of the sixth, seventh and eighth European Development Funds, paragraph 35 (OJ C 342, 1.12.2000).

adjustment [1]. In order to improve current practices in these countries the evaluation made various recommendations, e.g. on improving the recipient countries' ownership of their reform programmes. It also recommended that conditions should be clear and verifiable, and not too centred on purely formal commitments to carry out reforms. Its scope was limited, however, by the fact that it was carried out at a time when only the first instalments of the first SAF under the MEDA programme had been paid. It recognised that as they had only been introduced in 1996, and only provisional data had been available for 1997, an in-depth evaluation was not possible. It means, that only the first instalments of the first SAF under the first MEDA programme have been independently evaluated. Although, the evaluation was overall positive about the impact of the SAF, it is questionable whether any judgement could have been given on the SAF's impact on that basis. The evaluation report itself recognised for these first instalments that certain conditions had been more or less fulfilled already at the time of the signature of the Financing Agreement.

62. Systematic independent evaluations of individual SAF as complete programmes have not been carried out [2]. The Financing Agreements do not include clear provision for evaluation of these programmes. In addition, although the Financing Agreements for the Mediterranean countries state that the recipient shall submit a report on completion of the project, this has never been systematically enforced.

MFA to third countries

63. The various Council decisions on MFA state that the Commission shall send to the European Parliament and to the Council a report (usually at least once a year, for some decisions by 15 September), which should include an evaluation of the implementation of the decisions. In compliance with this requirement the Commission established annual reports. The 1997 and 1998 reports were both published only in November 1999 and the 1999 report was not published until the end of October 2000 [3].

64. The 1999 report gives a general overview of MFA (background, developments in the current year, trends and tendencies, burden sharing) and also contains a description of the situation in each beneficiary country. Overall the report is comprehensive, however the explanations concerning macroeconomic performance and structural reforms would have more relevance if links and causalities with the assistance were established. The explanatory parts on the implementation of the decisions are very short and cannot be considered as evaluations. The Commission did not request independent external evaluations either for the activity as a whole or for individual countries. The MFA given to EU accession countries, to the new independent States and to the western Balkans was not subject to evaluations of the kind carried out for other countries receiving similar support (see paragraph 61).

65. The absence of evaluations for MFA means that the Commission has not yet followed its general policy for the evaluation of Community expenditure programmes. The SEM 2000 initiative introduced a generalised policy for evaluation of Community expenditure programmes. According to this 'the operational DGs and services are responsible for regular evaluation of their programmes and for organising the capacity needed for planning and managing the evaluations needed in their policy area' [4]. The operational departments should also integrate the programming of evaluations into their work plans [5]. These requirements are not met in the field of MFA managed by DG ECFIN.

CONCLUSIONS AND RECOMMENDATIONS

Introduction

66. The two instruments have given the Commission the opportunity to enter into more meaningful dialogue with governments over the whole reform process, something traditional development projects in particular do not usually allow. There has been an evolution in the nature of these instruments over the years and the Commission should continue to reflect, involving all the DGs concerned, on the best way these instruments can be used as part of its overall policy towards the beneficiary countries.

67. The Commission does not act on its own. In the context of MFA, the European Council underlined the fact that the European Commission is not an international financial institution like the World Bank or the International Monetary Fund. In that context it has been underlined that macroeconomic interventions should

(1) Communication from the Commission to the European Parliament and to the Council: Community support for economic reform programmes and structural adjustment: review and prospects (COM(2000) 58 final of 4 February 2000).

(2) The MEDA management team (composed of external experts) carried out an evaluation of the Moroccan programme. This was an interesting document with many pertinent points, which could be of interest for SAF in other countries.

(3) Report from the Commission to the European Parliament and to the Council on the implementation of MFA to third countries in 1999 (COM(2000) 682 final of 27 October 2000).

(4) Focus on results: Strengthening evaluation of Commission activities; communication to the Commission from Mrs Schleyer in agreement with Mr Kinnock and the President (SEC(2000) 1051, 26.7.2000, p. 3).

(5) Spending more wisely: Implementation of the Commission's evaluation policy, communication to the Commission by Mrs Gradin and Mr Liikanen, in agreement with the President (SEC(1999) 69/4).

be exceptional. The role of the European Union as a third international player in this area, however, has not been clearly defined and it is not made explicit what the added value of the EU contribution is supposed to be (see paragraphs 30 to 33).

Recommendation 1

68. The Commission should always establish the reasons why a separate EU action, with all its administrative consequences, is necessary. The expected added value should not only be indicated compared to existing programmes of the BWI. In the case of MFA, complementarity should also be ensured with the traditional EU project and programme assistance.

Consistent approach to similar instruments

69. MFA and SAF are similar instruments. In both cases the funds are fungible and are disbursed in instalments once the Commission is satisfied that the conditions, mainly aimed at supporting structural reforms in the economy of the beneficiary State, set out in an agreement between the Commission and the government, have been met. However, MFA for the EU accession countries, the western Balkans and the new independent States is considered as an exceptional instrument, given mainly as loans, whereas SAF for the Mediterranean non-member States is seen as a normal instrument, always given as grants (see paragraphs 1 to 5).

Recommendation 2

70. The Commission should find a more harmonised approach for assistance on a macroeconomic level. The way the management of these instruments is divided between the different Commission's services, including the role of Delegations, should be re-examined. Lessons learned from experience in ACP States should also be taken into consideration.

Design, conditions and monitoring of agreements

71. The process, which results in the agreements with the beneficiary countries is not clearly documented. In the case of MFA this concerns the relevance of the conditions to broader political objectives, e.g. EU accession (see paragraph 44). In the case of SAF this relates to the justification of the global amount of the assistance and its division into instalments (see paragraph 20).

72. Where conditions in agreements are common, the Commission's monitoring makes use of work carried out by the IMF and the World Bank. The Commission's own monitoring is intermittent. It is focused on the need to check the fulfilment of conditions in order to approve the disbursement of the funds rather than ongoing monitoring of the economic and political conditions of the country (see paragraphs 52 to 55).

73. Although the specific conditions of the individual programmes have to be fulfilled before payments can be made, it is understandable that, in practice, the Commission needs a certain margin of manoeuvre in judging the real efforts of the beneficiary State towards the achievement of macroeconomic policy and reform objectives. In addition, it may sometimes have to take into account unforeseeable events. However, the non-fulfilment of some conditions and the problems encountered were not always established in a transparent enough manner and corrective action was not always asked for with sufficient persistence (see paragraphs 22 to 27 and 42 to 45).

Recommendation 3

74. The Commission should make its decision-making clearer by establishing written guidance for the various phases of the management of macroeconomic assistance. It should also more clearly document its considerations when deciding the content of the financing agreements with the beneficiary countries, as well as when deciding the disbursements on the basis of the assessment of the conditions stipulated in the agreement. The Commission should document its justification for waivers in situations where conditions are not fulfilled.

Assessment of partner government's budgetary and accounting processes

75. The quality of the budgetary processes in the beneficiary States plays a crucial role during the whole reform process and should be a key condition when attributing untied budgetary support. A high degree of transparency, accountability and external control of the management of public resources is vital for ensuring good governance and in helping to combat fraud and corruption (see paragraph 50).

Recommendation 4

76. The Commission's monitoring of the quality of financial management in beneficiary countries should be considerably improved and all relevant DGs should be involved. The Commission should take fully account of any work carried out by the BWI in this respect whenever the Commission is going to rely on their work.

Evaluations

77. The absence of evaluations (MFA) or their limited scope (SAF) means that the Commission has not yet fully implemented its general policy for the evaluation of Community expenditure programmes. The Commission therefore does not benefit systematically from the possibilities of a structured learning process (see paragraphs 61 to 65).

Recommendation 5

78. The Commission should regularly carry out comprehensive evaluations in order to identify what lessons can be learned for policy-making, particularly as regards the suitability of reform programmes, the relevance of its conditions to the reform process and the alleviation of the social costs of the reform programmes.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 7 March 2002.

For the Court of Auditors

Juan Manuel FABRA VALLÉS

President

ANNEX I

FINANCIAL EVOLUTION SAF 1992 TO 2000

(Mio EUR)

	Country	Year started	Amount committed SAF 1992 to 2000	Total per country	SAF from Protocols	SAF from MEDA funds	Total SAF from MEDA funds per country	Total Funds under MEDA 1 [1] (1996 to 2000)	SAF as % of MEDA funds	Payments made under MEDA 1996 to 2000	Amount still open under MEDA	Amount still open under Protocols
1	Algeria	1992	70		70							35
2	Algeria	1996	125	195	95	30	30	250	12 %		30	
3	Jordan	1995	30		30						0	
4	Jordan	1995	20		20						0	
5	Jordan SAF I	1996	100			100				100	0	
6	Jordan SAF II	1999	80	230		80	180	254	71 %	80		
7	Morocco	1993	80		80						0	
8	Morocco	1996	120	200		120	120	656	18 %	120	0	
9	Tunisia	1992	40		40						0	
10	Tunisia	1996	20		20						0	
11	Tunisia (SAF I)	1996	100			100				100	0	
12	Tunisia (SAF II)	1998	80			80				40	40	
13	Tunisia Sante	1999	40	280		40	220	428	51 %		40	
14	Lebanon	1999	50	50		50	50	182	27 %	30	20	
	TOTAL		955	955	355	600	600	1 770	34 %	470	130	35

(1) All dotations, including SAF and non-SAF development programmes.

Source: Court of Auditors based on Commission data.

ANNEX II

MACROFINANCIAL ASSISTANCE TO THIRD COUNTRIES
Details on disbursements 1998 to 2000

(Mio EUR)

	Decisions	Disbursements						
	1997 to 2000	1998		1999		2000		Total
A. EU ACCESSION COUNTRIES								
Bulgaria III	250	125	(February)					125
Bulgaria III		125	(December)					125
Bulgaria IV	100			40		60	(September)	100
Romania IV	200					100	(June)	100
B. WESTERN BALKANS								
Bosnia I	60			15	(December: grant)	10	(December: grant) (1)	25
Bosnia I				10	(December: loan)	10	(December: loan) (1)	20
FYROM I	40	15	(February)					15
FYROM II	80					10	(December: loan) (1)	10
FYROM II						20	(December: grant) (1)	20
Kosovo	35					20	(March: grant)	20
Kosovo						15	(August: grant)	15
Montenegro	20					7	(August: grant)	7
Montenegro						13	(December: grant) (1)	13
C. NEW INDEPENDENT STATES								
Armenia	265 (2)	28	(December: loan)					28
Armenia		8	(December: grant)	4	(December)			12
Georgia		110	(July: loan)					110
Georgia		10	(August: grant)	9	(September)			19
Ukraine III	150			58	(July)			58
TOTAL LOANS	980	403		121		180		**704**
TOTAL GRANTS	220	18		15		85		**118**

(1) Payment request in 2000, disbursement in January 2001.
(2) Common decision for Armenia and Georgia.

Source: Court of Auditors on basis of Commission data.

ANNEX III

FULFILMENT OF CONDITIONS

Kosovo

1. In Kosovo the strict respect of all conditions was not considered necessary for the decision of the Commission to propose the disbursement of the second instalment of the grant to the Region's budget (15 million euro). UNMIK had not been able to make the progress expected in consolidating the budget. Major problems on the revenue side included the failure to introduce a wage withholding tax of 15 % [1] and the delay in introducing a profit tax. The public utilities were a major problem on the expenditure side (e.g. inadequate billing system for electricity) [2]. In the absence of an increase in budgetary revenue there was a continuing need for a high level of budgetary support. In June 2000 there was a real danger of a cash shortage in the Kosovo budget and international donors were asked to provide cash. The second instalment was released because of these urgent financing needs. However, this speedy disbursement compromised the principle of macroeconomic conditionality, in spite of the Commission coming to the overall conclusion that the specific conditions attached to the EU budgetary support were met 'to a large extent'.

Bulgaria

2. The Court's audit in Bulgaria in April 2001 revealed that in the area of bank privatisation the State bank Biochim was still not yet sold, as it should have been according to the conditions. Representatives of the Ministry of Finance, the IMF and the World Bank expressed their view that the condition regarding the sale of the State bank Biochim was unrealistic. The World Bank's representatives also commented that they did not consider it a good idea to specify that individually named enterprises should be privatised at a specific date, as this could have an adverse effect on the sales price.

3. In the environment area Bulgaria was required to adopt legislation in full conformity with the EU directive on environmental impact assessment. In April 2000 the delegation considered that the condition was not met. In July 2000 DG ECFIN judged that the condition has not been fulfilled in formal terms but 'there has nevertheless been substantial progress towards achieving this'. It was the assessment of DG ECFIN that progress was sufficient to allow the release of a second instalment. However by April 2001 although a new law on environmental impact assessment had been drafted, it had still not been adopted by the Bulgarian parliament.

4. The Commission considered the environmental condition to be fulfilled in the context of the loan (bringing legislation into full conformity with the EU directive on the EIA). However in the regular report on Bulgaria's progress towards accession prepared by DG Enlargement (November 2000) the Commission stated that further legal changes will be needed to fully conform to EU requirements on the EIA.

5. Concerning the previous loan to Bulgaria, decided in 1997 (250 million euro), the Commission considered splitting the second instalment in two, as the conditions for preparation for the European Union were only partly met. However, the information resulting from the monitoring process was finally not taken into account and the whole amount was disbursed.

(1) There are important concerns of equity, as locals employed by the UN are exempted from taxation under the UN convention. UNMIK has tried (letter of 25 May 2000 by Mr Kouchner to the Secretary-General of the UN), so far without success, to propose that in the specific case of Kosovo these exemptions would not be applied.

(2) See report concerning the financial accounts of the European Agency for Reconstruction and the implementation of aid for Kosovo for the year 2000 (OJ C 355, 13.12.2001).

Montenegro

6. In November 2000 a first report was produced by a consultant which pointed out major problems with regard to budget transparency and completeness (e.g. 'cash figures do not give a true picture of budget execution'). In the final report the consultant concluded that 'Montenegro has made substantial progress — greater in some areas than in others — in meeting the conditions'. Concerning the condition 'Enhancement of fiscal and budgetary transparency' the report noted on the one hand that 'Montenegro has fully met the conditions relating to budget classification' and on the other hand that 'nevertheless, Montenegro still has some way to go in meeting international standards for fiscal transparency' (Montenegro only complied with three out of 20 of the IMF's code of good practices principles on fiscal transparency). The consultant did not make a clear recommendation for or against a disbursement decision. The Commission's proposal to the Economic and Financial Committee concerning the disbursement of the second instalment (under certain conditions), was, however, made even before this final report was available. The Commission carried out its own mission to Montenegro at the beginning of December 2000 and also found that 'substantial progress had been made in a number of areas while more action is needed in others' (e.g. unsatisfactory progress in strengthening of the role of the Ministry of Finance; little progress with regard to the reform of income taxation and clearance of arrears; expenditure control not satisfactory). The Montenegrin authorities were asked to take rapid action. To a certain extent the conditions were renegotiated and softened so that Montenegro could comply with them already in December 2000. As planned the Commission disbursed 12,95 million euro in January 2001.

Jordan

7. The analysis prepared by the Commission concerning the release of the first instalment of Jordan's SAF II explained that the introduction of VAT had been delayed but nevertheless concluded that the related condition is complied with.

Tunisia

8. For Tunisia's SAF 1, instalment two, an analysis by the Commission of how far conditions had been met concluded that a condition relating to the offer for sale of five public companies had been fulfilled although only two such operations had been carried out. The Commission released instalment two of Tunisia's SAF 1 in December 1997 after the financial controller's signature was obtained, even though it was recognised that five conditions had been only partially fulfilled. This money was transferred in euro to the Tunisian Central Bank. According to the Financing Agreement the corresponding value in dinars was then to be transferred to the budget following the double signature of the national coordinator and the Head of Delegation ([1]). The Head of Delegation did not sign until July 1998 as only then did the Commission consider that all the conditions had been met ([2]). Given this, the only explanation for having transferred the money in December 1997 could be that the Commission sought to improve its apparent rate of budgetary execution. No interest was ever paid on this amount, which remained in the Tunisian Central Bank's account for over six months.

([1]) The requirement for a double signature serves no useful purpose in the case of direct budgetary support managed from Brussels. The decision as to whether the conditions have been satisfied should be made once on behalf of the Communities. It should not be a two-stage process.

([2]) The condition relating to the offer for sale of five public companies was considered to be fulfilled and consequently was not followed up further.

THE COMMISSION'S REPLIES

SUMMARY

I and II. Although similar in a number of aspects, MFA (macrofinancial assistance) and SAFs (structural adjustment facilities) are designed differently and are meant to address different needs.

MFA is an exceptional instrument (based on ad hoc Council decisions) and is designed to help the beneficiary countries in dealing with serious but generally short-term macroeconomic imbalances (serious balance of payments and fiscal difficulties).

MEDA SAFs are regular instruments of financial cooperation with the beneficiary countries. They address more long-term budgetary needs associated with the development process of these countries and are decided in the context of the normal programming exercise applying to all operations implemented under the MEDA Regulation.

III. The amount allocated to an SAF takes into account the costs of the reforms supported by the operation and since 2001 is documented more fully. The Commission conducts close discussions with the country and the international financial institutions (IFI), in particular the International Monetary Fund (IMF) and the World Bank (WB) to coordinate action and to assess the country's real needs. In the case of SAFs, synergies with the World Bank are considered important, either as parallel operations with identical conditionality (to increase joint leverage and avoid 'donor splitting' by the beneficiary) or in the form of self-standing EU operations which further the goals of the association agreements to which the World Bank attaches great importance.

As SAFs accompany the reform programmes of the Mediterranean partners, a fixed timetable of disbursements is not required (instalments are released only upon compliance with conditionality). This is because (a) the rhythm of reforms of the partner country should be respected and (b) SAFs are not exceptional instruments to be used in the urgent financing of internal and external deficits.

IV. Although the Ecofin conclusions referred to by the Court are informal and not legally binding, the bulk of MFA follows the principles. Some exceptions may occur, which is not unexpected given the nature of the programme, though these are known about and subject to appropriate review.

Coordination, by its nature, can always be improved, but it is felt that there is generally a good balance achieved between coordination and action activities.

V. All the countries concerned by such aid are regularly subjected to IMF Article IV review, when budget implementation and the quality of the data concerning public finances are examined and evaluated. These provide a major input to assessing the quality of budgetary and accounting processes.

VI. Highly qualified and experienced staff, who have contacts with specialists and independent experts, are dedicated to the programmes. It is appropriate that the Commission works closely with the IFIs and uses the same information, as in many cases the objectives are the same. Disbursement can be based on an overall evaluation of the achievement of set objectives though all relevant available information should be weighed up to arrive at an appropriate conclusion. Some actions which may not have been foreseen in an original agreement may be important in achieving the overall objective.

VII. The Commission produces a report, which exceeds the minimum requirements. However, it is looking for continual improvement and as a result of a focus on evaluations the report should be further improved in the future with details of these results.

VIII. A systematic effort is made to ensure adequate complementarity with IMF/WB programmes. Generally the mobilisation of MFA and SAFs is associated with additional reform efforts required from the recipient partner countries. More evaluations are foreseen as part of the reform process which also includes output criteria. They should allow a better assessment of the value added of the EU interventions.

Although these two instruments are designed differently and pursue somewhat different objectives, an effort is under way to ensure consistency in their implementation procedures. The observation of the Court will be taken into account in this context.

The Commission will ensure, in all cases, that reasons for granting waivers are adequately documented.

This is foreseen as part of the general reform.

INTRODUCTION

4. Macrofinancial assistance (MFA) is an exceptional instrument (based on ad hoc Council decisions) designed to help beneficiary countries in dealing with mainly short-term macroeconomic imbalances.

In contrast, Structural adjustment facilities (SAFs) are a standard instrument of economic cooperation, aimed at supporting the beneficiary countries in their reform efforts over a long period.

DESIGN OF PROGRAMMES

19. As part of the reform of the management of external aid, the Commission is planning to draft a manual of procedures and to provide specific training on this manual.

The Commission believes that the necessary expertise exists within the departments managing these instruments to guarantee effective evaluation of the performance criteria associated with implementation.

20. The amount allocated to an SAF takes into account the costs of the reforms supported by the operation and since 2001 is documented more fully.

21. Through the Country Strategy Papers 2000 to 2006 exercise and the three-year indicative programmes 2000 to 2002, Commission departments have managed to provide, for the medium term, a structure for setting up SAF operations. In this way it is possible to expand, year by year, the scope of the reforms required for the modernisation of the country, in a framework which guarantees the coherence of EU support.

23. See the reply to paragraph 53.

24. The withdrawal of the World Bank was in part due to Lebanon's economic situation. There were extremely close consultations with the IMF and WB on the maintenance of the SAF. Both the IMF and the WB strongly urged the Commission to continue its operation so that there would be one way of bringing pressure to bear on the reform policy in Lebanon.

Although the Article IV consultations were delayed, the IMF, which was keeping a constant watch on the situation in Lebanon, was able to inform the Commission about all the necessary developments.

Meeting the conditions for the first tranche meant that preparations for VAT, the key item in fiscal reform in Lebanon, could be completed and the deadlock was broken in the negotiations on the association agreement. This justified disbursement, even though we made a point of expressing our deep concern about the macroeconomic situation in a letter from the Commissioner to the Finance Minister dated 28 July 2000.

The Commission opted for a non-binding formulation to demonstrate that it was reserving its freedom of judgement in relation to the IMF.

25. In the case of SAFs, synergies with the World Bank are considered important, either (a) in the form of parallel operations with identical conditionality so as to increase joint leverage and to avoid 'donor splitting' by the beneficiary or (b) in the form of

self-standing EU operations, not incompatible with World Bank ones, but furthering the goals of the association agreements to which the World Bank attaches great importance.

26. In each of the cases to which the Court refers, the Commission made a point of consulting the experts from the World Bank, who shared all their knowledge of the social sector. More generally this dialogue allowed the Commission departments to establish a balance in the nature of the actions covered by the programmes.

27. Only in exceptional cases have second tranche conditions been left open. However since January 2001, the Commission has not left any open conditions relating to second tranches in any SAF agreements.

28. The Genval informal Ecofin conclusions referred to by the Court provide general guidance for the design and implementation of MFA. However because of its ad hoc character, each macrofinancial or exceptional financial assistance decision sets *de novo* the principles and the conditions of implementation of the corresponding assistance package.

30. The motivation of the Commission's proposal, including its assessment of the factors that justify financial intervention by the Community, is generally laid down in the explanatory memorandum accompanying the Commission's proposal. The existence of a residual external financing gap in the recipient country's balance of payments (after financing from the international financial institutions has been taken into account) is an important, but not a sufficient condition for this type of assistance to be initiated.

The expected added value of the Community's intervention derives from the very nature of macrofinancial assistance. The assistance is generally made available to partner third countries, which are geographically close to the EU and maintain important political and economic links with it. This type of assistance complements financing provided by the relevant IFIs and its objectives are therefore consistent with those agreed by these institutions and the recipient country. However, the economic policy conditions (notably on structural reform) attached to the implementation of the assistance are also inspired by the economic cooperation agenda between the EU and the recipient country, as set out in association or cooperation agreements.

31. The Commission has put forward proposals for macrofinancial assistance when there were residual external financing needs, over and above those that could be covered by the IFIs.

The characteristics of the exceptional financial assistance to Armenia, Georgia and Tajikistan were similar to those applying to other macrofinancial assistance programmes with in particular:

— the necessity of being current on its external financial obligations towards the Community before being allowed to benefit from a new assistance package,

— a grant element justified by the exceptionally difficult economic and social situation in these countries and their limited debt-servicing capacity, as in Albania, Kosovo or Bosnia and Herzegovina,

— grant disbursements subject to the fulfilment by the beneficiary countries of macroeconomic and structural reform conditions.

The requested reduction in the net debt position of Armenia, Georgia and Tajikistan was designed to ease the debt-servicing obligations of these low income countries

33. It is necessary to put the implementation of macrofinancial assistance within a broader perspective.

In the early 1990s during the first years of the transition from central planning to market economies of most of the countries in central and eastern Europe, many of these countries benefited from one-off assistance packages (Hungary, Czech and Slovak Republics, Baltic countries). The fact that macrofinancial assistance has been provided repeatedly to a limited number of countries (notably, Romania, Bulgaria and Ukraine) of eastern and south-eastern Europe simply demonstrates that the transition process to the market economy has in some cases been complex and discontinuous. Because of difficult political circumstances, the necessary structural reforms have been delayed or imperfectly implemented in some countries and exceptional circumstances have reappeared.

35. With regard to the geographical proximity Armenia and Georgia can in many respects be regarded as European NIS. With the possible accession of Turkey, they will even become the EU's immediate neighbours, like Belarus, Ukraine and Moldova. They are of strategic interest to the Community, since their macroeconomic and political stability is essential to adequate energy supplies to Europe through the oil and gas corridors linking it to central Asia. These countries are linked to the European Union by a special relationship through their Partnership and Cooperation Agreements and important programmes like Traceca and Inogate. The case of Tajikistan is somewhat different, but the country's stability is also essential to central Asia's stability and to the proper functioning of the oil and gas corridors.

Although it is recognised that further progress in the area of human rights is required in some of the countries concerned, the Commission considers that the political preconditions have so far been respected and no country with a dubious track record in the respect of democratic principles and human rights is presently benefiting from an active MFA programme.

38. The Community assistance is generally decided at a particular point in time and committed on the basis of the estimated average residual financing needs of the recipient country's balance-of-payments, in the context of an IMF-supported programme. The disbursements take place, when the conditions of this assistance are fulfilled, in principle during the programme period, but irrespective of the balance-of-payments effective needs (which are constantly varying during the period) at the time of the disbursements (unless unexpected circumstances arise, the programme is discontinued or a reassessment of the external financial situation has been explicitly foreseen from the outset). This is the only practical way to implement financial assistance of this type and is the approach adopted by all major official donors.

39. As reflected in Annex II(1) to the Commission report to the European Parliament and to the Council on the implementation of macrofinancial assistance in 2000 (COM (2001) 288 final), Community assistance to Bulgaria in 1999/2000 represents about 50 % of the total bilateral support made available to this country (see also reply to paragraph 38).

40. In the view of the Commission, UNMIK had made particularly good progress in establishing a macroeconomic framework under very difficult circumstances. This included e.g. setting up a central fiscal authority ensuring fiscal control and the development of a revenue base. This justified in the Commission's view the release of the second payment.

This positive appraisal was corroborated by the positive appreciation of Kosovo's economic transformation from the IFIs and other international bodies. As appropriate when taking its decision, the Commission also took into account the external financing needs and the urgency. The Pristina office of the European Agency for Reconstruction was not responsible for determining whether the conditions necessary for releasing the second payment had been met. It was deemed appropriate to proceed with the implementation of macrofinancial assistance when conditions specifically attached to it were fulfilled, rather than introducing cross-conditionalities thereby running the risk of stalling progress in the area of the economic framework and the provision of basic services to Kosovo.

41. When the Kosovo crisis erupted, the Commission decided to provide Albania with emergency budgetary support (a grant) of up to EUR 67 million to help the country to cope with the presence of a larger number of refugees. Although only EUR 33 million was ultimately disbursed, because the refugees returned more quickly than anticipated, Albania then decided not to take advantage of the loan support already approved. This assistance is no longer programmed and the Commission agrees, could be cancelled.

43. MFA drawn up on policy-based conditionality may sometimes need to be formulated in general terms, so as to take into account complex circumstances and leave a margin of judgement. In the case of the two examples, the Commission would observe:

— with regard to Kosovo, at the second Donors' Conference of 17 November 1999, UNMIK, the European Commission and the World Bank presented detailed programmes and documentation. These documents described priority areas for which regulatory frameworks had to be established (e.g. energy, water and waste, transport, telecommunications, etc.). Results can be assessed on the basis of preparatory documents (e.g. the White Paper for private sector development), draft regulations (circulated in the JIAS or sent to the legal office) or adopted regulations,

— the condition mentioned in the case of FYROM was inspired by the World Bank's public expenditure and institutional review action plan. This action plan sets out certain steps to be undertaken, but was not very specific on the timetable to be followed (as most of the timetable was relative to the creation of the Civil Servants Agency). Therefore, it was deemed appropriate to formulate the condition broadly and to use the World Bank action plan for assessing whether the authorities had 'made significant progress'.

44. All the conditions associated with the 1999 macrofinancial loan to Romania were key issues identified in the Commission's opinions and regular reports of 1997, 1998 and 1999.

45. At the time of the action, Montenegro both faced a very complex and difficult external environment and was embarking on a transition period that involved institution-building and modernising the administration. The assistance needed to be implemented urgently for political, economic and financial reasons. Against this background, it was decided to reduce the usual minimum interval between disbursements from three to two months. The structural reform conditionality attached to the disbursement focused on the budgetary sphere, notably on the enhancement of fiscal and budgetary transparency, where it was considered feasible for the authorities to make satisfactory progress within two months.

However, as the Council decision made clear, the two-month period was a minimum and the assistance could not in any case be disbursed until conditions had been fulfilled. The actual disbursement of the second tranche took place four months after the first tranche precisely because of unsatisfactory compliance with the conditions.

ASSESSMENT OF PARTNER GOVERNMENT'S BUDGETARY AND ACCOUNTING PROCESSES

47. The MEDA countries are subject each year to an IMF Article IV review, when budget implementation and the quality of

the data concerning public finances are examined and evaluated. The reason why the Commission did not conduct a specific evaluation of these matters was because it works in close coordination with the World Bank, which carries out reviews of public spending in the region, and with the IMF, including its fiscal department, on all the fiscal aspects. These provide a major input to assessing the quality of budgetary and accounting processes.

48. The guide to budgetary aid procedures currently in preparation states that the assessment of public finances is one of the main steps in the preparation of a budgetary aid operation.

49. When macrofinancial assistance is used for its usual purpose of strengthening the country's external reserves, a close monitoring of the beneficiary country's national budget is not the main focus. The government is not expected to use the money paid to the central bank, since an increase in external reserves is not automatically translated into an increase in the Central Bank's credit to the government. The IMF quantitative targets monitoring is a sufficient guarantee in this respect.

When macrofinancial assistance is paid directly to the national budget (e.g. Kosovo, Montenegro), it is appropriate to monitor this budget. In this respect, the Commission services benefited from the overall budgetary monitoring implemented by the IFIs, by the EU pillar of the UN administration in Kosovo and by a consultant in Montenegro.

50. The Commission agrees that lessons learned should be duly taken into account. It also agrees with the importance of assessing the quality of public finance management in countries benefiting from budgetary aid, a major point emphasised by the IAS report. The Commission consults with donors including the World Bank and the IMF on the assessment of public finance management.

MONITORING OF MFA AND SAF

51. With regard to MFA, there are internal rules and procedures, although not always strictly formalised. The informal character of such rules and procedures results from the exceptional nature of the instrument.

The responsibility for the implementation of macrofinancial assistance lies with the geographical Units, but the adviser in charge of coordination of financial assistance supervises all operations and ensures overall consistency.

53. Commission departments, including the delegations, regularly monitor the economic and political developments of the beneficiary countries.

In implementing its programme of deconcentration of staff to the delegations, the Commission is enhancing their capacity to monitor the political and economic conditions in beneficiary countries.

55. While retaining its freedom of judgement, the Commission now systematically coordinates its action with the World Bank.

56. The rationale of SAFs (accompanying the reform programmes of the Mediterranean partners) does not require the establishment of a fixed timetable for disbursements. Payment of instalments is made only when conditionality is met. The rhythm of reforms of the partner country should be respected. It should be recalled that SAFs are not exceptional instruments used in response to short-term urgent external financing needs.

58. As foreseen in the Memorandum of Understanding defining disbursement conditions the Government of Jordan approved a draft competition law taking into account the comments of DG Competition. This draft was submitted by the Government to the parliament in 1997. Since then parliamentary committees have discussed the draft and sent it back several times to the Government with request for amendments. Unfortunately, in April 2001 the parliament refused the law. In conclusion, the interlocutor of the Commission, the Government of Jordan, has fully complied with the conditions as set out in the Memorandum of Understanding.

59. It is correct that there is generally consensus between the Commission and the IMF/World Bank about progress in the adjustment and reform process of the recipient countries. However, the Commission decisions concerning disbursements of macrofinancial assistance and of SAFs are taken independently.

60. The Council decisions authorising macrofinancial assistance operations stipulate that the Commission is responsible, in consultation with the EFC and in coordination with the IMF, for agreeing with the authorities of the recipient countries the conditions of the macrofinancial assistance operations and for verifying that these conditions have been fulfilled. The Commission endeavours in all cases to document fully the reasons for waiving conditions. The same approach is applied to SAFs (see also paragraph 74).

REPORTING AND EVALUATION

61 and 62. All the SAFs approved since 2000 include a financial provision to carry out a final independent evaluation of the programmes. The Court's comment about the report to be submitted by the recipient country will be taken into account for current and future programmes.

62. An evaluation of macroeconomic policy support is planned for 2004/05. It is not planned to cover MFA. Once the evaluation report is finalised, it will be made available on the Commission's website.

63. Substantial progress has recently been made: the Commission adopted the report on the implementation of macrofinancial assistance in 2000 (COM(2001) 288) on 1 June 2001.

64 and 65. The structural reform analysis contained in the annual report broadly corresponds to the policy-based conditions agreed with the beneficiary countries. However, given the sensitivity and the confidential character of the reforms agreed in the Memoranda of Understanding with the beneficiary countries' governments, the link between our analysis and the precise conditions attached to operations is generally not made explicit.

The Commission is planning to initiate independent evaluations of MFA programmes from 2003 onwards.

CONCLUSIONS AND RECOMMENDATIONS

66. The Commission shares the views of the Court and is presently exploring the best way to structure and implement these policy-based instruments so as to enhance consistency and efficiency.

67. As mentioned under paragraph 30, the MFA is generally made available to geographically close partner countries with important economic and political links with the EU. It complements financing provided by the relevant IFIs and its objectives are therefore consistent with those agreed by these institutions and the recipient country. However, the economic policy conditions (notably on structural reform) attached to the implementation of the assistance are also inspired by the economic cooperation agenda between the EU and the recipient country, as set out in association or cooperation agreements.

68. In the case of SAFs, synergies with the World Bank are systematically sought, either (a) in the form of parallel operations with identical conditionality so as to increase joint leverage and to avoid 'donor splitting' by the beneficiary or (b) in the form of self-standing EU operations, not incompatible with World Bank ones, but furthering the goals of the association agreements to which the World Bank attaches great importance.

In the case of MFA, the justification of a separate EU action is made explicit in the explanatory memoranda of the relevant Council decisions. Consistency is always sought with other EU instruments. (see reply to paragraph 30).

69. MFA and SAFs have different objectives as they aim to fulfil different needs although certain operational elements are similar, as noted by the Court.

70. The Commission wishes throughout its operations to harmonise its approach where possible while ensuring sufficient flexibility to cope with different requirements.

73. With respect to SAFs, the guide on budgetary aid, which is currently being prepared by AIDCO, takes into consideration several of the Court's recommendations. See also replies to paragraphs 60 and 74.

74. The Commission is working towards the establishment of a more systematic set of rules and procedures that should apply to financial instruments with macroeconomic implications. For instruments like MFA and SAFs, implementation is generally subject to the satisfactory fulfilment of policy-based conditionality. This type of conditionality may sometimes need to be formulated in broad terms, so as to take into account complex circumstances. It is often not only necessary but also productive to leave a margin of judgement.

For this reason, the verification of the satisfactory implementation of the conditions attached to MFA and SAFs require an expert and comprehensive assessment of the country's macroeconomic adjustment and structural reform programme.

75. The Commission fully agrees with the emphasis placed by the Court on the quality of budgetary processes and the importance of transparency.

76. The Commission intends to further enhance monitoring of financial management in the beneficiary countries.

The Commission maintains close working relations with the IMF and the World Bank, but the Community is not a member of these institutions. There may therefore be institutional constraints for the Commission to be involved in their work.

78. The Commission is considering ways to enhance evaluation procedures for MFA, notably by financing evaluation exercises from 2003 onwards. Annual reporting by the Commission to Parliament and to the Council concerning the implementation of MFA, as well as any future exercise of evaluation of this type of assistance, have to duly take into account the sensitivity and the confidential character of the policy measures agreed between the Commission and the beneficiary countries, as conditions for the disbursement of the assistance.

As regards the SAF, the Commission, when preparing operations, begins the analysis of the feasibility and impact of the reform process supported by an SAF. In addition, since 2001 provision is systematically made for the evaluation of the SAF.

ANNEX III

FULFILMENT OF CONDITIONS

Kosovo

1. In the case of Kosovo, the identification of conditions was particularly delicate given the exceptional circumstances and difficult situation on the ground. Nevertheless, following its review mission in June 2000, the Commission was convinced that the UNMIK progress in implementing the conditionality was sufficient to allow a disbursement.

   With regard to Kosovo's budget, the conditionality did not require budget consolidation, but enhanced revenue collection and better expenditure control. UNMIK had progressed in these areas and was commended on this by the International Community (Working Level Steering Group of 20 June 2000).

   As the Court acknowledges (footnote 1, page 18), there are important social and economic reasons ('important concerns of equity') behind the decision of UNMIK not to introduce the wage withholding tax. The Commission concurred with this view and therefore accepted this decision.

   With regard to self-financing, in the Commission's view, UNMIK had made significant progress towards increasing the domestically financed part of the budget: in the four budgeted months of 1999 (September to December), roughly one third of recurrent expenses had been covered by own resources, albeit in a distinct budgetary framework. In 2000, the budget plan foresaw external financing of about 50 % or DEM 220 million, while in fact the budget closed with a cash surplus of DEM 46 million, of which DEM 38 million was from domestic revenues. The 2001 budget plan foresees a further reduction in external financing (in absolute and relative terms).

Bulgaria

2. As mentioned above, the Commission always leaves a margin of judgement in the formulation of policy-based conditions.

   The Commission considers that naming individual enterprises in policy-based conditionality may, in some cases, be necessary to ensure minimum progress in the privatisation process, notably of large banks and other State-owned enterprises. The argument that this may affect the sales price is only true if the conditionality is made public, which is not the case with the conditions attached to macrofinancial assistance. It should be noted that the sale of Biochim was also explicitly part of the IMF/World Bank conditionality.

3. At the time of the release of the second tranche, the Commission was able to verify that a new bill on EIA was prepared by the Ministry of Environment to ensure compliance with the EU EIA directive. Assurances received by the Bulgarian authorities concerning the adoption of this new legislation were considered sufficient.

4. The Commission considered that the condition was sufficiently met with respect to the objectives of the macrofinancial assistance operation. Full compliance with the *acquis communautaire*, which is required for EU membership and is reviewed in the regular reports, is a far more demanding requirement and was not asked for in the agreed Memorandum of Understanding.

5. The agreement with the Bulgarian authorities specified that the assistance would be disbursed in two tranches. The conditions for the release of the second tranche were met to a very large extent in the second half of 1998. In June 1998, the possibility of splitting the second tranche was indeed considered. The process was delayed, however, for reasons related to difficulties with several EU Member States arising from debt issues. The full payment was only made in December 1998, after the Commission was satisfied that the respect of conditionality was adequate.

Montenegro

6. The main task of the consultant was supporting the Montenegrin Government in the area of budget/fiscal reform and helping the authorities to implement the economic policy conditions of this assistance. In pursuing his tasks the expert obviously provided useful information to the Commission that helped it to monitor the assistance. The Commission pursued its own monitoring and evaluation of the assistance through regular contacts and an assessment mission in December 2000.

   The consultant accomplished his tasks satisfactorily, especially given the short period of his assignment and the difficult environment at that time. In particular, the consultant helped the Montenegrin Ministry of Finance to make substantial progress in enhancing budgetary transparency and improving budgetary procedures. The Commission did not expect a clear recommendation for or against a disbursement decision, since it considered this to be its own responsibility.

The Commission went on mission to carry out its assessment of conditionality early in December 2000. At that time the Consultant was also present in Podgorica and the Commission had the opportunity to discuss his draft final report, which was available at the beginning of the mission. The consultation of the Economic and Financial Committee was based on the Commission's own assessment and the conclusions in the draft final report.

During its mission in December 2000, the Commission observed that the progress made in some areas had not been satisfactory. It therefore warned the Montenegrin authorities that without further substantial progress in these areas a disbursement of the second tranche would not be possible. The Commission also specified action that had to be taken, but in no way softened the conditions laid down in the Memorandum of Understanding. It was also necessary to explain the conditions in greater detail, since information about some aspects of the situation on the ground and of the policy environment had been incomplete at the time when the conditions were formulated.

Tunisia

(a) Sale of five companies: the joint World Bank/ADB/Commission evaluation mission considered this condition to have been fulfilled, as the stock market situation was so unfavourable that it would not have been reasonable to demand that the three remaining companies be put up for sale. In return the Tunisians provided a timetable for sale going beyond what had been demanded. It is true that, with hindsight, the technical waiver procedure could have been more transparent in this instance, but the head of mission (World Bank) did not consider it necessary and this procedure does not exist at the Commission.

(b) Five of the 35 conditions for the second tranche were fulfilled in part. This was reflected in the file submitted for the approval of the Director-General and subsequently of Financial Control. Mathematically, therefore, performance exceeded 85 %.

Given that there is never 100 % compliance, that performance of certain conditionalities went far beyond what was demanded, that the Tunisians offered guarantees for total achievement of the remaining conditions, the decision-makers gave the go-ahead for disbursement provided that the funds were not finally acquired (double signature) until 'full compliance' had been established. This will not happen again as the double signature procedure has been discontinued. At the time nobody could have known that it would take six months. It is quite clear that the Commission cannot alter the regulations of the Tunisian Central Bank.

This programme was considered exemplary, in particular in terms of coordination between donors and the delivery of the privatisation programme.