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(Information)

COURT OF AUDITORS

SPECIAL REPORT No 4/86

on financial and technical cooperation with India together with the Commission's replies

(Observations pursuant to Article 206a (4) of the EEC Treaty)

(87/C 75/01)

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1. INTRODUCTION

1.1. In 1974, the Council adopted several resolutions laying down the principle of financial and technical aid to non-associated developing countries (NADC). Since 1981, the legal basis for this aid has been Council Regulation (EEC) No 442/81 of 17 February 1981 (1). The Community's financial and technical cooperation with India began, for its part, in 1976. The flow of aid has grown over the years and has now stabilized at about 60 Mio ECU per year. Together with a roughly similar amount in food aid, the Community's annual financial commitments thus total some 120 Mio ECU.

1.2. This report deals with the projects financed in India under Article 930 of the budget 'Financial and technical cooperation with developing countries in Latin America and Asia'. Altogether, since 1976, these projects represent a Community commitment of 315 Mio ECU and they number about twenty (see *Table 1*). Only autonomous financing is involved here, since the Community has not entered into co-financing schemes in India with other donors. Many of the projects are being implemented. The Court of Auditors' audit covered 200 Mio ECU's worth of financing (64 % of the whole), 128,3 Mio ECU of which was checked on the spot (41 % of the appropriations committed), in the north, west and south of the country. Some useful information was, moreover, obtained from studying a report which the Commission's Financial Controller drew up in September 1985 on financing operations worth 68,5 Mio ECU.

1.3. The net outcome of this audit is that the results of the financial and technical cooperation with India are considered to be positive. The situation in India, compared with that of other developing countries, is indeed conducive to such cooperation. In the Member States of the Indian Union, the technical departments dealing with irrigation, water engineering, water supplies, etc., which were responsible for the majority of the projects financed by the EEC, seemed to be efficient. In some cases they have developed specific administrative structures for implementing the Community projects, which makes monitoring and checking the latter easier.

1.4. Serious reservations must, nevertheless, be expressed concerning the choice and implementation of the budgetary and accounting management mechanisms defined by mutual agreement by the Community and India, despite the fact that, at the outset, they enabled the cooperation with India to get off to a speedy start and allowed it to be managed, as far as the Community was concerned, with a very small administrative staff. But it would be unfortunate if the guidelines adopted in 1976 were to be followed in future without any change.

(1) The footnotes appear together at the end of the report.

1.5. This report comprises two parts:

(a) the projects financed;

(b) the management system for the aid granted to India.

2. THE PROJECTS FINANCED

Supplies of fertilizers

2.1. A scrutiny of the accounting records and management shows that supplies of fertilizers represent, to date, commitments worth 212 Mio ECU, i.e. 67,3 % of the financial and technical cooperation with India (see *Table 1*). Every year since 1979 the Commission has decided, after consulting the Committee for Aid to Non-Associated Developing Countries (NADC Committee), to finance a supply of fertilizers to India. As a rule, once these decisions have been taken, and the corresponding financing agreements have been signed, the Indian authorities — the Mineral and Metal Trading Corporation of India (MMTC) —, together with the Commission of the European Communities, issue invitations to tender. They choose the suppliers of fertilizers of Community origin who submit the most advantageous bids. The MMTC concludes a contract with these suppliers and, once they have fulfilled their obligations, pays them and submits the corresponding invoices for purchases and/or transportation to the Commission of the European Communities. Within the limits of the appropriations committed, the Commission then reimburses the Indian authorities in foreign currency for the sums in question.

2.2. This expenditure is charged to Article 930 of the budget, which, since 1981, is intended solely to cover expenditure committed in accordance with Council Regulation (EEC) No 442/81 of 17 February 1981 (1). It is questionable, however, whether this system complies legally with the rules laid down in this Regulation, since Article 6 (1) thereof stipulates that 'Aid may cover expenditure on imports . . . required to carry out projects and programmes'. This key provision states implicitly that the financial and technical aid is for financing 'projects' and 'programmes', terms which still have to be defined but which obviously do not cover international trading transactions. Moreover, it authorizes only secondary imports connected with the carrying-out of projects or programmes which are likely to further the aims of the Community's development policy. Imports are, however, the main element of the operations to supply fertilizers and are certainly not required, within the meaning of the Regulation, for carrying out projects or programmes financed by the Community.

Management of the operations to supply fertilizers

2.3. It is clear from examining the Commission's files that studies of India's fertilizer requirements have been carried out

Table 1

Situation regarding Community aid to India to finance financial and technical cooperation, as at 31. 12. 1985

Project No	Programmes Title	Amount committed (Mio ECU)	Amount paid (Mio ECU)
NA/76/1	Drought Prone Areas in Uttar Pradesh	6,0	6,0
NA/77/1	Construction of Warehouses for Storage of Foodgrains and Fertilizers (CWC)	6,4	6,4
NA/77/2	Intensive Grain Storage	5,6	5,6
NA/78/1	Cooperative Storage (NCDC)	15,4	15,1
NA/78/2	Cyclone Protection Shelters in Andhra Pradesh and Tamil Nadu	2,0	2,0
NA/79/9	Supply of Fertilizers (*)	25,0	25,0
NA/79/36	Cyclone and Flood Protection Project in Orissa	1,5	1,0
NA/79/37	Flood Protection Project in West Bengal	3,0	2,7
NA/80/5	Supply of Fertilizers (*)	28,0	28,0
NA/80/34	Cyclone Protection Shelters in Tamil Nadu (Phase II)	0,6	0,1
NA/80/37	Cyclone Protection Shelters in Kerala	3,8	3,8
NA/81/10	Supply of Fertilizers (*)	36,0	35,9
NA/81/13	Afforestation and Water Conservation Project in Uttar Pradesh and West Bengal	7,0	1,8
NA/82/10	Supply of Fertilizers (*)	45,0	45,0
NA/82/5	Cyclone Protection Shelters in Andhra Pradesh (Phase II)	3,0	0,3
NA/82/6	Cyclone Protection Shelters in Tamil Nadu (Phase III)	1,0	—
NA/82/30	Pilot Project for Village Trout Fish Farming in Jammu and Kashmir	1,0	0,4
NA/83/16	State Centres for Training in Rural Development	6,5	—
NA/83/18	Modernization of Tank Irrigation Systems in Tamil Nadu	25,0	1,3
NA/83/26	Supply of Fertilizers (*)	33,0	33,0
NA/84/10	Supply of Fertilizers (*)	45,0	6,7
NA/84/18	Development of Water Control Systems for Diversification of Crops in Maharashtra	15,0	—
	Total	314,8	220,1

(*) The total amount of appropriations committed for the supply of fertilizers therefore represents 212 Mio ECU.

by or on behalf of the Commission at regular intervals. These studies show that fertilizers are a key factor in India's 'green revolution' and that the country's increasing needs in this sphere cannot be met from its own domestic production, despite the fact that the latter is expanding. Any financial assistance given to India's import programme therefore also helps to ease the structural deficit on its balance of payments. In this respect, Community aid is undoubtedly useful. It meets a genuine need.

2.4. However, the fertilizer imports financed by the Community concern almost exclusively nitrate fertilizers (made from urea), whereas the above-mentioned studies show that India also needs other types of fertilizer, in particular muriate of potash fertilizers, which European producers would be able to supply. The Court has found signs in the Commission's files suggesting that pressure has been exerted by European producers of nitrate fertilizers.

2.5. The European producers' initial bids are all very similar to each other and all quite high. The MMTC has to date renegotiated the terms offered by the lowest bidders and has thus obtained lower prices. This practice would seem to indicate that the international procedure for calling for tenders, as derived from the Community practices developed from the very beginning, does not always make it possible to obtain the most advantageous prices.

2.6. On at least one occasion, invitations to tender were sent out by the Indian authorities before the Commission had consulted the NADC Committee, and therefore before it had taken the decision to finance the imports of fertilizers.

2.7. The Commission departments concerned have not always been informed in advance by the Indian authorities of the terms of the invitations to tender, nor even, in some cases, given the opportunity of being present at the opening of the tenders.

2.8. On at least one occasion, a supplier whose principal place of business was outside the Community received 6,3 Mio ECU of business financed from Community funds. Neither European nor Indian interests benefited from that particular transaction.

The advantages and disadvantages of the operations to supply fertilizers

The advantages

2.9. The first argument in favour of financing supplies of fertilizer is that they are without question necessary to the Indian economy in order to ensure continued agricultural expansion (see paragraph 2.3). For the Community, however, the main advantage is probable administrative. These operations are simple to administer. All that has to be done is monitor the invitations to tender and make payments on the basis of contracts and refund applications. The funds are transferred quickly, as is clear from *Table 1*, which shows that the supplies of fertilizer prior to 1984 have all been paid for in full, whereas, for the other types of project, only those decided before 1978 have now been definitively wound up. The reason why this kind of system was chosen was due to the fact that, when cooperation between India and the EEC first started, it was politically necessary to act quickly, and also to the fact that the Directorate-General for Development (DG VIII) had virtually no administrative resources available to it (see paragraphs 3.6—3.9).

2.10. Another consequence arises from the fact that the Community currency employed goes to exporters who are themselves from the Community. In other words, it is 'tied' aid. In a situation characterized by Indian protectionism and by competition from Japanese and North American exporters, contracts to supply fertilizers provide a guarantee that quantities of European goods equal to the amount of Community aid granted will be exported.

The disadvantages

2.11. Once the fertilizers have been delivered, it is no longer possible for any other products or technology to be transferred from Europe to the recipient country. Having decided to embark on a policy of cautiously and gradually opening up some aspects of its foreign trade, India is proving to be very interested in transfers of technology, in areas where it considers there is a gap to be filled. This attitude is apparent at a very high level, seems to be less pronounced in the middle administrative grades, but is again very evident amongst those in charge of projects on the spot.

2.12. Supplying fertilizers does not even forge a lasting link. This would not, however, be the case if what was being supplied was more advanced technology (agricultural processing equipment, for example) coupled with technical assistance, or if, at the very least, the supplies indirectly entailed this transfer of technology. This would mean, for example, that the possibility could be explored of financing the construction of oil mills for the production of edible vegetable oils, which the Indians badly need and the raw materials for which would initially be supplied by the Community.

Conclusions

2.13. All in all, the present policy consists in supplying 67,3 % of the Community aid in the form of consumable goods and, of all the possible consumable goods, restricting these supplies solely to nitrate fertilizers. It would be desirable to reduce step by step the share of supplies of consumable goods in total aid to India, provided that the country is in agreement, or even wishes such a reduction. This would thus afford greater opportunities for financing investment projects. In conjunction with this gradual reduction, the Community would need to set up administrative and financial departments, in Brussels and in Delhi, able to draw up, together with the Indian authorities, a growing number of projects and programmes which would contribute as effectively as possible to achieving the main development aims of Regulation (EEC) No 442/81 ([1]), namely the development of the rural environment and of food production to help the most needy sections of the population.

2.14. Insofar as the supply of consumable goods is to be continued, there must be some diversification away from supplying fertilizers only. And even as regards fertilizers, there are other types, apart from urea-based ones.

Supplies of fertilizers presented as counterpart funds

The associating of Indian projects with the supplies of fertilizers

2.15. The Commission has often presented the supplies of fertilizers as development projects, by annexing to them lists of investment projects for which this or that supply is supposed to provide the counterpart funds. Although there is no doubt whatsoever at the Community accounts level that the commitment and payment relate to supplies of fertilizers, as a case-by-case examination of the documents in support of the expenditure shows, there is a degree of ambiguity in the decisions submitted to the Council of Ministers (NADC Committee) and the financing agreements signed with the Republic of India.

2.16. In 1978—1980, the Commission presented the operation as a supply of fertilizer, on condition that India made certain investments. Later, it presented the operation as the financing of investments in the form of deliveries of fertilizer. Up until 1984, the financing decisions and agreements were nevertheless still worded 'supply of fertilizer' and the observations expressed by the Member States in the NADC Committee related solely to whether or not it was necessary to pay aid to India in the form of consumable goods. The development projects associated with the supplies of fertilizer have never been challenged as regards their own merits or shortcomings.

2.17. It is impossible to establish from an examination of the files whether, in taking its decision, the Community's intention was to finance, using budget appropriations, the importing by India of Community fertilizers, provided that specific development measures, financed out of the Indian Republic's budget, were carried out on behalf of the Community; or whether the Community wished to finance specific development measures by paying its contribution in kind in the form of fertilizers, for which the recipient is spared having to pay in foreign currency.

2.18. As pointed out in paragraphs 2.1 and 2.15, an analysis of the budgetary and accounting management rules out any possibility of doubt: the transactions involved here are, quite specifically, supplies of fertilizers. Nevertheless, at the Community's request, the Indian Republic has agreed to single out in its investment programme the projects which it associates 'politically' with the supply of fertilizers and for which it allows the Community, to some extent, a right of inspection (sending of implementation reports, acceptance of visits and of some expert advice, and recognition of a Community right to audit). One may legitimately question whether this process of singling out particular projects results in any additionality. Only projects completely financed in rupees are submitted to the Community, which normally means that any imports of goods or services from Europe are excluded (see paragraph 2.11). The Indian Republic, for its part, agrees to being 'tied' twice by the aid it receives. First of all, it may purchase only Community fertilizers, and in addition it has to agree to various restrictions on its internal development programme.

The nature and scope of the financial arrangements

2.19. From a financial point of view, the Commission's presentation cannot possibly be regarded as a 'counterpart' operation, such as exists in respect of food aid:

(a) in the case of food aid, the products supplied are sold. The funds thus raised are paid into an account which is then used to finance directly projects intended to help develop the sector producing those goods which were originally unobtainable on the home market and had to be imported. From the accounting point of view, the sequence is continuous. It is quite possible to follow the use of Community funds, from the commitment of the initial expenditure through to the final utilization of the appropriations authorized, i.e. the implementation of the counterpart investment;

(b) in the case of the arrangement for fertilizers, however, there is no financial link between the initial commitment for the supplies and the action by India as regards implementing the associated project. The revenue from the sale of the fertilizers on the Indian market is not credited to an account which will subsequently be used to finance these projects. The latter are financed in rupees out of the Indian budget, usually several years later.

2.20. The Commission does not take any follow-up action as regards the undertaking entered into by the recipient country to finance the associated projects. Nor is there any monitoring for accounting purposes of the payments made in India in order to implement these projects. In Delhi, the development adviser cannot exercise any financial sanction, such as the non-payment of the appropriations necessary for the progress of the 'projects', since these appropriations have already long since been spent to finance the supplies of fertilizer and, what is more, they are irrecoverable because they have already been paid to third parties who, for their part, have fulfilled their obligations. He is therefore in a very awkward situation as regards obtaining any information which will make it possible to follow the progress, difficulties or delays of the said 'projects'. In the case of supplies of fertilizer, this way of doing things is, moreover, logical.

2.21. But if, as the presentation of the financing decisions would seem the suggest, this type of operation were to be regarded as investment financing, it would then be wholly contrary to the Financial Regulation for Community appropriations to be made available to the recipient country prior to commencement of the projects. The supply of fertilizer would thus constitute a — wholly irregular — advance. Monitoring for accounting purposes of the use of these advances would, moreover, show that, in fact, of the amounts at present entered in the accounts as expenditure on cooperation with India, a high proportion has still not been disbursed for any project whatsoever. For example, the Court visited a medium-scale irrigation project — Project Kali II — in Gujarat which, in connection with a supply of fertilizer, NA/83/26, is shown in the Community's accounts as Community expenditure that had been wholly committed and paid since July 1985 (the date on which the fertilizer was paid for). In fact, in April 1986, no payments had been made for this equipment by anyone, anywhere, since implementation of the project had not yet even begun. This example is by no means an exception (see the annex for the information gathered by the Court on projects associated with the supplies of fertilizers).

The development projects

2.22. Besides these supplies of fertilizer, development projects, clearly approved as such by the Community authorities, account to date for only 32,7 % of the financial and technical cooperation with India and account for a total sum of 103 Mio ECU. This relatively low percentage is particularly regrettable and, indeed, worrying. An analysis of the accounts since 1975 does not reveal any trend towards a gradual rise in this percentage, despite the fact that development projects are what funds from Article 930 are normally used for.

2.23. Financings of this kind in fact correspond to the letter and spirit of Regulation (EEC) No 442/81 [1]:

(a) the aim is definitely to finance projects, i.e. usually investments to help to improve the structures of the recipient countries, or programmes, i.e. sets of measures to help to achieve one and the same aim (development of banking facilities in rural areas, research bodies, etc.), as laid down in the Regulation (see in particular Article 6) [1];

(b) direct financing in ECU makes it possible, if necessary, for payments to be made in local or foreign currency, sometimes directly by the Commission and under its immediate control, to the suppliers of equipment or of expert appraisal services. This makes for genuine cooperation, in which projects are carried out by means of technical aid from the Community and contributions from the recipient State;

(c) the application of the provisions of the Financial Regulation is not hampered by an absence of continuity in the financial and accounting mechanisms and it still remains possible automatically to arrange proper monitoring and checking, especially as regards advances. The option which the Commission reserves of not paying the fund committed, particularly the final balance, in the event of failure to comply with the financing agreement, acts as a stimulus to the Commission departments and the Indian authorities to carry out effective administrative and technical monitoring.

The following observations relate to seven measures involving 33,1 Mio ECU.

Modernization of irrigation systems

2.24. The financing agreement NA/83/18 of June 1984 provides that the Community will directly assist the Indian Government to finance, up to a maximum of 25 Mio ECU, a programme spread over five years to modernize 150 irrigation micro-systems in Tamil Nadu, the estimated cost of which was 41,3 Mio ECU. The systems to be modernized are very old (sometimes hundreds of years old). They consist of shallow natural hollows, blocked off by small earth dykes, enabling the monsoon rains to be collected. The water from each of these reservoirs is used to irrigate, by the force of gravity, fields of about one hundred hectares in size.

2.25. In early 1985, the Commission sent an expert on the spot for a week. Since then, the programme has got off to a good start. *Ad hoc* administrative and technical structures have been set up by the State of Tamil Nadu. They are subject to clear, reliable audit procedures and they keep a careful watch on the quality of the work being carried out.

2.26. Of the 150 reservoir sites so far selected, 48 have been positively assessed. According to the World Bank's criteria, their rates of profitability over 25 years, in terms of present value, are equal to a factor of 2 or even 2,5, and they are in the process of being modernized. Six others are at present being assessed. The work (on 36 systems) has been carried out rather slowly (selection by invitation to tender of building contractors employing a seasonal agricultural work-force), but carefully. The actual costs differ somewhat from the estimates and the objectives will have to be slightly lowered.

2.27. Special attention was paid to the way in which the irrigated fields will be managed in the future (system of water distribution, etc.). It is already certain that the improved irrigation systems will be made full use of by a farming population that has been practising the art of irrigation for well over a thousand years.

2.28. Irrigation by means of gravitation is an age-old process which has the advantage of not requiring pumping and not using up energy. The drawback is that it needs extensive, shallow reserves of water, which mean that much cultivable land is lost and a great deal of water is wasted through evaporation. These disadvantages could be lessened by making the reservoirs deeper. This would entail the use of pumps, and therefore energy. In view of the present state of the economy in Tamil Nadu, where hydro-electric energy is still quite limited and nuclear energy at the exploratory stage, a solution could probably be sought in wind and solar energy. It would perhaps be useful to investigate whether, given the respective costs/advantages of these alternatives, the project's profitability could not be further improved by installing systems of this kind with the help of European technical assistance. Success here would have a considerable impact on development, as Tamil Nadu still has several hundred micro-systems to modernize.

2.29. As regards the financing, the Tamil Nadu authorities have to date spent roughly 1,6 Mio ECU. The Commission made a first payment of 1,32 Mio ECU, on the basis of supporting documents (which were, however, incomplete ([2])), to the central government of India. The latter kept 30 % of this amount and made the remainder available to Tamil Nadu, 70 % of it (i.e. about 0,65 Mio ECU) in the form of loans and 30 % (i.e. about 0,27 Mio ECU) in the form of grants. This has been found to be in breach of the financing agreement signed by the two parties (see paragraphs 3.11—3.16).

Pilot project for trout farming

2.30. The NA/82/30 agreement concluded between the Community and the Indian Republic in late 1983 provides that the Community will supply 1 Mio ECU to help to carry out, over three and a half years, two phases of a project intended to show that rainbow trout can be bred in Kashmir. The project's estimated total cost is 1,37 Mio ECU. The project, which is being carried out in a region that already has some experimental carp-farming centres, involves introducing new equipment and techniques, with European technical assistance, in order to develop local trout production. Every year, under phase I, 10 tonnes of trout had to be produced and, under phase II, 400 000 fry were to be produced in order to enable 50 farmers, in turn, to breed trout.

2.31. This is a pilot project, initiated by the Commission in close collaboration with the State of Jammu and Kashmir, with a large element of technical assistance. Despite the relatively modest amount of funds committed, the Commission has devoted a great deal of preparation and administrative monitoring to this project.

2.32. The feasibility study was awarded to a Scottish expert, by private treaty. Subsequently, the technical assistance contract necessary for the development of the project itself was awarded to the same expert and was signed a few days after the financing agreement. Paragraph 6.3 of the latter stipulated that 'the consultancy services will be provided by an EEC consultant, selected by the Commission in accordance with its usual rules'.

2.33. The financing agreement also states, in paragraph 6.1, that 'the equipment and supplies of foreign origin will be procured from EEC Member Countries, after a call for price quotations among EEC specialized manufacturers', a procedure which has never been followed.

2.34. The phase I work has been completed and the planned objectives have been achieved. It has now been proved, from the technical point of view, that trout farming is possible in Kashmir. The transfer of technology still has to be consolidated in order to ensure that the local technical staff will be able to continue breeding trout, which, especially as regards the feeding of the fry and the trout themselves, is a tricky business. Above all, it still has to be ascertained, by experience, whether there exists a lucrative market for full-scale production of trout and whether it is possible to develop suitable marketing structures.

2.35. The Commission delegation in Delhi has been supervising the project in a reliable manner. The development adviser, fearing that the project would be diverted from its objectives by the Jammu and Kashmir authorities (towards semi-industrial production, rather than dissemination of new techniques and resources at village level), managed to have an intermediate evaluation carried out before financing phase II.

2.36. Of the 724 000 ECU earmarked to cover the purchase of equipment and the technical assistance, about 400 000 ECU have already been paid out by the Community. No application for reimbursement has, however, been made by the Jammu and Kashmir authorities for the 276 000 ECU which they are entitled to claim for the civil-engineering works they have carried out, at a cost which already amounts to some 300 000 ECU. The local authorities in fact prefer to receive all their Community aid in the form of increased technical assistance or additional imported equipment, rather than through the Indian financing procedures applicable to them (see paragraphs 3.11—3.16). In this particular case, they would be entitled to receive only 70 % of the 276 000 ECU (i.e. 193 200 ECU), of which 70 % would be in loans (i.e. 135 240 ECU) and 30 % in grants (i.e. 57 960 ECU).

2.37. The pilot project's development is dependent upon the acquisition of imported equipment (measuring instruments, an all-roads vehicle). Substantial customs duties, ranging from 100 % to 300 % according to the goods, have already had to be paid by the Kashmir authorities to the central government, amounting in total to some 0,140 Mio ECU (see paragraph 3.29).

Measures to deal with exceptional circumstances

2.38. Eight projects costing a total of 21,9 Mio ECU have been launched in India to deal with exceptional circumstances (Article 3 (3) of Regulation (EEC) No 442/81 [1]). Audits were carried out on five of them, involving a total of 7,1 Mio ECU and concerning the construction of cyclone-protection shelters in Tamil Nadu, Orissa and West Bengal.

Construction of cyclone-protection shelters in Tamil Nadu

2.39. According to three successive financing agreements (NA/78/2, NA/80/34 and NA/82/6), the Community undertook to finance three projects, for 1 Mio ECU, 0,6 Mio ECU and 1 Mio ECU respectively, to construct 50, 20 and 30 cyclone-protection shelters respectively; these are circular buildings covering some 400 m², spread along the coastline of Tamil Nadu and designed to afford the rural population some shelter in the event of a storm or cyclone. During calm weather, the shelters can be used for social purposes (schools, community clinics, meeting rooms, etc.) of a temporary or sporadic nature such as is compatible with the buildings' chief purpose.

2.40. Several million people live in the critical area. At the most, the 100 shelters planned could accommodate 100 000 persons. By now, they ought all to have been built. Only the phase I shelters were almost completed (44) or on the way to being so (six). Of the phase II shelters, six were completed and 13 were under construction. Phase III had not yet given rise to any expenditure, since not all the sites had been chosen.

2.41. Construction of the phase I shelters was possible only by exceeding the costs by about 50 %. For all the shelters under construction, the expenditure already paid out exceeds the total estimated cost. The remaining shelters can be built only at prices which are much higher still, because they are located in very inaccessible areas and this accessibility factor triples the cost of the work for these last tranches. Over the period, inflation was running at between 5 % and 15 % per year. It is therefore regrettable that the initial estimated costs used for the third phase were simply a repeat of those used for the second phase. The Tamil Nadu authorities, who bear the cost of the overruns, will have to either lower their aims or allocate extra resources to the programme.

2.42. On the basis of documents giving proof of the works' progress and of the expenditure paid out by the Tamil Nadu authorities, the Indian authorities received partial payments of appropriations amounting to some 1,8 Mio ECU. These sums, in derogation from the procedure described in paragraphs 3.11—3.16, were paid back in full by the central government to the Tamil Nadu authorities. About 70 % of the payment, however, was in the form of loans and only 30 % in the form of grants.

2.43. The shelters are of a satisfactory quality. Once handed over to the village authorities, however, they are not always properly maintained. What is more, it is highly likely that the shelters will not be used as planned in the event of a storm or cyclone, because they are almost all permanently occupied by refugees from Sri Lanka. In some cases there are permanent constructions built up against the shelters, showing that people are beginning to settle there.

2.44. If the shelters are to be used in the event of a cyclone, the people concerned must be given prior warning and must be willing to leave their homes. The alarm systems provided for under phase III are still being studied, however, and there is some delay in setting them up. Moreover, the local people have sometimes been reluctant, during the most recent cyclones, to leave their property unguarded. In some cases, nevertheless, the local press has reported that the shelters were used.

Cyclone and flood protection in Orissa and West Bengal

2.45. The financing agreements NA/79/36 and NA/79/37 of February 1980 provided for 4,5 Mio ECU for the construction of about 100 shelters and about 50 helicopter landing-sites, the construction of 100 raised sites on which to settle villages, the provision of lifeboats, and some other similar measures.

2.46. On the whole, the actual costs have proved to be much higher than the estimated costs, hence the virtually inevitable lowering of the objectives. The programmes, which were supposed to be completed by early 1983, have been delayed. The Community payments (about 3 Mio ECU by early 1985) have been slow to reach the local authorities responsible for setting up the installations.

2.47. The funds have all been transferred to the States in question. 70 % (i.e. 2 Mio ECU) has been transferred in the form of loans and only 30 % (i.e. 1 Mio ECU) in the form of grants.

2.48. The work which has been carried out is of good quality, with the exception of some regrettable individual defects (an unfinished floodgate on a flood-protection dyke, for example).

Observations common to the development projects

2.49. The development projects financed under Article 930 are not connected with any commercial operation. The fact that they are wholly financed in convertible currencies should have made it possible to carry out true cooperation measures. The Indian authorities have never shown the slightest reluctance, when asked, to move in this direction. To date, however, virtually no attempt has been made, when selecting projects, to move towards measures of this kind. Only the pilot project (see paragraph 2.30) for trout-farming is moving in this direction. If the delegation's development adviser were to pinpoint measures concerning a very specific sphere of rural development in India and to present them in the form of attractive projects, this could in future form the basis for a new phase of cooperation with India. Suggestions along these lines have already been made, in particular by the delegation in Delhi, and deserve consideration, especially those concerning the cartography of soils in non-strategic areas, the development of agri-foodstuffs technologies, water management in the irrigation systems and genetic and veterinary techniques in stock-farming. The Community could play a different role from that of passive supplier of funds, to which it at present confines itself all too often. If some specific areas of need were selected, in which Community aid could be concentrated, this would have the advantage of both encouraging the greatest possible concentration of the Community's human, intellectual, financial and technical resources to assist India, and facilitating the monitoring and supervision of the measures undertaken. All in all, this would be bound to lead to greater efficiency.

2.50. In respect of the implementation of the projects, subject to the observations on the aid management systems contained in the second part of the report, the findings made during the on-the-spot visits show that the projects assisted by the Community have in general been well managed by both the central and local government authorities in India. In particular, the checking of local procedures for invitations to tender, of works contracts, of local payments and the information gathered about the local administration of the projects all bear witness to very reliable management.

2.51. The main criticisms that can be made concern the frequent planning errors regarding time-limits and costs (hence the frequent need to adopt more modest aims in terms of quantities) which are largely attributable to the practice of employing local building contractors, who operate seasonally and who are, for this reason, unlikely to carry out the work within the allotted time. Without questioning the preference shown towards this category of contractors, which has the advantage of providing work in the slack season for an otherwise unemployed labour force, it would be preferable if the planning of operations were to take account of the repercussions that such a practice is virtually bound to have on the way work progresses. The penalties for delay, which at present are almost non-existent, could then be increased and implemented.

3. MANAGEMENT SYSTEM FOR THE AID GRANTED TO INDIA

File-keeping

3.1. The investigations carried out in the various geographical, technical and financial departments involved in deciding on and managing the Community aid have shown that the information available at the Commission is distributed in an irregular and incoherent manner. In some cases, there is no file containing the minimum amount of information necessary to follow up the projects. The absence of some items of information is attributable to the way the administrative structures have developed (splitting-up of departments, change of person in charge of the files, etc.), whilst the absence of others may be explained in terms of the administrative management procedures that have been set up or the choice of the types of financing.

3.2. The Commission's geographical and technical departments are involved in following up the projects. They have to check whether the measures are being carried out in accordance with the time-schedules and whether the aims agreed at the outset have been achieved. For this reason, the financing agreements often make payment, or partial payment, of the Community grant conditional upon the recipient's prior submission of preparatory technical documents or of interim implementation reports. For this reason, once received by the registry, these documents, if submitted in support of an application for payment, are sent straight to DG VIII's financial department. But the latter by no means always automatically sends a copy to the geographical or even the technical departments. The departments receiving copies, without the annexes, of the requests for funds do not themselves always think of asking the financial department about the content, which is, nevertheless, vital, of these annexes. The Court has thus found that several (geographical and technical) files did not contain background documents which were available in the financial files.

3.3. The technical departments are, in theory, responsible for the technical monitoring of the projects. To help them to carry out this task, provision has been made for them to be consulted on the proper progress of the projects before each payment of the grant is made. The work of the technical departments is organized in accordance with this provision. But some aid cases do not require the Commission itself to make any payments concerning them. This applies in particular to the pseudo-projects carried out in connection with the supplies of fertilizer, for which payments to the contractors and to the suppliers are made directly by the Indian authorities. In this case, the technical departments are never consulted by the financial departments. The inevitable result is that the technical files contain virtually no evidence to show that these projects have been monitored.

3.4. For the projects associated with the 'fertilizer' operations, as for the projects financed by the Community, it is stipulated that the authorities responsible for the implementation must submit interim reports at regular intervals enabling the project's progress to be monitored. In this particular case, however, Community funds are paid over very quickly, to refund the price of the imports of fertilizer, often well before the associated projects are themselves implemented on the spot. The submission of interim implementation reports is therefore no longer a condition for subsequent payments by the Community. Consequently, it is not surprising to find that, in the case of projects associated with supplies of fertilizer, there is very often no implementation report in the Commission's files, either in the technical files, for the reason given in paragraph 3.3, or in the geographical and financial files, for this sole additional reason.

3.5. These shortcomings are not simply formal. The lack of information in the files is the cause and reflection of inadequate control of the aid case itself. Faulty monitoring of the aid case is itself a shortcoming, because it does not make it possible to spot projects that are falling short of their objectives, to analyse the causes and, where appropriate, to advise on ways of remedying them. Apart from that, it is also the cause of weakness in the identification and negotiation of future projects, because of the lack of experience and of critical information which could perhaps be used to question or to alter the content of new projects submitted for Community financing.

The administrative resources employed by the Community

3.6. The administrative resources employed by the Community — the Directorate-General for External Relations (DG I), DG VIII and the Commission delegation in Delhi — for preparing, selecting, negotiating, carrying out and checking the projects financed within the framework of cooperation with India are inadequate, to such an extent that the high standard of services rendered can in no way make up for the inadequacies.

3.7. In Brussels (DG I), throughout 1985, when the Court's audit visit was being prepared, no desk officer was appointed for India. The person who had held this post had been transferred to other duties at the very beginning of the year and was not replaced until December. It should be enough to point out that India, with an annual financing of some 130 Mio ECU, is by far the most important of all the developing countries aided by the EEC, to show just how intolerable this situation is. Furthermore, the question of what direction cooperation with India will take in the future is a matter which calls for greater consideration and which presupposes close liaison between Brussels and the delegation in Delhi. This has been the case over the last year or two in particular, so that the lack of a desk officer since the end of 1984 lays the Commission open to considerable criticism.

3.8. The Commission delegation in India, which was opened in May 1983, is responsible in matters of cooperation for India, Nepal and Bhutan. It is still in its infancy. It has been allocated one development adviser, who, like the other staff working with him, is paid out of appropriations under Article 930 of the budget, in accordance with the procedures of the European Association for Cooperation. These costs are charged, as in other similar cases, to a reserve representing about 3 % of the appropriations allocated to financial and technical cooperation with developing countries in Latin America and Asia. This figure of 3 % is a maximum authorized annually by the Council. The cost of external technical experts recruited to supervise and tender advice on the implementation of the projects is also charged to this reserve. The development adviser has adequate administrative resources at his disposal (sufficient mission appropriations, administrative staff, etc.). To date, however, he has not yet made use of the possibility open to him of recruiting a local, university-trained assistant. Such an assistant would have been extremely useful from the very beginning. It is quite inexplicable that even after two years nobody has yet been recruited.

3.9. The system of managing the development aid has in fact developed very little over the last twenty years. This system has gradually been set up in countries which are generally sparsely populated. A Community presence has been established in these countries in the form of delegations or representative offices, which can be found in almost all beneficiary countries. When monitoring the way this mechanism works, the authorities in Brussels have relied on frequent on-the-spot visits. The extension of the range of recipients over the past ten years or so to all developing countries has put the problem of management in a new light. The area to be audited is no longer continent-wide but world-wide and it encompasses several blocs (South-East Asia, the Indian sub-continent, part of the Middle East, the Mediterranean basin, the Andean countries of South America, and Central America). Each of these units is on the scale of sub-Saharan Africa, but, except for the Mediterranean countries, each unit has only one delegation with a small staff to monitor it, even though the Community financing operations are often very scattered in geographical terms (particularly in the case of programme financing operations covering many micro-projects). Henceforth, in these countries, on-the-spot visits to projects from Brussels or from the delegation's headquarters can no longer be relied on almost to the exclusion of any other way of carrying out the necessary follow-up-work. On-the-spot visits, especially by the delegations, are still indispensable, but they must form part of a permanent management and audit system, based on accounts and supporting documents, which in themselves presuppose the existence of strict management procedures, covering all the Community activities in the countries receiving aid. It is therefore essential that the financial and accounting management mechanisms should make it possible to monitor the financing operations that have been decided on. If this is not the case, the Community will have to have recourse more and more often to global financing operations, intended mainly to improve the balance-of-payments situation of the recipient countries. It is thus, for example, that the financial, administrative and accounting system set up to regulate relations with India makes it easier to establish what funds have been spent by the Community than to ascertain the amounts actually disbursed on the spot for each project. If this kind of situation were to be allowed to persist, it would make the Community incapable of assessing the impact of the development aid it grants, even in general terms.

The mechanism for paying the Community grants

3.10. The terms of the agreements governing the financing of operations carried out as part of financial and technical cooperation with India vary according to the projects being financed. The agreements do, however, share a common pattern. The appropriations, denominated in ECU, are made available, upon presentation of suitable supporting documents, in the form of direct grants, to the Government of India, which passes them on to the organizations running the projects. On the basis of the documents in support of the payments made by the Commission, the Court might suppose that the grants paid by the Community to finance the projects did in fact reach the bodies running the projects in accordance with the terms agreed beforehand by the Community and the Republic of India. The Court's on-the-spot audit enquiries show, however, that because of the mechanisms of the Consolidated Fund of India, through which the Community grants are channelled, what actually happens on the spot is very different from what is laid down in the financing agreements.

The Consolidated Fund of India

The principle of channelling aid through the Fund

3.11. As regards financing investments designed to promote the country's internal development, the Indian constitution lays down some basic rules: fair treatment of the various States of the Union, allocation of the resources intended for financing development investment projects to a Consolidated Fund of India and management of these resources in the context of India's five-year development plans, according to the rules laid down on a proposal from two committees, the 'plan' committee and the 'finance' committee. As time has gone by, these two bodies, working on this basis, have defined the more specific rules set out below. All resources coming from outside India, even those allocated to specific projects, have to be channelled through the Consolidated Fund of India. Financing from this Fund is carried out as follows, with some exceptions.

The rules for distributing and converting the funds received

3.12. Projects managed by the Union itself (central projects) receive 100 % of the foreign aid allocated to them by the Fund. This may take the form of loans and/or grants.

3.13. In the case of projects managed by the States of the Union, the expenditure, once supporting documents have been supplied, is reimbursed *ex post facto*. The sum reimbursed is, with some exceptions, only part of the total. The amount which the Fund will reimburse is usually limited to 70 % of the expenditure for which the foreign aid was granted and this, of course, must also be authorized under the plan. The rules state that the remaining 30 %, plus any overrun of the forecast costs, are to be borne by the States, whose budgets are funded partly by local resources and partly by global contributions from the Consolidated Fund of India, adjusted in line with the economic and budgetary situation of the States on the basis of an allocation scale.

3.14. Lastly — and this is an important point —, the proportion of the foreign aid which is paid to the State is never disbursed wholly in the form of a grant, even when the foreign aid is 100 % donated, as in the case of the EEC. The Indian rule is that, in most cases, the proportion paid out by the Fund shall itself be disbursed 70 % in the form of loans and 30 % as grants. These percentages may be altered to 10 % and 90 % respectively for States regarded as particularly poor, but this does not happen automatically.

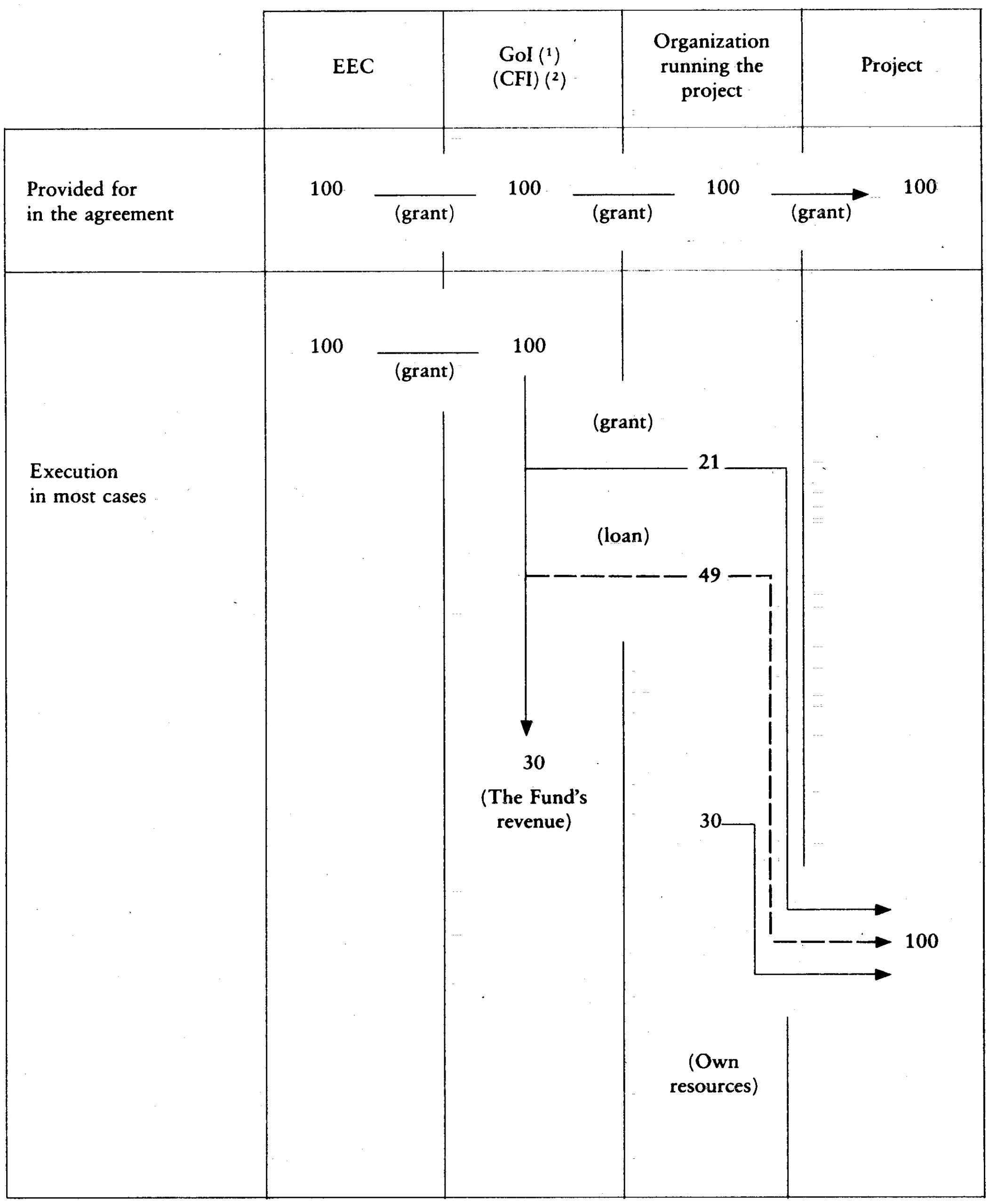
The effect on the Community grants

3.15. As a result of the foregoing, the vast majority of the projects financed by the Community have to pay the Consolidated Fund a levy of 0,30 ECU for every 1 ECU paid by the Community, in order to finance other development projects or programmes of which the Community is not even aware, or to contribute to the direct financing of the budgets of the States of the Union. Out of each ECU paid, similarly, 0,49 ECU is in effect made available to the project, but as a loan. In the end, only 0,21 ECU is made available to the project as a grant. *Table 2* summarizes this state of affairs in diagrammatic form.

3.16. The exceptions found by the Court concern, on the one hand, rural banking facility projects which are associated with supplies of fertilizer and are managed at federal level.

Table 2

Diagram showing the mechanism for making the Community aid available in India



(1) GoI: Government of India.
(2) CFI: Consolidated Fund of India

They have therefore received a transfer of 100 % of the Community aid allocated, but as a loan, not as a grant, which was, however, the form stipulated in the financing agreement (see annexed hereto the Court's audit enquiries concerning projects associated with supplies of fertilizers). On the other hand, the projects to construct cyclone-protection shelters, which are implemented by the States of the Union, have, by way of derogation from the general rules, received 100 % of the Community aid paid, though only 30 % of this is in the form of a grant, instead of the 100 % planned, and 70 % as a loan (see paragraph 2.42).

Observations on the operation of the Fund

3.17. Most of the foreign aid received by India consists of loans (from the World Bank, but also from many countries). In this case, converting part of the loan into a grant constitutes a genuine *quid pro quo* for the fact that the transfer made to each project is subject to a levy. The recipient federal State receives less in volume but more in quality. The other Indian States apart from the recipient State also receive part of the foreign aid in the form of a contribution to their budget from the Consolidated Fund of India, or in the form of loans granted out of the levies charged.

3.18. This situation has been accepted by the Community to date even though, project by project, it results in the negation of the financing agreements signed. Whilst the Commission is, of course, well aware of the existence of the Fund, on the whole it knows very little about the Fund's mechanisms, especially the role it plays in converting the aid. In any case, none of the documents submitted to the NADC Committee refers to these mechanisms. Admittedly, all things considered, the projects are usually fully financed and, given that as a rule they are in the end implemmented and are usually carried out well and that the amounts involved correspond, at the very least, to the costs originally planned, it may be asked what purpose is served by delving into the details of the internal financial rules of the Indian Union.

3.19. The point is, firstly, that the way in which the project itself is financed is not without impact on its own profitability. The fact that part of the funds is paid as a loan will in the long run result in recurring costs. When assessing the project's financial feasibility, it is at least necessary to be aware of this aspect of the operation. Prior information of this nature has never been taken into account by the Commission nor, *a fortiori*, by the national experts on the NADC Committee. This shortcoming is all the more regrettable as the main criticism aimed at the actual management of the projects relates to the extent to which costs have been underestimated (see paragraph 2.51).

3.20. The Commission must always be in a position to supervise whether projects are being carried out correctly, so that it is able to take action if they are not progressing normally. It can do this only by means of a single, continuous system of financial and accounting management. On the basis of documents proving the progress of the work, it must be able to decide whether or not to disburse Community funds and thus to exercise real control over the project's progress. Similarly, this continuous accounting link must enable it to check that Community funds have been used properly.

3.21. Attempts to justify the situation observed in India by arguing that it is inevitable, being based on the Indian constitution, are not tenable. The latter does not in fact impose the rules adopted, which have simply been chosen by the Indian authorities (see paragraph 3.11) and as such accepted by the EEC, even though the budget documents or the agreements signed with the Indian Republic make absolutely no mention of them whatsoever.

3.22. The fact that the rules of the Consolidated Fund are in any case accepted by the other donors is not a valid argument. The latter have accepted only reluctantly a system which reduces the volume of the loans they grant, and it should not be forgotten that the part transferred receives an interest-rate subsidy because of its partial conversion into a grant. It is not improbable that the levy charged on Community grants is used to fund this interest-rate subsidy.

Possible solutions offered by the Fund mechanism

3.23. The channelling of Community grants through the Consolidated Fund of India is not in itself a problem for the Community. The important thing is that, from the time when the financing agreements are being negotiated, India should be able to inform the Community how it plans to use the grants that will be allocated it to contribute to the success of the development projects to be financed. At this stage, it can easily explain in detail the financing arrangements for each project submitted (the shares in the financing of, respectively, the organization running the project, the Indian Union, the Community and other donors, and the nature of this finance: grants, loans, resources generated by the project, etc.).

3.24. Prior information of this kind would enable the Community to have an idea of the prospects for the aid, of how it will be used and of the project's financial equilibrium. Not only would it be able to give its opinion in full knowledge of the facts, but, subsequently, when a financing plan was agreed, there would no longer be anything standing in the way of full communication of the actual data relating to the project's financial execution. The Community would then be able to compare the initial commitment and the final execution.

3.25. The transparency thus achieved would reveal the true financial status of the Community grants and would in particular show how, as things now stand, they contribute, in the form of true *de facto* co-financings (see paragraph 3.22), to the implementation of very diverse projects. The Community's political authorities might obviously then prefer the other financing methods authorized by the Indian system.

3.26. The choice might be for the central projects of the Indian Union. These are usually programmes (e.g. the rural banking programme mentioned in the Annex). The Consolidated Fund of India's rules then allow all the funds to be transferred and do not require them to be converted into loans.

3.27. It would also be possible to emphasize the difference between the Community grants and the loans from other 'donors' in order to bring into play the Consolidated Fund of India's derogation clauses (the option of transferring all the funds and the option, in exceptional cases, of making the whole payment in the form of a grant).

3.28. These solutions, which in theory are the only ones that comply with Community rules, could be implemented in a way which was consistent with the Indian stipulation of fair distribution between the States. This is obvious from the central projects, which are of benefit to the whole federation. This could also apply to the other projects. In the space of very few years, and by taking account of the finance borne bilaterally by each of the Member States of the Community, India has put itself in the position of being able to distribute all the Community financing in a balanced way between all the States of the Union.

Collection of customs duties

3.29. Of the measures financed by the Community, there are very few for which the importing of Community equipment is essential for the implementation of a project or programme. Nevertheless, every time imports of this kind have been provided for in the financing agreements, difficulties have been encountered in implementing the provisions of Article 6 (1), second subparagraph, of Regulation (EEC) No 442/81 ([1]), whereby 'taxes, duties and charges . . . shall be excluded from Community financing', which are included word for word in the financing agreements. The central government authorities in India in fact subject these imports to stringent authorization arrangements, which lead to lengthy delays. In addition, they levy high customs duties, of as much as 300 % of the value of the goods (see paragraph 2.37). Admittedly, these duties are not borne by the Community budget, but they place a heavy burden on the local financing of the projects, whilst no mention is made of them in the initial presentation of the estimated costs intended to enable the Community authorities to appraise the projects' feasibility. Exemption may be granted on a case-by-case basis, but this involves months of negotiations with the Delhi authorities, and it is impossible to know in advance how long these talks will last nor what their outcome will be. This is yet another obstacle to the drawing-up of a reliable financing plan at the time when the proposal is being decided on.

Need for an outline agreement

3.30. After ten years of cooperation with India, no outline agreement has been negotiated or signed with that country. This shortcoming is regrettable. For other countries with which cooperation is on a large scale, the Community has specified the legal, administrative and financial context governing this cooperation, by making such outline agreements. Since then, each project financed by the Community in these same countries is the subject merely of a financial and technical memorandum laying down the nature and financial limits of the project to be carried out and describing the physical features of these projects and the specific administrative conditions governing their implementation.

3.31. The value of this approach lies in the fact that it enables the budgetary, financial and administrative rules and the control arrangements applicable to the projects financed by the Community to be negotiated only once, but in detail. Thereafter, each specific project can be arranged by reference solely to its financial and technical components, within a procedural framework that is, as a rule, clear and agreed in advance.

3.32. In the case of India, the biggest recipient of Community aid of all the developing countries in Latin America and Asia, negotiating such an agreement would make it necessary to define clearly and unambiguously the financial regulations governing Community grants, the customs rules applicable to the importing of Community equipment, and the financial monitoring and control procedures for projects decided in association with other projects directly financed by the Community. The nebulousness at present surrounding these matters has allowed the *de facto* development of mechanisms which it is difficult to reconcile with the Community principles regarding budgetary and accounting management and control.

4. CONCLUSIONS

4.1. To date, the Community's financial and technical cooperation with India has been conducted against the backdrop of a planned economy and a policy of economic isolation from the international market. The annual supplies of fertilizer which allowed considerable foreign currency savings to be made and the projects implemented on the basis of Indian technology and resources were wholly compatible with India's political and economic options. The Community's limited administrative resources hardly made it possible to administer a more elaborate form of cooperation. Nevertheless, although the projects have been carried out satisfactorily on the spot and have helped to achieve the aims assigned to them, there may be some doubt as to whether the Community has put itself in a position to tackle the future with the requisite efficiency.

4.2. It is now common knowledge in India that increasingly large transfers of technology are necessary in order to ensure the country's internal development. On the other hand, opening India up to the outside world implies seeking additional export outlets. In this new environment, Community cooperation can no longer reasonably be confined to mere transfers of funds, designed to steady the balance of payments and to improve the country's budgetary situation. It is therefore paradoxical that about two-thirds of Community aid should still be allocated in the form of grants for purchasing consumable goods.

4.3. Careful thought, which has to date been lacking, is essential to create more lasting ties with India. It ought to be possible to expect some effects from the implementation of projects that help India to benefit from the technological assistance the Community is able to offer. The capacity for self-development shown by India in the setting-up and improvement of its own rural infrastructure should also not be neglected. They could be used in the form of Indian technical assistance to help the development of other, even poorer third countries. The possibility of using Title 9 of the Community budget as financial support for such a 'triangular' system of technical assistance must not be ruled out.

4.4. In-depth consideration can only lead to better definition of the aims of the Community's cooperation with India. Negotiating an outline agreement is bound to enable the situation concerning the management and monitoring of Community funds to be clarified. Then the Community will unquestionably be in a better position to pursue a form of financial and technical cooperation that is adapted to India's new economic and political environment.

This report was adopted by the Court of Auditors in Luxembourg at its meeting of 4 December 1986.

For the Court of Auditors

Marcel MART

President

(1) OJ No L 48, 21. 2. 1981, p. 8.

(2) According to the provisions of paragraph 7.3 (technical and administrative provisions) of the agreement NA/83/18.

ANNEX

Example of six projects associated with the supplies of fertilizer: information gathered by the Court

ANNEX

Example of six projects associated with the supplies of fertilizers: information gathered by the Court

Fertilizer supply concerned — Reference:	NA/80/5		NA/79/C1	NA/81/10	NA/82/10	NA/81/10	NA/82/10	NA/83/26
— Amount committed: — date	28 Mio ECU Early 1981		25 Mio ECU Early 1979	36 Mio ECU 22. 12. 1981	45 Mio ECU 19. 5. 1983	36 Mio ECU Late 1981	45 Mio ECU 19. 5. 1983	33 Mio ECU 2. 7. 1984
— Amount paid — last movement	28 Mio ECU		25 Mio ECU 31. 12. 1981	35,895 Mio ECU 30. 9. 1985	45 Mio ECU 31. 7. 1984	35,895 Mio ECU 30. 9. 1985	45 Mio ECU 31. 7. 1984	33 Mio ECU July 1985
— Observation	Not checked in detail		Confusion between various operations to supply fertilizers explains why not all the reimbursements for the supply operation NA/81/10 have been made, whereas the operation NA/82/10 has been wound up since July 1984			cf. ARDC	0,050 Mio ECU planned for the water-supply project (purchase of equipment in foreign currency) was not committed for this purpose and was incorrectly used for fertilizers	Note the presence of a non-Community firm amongst the suppliers of fertilizer
Project associated with the supply of fertilizer — Reference:	Development of soya growing in Uttar Pradesh NA/80/5/C	Agricultural markets in Uttar Pradesh NA/80/5/A	Agricultural Refinance and Development Corporation (ARDC) rural banking facilities			Water supply in Himachal Pradesh NA/81/10/II	Water supply Tamil Nadu NA/82/10/I	KALI II Medium-scale irrigation NA/83/26/III
			NA/79/CI	NA/81/10/I	NA/82/10/III			
— Subject:	Over 2 years to improve the growing, processing and marketing of soya in Uttar Pradesh	Over 3 years to replace the traditional marketing techniques with a system of 115 markets ensuring greater transparency as regards prices	The ARDC project makes it possible, by means of the resourses obtained, to lend funds at preferential rates to banks which grant loans through their own channels to farmers carrying out small productive investment projects			Over 3 years to construct 308 water-supply networks for 1 427 villages (346 000 persons) in Himachal Pradesh	Over 2 years to construct 108 village water-supply systems for 726 villages near Coimbatore and Periyar which are affected by water containing fluorine	Over 4 years to construct an irrigation scheme covering 3 000 ha (1 400 of which are irrigable) in a very dry area of Gujarat, and to draw up a pilot water-management plan
— Total estimated amount of project		30 Mio ECU	Several thousand million ECU spread over about ten years			18 Mio ECU	17 Mio ECU	7 Mio ECU
— Share of financing 'associated' with the supply of fertilizer	3,7 Mio ECU	11,5 Mio ECU	18 Mio ECU	18 Mio ECU	21,7 Mio ECU i.e. in total: 57,7 Mio ECU	18 Mio ECU	17 Mio ECU	7 Mio ECU
Observation: — Arrangements for making the funds available, from the CFI percentage paid: of which: + loans	70 % (2,6 Mio ECU) 49 % (1,8 Mio ECU)	70 % (8,05 Mio ECU) 49 % (5,6 Mio ECU)	100 % 100 % (6,5 or 7 % over ± 9 years, according to the end uses)			70 % (12,6 Mio ECU) 49 % (8,82 Mio ECU)	70 % (11,9 Mio ECU) 49 % (8,33 Mio ECU)	70 % (4,9 Mio ECU) 49 % (3,43 Mio ECU)
+ grants	21 % (0,8 Mio ECU)	21 % (2,4 Mio ECU)	0 %			21 % (3,87 Mio ECU)	21 % (3,57 Mio ECU)	21 % (1,47 Mio ECU)

— CFI payment to the project: — amount — date	information not available information not available	information not available information not available	18 Mio ECU 16,2 Mio ECU 19,3 Mio ECU 31. 3. 1982 30. 3. 1985 30. 3. 1985	10,6 Mio ECU 5. 11. 1985	2,12 Mio ECU 6. 2. 1985	nothing
— Revised objectives	Costs increased by 27 % in 1983	73 markets instead of 115	no	302 networks instead of 308, completion deferred until June 1986	yes, 427 villages connected to the supply instead of 726	no
— Results achieved	Additional increase of 32 % and factory 2/3 completed by March 1985	Being completed	The Government of India still has to pay 1,8 and 2,4 Mio ECU to the administrator of the ARDC	212 networks under construction in March 1985	Start-up of work: — several networks are in operation	nothing, subject to finalization of the studies and plans; project ready to get started
— Results expected	Lower than the original objectives		Utilization of all the Community funds	Finishing off the 212 networks would raise the cost by 27 Mio ECU	The 427 villages will perhaps be connected if the drilling operations do not prove too negative	Original objectives, minus the pilot plan (because a similar plan is already being financed by the World Bank)
— Other observations	— Over half the 150 cooperatives planned still had to be formed by March 1985. — Very little attention seems to be paid to developing farming practices. — It is likely that the processing factory will not have sufficient quantities at its disposal to operate profitably.	— The 5,6 Mio ECU lent and the 3,45 Mio ECU kept back by the Government of India will have to be refunded by the bodies managing the markets. — The 3,45 Mio ECU were borrowed from banks at a high rate of interest. — The work carried out is of a high standard, but the maintenance could be better.	— The implementation reports show that all the 57,7 Mio ECU have been used up, whereas in fact in 1986 this is still not the case (balance of 4,2 Mio ECU). — The ARDC system is complex but seems to be well managed. Its complexity generates high administrative costs. The loans to the farmers are at fairly high rates (10 % or 12,5 % over 9 or 15 years). — The 'fertilizer' appropriations are not allocated to specific programmes. They therefore contribute to all the ARDC programmes (e.g. purchase of taxi, but also, of course, rural development in the strict sense).	— In order to attain the revised objectives, 40 Mio ECU would have to be spent. — The authorities have not sent any periodic implementation reports to the Commission. — Some minor (technical) faults have been found.	— The project is useful because the fluorine is adversely affecting the health of the inhabitants concerned. — An *ad hoc* administrative structure has been set up for the project. — The project is being properly managed (audited by the auditor-general of Madras) and the work carried out is of a reasonable standard. — There has been a substantial rise in the costs. — Importing the measuring instruments is problematical because: — the Commission used the foreign currency for fertilizers by mistake; — the Government of India wants to charge high customs duties on the instruments.	— Start-up is likely to be several months delayed because the environment departments are holding up the project (forest in the area to be flooded). — The project's value is indisputable, even though its profitability is low (rate of 1,1 over 50 years). — It has been properly prepared. — A European expert came to give some very welcome advice (cost savings). — The project will increase the irrigable potential, but not necessarily the irrigated areas (design weakness regarding the future operation of the system).

COMMISSION'S REPLIES

2. THE PROJECTS FINANCED

Supplies of fertilizers

2.1. to 2.8. Apart from 1985 (because of a very depressed market), the European suppliers have sold at prices which correspond to the world market prices. As no single producer can supply the total quantity required, a procedure of negotiation forms part of the tendering. Often the occasion has been used by MMTC to supplement the purchase financed by the EEC with commercial purchases from their own funds, to the same producers and at the same prices, providing an added benefit to the European producers. A representative of the Commission has been participating in the tender opening since 1984. It is correct that the headquarters of a supplier in 1983 was outside the EEC, however, the producing company was a subsidiary company inside the EEC.

In some cases, because of timing of deliveries, fertilizer tenders have been launched before the signing of the Financing Agreements, however always with a suspension clause. Such procedures do gain time and are not uncommon, e.g. in the ACP context.

2.4. Of the fertilizers consumed in India, 68 % are nitrate fertilizers, principally urea, as against only 10 % potash and 22 % of phosphate fertilizers. It is therefore understandable that India is giving priority to securing its supplies of nitrate fertilizers. Seven Member States are represented on the urea market. Nitrate fertilizers are also the only type of which Europe produces a surplus. However, the financing agreements provide for the possibility of diversifying purchases and obtaining other types of fertilizer if requested by the Indian authorities.

Only in 1982 did such a request occur, for the supply of potash, which was then supplied to their satisfaction.

Conclusions

2.13. Given the particular advantages of projects which allow for transfers of technology, the Commission too considers that in the interests of India's development it would be preferable in the future to finance a decreasing percentage of the total Community programme of aid to India by means of deliveries of fertilizers and intends, with India's agreement, to do so.

Supplies of fertilizers presented as counterpart funds

The associating of Indian projects with the supplies of fertilizers

2.15. to 2.18. The practice of association was introduced in order to take advantage of India undeniable capacity to supply the expertise and material resources necessary to carry out development projects, particularly in the fields of agriculture and social infrastructure; therefore the main requirement is finance and not know-how. As a result, the practice is based in principle not on commodity aid, but on contributing to development in a way which suits both Indian and European interests. That is why the supply of fertilizers and the corresponding development projects are always integrated in one financial agreement, without this implying that the development projects themselves are the counterpart for accounting purposes of the Community finance.

It is incorrect to state that this practice simplifies financial management and therefore to assume that it was chosen for this reason; projects financed by counterpart funding receive — as they must — the same attention as directly financed projects. If it has been the case that such a project has not received the appropriate attention, this is due to inadequate staffing levels, as the Court of Auditors rightly points out.

The nature and scope of the financial arrangements

2.19. to 2.20. The Court of Auditors' report leaves the clear impression that a qualitative difference exists with regard to the monitoring of projects according to whether they are funded directly by the European Communities or through the supply of fertilizer. It is true that, in the case of directly funded projects, more detailed financial information is available to the European Communities, and that the EEC can, ultimately, threaten to withhold payments.

It should also be pointed out that, even in the case of fertilizer supply counterpart projects, the fact that the projects are receiving funding from the EEC is clearly known by the project authorities. Thus, in some projects, the project authorities have established 'EEC Project Implementation Cells' responsible for the project components receiving EEC assistance.

2.21. For the reasons indicated above (2.15—2.18), the Commission does not share the views expressed in this paragraph of the Court of Auditors' report. It is also evident that supplies of fertilizer made a practical contribution to aiding the development of agricultural production and the Indian rural sector.

Pilot project for trout farming

2.32. There is no conflict between the award of the contract to the consultant by mutual agreement and the stipulations of point 6.3 of the financing agreement. This procedure was considered by all as the most economic and prudent solution. Commission rules on restricted tender were only introduced in 1986, many years after the technical assistance contract was concluded.

2.33. It is true that this selection procedure might have been broadened but in this case account must be taken of the fact that it was a pilot project and that the buying of equipment — small both in value and in quantity — had been entrusted to the consultant because of its technical nature.

In fact the equipment, originating in several Member States of the Community, was supplied by a single firm which was responsible for ensuring that the equipment was compatible, as was necessary to avoid the failure of this pilot scheme.

Observations common to the development projects

2.51. It is correct that many projects in the past have experienced implementation delays and cost over-runs (a problem equally valid for the directly financed and counterpart-financed projects). It is partly explained by higher-than-expected inflation rates and administrative delays. However, experts' missions incorporated into project appraisal and systematic provisions for independent monitoring and ongoing evaluation, applied in the most recently approved projects, should diminish these problems in the future.

3. MANAGEMENT SYSTEM FOR THE AID GRANTED TO INDIA

File-keeping

3.2. Reimbursement claims from non-associated countries are usually channelled direct and in the original to the financial service, which places documentation at the disposal of the technical or geographical service, as appropriate, for opinion. It is for them to decide in which cases photocopies are needed for their own files. Original documentation is then returned to the financial service for execution of disbursement and channelled via financial control and DG XIX to the Court of Auditors as prescribed.

3.3. to 3.5. The Commission does not share the opinion of the Court of Auditors that financing a project by means of fertilizer supplies does not allow its implementation to be monitored as well as with direct financing.

It is true that this type of financing does not allow the Commission to monitor the progress of the project before each disbursement and hence to carry out prior checks on the Indian administration.

From the Indian point of view, however, the technical, administrative and financial monitoring procedure is exactly the same in each case, as both fit into the same framework of Indian budgetary and administrative procedures. The only difference is that in the case of direct financing the Indian authorities pass on to the Commission the reimbursement claims submitted by the States, which is obviously not the case with 'fertilizer' projects.

Similarly, there is no fundamental difference between the project monitoring mechanisms available to the Commission, whatever type of financing is being used:

— the monitoring provisions of the financing agreements (intervals between interim reports, access to documents) are the same;

— the consultants sent periodically by the Commission to monitor projects have looked at directly or indirectly financed projects without distinction;

— as far as the delegation is concerned, no particular priority is given to monitoring directly financed projects compared to any others.

From both the Commission and Indian point of view, it is certain that the quality of monitoring received by a project is determined not so much by the type of financing as by the time devoted to the monitoring, the regularity of visits of inspection and the quality of the local staff in charge of its implementation, whose real ability the Court of Auditors was able to judge on the spot.

The Commission will remind the Indian authorities of their obligations in this respect in order to improve the implementation files.

The administrative resources employed by the Community

3.6. to 3.9. It is correct that the lack of personnel in Brussels and in the Delegation in New Delhi has limited the Commission possibility for intervention and control. However, the steps possible under the restrictions imposed by the budget have been taken to improve the situation. An official responsible for development aid to India has been appointed at the Commission in Brussels. A second development adviser will be posted to the Delegation early in 1987. In view of the fact that the advisers are responsible for other countries besides India, the measures are still only partially sufficient. Project reporting will also be improved by standardization

The mechanism for paying the Community grants

3.10. to 3.14. The report takes a very negative view on the operation of the Consolidated Fund, in the Commission's view not giving sufficient consideration to the complexity and size of the Republic of India, which understandably requires the central government to pursue policies which not only reinforce the solidity of the federal structure but also ensure a fair distribution of resources between individual

States. The 'Indian Financial System for External Assistance', through the system of additional funding, provides that the main beneficiary is the State in which the project is being implemented. However, it also provides for a spill-over effect benefiting those States, mostly the poorest, which do not attract direct aid from the international community.

Even if the channelling system is criticized by certain donors, the Commission notes that it is nevertheless generally accepted by everybody and the fact that Community aid is provided in grant form makes no difference to the underlying reasons why the Indian Government maintains the general arrangements. In all cases, the quality of the projects is determined by their technical and economic feasibility. The Indian policy that all projects have to be economically viable, even in cases where grant financing is involved, can only be applauded.

The effects on the Community grants

3.15. Whatever the validity of the Indian system, the essential question is whether its application to Community aid violates the letter and the spirit of the financing agreements. The Court of Auditors considers that the fact that only 21 % of the EEC grant goes to the State implementing the project means that benefits are diverted to the central government to the disadvantage of the States. This reasoning is questionable as India by its constitution is a Union of States and the Federal State consists of the central government and the governments of the individual States. The beneficiary of the Community aid in the financing agreements is in each case the 'Republic of India', i.e. the Federal Union of the States and never a specific State. Further, the majority of projects financed by the EEC are basic infrastructure projects, e.g. irrigation, water supply, which are, on the local level, implemented by the State services as part of their development plan and subsequently, free of charge, transferred to the rural population (individuals or village communities) who constitute the ultimate and real beneficiaries of the project. Hence, if a financing agreement provides for EEC financing of 100 ECU, then 100 ECU (or the rupee equivalent) worth of work is executed and transferred to the beneficiary population, fully in compliance with the principal objective of the EEC development commitment.

Observations on the operation of the Fund

3.17. The Court of Auditors should be aware of the fact that the Commission is obliged to accept the institutional regulations of the Federal Republic of India concerning the rules of allocation and transfer of aid made available from the Community. It is not correct to consider that the position of the Community is fundamentally different from that of the other donors, because its aid is in the form of grants. This is the case of several other important donors, e.g. UK aid (largest bilateral donor with more than 200 Mio ECU annually) is 100 % grant. Also Danish and Dutch project aid, which like the Community covers local costs, is in grant form.

Possible solutions offered by the Fund mechanism

3.23. However, it is no problem for the Commission in the financing proposals and agreements to present the system in a more transparent way, though the system should be well known to all the Members States providing bilateral aid to India. But it will not, and should not, determine which projects can be considered for EEC financing.

Collection of customs duties

3.29. This problem has only arisen recently with the project NA/82/30, Fish Farming in Kashmir, as it is the first project with an equipment import component. Even though taxes and duties are not financed out of EEC contributions, their application increases the cost and financial burden of the projects and implies a decrease in the additional funds for the projects for which the EEC aid is provided as grants. Hence, the Indian authorities were strongly requested during the last annual meeting to consider a general tax exemption. The Commission is pursuing this question.

Need for an outline agreement

3.30. to 3.32. The principle of cooperation for development aid is clearly set out in the Community's Agreement with India (Regulation (EEC) No 3246/81 of 26 October 1984), on commercial relations and economic cooperation with that country.

It should, however, be noted that the outline agreements reached with other countries, such as Indonesia, include general conditions similar to those in the financing agreements with India. Consequently, the conclusion of an outline agreement of this type with India would not add anything fundamental.

Discussions on an outline agreement might, on the other hand, make sense if some points of substance were included, notably a greater transfer of know-how leading to more dynamic cooperation.

The Commission therefore intends to initiate a change in Community cooperation with India (as with other countries), which was at first seen simply in terms of trade and aid, by broadening it to include cooperation in the following areas: industry, science and technology, energy and fishing, and hence also training, research and encouragement for cooperation between enterprises and for technology transfer.

As for financing aid projects, particular attention will be given to those which offer the possibility of technology transfer, notably as a result of cooperation between European and Indian firms.

Concerning procedural matters, the points highlighted in the Court of Auditors' report and discussed above will in the future be more clearly presented in the special provisions of the financing agreements.

4. CONCLUSIONS

4.1. to 4.4. In overall terms, the Commission shares the concern expressed by the Court of Auditors in its conclusions concerning increased transfers of technology, the search for additional export outlets and the establishment of more lasting ties with India.

However, in view of the fact that the intention of development aid is to benefit the poorest sections of the population, transfer of technology as a concept has to be applied with an awareness of the absorption capacities of the rural population and with due consideration for cultural and social factors. Contacts with Indian authorities indicate that they are prepared to examine together with the Commission how fresh ground can be broken in this respect.

The application of Indian know-how to help other less developed countries is a useful proposal which has already been put into practice, e.g. the Community has financed training courses in irrigation techniques for African technicians at specialized institutions in India.

As for the question of the negotiation of a framework agreement, it will be kept in mind as a possibility for improving development cooperation between India and the Community.