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IS THE NEW EUROPEAN NEIGHBOURHOOD AND  
PARTNERSHIP INSTRUMENT SUCCESSFULLY LAUNCHED  
AND ACHIEVING RESULTS IN THE SOUTHERN CAUCASUS  
(ARMENIA, AZERBAIJAN AND GEORGIA)?



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Special Report No 13 // 2010

# IS THE NEW EUROPEAN NEIGHBOURHOOD AND PARTNERSHIP INSTRUMENT SUCCESSFULLY LAUNCHED AND ACHIEVING RESULTS IN THE SOUTHERN CAUCASUS (ARMENIA, AZERBAIJAN AND GEORGIA)?

(pursuant to Article 287(4), second subparagraph, TFEU)

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**REPLY OF THE COMMISSION**

# ACRONYMS AND ABBREVIATIONS

**AP:** annual programme

**DG RELEX:** Directorate General for External Relations

**EC:** European Commission

**ENP:** European Neighbourhood Policy

**ENPI:** European Neighbourhood and Partnership Instrument

**EU:** European Union

**EuropeAid:** Directorate General for External Cooperation Programmes

**GFSM:** Government Finance Statistics Manual

**MEDA:** Mediterranean Development Assistance (Measures to accompany the reform of economic and social structures in the Mediterranean non-member countries)

**PAO:** Programme Administration Office

**PFM:** Public Finance Management

**Tacis:** technical assistance to the Commonwealth of Independent States

**VET:** Vocational Education and Training

# SUMMARY

## I.

The European Neighbourhood and Partnership Instrument was launched in 2007 as a new framework for planning and delivering assistance to 17 partner countries and territories. It became the main instrument for EU financial support to the three countries in the Southern Caucasus (Armenia, Azerbaijan, Georgia) which are of strong economic and strategic interest for the EU (see paragraphs 1 to 6).

## II.

The objective of the audit was to assess whether the new ENPI was successfully launched and achieving results in the Southern Caucasus. The overall question is answered by addressing three sub-questions:

- (a) Were the first annual action programmes well designed?
- (b) Has the implementation of the first annual action programmes led to timely and successful achievements?
- (c) Has the Commission adequately exploited the delivery tools available under the European Neighbourhood and Partnership Instrument?

## III.

The Court's audit examined the planning system to define EU assistance priorities, the achievements of the first annual action programmes and the deployment of the various delivery tools.



## SUMMARY

### IV.

As regards programming and design, the Commission applied a multiannual planning system to define EU assistance priorities in line with the ENPI Regulation. However the usefulness of the programming work was reduced by insufficient clarity and prioritisation. The lengthy programming and design process did not suit the fast changing and conflict-affected environment of the Southern Caucasus, endangering the relevance of the assistance. Programming and design of assistance were not sufficiently guided by a structured dialogue with the beneficiary countries (see paragraphs 10 to 34).

### V.

Achievements overall were mixed. While the programme for Vocational and Educational Training in Armenia positively influenced and strengthened the reform process, hardly any concrete steps had been taken towards achieving progress for energy reform in Azerbaijan. The programme for public finance management reform in Georgia progressed very little during its first 12 months but change was stimulated in the second year. In the conflict region of Abkhazia, the ENPI has not yet proved to be an appropriate instrument for economic rehabilitation and confidence building. The Twinning tool was still in the start-up phase (see paragraphs 35 to 56).

### VI.

Concerning the delivery tools, the Commission succeeded in varying the way in which it provided financial assistance by bringing in sector budget support and Twinning. However the predominant tool, sector budget support, was insufficiently prepared, compromising performance. The use of delivery tools has not been selective enough (see paragraphs 57 to 66).

### VII.

On the basis of these observations, the Court makes recommendations which could help the Commission to increase the effectiveness of the assistance given to Armenia, Azerbaijan and Georgia (see paragraphs 67 to 75). Key recommendations are streamlining the programming and design process and using the tool of sector budget support more selectively.

# INTRODUCTION

1. Following the enlargement of 2004 the European Union (EU) has sought to avoid new dividing lines in Europe and to promote stability and prosperity within and beyond the new borders of the EU. A new European Neighbourhood Policy (ENP) was developed, based on action plans agreed between the EU and each partner country.
2. The ENP aims to go beyond the existing Partnership and Cooperation Agreements to offer neighbouring countries the prospect of an increasingly closer relationship with the EU. The overall goal is to foster the political and economic reform processes, promoting closer economic integration as well as approximation to EU standards and sustainable development.
3. The European Neighbourhood and Partnership Instrument (ENPI)<sup>1</sup> was launched in 2007 as a new framework for planning and delivering assistance. With an envelope of 5,6 billion euro for the period 2007–10, the ENPI provides assistance to 17 partner countries and territories: ten in the Mediterranean region<sup>2</sup>, four in eastern Europe<sup>3</sup> and three in the Southern Caucasus (Armenia, Azerbaijan, Georgia) (see **Map — Southern Caucasus**). By replacing Tacis<sup>4</sup> and MEDA<sup>5</sup>, the ENPI became the main instrument for EU financial support to these countries.

<sup>1</sup> Regulation (EC) No 1638/2006 of the European Parliament and of the Council of 24 October 2006 laying down general provisions establishing a European Neighbourhood and Partnership Instrument (OJ L 310, 9.11.2006). The Regulation applies from 1.1.2007 to 31.12.2013.

<sup>2</sup> Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestinian territories, Syria, Tunisia.

<sup>3</sup> Belarus, Moldova, Russian Federation, Ukraine.

<sup>4</sup> Technical assistance to the Commonwealth of Independent States.

<sup>5</sup> Financial and technical measures to accompany the reform of economic and social structures in the framework of the Euro-Mediterranean partnership.

MAP

## SOUTHERN CAUCASUS



Source: Eurostat.

4. The most significant components of the ENPI are the annual action programmes, devoting 311 million euro to the three Southern Caucasus countries for the period 2007–10<sup>6</sup>. In addition to these national allocations, the countries benefit from ENPI multi-country, cross-border and regional programmes, as well as from programmes financed by specific budget lines.
5. The ENPI offers a broader range of tools for delivering assistance (see *Annex I*) than the former Tacis instrument, including Twinning<sup>7</sup> and sector budget support. The Commission defines sector budget support as ‘the transfer of financial resources from an external financing agency to the National Treasury of a partner country in support of a sector programme, following the respect by the latter of agreed conditions for payment. The financial resources thus received are part of the global resources of the partner country, and are consequently used in accordance with the public financial management system of the partner country’.
6. While the Southern Caucasus is on the fringe of the ENP Eastern Region (only Georgia, via the Black Sea, shares a sea border with the EU), the countries are of strong economic and strategic interest for the EU. The Court has never previously targeted the Southern Caucasus region for a performance audit, whereas two audits covered the adjoining eastern European states of firstly the Russian Federation (2006)<sup>8</sup>, then Belarus, Moldova and Ukraine (2008)<sup>9</sup>. The other region within the ENP, the Mediterranean countries, was the subject of a Special Report published in 2006<sup>10</sup>.
- <sup>6</sup> The funds are allocated as follows: Armenia 98,4 million euro, Azerbaijan 92,2 million euro and Georgia 120,4 million euro. Following the 2008 conflict in Georgia, the Commission decided to increase Georgia’s allocation by 61,5 million euro (see *Annex V*).
- <sup>7</sup> Secondment of national experts by public administrations of EU Member States to the beneficiary countries on a full-time and long-term basis. Twinning contracts constitute the legal documents, which commit both parties to achieving the results desired.
- <sup>8</sup> Special Report No 2/2006 concerning the performance of projects financed under Tacis in the Russian Federation (OJ C 119, 19.5.2006).
- <sup>9</sup> Special Report No 9/2008 concerning the effectiveness of EU support in the area of freedom, security and justice for Belarus, Moldova and Ukraine (OJ C 71, 25.3.2009).
- <sup>10</sup> Special Report No 5/2006 concerning the MEDA programme (OJ C 200, 24.8.2006).

# AUDIT SCOPE AND APPROACH

- 7.** The objective of the audit was to assess whether the new ENPI was successfully launched and achieving results in the Southern Caucasus. The audit focused on the first ENPI annual action programmes which were approved by the Commission in the period October to December 2007. These programmes have a multiannual period of execution allowing payments up to 2013.
- 8.** The overall audit question is answered by addressing three sub-questions:
- (a) Were the first annual action programmes well designed?
  - (b) Has the implementation of the first annual action programmes led to timely and successful achievements?
  - (c) Has the Commission adequately exploited the delivery tools available under the ENPI?
- 9.** Firstly, the audit examined the strategic planning system for determining the assistance priorities principally at Commission Headquarters (DG RELEX and EuropeAid in Brussels). Secondly, on the spot missions were carried out between March and November 2009 in each of the three countries to verify the first operational achievements and the delivery tools applied<sup>11</sup>. These missions included visits to the EC Delegations and to national implementing bodies as well as to monitoring units<sup>12</sup>.

<sup>11</sup> The corresponding payments took place in 2008 and 2009.

<sup>12</sup> The Commission contracts a consortium to monitor the programmes.

# OBSERVATIONS

## WERE THE FIRST ANNUAL ACTION PROGRAMMES WELL DESIGNED?

- 10.** The ENPI regulation requires multiannual programming and strategy papers. Multiannual programming helps to identify recipient country needs and to translate them into strategic development objectives. The subsequent design phase turns development objectives into programme and project proposals (identification and formulation) and concludes with a decision on a financial contribution.
- 11.** The Court examined whether the planning system identifies and prioritises the needs of the recipient countries in a clear and timely way, based on a structured dialogue with the beneficiaries.

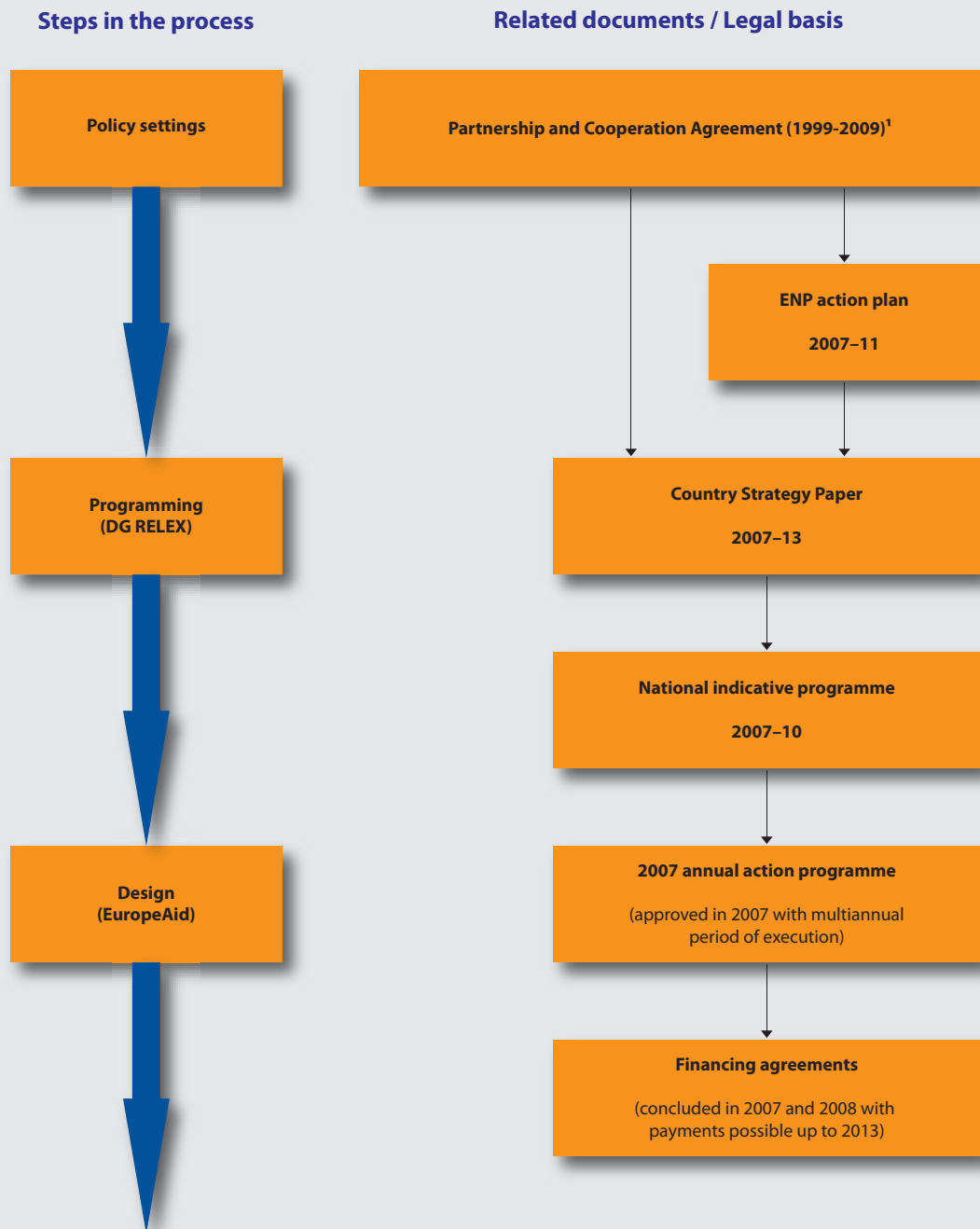
## A STRATEGIC FRAMEWORK IS IN PLACE

- 12.** The development of the first annual action programmes was the result of a strategic planning process. The steps of this process, the related documents and the links between the documents were analysed by the Court (see **Diagram 1**). Two Directorates General of the Commission are responsible: DG RELEX carries out the multiannual programming while EuropeAid designs and implements the yearly programmes.
- 13.** After intensive preparatory work by the Commission, the ENP action plans were bilaterally agreed in November 2006 between the EU and Armenia, Azerbaijan and Georgia. Together with the Partnership and Cooperation Agreements of 1999<sup>13</sup>, they form the main policy framework for the ENPI.

<sup>13</sup> These agreements form the legal basis of the relations between the EU and the three countries. They were concluded for an initial period of 10 years and are automatically renewed thereafter year by year provided that neither party gives written notice of denunciation.

## DIAGRAM I

## OVERVIEW OF AUDITED DOCUMENTS LINKED TO PLANNING PROCESS



<sup>1</sup> Automatically renewed year by year if no notice of termination.

**14.** Based on this framework, DG RELEX developed two strategic documents for each of the three countries:

- (a) the 2007–13 Country Strategy Paper. This paper does not contain any financial forecast but provides an overview of all future EC assistance priorities<sup>14</sup> to be covered in the next seven years;
- (b) the 2007–10 national indicative programme. This document translates the assistance priorities of the Country Strategy Paper into funding priorities for the next four years under the national allocation of the ENPI. It includes an estimate of the overall amount needed and gives an indicative breakdown of resources for the selected priorities.

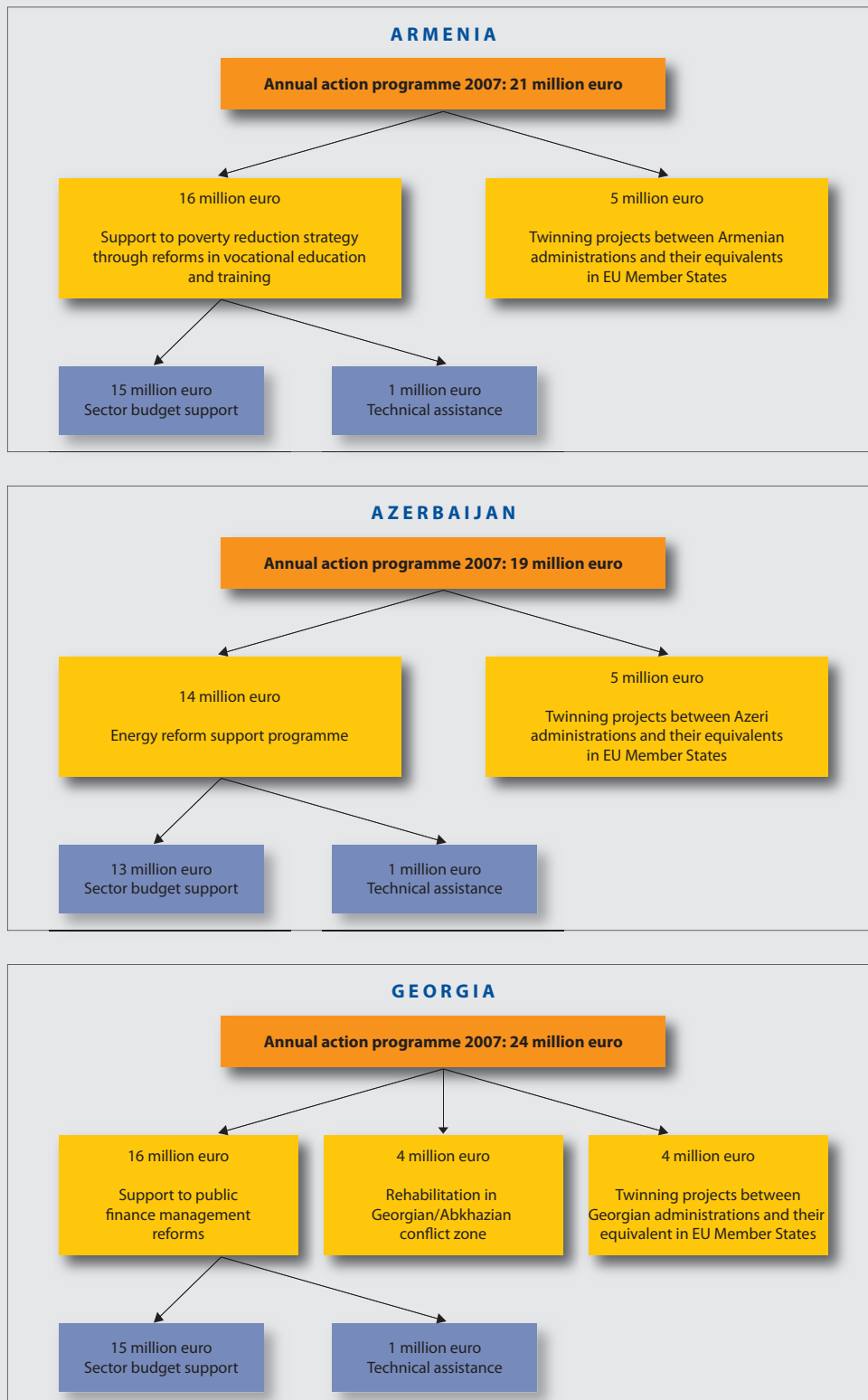
**15.** Next, EuropeAid designed the 2007 annual action programmes (see *Diagram II*). Different assistance priorities were fixed for the three countries based on the priority areas identified in the national indicative programmes:

- (a) in Armenia highest priority was given to vocational education and training (VET). The Commission considers that progress in this area should help to reduce poverty in the medium and long term (see paragraphs 36 to 39);
- (b) in Azerbaijan, highest priority was given to the energy sector, with an emphasis on renewable energy sources and energy efficiency (see paragraphs 40 to 44);
- (c) in Georgia, Public Finance Management was the highest priority, with EU support designed to contribute to fostering economic growth and reducing poverty in the medium and long term (see paragraphs 46 to 48). Economic rehabilitation and confidence building in conflict zones was a further priority (see paragraphs 49 to 52).

<sup>14</sup> Encompassing ENPI country programmes, multi-country programmes, cross-border cooperation programmes as well as thematic programmes and the Stability Instrument.

## DIAGRAM II

## OVERVIEW OF THE 2007 ANNUAL ACTION PROGRAMMES





16. The assistance is mainly given in the form of sector budget support, with an element of technical assistance to support implementation. In addition, all three 2007 annual action programmes included a Twinning facility for the cooperation between beneficiary country administrations and their equivalents in EU Member States.
17. The last step in the design phase was the conclusion of financing agreements between the Commission and the beneficiary states. The financing agreements determine general and specific conditions as well as the technical and administrative provisions of the support.

#### **INSUFFICIENT CLARITY AND PRIORITISATION REDUCES THE BENEFITS OF MULTIANNUAL PROGRAMMING BY DG RELEX**

18. Weaknesses in the links between ENP action plan, Country Strategy Paper and national indicative programme contribute to insufficient clarity in planning. The effectiveness of programming is reduced by insufficient prioritisation (see paragraphs 19 to 27).
19. Clarity is compromised when the same subject is treated within individual documents in different ways. For instance, in Armenia, the subject of education is covered in the Country Strategy Paper under two headings: 'Economic and social reform, poverty reduction and sustainable development' and 'People-to-people contacts'. Furthermore, the same priorities are sometimes reformulated and restructured from one document to the next. In Georgia, for example, the issue of Public Finance Management appears under different priority headings throughout the strategic documents.
20. Three different time frames are used at strategic level. The ENP action plan covers five years, while the Country Strategy Paper covers the entire seven years of the EU's financial perspectives and the national indicative programme covers four years.

- 21.** The ENP action plan should provide a key reference point for setting assistance priorities, laying out a range of priority areas, specific actions and general objectives. However, the many priority actions and their wide formulation undermine the attempt at prioritisation (see **Box 1**).
- 22.** The Country Strategy Paper 2007–13, derived in part from the ENP action plan, gives a good overview of the country’s situation but does not help much to narrow down priorities. The consequent national indicative programme 2007–10, covering a shorter, four-year period, reduces the number of main priorities but introduces new sub-priorities. Thus, a wide range of subjects remains eligible for financial assistance (see **Box 2**). This contrasts with the practice in other areas of external assistance<sup>15</sup>, where usually only two focal sectors are identified.

<sup>15</sup> Development and Cooperation Instrument; European Development Fund.

#### BOX 1

### WIDE PRIORITY SETTING IN ENP ACTION PLAN: EXAMPLE ARMENIA

The ENP action plan for Armenia determines eight priority areas for cooperation including 54 specific actions. These priority areas are complemented by a further 248 actions listed under seven ‘General Objectives’, subdivided into 20 sub-objectives, subdivided into 62 sub-sub-objectives.

#### BOX 2

### WIDE RANGE OF SUBJECTS FOR POSSIBLE FINANCIAL ASSISTANCE IN NATIONAL INDICATIVE PROGRAMME: EXAMPLE AZERBAIJAN

The national indicative programme for Azerbaijan has three very widely formulated priority areas (e.g. ‘Support for democratic development and good governance’), 10 sub-priorities (e.g. ‘Environment’) and 19 specific objectives (e.g. ‘Facilitate trade and improve the investment climate and the employment and social situation in a sustainable manner’).

23. The national indicative programme adds little to the Country Strategy Paper, apart from giving the indicative budget for the priorities selected for years 2007–10. It does not propose a timescale for implementing priorities. Moreover, long-term impact, specific objectives, expected results and indicators of achievement are only described in a rather general and broad way. Nor is there specific guidance on sectors suitable for the Twinning instrument or for sector budget support. The latter is encouraged and recommended only very generally ‘as the first choice ... wherever necessary conditions are met’<sup>16</sup>.

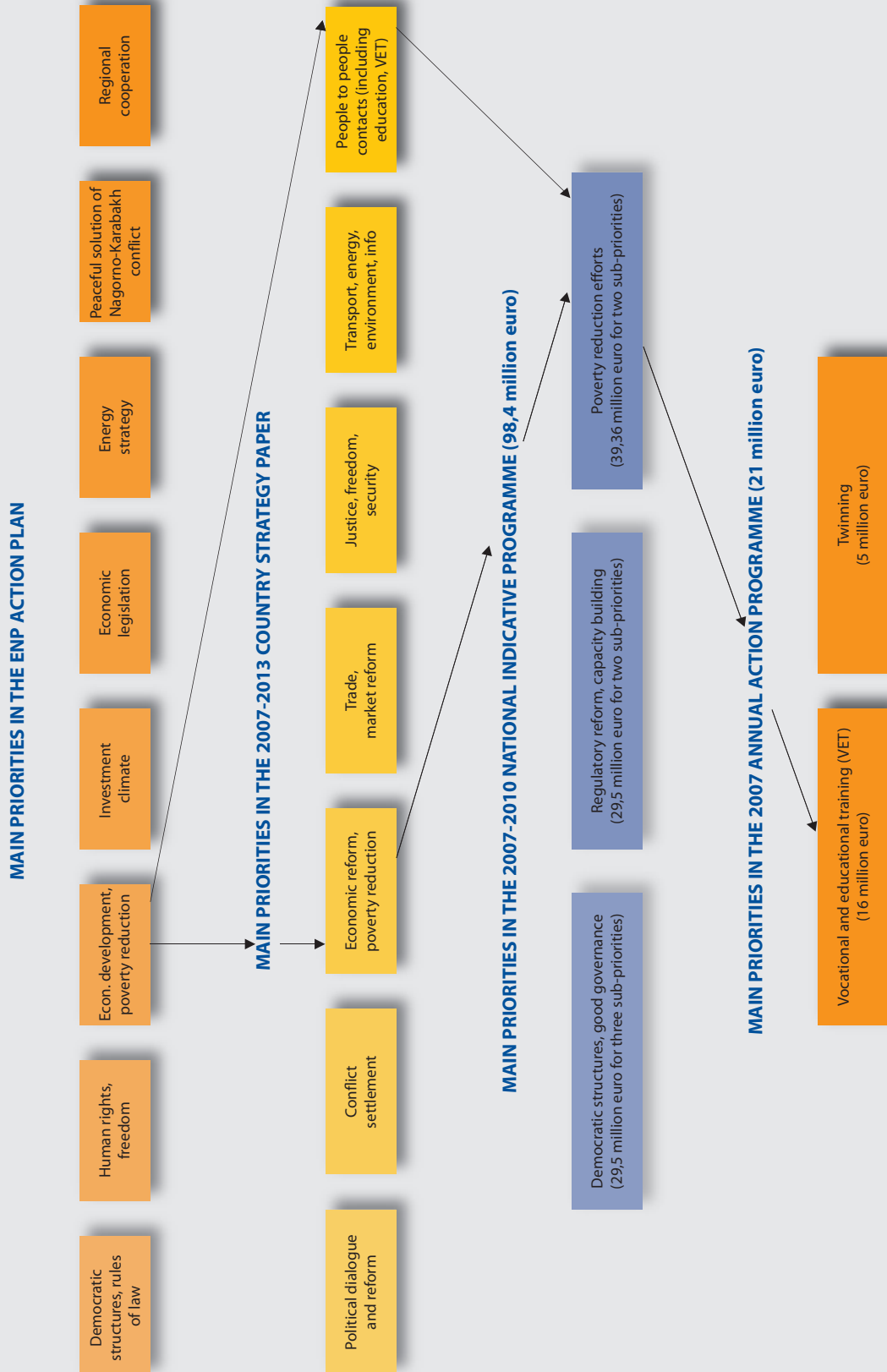
<sup>16</sup> See 2007–10 national indicative programme for Armenia.

**AREAS SELECTED FOR ASSISTANCE DID NOT DERIVE CLEARLY ENOUGH FROM THE PROGRAMMING DOCUMENTS**

24. The Country Strategy Paper and national indicative programme provided all the areas where the assistance could be given in the next seven year period (2007–13), including indicative allocations for the next four year period (2007–10). Within the Commission, responsibility for determining where to focus in year one (2007) fell to EuropeAid (see paragraph 12).
25. In deciding where to focus, EuropeAid was strongly guided by its commitment to channel at least 50 % of the Community aid via national systems (see paragraph 58). In this way, the suitability of an area for sector budget support became an important factor for determining assistance in the 2007 annual action programmes.
26. For example, in Armenia VET was selected as the main area to be covered in the first annual action programme. However, none of the strategic documents highlight VET; it is concealed among the 25 specific objectives of the seven sub-priorities in the 2007–10 national indicative programme (see **Diagram III**). In Georgia, Public Finance Management, the main focus of the annual action programme had only marginal importance within both the Country Strategy Paper priorities (where it is the last indent within the fifth priority) and the national indicative programme, where it is mentioned within the third sub-priority of the first priority area.

DIAGRAM III

LINKS OF PRIORITY SETTING IN THE 2007 ANNUAL ACTION PROGRAMME TO STRATEGIC DOCUMENTS (EXAMPLE OF ARMENIA)



Source: European Court of Auditors analysis based on Commission's strategic documents.

27. When using sector budget support as the principal tool, the EU will only be able to address meaningfully around half of the sub-priorities defined by the 2007–10 national indicative programmes, since sector budget support involves a relatively high share of the available annual funding. For instance, in Azerbaijan during the four-year period, sector budget support programmes will only cover four out of 10 sub-priorities.

<sup>17</sup> According to the ENPI Regulation, strategy papers shall be reviewed at mid-term or whenever necessary and may be revised.

### TWO YEAR PROGRAMMING AND DESIGN PROCESS INVOLVES RISKS TO THE RELEVANCE OF THE ASSISTANCE

28. The 2007 annual action programme resulted from a programming (DG RELEX) and design process (EuropeAid) lasting more than two years. In Georgia for example, the first payments under the 2007 annual action programme took place in February 2008, while the first strategic needs assessment in view of the Country Strategy Paper occurred in November 2005 (see *Table*).
29. The Country Strategy Paper, national indicative programme and annual programme were subject to a series of quality control and consultation procedures before they were approved by the Commission. The process comprised mainly assessments from the Commission's quality support groups, the Commission's inter-service consultation procedure, review by the ENPI Management Committee of the Member States and scrutiny by the European Parliament.
30. While each programming step had its own justification, together they contributed to a lengthy planning schedule. The main reason for the long start-up phase of the ENPI is that the quality control and approval procedures were carried out in two successive stages: first under the responsibility of DG RELEX for the 2007–13 Country Strategy Paper and the 2007–10 national indicative programme, and subsequently under EuropeAid for the 2007 annual action programme. However, these successive procedures in DG RELEX and EuropeAid take place only when the Country Strategy Paper or the national indicative programme are introduced or revised<sup>17</sup>.

TABLE

### ENPI PROGRAMMING STEPS AND DESIGN PROCESS FOR 2007 ANNUAL ACTION PROGRAMME (EXAMPLE GEORGIA)

Phases	Key processing steps	Time	Main responsible DG	Planning instrument
Main drafting	First concept paper and mission to Tbilisi by DG RELEX	Nov. 2005	RELEX	Country Strategy Paper 2007–13 + national indicative programme 2007–10
	Programming mission to Tbilisi	June 2006		
	Georgia Country Team meeting	July 2006		
	Presentation of draft Country Strategy Paper / national indicative programme (NIP) to Georgian authorities	Sept. 2006		
Quality control + redrafting + democratic scrutiny	Assessment by interservice Quality Support Group	Sept. 2006		
	Submission of comments by Georgian authorities	Oct. and Nov. 2006		
	Inter-service consultation	Nov. 2006		
	Meeting of ENPI Management Committee	Dec. 2006		
Formal approval	Consultation of European Parliament	Dec. 2006		
	Agreement by Georgia on the NIP's budget and priorities	Feb. 2007		
Formal approval	Approval by Commission	March 2007		
	Approval by Commission	March 2007		
Main drafting	Identification and formulation of measures to be financed (including mission to Georgia)	End 2006/start 2007	EuropeAid	National programme 2007 + financing agreements
Quality control + redrafting + democratic scrutiny	Assessment by operational quality support group (in two consecutive steps) of (1) identification fiches	Feb. 2007		
	(2) action fiches	April 2007		
	Inter-service consultation	May 2007		
	Meeting of ENPI Management Committee	July 2007		
Formal approval	Consultation of European Parliament	Sept. 2007		
	Approval by Commission	Oct. 2007		
Formal approval	Signature of financing agreements with Georgia	Dec. 2007/Jan. 2008		
	Signature of financing agreements with Georgia	Dec. 2007/Jan. 2008		
First payments		Feb. 2008		

- 31.** A risk of such a long schedule is the loss of relevance of the assistance. A further issue is whether the strategy could cover a shorter period than the seven years of the financial perspectives. In the fast changing and conflict-affected environment of the Southern Caucasus countries, losses of relevance arise inevitably for such a long-term strategy, calling for mid-term revisions. The August 2008 war between Georgia and Russia created significant new needs (see **Annex V**). In Armenia, the major political crisis during the first half of 2008<sup>18</sup> led to needs not covered by the strategy, with the result that EU advisory groups were established to give direct advice to the government (see paragraph 65). Another example of a new development is the increased political will to launch the Eastern Partnership<sup>19</sup>. Generally, the countries' situation changed considerably because of the worldwide financial and economic crisis.

<sup>18</sup> The country was badly affected by a political crisis during the first half of 2008 following contested presidential elections in February 2008.

<sup>19</sup> Joint Declaration of the Prague Eastern Partnership Summit, Prague, 7 May 2009.

<sup>20</sup> The change took place in February 2008.

#### **PROGRAMMING AND DESIGN OF ASSISTANCE ARE NOT SUFFICIENTLY GUIDED BY A STRUCTURED DIALOGUE WITH BENEFICIARY STATES**

- 32.** The partnership principle demands that the counterparts from beneficiary countries are included to the greatest possible extent in the programming and design of all operations. For the Southern Caucasus countries several factors made a systematic and balanced dialogue difficult:
- (a) the Commission was thinly represented on the spot in Armenia and Azerbaijan. The regional Delegation in Yerevan (Armenia) had yet to be transformed into a fully fledged Delegation<sup>20</sup>; the Delegation in Baku (Azerbaijan) was first established in February 2008 but only became fully operational in 2009;
  - (b) the Commission's focus on internal procedures in the programming (DG RELEX) and design process (EuropeAid) limited the opportunities for a dialogue with the beneficiary countries: while the Commission has established various rules and guidelines for its internal dialogue, there were no specific guidelines for structured dialogue with the beneficiary country;
  - (c) the National Coordinating Units within the beneficiary countries failed to bring together the different positions and interests inside the country and thus could not act as an effective interlocutor between the Commission and the governments.

- 33.** As a result, the consultations with national authorities, other donors and civil society organisations on priority setting in the Country Strategy Paper, national indicative programme and annual action programme were limited. The dialogue was mainly driven by the Commission Headquarters (DG RELEX and EuropeAid), restricting a direct exchange of views to the few days of in-country missions. From the Commission's subsequent reports of these visits it was not always evident what had been discussed.
  
- 34.** As a result of weaknesses in dialogue the three countries sometimes misunderstood the different purposes of the various planning documents as well as the nature of the new delivery tools. Neither were the countries always aware of when their comments on priorities or programmes could still influence the decision-making of the Commission.



### HAS THE IMPLEMENTATION OF THE FIRST ANNUAL ACTION PROGRAMMES LED TO TIMELY AND SUCCESSFUL ACHIEVEMENTS?

- 35.** Three years after the launch of the ENPI in 2007, the Court examined how the EU's decisions to provide financial assistance had been translated into activities on the ground and to what extent these activities had contributed towards the achievement of the programmes' intended results.

#### ARMENIA: REFORM PROCESS WAS STRENGTHENED IN ASSISTANCE PRIORITY 'VOCATIONAL EDUCATIONAL TRAINING' BUT PROGRESS IS STILL VERY FRAGILE

- 36.** The first sector budget support programme for VET under the ENPI was launched in January 2008 (see paragraph 15(a)) with the overall objective of supporting the government's Poverty Reduction Strategy. The purpose was to increase the quality of the VET sector and bring the structure and context of the VET system in line with labour market skill needs, thus promoting employability of the active population and business competitiveness.
- 37.** Payment of the sector budget support depended on the fulfilment of general conditions<sup>21</sup> and of specific conditions relating to VET. The latter included the selection and upgrade of regional VET centres and the building up of national VET institutions. The budget support was payable in three instalments of 5 million euro each, the first being fixed and the second and third being variable depending on the degree to which conditions were fulfilled.

<sup>21</sup> Continue implementation of a sound policy for macro-economic stabilisation; continue improvement in public finance; making available documents relating to the implementation of the programme.

- 38.** The Commission paid the first fixed instalment of 5 million euro in June 2008. To determine how much of the second variable instalment to pay, the Commission contracted external experts at the end of 2008 to review the progress of the reforms. On the basis of the experts' conclusion that not all conditions had been met, although reasonable progress had been made, in January 2009, the Commission released 3,25 million euro out of the 5 million euro maximum (see *Annex II*). The reduced payment prompted the government to take further action, such as providing equipment for regional VET centres and allocating extra staff to the VET department of the Ministry of Education and Science.
- 39.** Overall, the Court concluded that the first sector budget support programme under the ENPI positively influenced and strengthened the VET reform process in Armenia. However progress was still very fragile as the support programme did not tackle certain structural obstacles:
- (a) the sector programme had not yet sufficiently addressed the demand side of VET, such as how to gauge the needs of employers and the unemployed;

## BOX 3

**LACK OF FUNDING IN REGIONAL VET CENTRES**

Renovation at Ijevan college comprised a new roof, installing gas central heating and replacing the windows by the entrance and the central stairway. While a modern heating system supplanted wood-burning stoves in the classrooms, its effectiveness was undermined by the failure to replace more than about 10 % of the windows. The old windows were ill-fitting and revealed frequent cracks.

At Vanadzor, by contrast, all the windows had been replaced. But the new gas central heating relied on old radiators which had not been used for around 20 years. The extent of the renovations thus appeared insufficient, with no money even to upgrade the very basic toilet facilities.

Equipment procured for Ijevan consisted of general items (classroom and office furniture, computers, sports equipment), material for basic courses plus items for specialised courses (vehicle repairs and wood-processing). While welcoming the new supplies, the college Director mentioned the need to refurbish rooms to install everything. The money was not yet available. The college was experiencing funding problems generally, since student numbers had fallen by 230 (from 780) over the previous two years, due to Yerevan State University opening a branch in Ijevan.

- (b) the fragmented government responsibility for VET institutions, causing difficulties for sector coordination. Out of 82 state-run colleges, only 51 fall under the responsibility of the Ministry of Education and Science with the remainder under the responsibility of other ministries;
- (c) without significant increases in regular funding, particularly from the state, VET reform can accomplish little. The auditors' site visit to two colleges targeted by the programme (Ijevan and Vanadzor) revealed how lack of funding was undermining the objective to transform them into sustainable regional VET centres. The extent of the renovations appeared to be incoherent and minimal (see **Box 3**).

#### **AZERBAIJAN: UNSATISFACTORY PROGRESS IN ASSISTANCE PRIORITY 'ENERGY'**

- 40.** Azerbaijan has rapidly become a significant producer of oil and gas, as well as an emerging transit country for supplies to the EU from the Caspian Basin and Central Asia. The importance of the energy sector for both sides has been reflected in a 'Specific Memorandum of Understanding on a strategic partnership between the EU and the Republic of Azerbaijan in the field of energy', concluded in November 2006.
- 41.** The sector budget support programme under the ENPI focuses on two areas undeveloped in Azerbaijan: renewable energy sources and energy efficiency (see paragraph 15(b)). The total assistance of 13 million euro is planned to be disbursed over a three-year period through an initial fixed instalment of 3 million euro and two subsequent variable instalments of 5 million euro each.
- 42.** While the release of the first fixed tranche depends only on the fulfilment of two general conditions, the release of the subsequent 5 million euro variable instalments in full also requires the fulfilment of five specific conditions. These comprise the approval by the government of a comprehensive energy strategy, three measures in the fields of renewable energy sources and energy efficiency (action plans, a new legislative framework, the creation of a state agency) and the adoption of a PFM action plan (see **Annex III**).

- 43.** At the moment of the Court's on-the-spot visit in November 2009, Azerbaijan had not yet requested any payment. Two years of stagnation had followed the Commission's financing decision in December 2007 (see **Box 4**). Hardly any concrete steps had been taken towards achieving the programme objectives. The sector strategy was not revised and a sector policy dialogue was not established. So far then, the offered EU sector budget support could scarcely create any incentive or leverage to speed up the intended reform process.
- 44.** Nevertheless, Azerbaijan showed some interest in developing renewable energy sources. For example, independently from EU support, three pilot wind turbines were erected in 2008 and 2009 on the coastal plain north of Baku and measures were being taken for the creation of a first wind farm in the same area. However, studies by various donors highlighted the lack of a national framework for private intervention in the renewable field, such as a guarantee of access to the electricity grid. Powerful national producers need to agree to changes in the direction of state policy in order to ensure progress.

**BOX 4**

### **AZERBAIJAN: LITTLE PROGRESS IN THE TWO YEARS FOLLOWING THE COMMISSION'S FINANCING DECISION ON THE ENERGY REFORM SUPPORT PROGRAMME**

The preparatory period for the implementation of the energy reform support programme was exceptionally long compared to the other two countries. After the Commission's financing decision in December 2007, two years passed: a one-year process of reflection in Azerbaijan before the signing of the corresponding financing agreement in December 2008, followed by a further year to define the internal implementation modes for the new sector budget support tool. A reason was lengthy internal approval procedures in Azerbaijan, combined with insufficient information from the Commission on the new assistance tool.

The internal implementation modes introduced by Azerbaijan emphasised the procurement and spending of the EU assistance (13 million euro), whereas only the compliance with the conditions of the support programme would ensure the release of funds by the Commission.

**GEORGIA: MODEST PROGRESS IN ASSISTANCE PRIORITY 'PUBLIC FINANCE MANAGEMENT' AND NO PROGRESS IN ASSISTANCE PRIORITY 'ECONOMIC REHABILITATION AND CONFIDENCE BUILDING'**

45. As explained in paragraph 15(c), assistance in Georgia was given principally to the area of 'Public Finance Management' (PFM). 'Economic rehabilitation and confidence building for Abkhazia/Western Georgia' was chosen as a further priority.

**PUBLIC FINANCE MANAGEMENT**

46. The ENPI sector budget support programme for PFM reform (15 million euro), launched in December 2007, aimed to address the goal of 'improving efficiency in public service and thereby contributing to poverty reduction'. The budget support was payable in three equal instalments of 5 million euro, the first being fixed and the second and third each a combination of fixed and variable instalments. Seven specific conditions targeted the overall planning and monitoring of the PFM reform agenda as well as advances in six areas of the PFM system. **Annex IV** shows the specific conditions for the second instalment.

- 47.** The PFM programme began slowly, with insufficient effort on the Georgian side to engage in reform. The Delegation complained about the difficulty of constructive dialogue with their Georgian counterparts. Nevertheless, in December 2008 EuropeAid released part of the second instalment, paying 4 million euro out of a maximum of 5 million euro. This disbursement decision was based on two successive external reviews of the progress made: one concluding negatively (November 2008) and a subsequent one concluding positively on the basis of new evidence made available at the time (December 2008). The Court noted that, given the very difficult situation in Georgia as from August 2008, the Commission considered the efforts in PFM reforms as sufficient to allow them to release. Nevertheless, the Court also observes that not all conditions set to release this instalment had been met.
  
- 48.** To summarise, the PFM programme progressed very little during its first 12 months. However, the beginning of 2009 saw an encouraging change of attitude from the Georgian side. For example, having shown hostility in 2008 towards the concept of internal audit, the government adopted an Internal Audit Strategy in 2009. Their increased receptiveness towards PFM reform might be explained by changed basic conditions. After the twin shock of the August 2008 conflict with Russia and the global recession, the Georgian economy depended on outside aid, leading the government to pay more attention to inflows of EU budget support.

#### ECONOMIC REHABILITATION AND CONFIDENCE BUILDING

- 49.** After Georgia's independence from the Soviet Union in 1991, conflicts with secessionist movements in the areas of Abkhazia and South Ossetia had ended with ceasefire agreements and a situation of 'no war, no peace'. Since then, the EU had been supporting programmes for social and economic rehabilitation in both areas. And in Georgian government-controlled areas, the EU had financed measures to support 'internally displaced persons'. The August 2008 war between Georgia and Russia represented a setback for these programmes, with the peace-building process between Georgia and its break-away territories largely destroyed.
- 50.** The first programme under the ENPI (technical assistance) envisaged 4 million euro for economic rehabilitation and confidence-building measures. This programme, focusing on rehabilitation in the break-away region of Abkhazia, did not materialise as, already before the August 2008 war, the funds were de facto blocked, although the financing agreement had been signed by both the Commission and the Georgian authorities in January 2008. Political concerns on the part of both Georgia and Abkhazia have prevented any progress:
- (a) the general worry of the Georgian authorities has been that external support to Abkhazia could stabilise its break-away status. For example, they feared that schools in Abkhazia could be supported where the Georgian language might not be used or taught, or that projects could be implemented directly by local non-governmental organisations (NGOs), favouring separatism;
  - (b) the Abkhaz authorities seemed to perceive the EU's actions as being only in line with Georgian interests since the Georgian government alone agrees to and signs the programme.

- 51.** To conclude up to the end of 2009, the ENPI had not proven to be an appropriate instrument for economic rehabilitation and confidence building in the conflict region of Abkhazia.
- 52.** In contrast to Abkhazia, where the doors were still open for discussion, there has been no cooperation between South Ossetia and Georgia since the conflict, and all EU reconstruction projects under way have come to a standstill. There is no basis (such as political will or joint interest) for continuing with rehabilitation programmes. Consequently the Commission reallocated 6 million euro originally intended for the Georgia/South Ossetia conflict zone in the 2008 annual action programme to the needs of new 'internally displaced persons' in Georgian government-controlled areas, especially to further housing support. It should be noted that the implementation of similar measures involved risks relating to value for money (see *Annex V*).

#### ALL COUNTRIES: TWINNING UNDER ENPI WAS STILL IN THE START-UP PHASE

- 53.** The 2007 annual action programmes offer a Twinning facility, allocating 14 million euro in total to the three countries<sup>22</sup>. The Commission envisaged that the first Twinning projects should start in 2008. However, it was only in June 2009 that the first Twinning contract under the ENPI was signed in Georgia. In Armenia and Azerbaijan, several contracts were under preparation in the second half of 2009 but not yet signed. Thus, the start of the Twinning tool under the ENPI was delayed<sup>23</sup>.
- 54.** A main reason lay in the reluctance of the countries to devote resources to build up the necessary management structure for Twinning. Potentially, the incentive for approximation through Twinning is lowered by the lack of EU accession perspectives.

<sup>22</sup> The TAIEX instrument (Technical Assistance Information Exchange Office), previously reserved for EU candidate countries, was also made available to neighbourhood countries.

<sup>23</sup> However, in Azerbaijan, three Tacis-financed twinning contracts started in 2008.



- 55.** A Programme Administration Office (PAO) was required in each country to manage the Twinning tool. The Commission supported the establishment of these PAOs through successive Tacis projects. However, at the end of these projects, the PAOs were not yet able to steer and direct the Twinning tool independently. Instead of building up capacity, the external experts from the Tacis projects tended to take over the function of the PAO.
  
- 56.** The Commission provided further technical assistance contracts involving private consultants to prepare terms of reference for Twinning projects. Thus the early experience of Twinning involved substantial private sector input in a field where the knowledge should be the preserve of public bodies.

### HAS THE COMMISSION ADEQUATELY EXPLOITED THE DELIVERY TOOLS AVAILABLE UNDER THE EUROPEAN NEIGHBOURHOOD AND PARTNERSHIP INSTRUMENT?

- 57.** The effectiveness of the assistance depends to a large extent on wise use of the different modes of delivery. The Court examined whether the Commission applied adequately the new tool of sector budget support and employed the various tools available appropriately.

<sup>24</sup> Mainly transfer of expertise and know-how, including training but also supplies and assistance to catalyse and support investments.

### THE COMMISSION VARIED THE WAY IN WHICH IT PROVIDED FINANCIAL ASSISTANCE

- 58.** The new tool most strongly favoured by the Commission is sector budget support. The Commission, in line with current worldwide thinking amongst many donors, considers that support to government budgets offers greater potential for development than project-based assistance. Through bringing in sector budget support and Twinning, the Commission managed a change from the technical assistance projects predominating under Tacis<sup>24</sup>.
- 59.** The use of sector budget support is also in line with the 'European Consensus on Development' of December 2005, which aims to channel 50 % of government-to-government assistance through country systems. However, while the primary objective of EU development cooperation is poverty reduction, its cooperation with the Southern Caucasus countries has the principal objective of bringing them closer to the EU. For example, in the Country Strategy Paper for Georgia, the Commission underlined that the support for closer EU–Georgia economic and social integration should constitute the main focus of assistance. In this way, according to the Country Strategy Paper, the EU should have a role distinct from other donors who were focusing on development.

## SHIFT TO SECTOR BUDGET SUPPORT WAS INSUFFICIENTLY PREPARED, AFFECTING PERFORMANCE

- 60.** Several factors show that the Commission did not sufficiently prepare the shift to sector budget support, undermining its implementation (see problems described in paragraphs 39, 43 and 47):
- (a) conclusions on the pre-conditions for effective use of sector budget support were not sufficiently documented (see paragraphs 61 and 62);
  - (b) it was wrongly assumed that the partner countries would have a good understanding of the new sector budget support tool from earlier experience with similar types of measure (see paragraph 63);
  - (c) locally the Commission lacked expertise in the mechanisms of sector budget support. The Delegations had to rely extensively on the work of external experts for the technical aspects of implementation modes (e.g. designing the matrices of conditions or interpreting whether conditions were satisfactorily met).
- 61.** According to its own guidelines, before embarking on a sector support programme, the Commission should examine the situation in seven 'key assessment areas' (see **Box 5**). The Commission carried out such assessments but did not arrive at clearly documented conclusions. The assessments also tended to give substantial weight to what the beneficiary countries promised to do in the future. This weakness was particularly prevalent in assessing the existence of effective systems for monitoring and sector coordination. For example in Georgia, the Commission recognised the weak performance monitoring system in place but concluded only 'that the full introduction of the Medium-Term Expenditure Framework envisages that reliable and relevant performance indicators will be introduced'.

- 62.** Furthermore, the Court found no evidence that the Commission, before opting for sector budget support, assessed the alternatives for implementing a sector support programme, namely pool funding and EC project procedures<sup>25</sup>.
- 63.** In its planning documents the Commission expressed confidence that the budget support mechanism would be well understood by the beneficiary countries as they already had experience of similar measures. However, in practice the countries had learnt few lessons from these earlier experiences. Although the food security programmes in the countries had provided budget support for many years, they were too specific to serve as a useful guide for the introduction of sector budget support envisaged under the ENPI. For instance, food security programmes did not focus on reform of a single sector, did not involve the same ministries and tended to provide budget support in fixed as opposed to variable tranches.

<sup>25</sup> EuropeAid guidelines on support to sector programmes (July 2007).

## BOX 5

### SEVEN KEY ASSESSMENT AREAS FOR SECTOR SUPPORT PROGRAMMES

(1) The stability of the macro-economic framework (2) The credibility and relevance of a programme to improve Public Finance Management systems (3) The coherence and consistency of the sector policy and overall strategic framework (4) The credibility, comprehensiveness and transparency of the annual sector budgets, including a medium-term strategic budgeting perspective (5) The existence and effectiveness of a government-led system of sector and donor coordination (6) The existence and effectiveness of a performance monitoring system (7) The existence and effectiveness of a programme to strengthen institutional capacities.

*Source:* EuropeAid guidelines on support to sector programmes (July 2007).

## USE OF DELIVERY TOOLS HAS NOT BEEN SELECTIVE ENOUGH

- 64.** Essentially the 2007 annual action programmes offer only two main tools: sector budget support and Twinning (72 %<sup>26</sup> and 22 % respectively of the total budget allocation of all three countries). Traditional support through technical assistance projects only played a role in the rehabilitation of conflict zones in Georgia (6 %). This emphasis on sector budget support and Twinning within the annual action programmes has its limitations:
- (a) direct financial assistance to civil society and the private sector is only possible in specific programmes such as the instrument for the promotion of democracy and human rights<sup>27</sup> but hardly under the ENPI annual action programme; at the same time the visibility of the EU assistance is less evident through the predominant use of sector budget support;
  - (b) rapid, flexible and tailor-made solutions to specific problems are very difficult to fit into the framework of sector budget support and Twinning (see paragraph 65).
- 65.** In Armenia, direct ENP objectives were financed outside the ENPI. To assist the reform process in line with the ENP action plan, the Delegation established the 'EU advisory group' with funding from the Stability Instrument. The EU advisory group was supposed to offer comprehensive support to a number of key bodies such as ministries by providing personal advisers. This delivery tool comes in addition to Twinning, requiring coordination.
- 66.** The Court found sector budget support to be the preferred aid modality in the three countries, without resulting from a detailed evaluation between different tools. Concerning Azerbaijan, there were doubts about whether sector budget support should be used in a country benefiting from increasing oil and gas exports<sup>28</sup>. Thus the question of appropriateness of budget support was raised in the ENPI Management Committee meeting of September 2007. Nevertheless, the Commission opted for sector budget support as the main support tool in Azerbaijan. During the audit, representatives of the government stressed to the auditors that the country preferred technical assistance to budget support.

<sup>26</sup> Including 3 million euro technical assistance to get sector budget support off the ground.

<sup>27</sup> Regulation (EC) No 1889/2006 of the European Parliament and of the Council of 20 December 2006 on establishing a financing instrument for the promotion of democracy and human rights worldwide (OJ L 386, 29.12.2006, p. 1).

<sup>28</sup> 2006 was the first year of significant revenues from oil and gas exports.

# CONCLUSIONS AND RECOMMENDATIONS

- 67.** The Commission set the new ENPI in motion in the three countries of the Southern Caucasus, however with mixed results.

## **WEAKNESSES IN THE PLANNING PROCESS FOR THE FIRST ANNUAL ACTION PROGRAMMES**

- 68.** In line with the ENPI Regulation, the Commission applied a multiannual planning system to define EU assistance priorities. However, weaknesses in the links between ENP action plan, Country Strategy Paper and national indicative programme contribute to insufficient clarity in planning. Clarity was further reduced as the same priorities were reformulated and restructured from one document to the next. The usefulness of programming is reduced by insufficient prioritisation.
- 69.** These three successive documents did not sufficiently narrow down priorities. The areas selected for assistance in the first annual action programmes did not derive clearly enough from these strategic documents. Instead, the suitability of an area for sector budget support became an important factor for determining assistance in the 2007 annual action programmes. Moreover the three documents cover different time periods (five, seven and four years respectively).
- 70.** The programming and design process took over two years before the approval of the first annual action programmes. The main reason was that quality control and approval procedures occurred in two successive cycles in two different Directorates-General, DG RELEX and EuropeAid. The total length of the process does not suit the fast changing and conflict-related environment of the Southern Caucasus, endangering the relevance of the assistance.

- 71.** Programming and design of assistance were not sufficiently guided by a structured dialogue with beneficiary countries, as the process was largely driven by the internal procedures of the Commission. Dialogue was also hindered by the Commission's thin presence on the spot in Armenia and Azerbaijan and by the lack of an appropriate national interlocutor to bring together the countries' interests.

#### RECOMMENDATION 1

With the establishment of the European External Action Service, the opportunity should be taken to streamline the programming and design process. In this context the Commission should consider:

- (a) providing for an organisational structure that strengthens the links between the strategic documents (programming) and the annual action programmes (design) and avoids successive cycles of approval;
- (b) rationalising the strategic documents (looking for possibilities to merge documents and to harmonise the time periods covered);
- (c) prioritising further during programming, with the guiding objective of offering neighbouring countries the prospect of an increasingly closer relationship with the EU.

## MIXED ACHIEVEMENTS IN THE IMPLEMENTATION OF THE FIRST ANNUAL ACTION PROGRAMMES

- 72.** Overall, achievements were mixed. While the sector budget support programme for VET in Armenia managed to strengthen the process of reform, the programme targeting energy reform in Azerbaijan made unsatisfactory progress. The programme for PFM reform in Georgia began to stimulate change in its second year after little activity by the Georgian counterparts during the first 12 months. The ENPI proved to be not yet an appropriate instrument for economic rehabilitation and confidence building in the conflict region of Abkhazia.
- 73.** In all three countries the Twinning component funded under the ENPI remained in the preparatory phase, largely due to the countries' reluctance to devote resources to the structure needed for managing the tool.

### RECOMMENDATION 2

The Commission should:

- (a) For Armenia: with the aim of achieving sustainable improvement in the VET area, give attention to issues so far neglected in the reform process: the demand side of VET (needs of employers and unemployed), sector co-ordination by the government and the lack of adequate (regular) national funding;
- (b) For Azerbaijan: examine whether the country, after a period of considerable delay, remains willing to fulfil the conditions set for progress in the area of energy reform;
- (c) For Georgia: assess fulfilment of conditions set for the sector budget support programme in the field of Public Finance Management more rigorously, with regard to economic rehabilitation and confidence building in conflict zones, consider using instruments other than ENPI;
- (d) For Twinning in all three countries: ensure the recipient governments' commitment to build up their own capacity for managing the tool.



## **NEW DELIVERY TOOLS INTRODUCED, BUT USE OF SECTOR BUDGET SUPPORT NOT SELECTIVE ENOUGH**

- 74.** By bringing in sector budget support and Twinning, the Commission has succeeded in introducing alternatives to the technical assistance projects that previously predominated. However, sector budget support was introduced with insufficient preparation, affecting performance. While the Commission assessed the preconditions for its effective use, they did not arrive at clearly documented conclusions and tended to give substantial weight to what the beneficiary countries promised to do in the future. They were also too optimistic when they assumed that earlier experiences would give the countries a good understanding of how the new tool should work. Finally the Commission did not provide sufficient staff on the spot with appropriate expertise.
- 75.** The 2007 annual action programmes essentially offered the countries two delivery tools, sector budget support and Twinning. The emphasis on these two tools restricted the possibility of direct ENPI assistance to civil society and the private sector and did not allow the annual action programmes to give swift and agile solutions to particular problems. Furthermore, the predominant use of sector budget support reduced the visibility of the EU assistance. In the case of Azerbaijan, sector budget support did not address the country's need for technical assistance. Sector budget support is not automatically the right tool for all countries at all times.

**RECOMMENDATION 3**

The Commission should:

- (a) choose sector budget support more selectively by considering all available options in ENPI and develop a more balanced deployment of the different tools;
- (b) improve the preparation and documentation of the decisions to launch budget support operations;
- (c) provide sufficient qualified staff for its implementation as sector budget support requires different analytical skills from project financing;
- (d) identify possibilities to make sector budget support more visible and ensure the monitoring of this new tool;
- (e) help to strengthen the general framework for public administration in the recipient countries by using complementary measures to Twinning (e.g. general horizontal support to the public service).

This Report was adopted by Chamber III, headed by Mr Jan KINŠT, Member of the Court of Auditors, in Luxembourg at its meeting of 16 November 2010.

*For the Court of Auditors*



Vítor Manuel da SILVA CALDEIRA  
*President*

## RANGE OF TOOLS FOR DELIVERING ASSISTANCE UNDER ENPI<sup>1</sup>

### TYPES OF MEASURES

1. Community assistance shall be used to finance programmes, projects and any type of measure contributing to the objectives of this Regulation.
2. Community assistance may also be used:
  - (a) to finance technical assistance and targeted administrative measures, including those co-operation measures involving public-sector experts dispatched from the Member States and their regional and local authorities involved in the programme;
  - (b) to finance investments and investment-related activities;
  - (c) for contributions to the EIB or other financial intermediaries, in accordance with Article 23, for loan financing, equity investments, guarantee funds or investment funds;
  - (d) for debt relief programmes in exceptional cases, under an internationally agreed debt relief programme;
  - (e) for sectoral or general budget support if the partner country's management of public spending is sufficiently transparent, reliable and effective, and where it has put in place properly formulated sectoral or macroeconomic policies approved by its principal donors, including, where relevant, the international financial institutions;
  - (f) to provide interest-rate subsidies, in particular for environmental loans;
  - (g) to provide insurance against non-commercial risks;
  - (h) to contribute to a fund established by the Community, its Member States, international and regional organisations, other donors or partner countries;
  - (i) to contribute to the capital of international financial institutions or the regional development banks;
  - (j) to finance the costs necessary for the effective administration and supervision of projects and programmes by the countries benefiting from Community assistance;
  - (k) to finance microprojects;
  - (l) for food security measures.

<sup>1</sup> Article 15 of Regulation (EC) No 1638/2006.

## ARMENIA: SPECIFIC CONDITIONS OF SECTOR SUPPORT PROGRAMME FOR VOCATIONAL AND EDUCATIONAL TRAINING, SECOND VARIABLE INSTALMENT (5 MILLION EURO)

Conditions	Weight	Available amount (million euro)	Actual amount disbursed (million euro)
1. Rehabilitation works and supplies of upgraded equipment are on-going in the selected VET centres: <ul style="list-style-type: none"> <li>• Contracts for rehabilitation works signed for the full amount</li> <li>• Equipment supply tenders ready to be launched</li> </ul>	40 %	2	1,5
2. Mapping of donors' interventions in education is prepared	10 %	0,5	0,5
3. Internal monitoring capacities of the Ministry reinforced and monitoring mechanism for sector policy support programme 2007 set up	10 %	0,5	0,25
4. Preparation and approval of decision on establishment of the National Centre for VET development	10 %	0,5	0,5
5. Revised organisational chart of VET department, in accordance with the functional review proposed by the Task Force and approved by the Ministry of Education and Science, is adopted by the government	10 %	0,5	0,25
6. Job descriptions and competence profiles for VET Department staff developed, adopted by the Task Force and endorsed by the Civil Service Council	10 %	0,5	0,25
7. The Task Force becomes the National VET Council as a tripartite body responsible to give guidance on the development of national VET system: <ul style="list-style-type: none"> <li>• Task and responsibility of the National VET Council clearly defined</li> <li>• Legal acts on establishment of the Council approved</li> </ul>	10 %	0,5	0
	<b>100 %</b>	<b>5</b>	<b>3,25</b>

### AZERBAIJAN: SPECIFIC CONDITIONS OF SECTOR SUPPORT PROGRAMME FOR ENERGY REFORM, SECOND VARIABLE INSTALMENT (5 MILLION EURO)

Specific conditions	Weight (variable tranche)	Available amount (million euro)	Actual amount disbursed (million euro)
<b>1. Policy framework</b>			
Comprehensive and fully integrated sector strategy approved by government	25 %	1,25	0
<b>2. Renewable Energy Sources and Energy Efficiency action plans</b>			
Time bound APs to implement Renewable Energy Sources and Energy Efficiency strategies during energy reform support programme to 2010 agreed with other institutions and approved by Ministry of Industry and Energy Decree	15 %	0,75	0
<b>3. Renewable Energy Sources and Energy Efficiency Legislative Framework</b>			
Draft legislation on use of Renewable Energy Sources and adoption of Energy Efficient submitted to Parliament	20 %	1,00	0
<b>4. State Agency for Renewable Energy Sources and Energy Efficiency</b>			
State Agency for Renewable Energy Sources and Energy Efficiency, subordinated to Minister of Industry and Energy, established, its rights and responsibilities defined and operation provided	20 %	1,00	0
<b>5. Public Finance Management</b>			
Public Finance Management AP approved	20 %	1,00	0

## SPECIFIC CONDITIONS OF SECTOR SUPPORT PROGRAMME FOR PUBLIC FINANCE MANAGEMENT REFORM IN GEORGIA, SECOND VARIABLE INSTALMENT (5 MILLION EURO)

	Specific conditions	Indicators	Weight (variable tranche)	Available amount (million euro)	Actual amount disbursed (million euro)
Fixed tranche	<b>1. Planning and Monitoring of PFM Reform Agenda</b>				
	The Ministry of Finance will update the PFM Strategic Vision following the results of the Public Expenditure and Financial Accountability (PEFA) and will further develop an action plan with deadlines and milestones required to update the broader PFM reform agenda.	PFM action plan with time bound result based indicators endorsed by relevant agencies	N/A		
	<b>2. MTEF-based Budget Process</b>			3	3
	Budget planning and Mid-Term Expenditure Framework (MTEF) process is further strengthened by improving medium term sector planning along with improved sector costing and integrating this into the annual budget formulation process. Content of the MTEF 2009–12 contributions is improved in three selected line ministries and coverage is extended to include regional government strategies.	Basic Data and Directions (BDD) 2009–12 is extended to include broad outline of regional government strategies and priorities; Ministry of Justice, Ministry of Energy and Ministry of Labour and Social Affairs have costed strategies that clearly show a linkage between policy, expenditure planning and annual budget formulation; One selected region has a costed strategy that clearly shows a linkage between medium term expenditure planning and annual budget formulation	N/A		
Variable tranche	<b>3. Treasury Accountancy Systems</b>				
	The first phase of Government Finance Statistics Manual (GFSM) 2001 has been completed.	Treasury General Ledger incorporating GFSM 2001 budget classification is operational	20 %	0,4	0,4
	<b>4. External Audit</b>				
	The Chamber of Control has prepared Audit Management Policy and Procedural Guidelines. Draft Law on the Chamber of Control adopted.	The Chamber of Control new management policy and corporate development strategy has been revised and adopted;	10 %	0,2	0,2
		Auditing guidelines are available and used as basic training materials for all staff	10 %	0,2	0

### SPECIFIC CONDITIONS OF SECTOR SUPPORT PROGRAMME FOR PUBLIC FINANCE MANAGEMENT REFORM IN GEORGIA, SECOND VARIABLE INSTALMENT (5 MILLION EURO)

Specific conditions	Indicators	Weight (variable tranche)	Available amount (million euro)	Actual amount disbursed (million euro)
<b>5. Internal Control Systems and Internal Audit</b>				
A policy paper and an action plan for the gradual introduction of a harmonised public internal financial control system (managerial accountability and internal audit) is approved by the government.	Cabinet minutes approving the policy paper and action plan	20 %	0,4	0
<b>6. Public Procurement</b>				
An action plan based on working group recommendations aimed at restructuring the public procurement legal and regulatory framework have been submitted to government and adopted.	Working group recommendations;	10 %	0,2	0
	Action plan approved by the Cabinet	10 %	0,2	0
<b>7. Revenue Services</b>				
Revenue Corporate Strategy drafted. Procedure Guidelines drafted. Procedures for all aspects of customs control and taxpayers system on risk analysis are further developed and approved by the Ministry of Finance.	A methodology, system and standard for the development and maintenance of all Revenue Service procedures are in use	20 %	0,4	0,4
		<b>100 %</b>	<b>5,00</b>	<b>4</b>

## GEORGIA: RISKS TO VALUE FOR MONEY IN ADDITIONAL EU POST-CRISIS ALLOCATION

The EU responded to the crisis of August 2008 by extending political and financial support to Georgia, pledging a sum of up to 500 million euro at a donor conference in October 2008. These funds draw on several financial instruments including ENPI. Although the 2007–10 ENPI national indicative programme was not modified, the Commission decided to increase Georgia's national ENPI allocation by 61,5 million euro committed through special measures as an important part of the humanitarian assistance package.

The additional ENPI allocation has mainly supported the resettlement in Georgia proper of persons displaced during the fighting of 2008. The delivery mode is targeted budget support for the housing needs of 'internally displaced persons' to be implemented by the Municipal Development Fund of Georgia<sup>1</sup>. By July 2009 the Commission had made two payments (9,8 million euro and 12,1 million euro) to the state budget for the construction of houses including related water and electricity networks.

The underlying expenditure was verified by external auditors as being compliant with applicable legislation and rules. However a value for money audit has not yet been carried out in spite of the high risks involved: no open tender applied by the Municipal Development Fund for contracted companies; weak progress in internal and external control of the PFM area; negative experiences in South Ossetia's forerunner programme with regard to the quality of shelter construction.

<sup>1</sup> The Municipal Development Fund of Georgia is a legal entity of public law, established in 1997 by a Decree of the President of Georgia within the state programme for municipal development.



# REPLY OF THE COMMISSION

## SUMMARY

### IV.

The national indicative programme is an indicative multiannual programming document specifying the priorities for European Neighbourhood and Partnership Instrument (ENPI) bilateral assistance in a given partner country. The annual programming exercise is a cycle that lasts around one year — from identification to a Commission Decision — thereby ensuring the relevance of the assistance.

Furthermore, the ENPI is not the only tool available to address issues in the South Caucasus. The Instrument for Stability is precisely designed to address immediate needs stemming from a crisis. This instrument has indeed been used to respond to specific requests from partner countries (e.g. the post-election crisis in Armenia).

### V.

Despite initial delays, notably in the case of Azerbaijan (see the Commission's reply to observation 43) and some issues resulting from adjustment to external factors (such as in Georgia), the overall achievements of the budget support and of Twinning arrangements launched in the South Caucasus countries are positive. Twinning arrangements are now operating in all three countries.

Regarding Georgia, it should be noted that the European Neighbourhood and Partnership Instrument (ENPI) is not intended to be the main instrument to provide conflict-related assistance, but is a strong supplement to the conflict-related instruments, including the Instrument for Stability. The Instrument for Stability can initiate projects swiftly to respond to crises, but cannot be programmed nor run projects over the medium term, which is when the ENPI can take over.

### VI.

The introduction of a new instrument inevitably entails a period of adaptation. The introduction of the European Neighbourhood and Partnership Instrument (ENPI) is no exception. Nevertheless, the successful launch of all the action programmes in the region is an indication that there have been no major flaws in the preparations.

### VII.

The Commission is continuing to work on further streamlining of the programming process in order to take into account the lessons learned and make the assistance more effective.

Sector budget support was the preferred form of aid in 2007 due to the potential leverage in terms of enhanced policy dialogue with the partner countries and ownership on their part that it entails. Its use is adequately assessed and direct links and synergies are maintained with complementary forms and action (e.g. the project approach and Twinning).

## REPLY OF THE COMMISSION

### OBSERVATIONS

#### 18.

There are two strategic programming documents — the Country Strategy Paper (CSP), which covers all European Union assistance over seven years, and the national indicative programme (NIP) for bilateral European Neighbourhood and Partnership Instrument (ENPI) assistance, which covers four plus three years (4+3) to take into account the results of the mid-term review of the Country Strategy Paper (CSP). The Commission considers that there is a clear link between these two documents because each NIP responds to the analysis provided by the respective CSP. The national indicative programmes reflect the ENPI's objective of supporting the broad cooperation agenda of the European Neighbourhood Policy (ENP). The NIP specifies the priorities of EU assistance, based on strategic priorities, but generally does not indicate the form of aid (apart from providing general guidance under the 'Implementation' section of the NIP). Priorities cannot be delimited too narrowly in order to leave some flexibility for adapting to new policy developments and a changing environment (see also paragraph 20).

#### 19.

It is normal that certain priorities in the CSP reappear in the NIP. The Country Strategy Papers (CSPs) for the South Caucasus countries cover the seven years of the financial framework and set the overarching aims of EU assistance to the country concerned during this time frame. The national indicative programmes (NIPs) adopted within the framework of the CSPs set priorities for the European Neighbourhood and Partnership Instrument (ENPI) bilateral programme for four plus three years together with specific indicative financial allocations for each priority area.

Public finance management is a key cross-cutting issue that touches upon and influences each and every decision taken by a public administration and effective use of the EU assistance in the partner country.

#### 20.

The ENP action plan sets out a reform agenda and thus gives focus to the work on implementation of the Agreement in the context of the ENP. The ENP action plan is negotiated on the basis of the PCA. The ENP action plan was concluded initially for a duration of five years, but will remain valid until a successor document replaces it. The Country Strategy Paper (CSP) is a programming document and, as such, corresponds to the cycle of the European Commission financial framework. In cases where an action plan is revised earlier and, as a result, substantial changes to the CSP are necessary, it is possible to revise the CSP. The national indicative programme (NIP), which specifies the support to be provided under the European Neighbourhood and Partnership Instrument (ENPI), has a shorter time frame, allowing greater detail than the CSP. Finally, the Mid-Term Review of the CSP offers an opportunity to update priorities so that they can be taken into account in the next national indicative programme (NIP) planning period.

## REPLY OF THE COMMISSION

### 21.

The European Neighbourhood Policy (ENP) action plan does indeed serve as a key reference document for the European Neighbourhood and Partnership Instrument (ENPI). However, its scope is significantly broader, as it outlines a national reform agenda across the many areas covered by the ENP, some of which receive European Union assistance.

#### **Box 1 – Wide priority setting in ENP action plan: example Armenia**

The European Neighbourhood Policy (ENP) action plan sets out mutually agreed political priorities for the European Union's cooperation with Armenia. The ENP action plan covers the full range of the European Union's relationship with Armenia and therefore naturally needs to be comprehensive. A relatively broad ENP action plan also provides greater flexibility in the context of the rapidly evolving policy framework in Armenia.

### 22.

The main objective of the Country Strategy Paper (CSP) is to outline the strategic priorities of the European Union assistance to a given partner country within a given funding period. This serves as the basis for the overall European Union assistance over seven years covering not only the European Neighbourhood and Partnership Instrument (ENPI) but also other instruments. The national indicative programme (NIP) sets out the priorities for ENPI bilateral assistance over three or four years. The need to focus assistance on fewer priorities for reasons relating to aid effectiveness and efficiency has to be balanced against the need for the European Commission to support the broad cooperation and growing political and sectoral agenda with the ENPI countries. This requires the European Commission to be able to assist efforts to harmonise with European Union standards in a wide range of areas.

#### **Box 2 – Wide range of subjects for possible financial assistance in national indicative programme: example Azerbaijan**

The national indicative programme (NIP) has been designed to allow sufficient flexibility for implementing European Union assistance in the evolving policy environment of the partner country and against a broad European Neighbourhood Policy (ENP) agenda.

### 23.

While the Country Strategy Paper (CSP) explains the overall Commission response over seven years, the national indicative programme (NIP) sets priorities for European Neighbourhood and Partnership Instrument (ENPI) bilateral assistance during four and/or three years. The NIP specifies the priorities of EU assistance, based on strategic priorities, but generally does not indicate the form of aid (apart from providing general guidance under the 'Implementation' section of the NIP). This flexibility is also essential as it makes it possible to frontload programmes that are at an advanced stage of preparation and backload those where preparations are more time-consuming. This flexibility also allows factoring in budgetary variations decided by the budgetary authority.

## REPLY OF THE COMMISSION

On the lack of 'guidance' for Twinning and sector budget support, the Commission stresses the demand-driven nature of the former and the subsequent assessment process for the latter. Both types of action are properly identified and consequently designed in line with partner countries' reform needs throughout the programming period. Because of their dynamic nature and the need to respond to developments in specific policies, guidance can be initially provided in broad terms at the level of priority areas identified in the Country Strategy Paper/national indicative programmes.

### 25.

Sector budget support was a response to two specific challenges: fragmentation of aid and lack of ownership, in accordance with the principles of the Paris Declaration. The Commission, in line with the Member States, committed itself to channel — whenever conditions allow — at least 50 % of Community aid via national systems, as called for by the 'European Consensus on Development' of December 2005, further reinforced by the 2008 Accra Agenda for Action for accelerating and deepening implementation of the Paris Declaration.

### 26.

Vocational education and training (VET) is linked to a number of priority areas in the national indicative programme (NIP) and the action plan, such as economic development, social cohesion, sustainable development and people-to-people contacts.

During the identification stage for the 2007 annual action programme, the consensus between the Commission and the partner country was to tackle poverty reduction, a priority in the NIP and also in the European Neighbourhood Policy (ENP) action plan and the Poverty Reduction Strategy Paper, in Armenia. In these documents, education was identified as the key to poverty reduction. The limited resources available under the 2007 annual action programme made it essential to focus on one specific aspect of education. VET, with its regional focus, was highly relevant to both sub-priorities of the third priority area of the national indicative programme (Support for Poverty Reduction), which accounts for 40 % of the allocation under the national indicative programme for 2007–10. The urgent needs for assistance in this area are undisputable with a poverty rate of 25,6 % of the population in 2006 (International Monetary Fund data).

## REPLY OF THE COMMISSION

### 27.

The list of sub-priorities in the national indicative programme (NIP) is to be understood as indicative. In practice, this means that, in close cooperation with the partner country, the Commission selects from the indicative list in the NIP the sub-priority (or sub-priorities) that appear(s) the best candidate(s) for support in any given year without any obligation to cover the entire list of sub-priorities within the NIP's time frame.

### 28.

The Commission actually started preparation of the 2007 action programme sufficiently ahead of the entry into force of the ENPI Regulation ensuring timely commitment of the allocated funds.

### 29–30.

The Commission welcomes the acknowledgment by the Court of the fact that this process took place with the introduction of the European Neighbourhood and Partnership Instrument (ENPI), but also wants to clarify that subsequent Country Strategy Paper/national indicative programme (CSP/NIP) programming is actually performed in parallel to annual programming (for example, the mid-term review process for the 2011–13 NIP is taking place at around the time of the 2010 annual programming or 2011 identification exercise).

The European Neighbourhood and Partnership Instrument (ENPI) decision process is lengthy because programming documents are submitted to the comitology procedure. Since co-decision applies (which is not the case under Tacis), the European Parliament also has a formal right of scrutiny before the Commission Decision is adopted. Moreover, in the programming process the partnership principle established in Articles 4 and 5 of the ENPI Regulation is turned into consultations with civil society representatives, European Union Member States, other donors and international financial institutions, thus further extending the process.

The Commission points out that, while the quality control and approval procedures follow a set path, irrespective of the scope of the action, what has been 'carried out in two successive stages' is different in both content and nature: DG RELEX intervenes at the level of the multiannual programming documents (Country Strategy Paper/national indicative programme), whereas EuropeAid goes a stage further with implementation of the NIP by means of annual action programmes identifying the specific programmes and projects to be financed.

## REPLY OF THE COMMISSION

### 31.

The comprehensive consultations allow an inclusive programming process. Shortening the process might lead to certain gains but could also adversely affect the degree of involvement of other stakeholders (e.g. line Directorates-General within the Commission, European Union Member States or the European Parliament). The European Neighbourhood and Partnership Instrument (ENPI) is not designed to respond to crisis situations, but, instead, to support medium- and long-term reform processes in the framework of the European Neighbourhood Policy (ENP). These require a longer-term vision reflected in the Country Strategy Paper (CSP), but also have to allow mid-term adjustments to respond to evolving priorities and needs. Consequently, the Eastern Partnership launched in 2009 was fully reflected in the mid-term review of the relevant CSPs and the drafting of the new NIPs for 2011–13. As for the crises in Georgia and Armenia, the Instrument for Stability was the European Union's main crisis response instrument and thus effectively supplemented the ENPI support.

### 32.

Programming tasks are carried out by the Commission departments concerned, in close dialogue with partner countries. Importantly, the European Parliament and Member States are also involved. During the programming process, there was continuous contact between Commission departments and their government counterparts.

### 32. (a)

At the time of the programming exercise for the 2007 action programme, the Delegations in Yerevan and Baku had not yet been formally established. Both Delegations were officially opened in 2008 and became fully operational in the course of 2009, with the devolution process verified by the European Commission departments concerned in late 2009 and early 2010 respectively.

Today all three countries in the South Caucasus have fully fledged European Union Delegations.

### 32. (b)

Under the European Neighbourhood and Partnership Instrument (ENPI), the dialogue with partner countries is a structured and well-established process in line with the internal programming cycle. Regarding development of the Country Strategy Paper (CSP) and the national indicative programme (NIP), guidance on these aspects is provided by the inter-service quality support group. The general programming guidelines for the 2005 ENPI CSP/NIPs included in-country discussions as an important part of the process of preparing the CSP/NIP. The revised guidelines for the 2009 mid-term review are clearer on this point, requiring two programming missions with government consultations in the process of preparing new NIPs. The NIPs for 2011–13 have to take account of the dialogue with partner countries during the programming period.

## REPLY OF THE COMMISSION

### 32. (c)

The National Coordinating Units (NCUs) were informed about the introduction of European Neighbourhood and Partnership Instrument (ENPI) procedures, but the NCUs were learning their role as the programming was underway. Nevertheless, technical assistance projects to support NCUs have addressed initial shortcomings by enhancing their role as an effective counterpart. Since the launch of the ENPI, NCUs are the Commission's first entry point to the government when discussing implementation and programming matters under the ENPI.

### 33.

Consultations with national authorities, other donors and civil society organisations on priority-setting are major steps at the level of both Country Strategy Papers/national indicative programmes and of annual action programmes. This is not only documented in the various mission reports, but also reflected in the relevant 'action fiches' which are prepared in close negotiation with the partner countries. The extent and frequency of these consultations depend heavily on the existence of a Delegation in the partner country. See reply to paragraph 60 (c) for the timing of the opening of fully fledged Delegations in the region.

### 34.

In the case of the introduction of sector budget support and Twinning under the European Neighbourhood and Partnership Instrument (ENPI) — which was a new instrument itself in 2007 — the partner countries were well informed of the purpose of the different strategy papers and programming documents (ad hoc information/training seminars were also organised for relevant stakeholders).

Commission staff informed their counterparts in each partner country about the procedures and the rationale for the programming documents during the programming missions. Since priorities were discussed with partner countries, they had the opportunity to influence the Commission's decisions. The now fully fledged European Union Delegations in all three countries allow closer dialogue with partner countries than was the case during planning of the national indicative programme for 2007–10.

### 36.

See reply to paragraph 39(a). The main aim of the vocational education and training (VET) support programme in the 2007 action programme was to lay the institutional and structural foundations for operating a fully fledged VET reform programme.

### 39.

The Commission welcomes the positive acknowledgment by the Court of the European Union's support for the VET reform process in Armenia.



## REPLY OF THE COMMISSION

### 39. (a)

The 2007 action programme for vocational education and training (VET) in Armenia was primarily concerned with laying the foundations for VET reform, i.e. building the institutional capacity for policy formulation, performance monitoring and organisation and supporting the refurbishment efforts for delivery of VET in colleges throughout the country. However, the VET programme did introduce development of competency-based curricula by sectoral committees led by employers.

The follow-up programme to support VET reform in the 2009 action programme is focusing on developing relevant VET curricula to meet labour market needs at national and regional levels and pursuing refurbishment efforts in VET colleges (see the Commission's reply to observation (c) below).

### 39. (b)

Under the 2007 annual action programme, the National VET Council was established as a tripartite body precisely to respond to the fragmented nature of VET in the country. It is responsible for overall guidance and coordination for development of the national VET system. This body represents all the stakeholders — including the line ministries responsible for VET — employers and social partners. One of the outputs from this Council has been the decision to further streamline responsibility for VET institutions. As a result, one of the conditions being developed under the 2009 follow-up support programme for VET is the adoption of a strategy for transferring all middle professional and preliminary education institutions to place them under the administrative authority of the Ministry of Education and Science.

### 39. (c)

The Commission acknowledges that the needs for refurbishment works in the colleges concerned are substantial and that, in some cases, upgrading of the facilities has not been completed due to the scale of the work to be performed. For all institutions concerned, the work remaining to be done was identified by external consultants in early 2010 and has been annexed to the 2009 VET follow-up reform programme conditionality matrix in order to set specific targets for the work to be reviewed during the relevant disbursement verification mission.

### 43.

The delay in implementation of the sector budget support (SBS) on energy was due to the government of Azerbaijan's slow adaptation to a new method of implementation, including its related efforts to set up an internal mechanism to manage the programme (see the reply to observation 32 (c)). The mechanism was approved by a governmental decree in November 2009. Since the time of the audit, the Commission received a request for payment of the first tranche of the 2007 SBS, which was released in June 2010.

The Steering Committee was set up in early 2010 and the Delegation has already started the policy dialogue on implementation of the conditions for the second tranche. The government of Azerbaijan has already implemented one key condition for the second tranche, by setting up and staffing an Agency for Renewable and Alternative Energy Sources, by presidential decree.



## REPLY OF THE COMMISSION

**Box 4 – Azerbaijan: Little progress in the two years following the Commission’s financing decision on the energy reform support programme**

With regards to information on the budget support modality, both headquarters and the Delegation have informed the government of Azerbaijan about the budget support form of aid during several meetings from 2007 onwards. In addition, the Commission organised two budget support seminars for the relevant Azerbaijani stakeholders to inform them about the new modality.

See also see the reply to observation 43.

It is a national prerogative of a partner country to choose the internal mechanism, which it considers adequate to implement a (budget support) programme.

According to Azerbaijani legislation, the beneficiary shall take responsibility for the proper, effective, efficient and targeted use of the funds received for the implementation of the programme according to the requirements of the action plan, for the accuracy of reports and required information and their due submission to the Coordinator and take appropriate respective measures.

**45.**

The Commission underlines that the increasing political tensions between Georgia and the Russian Federation from November 2007 leading to the war in August 2008 were not conducive to progress with implementation of the assistance priorities. By the nature of events, government priorities had a different focus at that time and throughout 2009.

**47.**

The Commission decided to release 4 million euro (instead of the maximum of 5 million euro available under the second instalment), because not all the conditions set to release the instalment had been met. Based on the findings of the two external mission reports, and in particular in view of the renewed commitment by the government towards public financial management following the Brussels Donors Conference end of October 2008, the Commission deemed that this amount adequately reflected the achievements and actions taken by the government of Georgia in PFM Reforms.

## REPLY OF THE COMMISSION

### 48.

The European Commission agrees that the increased receptiveness was mainly due to the change in the basic conditions (peace and reduced external threats) and that this contributed to renewing the interest in public finance management (PFM) reforms. The EC considers that a part of such a new proactive attitude, was driven by the Joint Donors Conference for Georgia of 22 October 2008, where the government committed to PFM reforms in order to ensure the best possible use of the substantial pledge received (3,44 billion euro).

Since the time of the audit, an internal audit system is being developed and undergoing pilot tests and the budget classification applies international government finance statistics (GFS) standards. In April 2009, the Chamber of Control adopted its Strategic Development Plan for 2009–11. In November 2009, the Fiscal Committee was set up under the Budget and Finance Committee of Parliament to monitor the public finance management reforms closely. At the end of March 2010, the Minister of Finance established the Coordination Council for the implementation of 2009–13 Public Finance Management Reform Strategy.

### 49.

This comment is not specific to the European Union. The war was a setback for all donor-funded activities, with programmes ceasing completely in South Ossetia and interrupted or delayed in Abkhazia.

### 50.

Since the time of the audit, this programme was unblocked thanks to political consultations and efforts by the European Union Delegation. Implementation started in early 2010.

#### 50. (a)

The European Union has always been firm on non-recognition of the independence of the breakaway regions. When preparing the rehabilitation and confidence-building programmes, the European Union consults the Georgian government and ensures that there are no perceived risks of consolidating the status quo. The Georgian government is open to continuation of the European Union assistance and programmes for confidence-building.

#### 50. (b)

So far, the Abkhaz de facto authorities have generally been open to discussions with the European Union (EU) and to continuation of the EU's activities and programmes, including the economic rehabilitation and confidence-building measures.

## REPLY OF THE COMMISSION

### 51.

The appropriateness of the ENPI in post-conflict rehabilitation can only be assessed in the long-term. Although the European Neighbourhood and Partnership Instrument (ENPI) is not the main European Union instrument for conflict-related assistance, it strongly supplements such instruments. For example, projects financed under the European Union Instrument for Stability cannot be programmed nor continue over the longer term. The ENPI can complement the Instrument for Stability by programming and continuing projects that have proved effective under the Instrument for Stability. See also the reply to paragraph V of the summary. Moreover, signature of ENPI programmes by the Georgian government can be important for ensuring the political backing of the government for confidence-building and peaceful resolution of conflicts.

### 52.

As is the case for other donors, there is still no political will or other basis for continuing the European Union programmes planned for South Ossetia, Georgia. This has led to reallocation of funds from the 2008 annual action programme under the European Neighbourhood and Partnership Instrument (ENPI). This was taken into consideration when planning the national indicative programme (NIP) for 2011–13 and will be taken into account for identifying new confidence-building and rehabilitation programmes regarding Georgia's breakaway regions (i.e. programmes will only focus on such regions where there may be interest, acceptance or minimum tolerance for continued European Union confidence-building programmes).

The strategy for implementation of the measures mentioned was based on risk prevention using targeted budget support based on reimbursement of expenditure submitted to prior control.

### 53.

Implementation of the tool started in 2008 and was generally applied throughout the region in 2009. The Commission reiterates the demand-driven nature of Twinning, resulting in considerable efforts on internal coordination in the partner country to establish a list of priorities and, consequently, draft proposals for projects. Another aspect is related to the time required for the tendering and contracting procedures, which also involve European Union Member State administrations.

### 54.

This form of aid was welcomed by the partners and a significant project pipeline has been built up since its inception under the European Neighbourhood and Partnership Instrument (ENPI). Being 'demand-driven', the quality and end-result will depend on the beneficiary making available the resources and keeping up its commitment.

## REPLY OF THE COMMISSION

### 55–56.

The Commission points out that any support granted to the Programme Administration Office (PAO), normally embedded in the national administration, entails capacity-building. Results have been mixed from one country to another, mainly due to internal structural and functional difficulties and/or weaknesses in the partner country. Tacis technical assistance projects in progress at the time Twinning was launched in the region have been a valuable asset and have made it possible to bridge capacity gaps when and where necessary.

### 58.

Substantial sector-wide reforms require ownership of the reform process on the part of the partner country and a consolidated assistance programme.

Sector budget support was a response to two specific challenges: fragmentation of aid and lack of ownership, in accordance with the principles of the Paris Declaration. The Commission, in line with the Member States, committed itself to channel — whenever conditions allow — at least 50 % of Community aid via national country systems, as called for by the ‘European Consensus on Development’ of December 2005, further reinforced by the 2008 Accra Agenda for Action for accelerating and deepening implementation of the Paris Declaration.

The project approach was extensively used under Tacis to engage partner countries in substantial policy reforms. However, it became apparent that individual projects would not best serve the sector-wide approach necessary for comprehensive reforms. Instead, it became clear that sector budget support offered greater potential to stimulate policy dialogue and to plan comprehensive reforms in a given sector.

### 59.

The Commission points out that poverty reduction remains a major objective in the Southern Caucasus, as stated in the three Country Strategy Papers/national indicative programmes, and that the support for closer economic and social integration with Europe is also a means to promote growth, thus tackling poverty reduction.

The Commission sees no contradiction between bringing partners closer to the European Union and using country systems, the rationale being to enhance partnership by increasing ownership on the partner country’s side.

### 60.

The introduction of a new instrument inevitably entails a period of adaptation. The introduction of the European Neighbourhood and Partnership Instrument (ENPI) is no exception. Nevertheless, the successful launch of all the action programmes in the region suggests that there were no major design flaws.

## REPLY OF THE COMMISSION

### 60. (a)

The effective use of sector budget support is assessed by a sector readiness assessment which explores 'the seven key assessment areas' in detail during the identification phase, as can be seen from the content of the 'identification fiche' for the 2007 national programme and is evidenced by the conclusions of the quality support groups.

### 60. (b)

The Commission considered that earlier experience in the partner countries in dealing with food security programmes would provide a good starting point for introducing sector budget support.

### 60. (c)

Relevant and sufficient training was organised, both at headquarters and in the country, for the benefit of Delegation staff and partner countries' representatives alike. Use of external expertise is inherent in project cycle management. The Commission wishes to recall here that, at the time of inception of the European Neighbourhood and Partnership Instrument (ENPI), two of the three Delegations in the region (Armenia and Azerbaijan) were still being established. The Delegation in Armenia became an officially fully fledged Delegation in 2009. The Delegation in Azerbaijan was opened in 2008 and became fully operational in 2009.

### 61.

When preparing the sector readiness assessments, the Commission pays the utmost attention to the terms of reference to make sure that all key factors are considered to the fullest possible extent. The results of such assessments depend very much, on the one hand, on the accessibility, availability and reliability of quantitative and qualitative data in the partner country and, on the other, on the quality of the expert support. The observation that substantial weight is given to what beneficiary countries promised to do in the future is part of the Commission's dynamic approach to assessing the seven key areas.

### 62.

See reply to paragraph 58.

### 63.

The food security programme (FSP) worked with a range of ministries, principally with the Ministry of Agriculture, but also with the Ministry of Finance, the Ministry of Education and the Ministry of Health, Labour and Social Assistance.

Some of these ministries have been (or will be) among the main recipients of one (or more) European Commission budget support (BS) operation(s). The European Commission therefore considers that the FSP contributed, to a certain extent, to making the Caucasian counterparts aware of budget support operations and of the procedures for implementing budget support.

## REPLY OF THE COMMISSION

### 64. (a)

The technical and financial cooperation resulting from the multiannual strategic framework (Country Strategy Paper/national indicative programme) is, by nature, governmental cooperation. It is based on a selected number of priority areas jointly agreed with the partner countries. In parallel, the thematic budget line instruments allow tackling additional areas/priorities and supporting non-governmental stakeholders not included in the Country Strategy Paper/national indicative programme.

As regards the issue of visibility, one of the main aspects of sector policy support via budget support is the increase in opportunities for visible dialogue between the EC and the partner country such as ceremonies for signing financing agreements and disbursement of funds for sector reform programmes.

### 64. (b)

The Commission reiterates the principles of flexibility and adaptability, which underpin the multiannual strategic framework (Country Strategy Paper/national indicative programme). In the light of the jointly set priorities, annual action programmes are prepared to tackle specific problems. As regards content, the objectives, activities and benchmarks for sector budget support are tailor-made to provide support for resolving the problems and needs identified. As explained below, other instruments are available to deal with urgent issues or crises/emergencies.

### 65.

The European Union Advisory Group was established in response to a request by the President of Armenia, in the aftermath of the elections in February 2008, to provide support for implementation of the European Neighbourhood Policy (ENP) action plan at a time of internal political crisis. This advisory group was funded from the Instrument for Stability, which is an instrument for crisis prevention and response that can be deployed rapidly. The follow-up funding will be provided from the ENPI bilateral allocation.

Regarding coordination of activities, the European Union advisory group has established an open link with the Twinning Programme Administration Office (PAO) to make ensure complementary action.

# REPLY OF THE COMMISSION

## CONCLUSIONS AND RECOMMENDATIONS

### 66.

The Commission's assessment at that time was positive regarding the 2007 Annual action programme (AAP). It is therefore not a contradiction to support a reform strategy with sector budget support in a country that, despite a high rate of income, remains largely underdeveloped. The real aim of sector budget support/general budget support is to enhance policy dialogue between the EU and Azerbaijan and set a range of objectives in order to achieve valuable reforms, whether the sector is rich or poor. In addition, while it is important to boost poor sectors like rural development (identified in the 2009 and 2010 annual action programmes), it is also strategic — in macroeconomic terms — to stabilise sectors benefiting from large allocations of national budgetary resources.

The Commission assessed positively the budget support modality after a long process of identification and policy dialogue with the government of Azerbaijan and based its opinion on government formal statements. All official correspondences with the main stakeholders i.e. Ministry of Finance, Ministry of Energy and Industry, Ministry of Economic Development always confirmed the government commitment to the objectives and the modality of the programme. The Court's statement regarding the preference of the government on 'know how' instead in 'budget support' is to be considered as non-official, and therefore not representing the formal position of the government of Azerbaijan

### 68.

The Country Strategy Papers (CSPs) for the South Caucasus countries cover the seven years of the financial framework and set the overarching aims of European Union cooperation with the country concerned during this time-frame. The national indicative programmes (NIPs) adopted within the framework of the CSPs set priorities for the European Neighbourhood and Partnership Instrument (ENPI) bilateral programme for three to four years. Naturally, certain priorities in the CSP reappear in the NIP.

There are only two strategic programming documents — the Country Strategy Paper (CSP), which covers all European Union assistance over seven years, and the national indicative programme (NIP) for bilateral European Neighbourhood and Partnership Instrument (ENPI) assistance, which covers four plus three years (4+3) to take into account the results of the mid-term review of the Country Strategy Paper (CSP). The Commission considers that there is a clear link between the strategic documents because each NIP responds to the analysis provided by the respective CSP. The national indicative programmes reflect the ENPI's objective of supporting the broad cooperation agenda of the European Neighbourhood Policy (ENP). The NIP specifies the priorities of EU assistance, based on strategic priorities, but generally does not indicate the form of aid (apart from providing general guidance under the 'Implementation' section of the NIP). Priorities cannot be delimited too narrowly in order to leave some flexibility for adapting to new policy developments and a changing environment.

## REPLY OF THE COMMISSION

### 69.

The European Neighbourhood Policy (ENP) action plan is a political document that should be distinguished from the Country Strategy Paper (CSP) and the national indicative programme (NIP), which are programming documents. The CSP is a programming document and, as such, corresponds to the cycle of the European Commission financial framework. In cases where an action plan is revised earlier and, as a result, substantial changes to the CSP are necessary it is possible to revise the CSP. The NIP, which specifies the support to be provided under the European Neighbourhood and Partnership Instrument (ENPI), has a shorter-frame, allowing greater detail than the CSP. The relatively broad scope of the ENPI NIPs reflects the comprehensive nature of cooperation under the ENP, which the ENPI is designed to support. It also allows a response to evolving priorities and needs.

Finally, the area(s) selected for support under a particular annual programme are derived first from the priority areas to be covered and their sub-priorities. Annual action programmes (AAPs) would not focus on an area not covered by the sub-priorities set. Final selection of a specific area for a given year depends on the specific context in the country at that point in time.

Sector budget support was a response to two specific challenges: fragmentation of aid and lack of ownership, in accordance with the principles of the Paris Declaration. The Commission, in line with the Member States, committed itself to channel — whenever conditions allow — at least 50 % of Community aid via national systems, as called for by the 'European Consensus on Development' of December 2005, further reinforced by the 2008 Accra Agenda for Action for accelerating and deepening implementation of the Paris Declaration.

### 70.

The Commission actually started preparation of the 2007 action programme sufficiently ahead of the entry into force of the ENPI Regulation ensuring timely commitment of the allocated funds.

Moreover, the ENPI decision process is lengthy because programming documents are submitted to the comitology procedure. Since co-decision applies (which is not the case under Tacis), the European Parliament also has a formal right of scrutiny before the Commission Decision is adopted. As for loss of relevance, the ENPI is not designed to tackle crisis situations (for which the European Union Instrument for Stability is designed) but, instead, to accompany medium- to longer-term reform processes in the framework of the European Neighbourhood Policy (ENP). The mid-term review process provided for in the ENPI Regulation provides an opportunity to update and adjust programming to new conditions.



## REPLY OF THE COMMISSION

### 71.

Under the European Neighbourhood and Partnership Instrument (ENPI), efforts have been made to structure the dialogue with partner countries better. Regarding development of the Country Strategy Paper (CSP) and the national indicative programme (NIP), guidance on these aspects is provided by the Interservice Quality Support Group. The general programming guidelines for the 2005 ENPI CSPs/NIPs included in-country discussions as part of the process of preparing the CSP/NIP. The revised guidelines for the 2009 mid-term review are clearer on this point, requiring two programming missions with government consultations in the process of preparing new NIPs. The NIPs for 2011–13 have to take account of the consultations with the partner country during the programming period and provide for dialogue and alignment during implementation. While the limited Commission presence in Baku and Yerevan posed a challenge to close dialogue with partners during the programming of the NIP for 2007–10, the now fully fledged European Union Delegations have created more favourable conditions for continuous exchanges and cooperation.

### Recommendation 1 (a)

The Commission is aware of the need to create an even stronger link between programming and implementation. On the policy side, six years after its launch the European Neighbourhood Policy (ENP) has gradually built closer relationships with partner countries based on ENP action plans and a significant number of sub-committees. The launch of the Eastern Partnership has led to increased efforts to deepen bilateral relations, inter alia via negotiations on new association and trade agreements. The increasingly structured relations between the European Union and partner countries provide an opportunity for reinforcing the links between policy and financial cooperation.

### Recommendation 1 (b)

In the new programming period (post-2013), a better defined policy framework will provide opportunities for streamlining documents and avoiding repetitions, as recommended by the Court. While the distinction between a political document (European Neighbourhood Policy action plan) and programming documents (Country Strategy Paper (CSP) and the national indicative programme (NIP)) reflects sound functional logic, the contents of the documents could be streamlined and their timing made more coherent.

## REPLY OF THE COMMISSION

### **Recommendation 1 (c)**

The more clearly defined policy framework of the Eastern Partnership and the increasingly structured relations between the European Union and partner countries will allow more effective prioritisation. Ongoing negotiations will help to identify the bottlenecks in moving towards deeper bilateral relations and new agreements. This in turn will make future policy dialogue more focused and provide a more solid basis for prioritisation.

### **72.**

Since the time of the audit, despite some initial delays, notably in the case of Azerbaijan, and some adjustment issues resulting from external factors (such as in Georgia), the overall achievements of the budget support operations and the launch of Twinning arrangements are positive.

Regarding Georgia, it should be noted that the European Neighbourhood and Partnership Instrument (ENPI) is not intended to be the main instrument to provide conflict-related assistance, but is a strong supplement to the conflict-related instruments, including the Instrument for Stability. The Instrument for Stability can initiate projects swiftly to respond to crises, but cannot run projects over the medium term. Consequently, after the immediate crisis phase, the ENPI can take forward successful Stability Instrument initiatives that will have a confidence-building effect in the medium term.

### **73.**

Twinning arrangements are now operating in all three countries. After initial delays, Twinning is now a functioning aid delivery tool in the Southern Caucasus. This is partly due to Programme Administration Offices (PAOs) having received capacity-building support from technical assistance projects under specific programmes to support PAOs, as these entities needed to develop expertise on Twinning in order to launch this instrument efficiently.

### **Recommendation 2 (a)**

The follow-up 2009 sector budget support programme on vocational education and training (VET) focuses essentially on developing delivery of VET based on labour market needs, from development of curricula to rationalisation of education provision in the regions. Furthermore, as mentioned in the Commission's reply to paragraph 39 (b), the programme will also include adoption of the strategy for transferring all middle professional and preliminary education institutions to place them under the administrative authority of the Ministry of Education and Science. Finally, the conditionality matrix under development for the programme includes a specific condition to assess the government's commitment to the financial sustainability of the VET sector in the country.

## REPLY OF THE COMMISSION

### **Recommendation 2 (b)**

The delay in implementation of the sector budget support on energy was not due to lack of commitment by the government of Azerbaijan. On the contrary, the Commission recognises Azerbaijan's effort to set a logframe in order to manage the programme (see the replies to paragraphs 32(c) and 43).

The mechanism to follow budget support operations was approved by governmental decree in November 2009. Since then the Commission has received a request from the government for payment of the first tranche of the 2007 SBS, which was released by the Commission in June 2010.

### **Recommendation 2 (c)**

The Commission is committed to applying the highest degree of rigour in reviews of each budget support condition in each and every sector supported by budget support operations (not only in public finance management) as evidenced by detailed and comprehensive disbursement dossiers accompanying each payment decision.

Regarding confidence-building measures, the Commission considers that this recommendation has already been addressed since it uses instruments other than the European Neighbourhood and Partnership Instrument (ENPI) for rehabilitation and confidence-building activities (for example, the Instrument for Stability, the European Instrument for Democracy and Human Rights, etc.).

### **Recommendation 2 (d)**

The Commission considers that this recommendation has already been tackled in the region, as previously explained (see the replies to paragraphs 53 to 56 and 73).

### **74.**

The Commission welcomes the positive acknowledgement by the Court of the successful introduction of new forms of support. The launch of all the action programmes in the region in accordance with the original planning is a clear indication that no major flaws in the preparations have surfaced.

Budget support was the preferred form of aid in 2007 due to the potential leverage in terms of enhanced policy dialogue with the partner countries and ownership on their part that it entails. However, its use is adequately assessed and direct links and synergies are maintained with complementary forms and action (e.g. the project approach and Twinning).

With regard to the preparatory work for the introduction of the new aid modality, the Commission wishes to point out the following:

- the Commission considered that earlier experience in the partner countries in dealing with food security programmes would provide a good starting point for introducing sector budget support. Some of these ministries have been (or will be) among the main recipients of one (or more) budget support operation(s);

## REPLY OF THE COMMISSION

- when preparing the sector readiness assessments, the Commission pays the utmost attention to the terms of reference to make sure that all key factors are considered to the fullest possible extent. The results of such assessments depend very much, on the one hand, on the accessibility, availability and reliability of quantitative and qualitative data in the partner country and, on the other, on the quality of the expert support. The observation that substantial weight is given to what beneficiary countries promised to do in the future is part of the Commission's dynamic approach to assessing the seven key areas;
- relevant and sufficient training was organised, both at headquarters and in the country, for the benefit of Delegation staff and partner countries' representatives alike.

### 75.

The Commission points out that the 2007 national programme was also designed bearing in mind the ongoing and planned Tacis projects in the Caucasus. The European Neighbourhood and Partnership Instrument (ENPI) is not the sole instrument available to assist partner countries. As an example, in the case of civil society, specific instruments such as the European Instrument for Democracy and Human Rights (EIDHR) and the non-state actors and local authorities programme are designed to assist civil society.

The budget support programme has been designed together with government of Azerbaijan. The needs of know how have been addressed with other modalities like the Twinning.

As regards the issue of visibility, the European Union Delegation to Georgia reported that the Georgian public TV systematically broadcast in prime time each and every signature and disbursement of budget support operations. This contributes considerably to raising citizens' awareness of European Union aid and operations.

### **Recommendation 3 (a)**

While pursuing the (ongoing) support for sector policies, the Commission intends to ensure an adequate balance of tools, in line with the confirmed priority areas following the mid-term review of the Country Strategy Paper/national indicative programme and developments in the political and economic context in partner countries.

### **Recommendation 3 (b)**

The effective use of sector budget support is assessed by a sector readiness assessment which explores 'the seven key assessment areas' in detail during the identification phase, as can be seen from the content of the 'identification fiche' for the 2007 national programme and is evidenced by the conclusions of the quality support groups.

## REPLY OF THE COMMISSION

### **Recommendation 3 (c)**

For some years now the Commission has been developing a considerable range of training for staff covering all areas, including macro-financial analysis, budget support, public finance management (PFM) and performance measurement.

In each recruitment procedure, due attention is paid, in particular, to applicants' knowledge and experience of budget support and PFM. The evaluation grid used by selection boards explicitly mentions these areas.

### **Recommendation 3 (d)**

The Commission is currently considering measures and methods to make sector budget support (SBS) more visible. However, the Commission is striving to render such operations visible by ensuring media and press coverage of key events in the implementation of budget support operations. For example, by having the Georgian public TV systematically broadcasting in prime time each signature and disbursement of budget support operations. This contributes considerably to raising citizens' awareness of European Union aid and operations.

Concerning monitoring of SBS, the Commission is at present piloting a new form of result-oriented monitoring (ROM), explicitly tailored to Sector Policy Support Programme (SPSP) operations. In this context, the Delegation to Georgia is a frontrunner, with one of its programmes (2007 Annual Action Plan — Public Finance Management, Sector Budget Support, Part I) already having been monitored and a second assessment under way for its 2008 annual action programme on SBS for justice.

### **Recommendation 3 (e)**

The Commission has been supporting strengthening of the public administrations in partner countries by means of a variety of technical assistance projects. Nevertheless, at the launch of the Eastern Partnership in 2009, the Commission acknowledged the need to reinforce the capacity of national administrations to meet the obligations stemming from agreements in the process of being negotiated (Association Agreements, Deep and Comprehensive Trade Agreement, etc.). For this reason, with effect from 2011 the Commission is proposing to help national authorities under the comprehensive institution-building initiative — with the aim of building capacity in clusters of institutions for adequate application of rules and regulations in key areas.



European Court of Auditors

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