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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT AND THE COUNCIL**

Mid-term review of the financial instruments for external actions

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Mid-Term Review of the Financial Instruments for External Actions

1. THE REFORM OF THE FINANCIAL INSTRUMENTS

Recent reform of the financial instruments for external actions has successfully streamlined more than 30 different ad hoc legal acts into four geographic and four thematic instruments, plus a series of thematic programmes.¹ This major rationalisation and simplification has brought huge benefits in terms of:

- ensuring overall policy coherence, consistency, and synergy between the Union's main external relations tools (political dialogue, trade, aid, economic cooperation, external projection of internal policies, and multilateralism);
- streamlining procedures to make aid programming, delivery, and crisis response more effective, efficient and flexible; and
- facilitating dialogue and coordination with beneficiaries, between the institutions, and with other donors.

The new architecture has put in place, for the first time, a set of comprehensive cooperation frameworks under a number of focused Regulations, which are coordinated with and complemented by EIB operations, CFSP/ESDP operations, and macro-financial assistance.

The new instruments are being implemented through Country Strategy Papers, Regional Strategy Papers, Thematic Strategy Papers and, for the IPA, Multi-annual Indicative Planning Documents. These programming documents, accompanied by multi-annual financial allocations, allow clear commitment and delivery of aid in partnership with the beneficiaries.

2. THE MID-TERM REVIEW CLAUSE IN THE FINANCIAL INSTRUMENTS

The seven new Regulations (not the Humanitarian Aid Regulation) all contain a clause requiring the Commission to submit a report on their implementation by 31 December 2010, and to propose any necessary amendments. This evaluation explicitly includes the indicative financial allocations set out in Annex IV of the DCI and the financial breakdown referred to in Article 29(1) of the ENPI.

Although the clause sets a deadline of 31 December 2010, in final negotiations before the instruments were adopted, the Commission agreed — at Parliament's request — to carry out the review before the 2009 European Parliament elections and to take Parliament's reports and recommendations into account.

¹ The instruments concerned are the Development Cooperation Instrument (DCI), the European Neighbourhood and Partnership Instrument (ENPI), the European Instrument for Democracy and Human Rights (EIDHR), the Instrument for Stability (IfS), the Instrument for Cooperation with Industrialised Countries (ICI), the Instrument for Nuclear Safety Cooperation (INSC), the Instrument for Pre-accession Assistance (IPA) and the Humanitarian Aid Regulation. The Humanitarian Aid Regulation was not amended.

This mid-term review (MTR) covers the legal instruments only. Parliament recommendations not affecting the legal texts will be considered in the mid-term review of the strategy and programming documents. That review will assess performance so far and update the strategies in the light of developments in partner countries. Particular attention will be paid at that point to civil society participation and aid effectiveness. The review process and updated strategy papers, together with multi-annual indicative programmes allocating the budget for 2011-2013 by sector, are expected to be completed by the end of 2009. The IPA is governed by a different strategy and programming framework which covers a rolling three-year period updated annually in line with the Enlargement Strategy Paper.

Financial envelopes are considered only in terms of whether they comply with the reference amounts and indicative allocations set out in the legal instruments. The MTR does not prejudice the budget review to be presented later this year or the annual budgetary procedure.

It aims to verify that the instruments are meeting the objectives set for the reform, partly through major simplification. Simplification being an ongoing process, the Commission will also consider the scope for further improvements, including amendments to the Financial Regulation, in particular as regards the control environment.

This Communication is accompanied by:

- a Commission staff working paper reporting in more detail on the individual instruments;
- legislative proposals, where the Commission has concluded from the review that certain amendments are necessary.

3. FINDINGS REQUIRING LEGISLATIVE PROPOSALS

3.1 The need to fill the legislative gap

To ensure that the objectives of the policies and the new instruments are consistent and coherent with the overall direction of EU policy, the Commission committed itself to entering into a policy strategy dialogue with the Council and Parliament. This dialogue was enshrined in Declaration Nos 4 and 5 on ‘Democratic scrutiny and coherence of external actions’ annexed to the Interinstitutional Agreement on budgetary discipline and sound financial management (IIA).²

Dialogue followed in 2007 on the draft strategy papers submitted to Council and Parliament for the implementation of the various instruments. For the IPA, dialogue takes place on an annual basis. Overall, the new instruments have fulfilled the objectives set in the reform of the external action financial instruments (see working paper).

The main issue raised during the scrutiny process concerned the Development Cooperation Instrument (DCI), where Parliament took the view that some of the actions programmed under the geographic programmes were not eligible under the DCI Regulation. It considered that either they were not sufficiently geared to the eradication of poverty and the Millennium Development Goals or they did not fulfil the criteria for Official Development Assistance (ODA) as required under Article 2(4). Parliament adopted four resolutions signalling that, in

² OJ C 139, 14.6.2006, p. 1.

its view, the Commission had exceeded its implementing powers, and calling for the withdrawal of the measures.

At the same time, the budget authority launched four preparatory actions in 2007 and 2008 aimed at supporting non-ODA measures that cannot be financed under the DCI:

- business and scientific exchanges with China
- business and scientific exchanges with India
- cooperation with middle-income countries in Asia
- cooperation with middle-income countries in Latin America.

Indeed, with the rise of emerging economies, in particular China, India and Brazil, and the intensification of EU relations with several dynamic developing-country partners, having the scope to fund measures going beyond ODA in these countries is becoming increasingly important.

Parliament also objected to using the DCI to finance the European mobility component of the Erasmus Mundus External Cooperation Window Programme (EMECW) on the grounds that it would not meet the criteria for ODA eligibility. So as not to jeopardise the whole programme, the Commission agreed to exclude such funding from the DCI from 2010 onwards, and to find a legislative solution in the framework of the mid-term review.

It follows from these limitations that, while the DCI Regulation should remain the main cooperation framework for these countries, the financial architecture for external actions lacks a legal basis for financing such measures. It is proposed to fill this gap within the current legal and budgetary constraints for 2007-2013 by amending the ICI Regulation to extend its coverage to the DCI countries. This amendment is limited in scope in terms of its policy content, budgetary implications and time frame. It does not prejudice any future proposal on external cooperation financial instruments under the next financial framework.

Based on experience of the Preparatory Actions, the Commission proposes legislative follow up to allow the financing of measures other than Official Development Assistance in countries falling under the DCI Regulation.

3.2 Other required legislative amendments

The mid-term review of the financial instruments has identified the need to proceed with two further sets of amendments.

3.2.1 *Instrument for Stability (IfS)*

The IfS is the newest and most innovative financial instrument, introduced with the objective of enabling a consistent and integrated response to crises and impending crises, using a single legal instrument with simplified decision-making procedures. It also has considerably greater financial resources than its pilot predecessor, the Rapid Reaction Mechanism. Although the instrument is clearly fulfilling its objective, a number of limited amendments are required.

- Objectives and scope

On 20 May 2008, the European Court of Justice annulled Council Decision 2004/833/CFSP of 2 December 2004 implementing Joint Action 2002/589/CFSP in the framework of the

moratorium on small arms and light weapons.³ The Court held that measures to combat the proliferation of small arms fall within the competences conferred on the Community in the field of development policy and cannot be pursued as part of the CFSP if their main aim or component relates to development policy. This view was not shared by the Council when the IfS was adopted in November 2006, and Article 3(2)(i) of the Regulation includes the following restriction:

‘Assistance [...] shall not include support for measures to combat the proliferation of arms’.

When the IfS Regulation was adopted, the Council and the Commission issued a joint statement in which they agreed that, as part of the mid-term review of the Regulation, the scope of Article 3(2)(i) would be revised as necessary. In view of its clear wording excluding such financing, it is proposed to revise the Article to bring it into line with the case law of the Court. For the same reason, Article 4(1)(a) on action in support of the fight against the illicit trafficking should be amended to refer explicitly to ‘small arms and light weapons’.

It is proposed to amend Article 3(2)(i) and 4(1)(a) in the light of the Court’s rulings and to abolish the restriction on support for measures to combat the proliferation of small arms and light weapons.

- Participation and rules of origin

Some difficulties have been encountered in implementing measures under Article 4(3) relating to pre- and post-crisis capacity building. Many of these measures entail issuing calls for proposals for peace-building partnership support (civil society capacity-building; civil society early warning and field-based analysis activities on conflict prevention; and pro-active policy advice from civil society). Under Article 17, on participation and rules of origin, partners from OECD countries that do not belong to the EU or the European Economic Area are not eligible for the award of procurement or grant contracts under Article 4(3) on pre- and post-crisis capacity building, but no such restriction exists for contracts under Article 3 on crisis response. This excludes countries such as Switzerland and Canada from participation, although excellent proposals have been received from these countries. It poses a serious setback to the potential quality of action, and the attainment of the objectives of Article 4(3), which are closely linked to those pursued under Article 3.

It is proposed to insert a technical amendment to Article 17 in order to open up participation in the award of procurement or grant contracts for measures under Article 4(3), as is already the case for measures under Article 3.

- Financial provisions

The Regulation limits the share of the budget allocation for measures under Article 4(1) concerning threats to law and order, the security and safety of individuals, critical infrastructure and public health to 7%. This percentage has proven inadequate and needs to be increased. Developing effective actions in these areas requires more substantial measures to give them real impact, visibility and credibility. In addition, developing trans-regional actions which are complementary to national and regional envelopes requires an appropriate level of funding to reach critical mass. The budgetary allocations so far subject to the 7% limit in Article 24 of the IfS Regulation do not allow these objectives to be met.

³ ECJ, Case C-91/05 (ECOWAS).

It is proposed to amend Article 24 to increase the maximum share of measures under Article 4(1) from 7% to 10%.

3.2.2 Taxes, duties and charges under the DCI and EIDHR Regulations

The main difficulties encountered in implementing programmes and projects are linked to the payment of taxes, duties and charges under the DCI and the EIDHR Regulations. The flexibility inserted in the other instruments is required — in exceptional cases and duly justified circumstances — to allow the payment of taxes, duties and charges. This is particularly important where projects or programmes are implemented by NGOs which may be obliged to subcontract specific works or service activities to the private sector. Furthermore, one of the fundamental principles of the EIDHR, which works mainly with NGOs, is its independence from the consent of third country governments and other public authorities. In this context, insistence on the ineligibility of payment of taxes and duties has proven to be problematic in practice.

It is therefore important to harmonise the wording of Article 13(6) of the EIDHR and Article 25(2) of the DCI with the corresponding provisions of the other external action financial instruments as follows: *‘Community financing shall, in principle, not be used for paying taxes, duties or charges in beneficiary countries’*. The ICI Regulation has a different wording which is not problematic, but it is proposed to align that too for the sake of consistency.

The internal guidelines for all instruments will ensure that this flexibility is limited and applied consistently by clarifying that exceptions can only be made in individual cases under exceptional circumstances.

It is proposed to harmonise the EIDHR and DCI Regulations with the other instruments as regards payment of taxes, duties and charges.

4. OTHER MAIN FINDINGS

The Commission considers that, overall, the regulations are adequate and do not require amendments other than those proposed. No major problems have been encountered in programming. Although it is too early yet to evaluate the impact of the activities, implementation is now ongoing without serious difficulties. The record 2008 budget implementation of commitments and payments and the fact that outstanding commitments have not risen in spite of the increase in commitments are indicators of the pace of delivery.

4.1 The European Neighbourhood and Partnership Instrument (ENPI)

The scope and objective of the ENPI, as a policy-driven instrument, have proven adequate to support the European Neighbourhood Policy (ENP). Country programming documents are mainly geared to supporting the implementation of the ENP action plans. Multi-country programmes support the policy’s regional dimensions (the Eastern Partnership, the Union for the Mediterranean, and Black Sea Synergy). The innovative cross-border cooperation component was launched within the limit of 5% of the reference amount set in the Regulation. The Commission has also programmed funds with a view to devoting up to 3% of the funding for our neighbours to areas concerning or related to migration.

The fact that the Regulation does not unambiguously allow ‘revolving funds’ to be set up is a problem when it comes to supporting private sector and SME development under the Facility for Euro Mediterranean Investment and Partnership (FEMIP) or the Neighbourhood Investment Facility (NIF). A legislative amendment to address this issue was proposed last year.⁴

A second concern relates to the need for the ENPI to respond to crises which require additional resources. Point 37 of the Interinstitutional Agreement allows an increase by more than 5% of the legislative financial envelope if ‘*new, objective, long term circumstances arise for which explicit and precise reasons are given*’. The Commission considers that this particular provision applies in connection with events in the occupied Palestinian territories and in Georgia, for which the budget authority has approved significant reinforcements.

The Commission takes note of Parliament’s resolution on the review of the European Neighbourhood and Partnership Instrument.⁵ It broadly agrees with most of the recommendations and will take due account of them when reviewing the strategy documents.

On the whole, the ENPI Regulation appears adequate to sustain cooperation with neighbouring countries provided that the legislative authority adopts the amendment proposed in May 2008 as regards the option of using revolving funds. Without this option, achievement of the objectives will be seriously hampered. The budget authority should also be aware of potential crisis-related needs, for which it may become necessary to fall back on the flexibility mechanisms provided in the IIA.

4.2 The Instrument for Pre-Accession Assistance (IPA)

The IPA Regulation is proving fully adequate in successfully steering candidates and potential candidates towards EU membership. Streamlining the five former Regulations⁶ within a single framework, but with different components, allows programming and delivery of coherent, tailor-made assistance to each beneficiary country. The ‘Transition Assistance and Institution Building’ component allows progressive alignment with EU standards and policies. The ‘Cross-Border Cooperation’ component has simplified, compared to previous instruments, programming and implementation, which now take place under a single set of rules and a single budget applying on both sides of the border, including at borders with EU Member States. Finally, the ‘Regional Development’, ‘Human Resources Development’ and ‘Rural Development’ components are preparing candidate countries (through ‘learning by doing’) for the implementation and management of cohesion, structural and rural development funds upon accession.

Programming has smoothly taken over from the five previous instruments and implementation started in the course of 2008. Delivery against the declared objectives is, so far, essentially visible in terms of governance effects produced by the IPA programming exercise. All beneficiary countries have made progress towards assuming greater responsibility for and ownership of the management of IPA programmes, in accordance with the principles of sound financial management and in full compliance with the Financial Regulation.

⁴ COM/2008/308, 21.05.2008.

⁵ P6-TA(2009)0078, 19.02.2009.

⁶ PHARE, ISPA, SAPARD, the Turkish pre-accession instrument, and CARDS.

Programming has so far allowed important initiatives (such as the Infrastructure Projects Facility, the Energy Efficiency Facility, and the European Fund for South East Europe for small businesses development) and education programmes (Erasmus Mundus, Youth in Action, Tempus) to be launched or reinforced, and regional cooperation initiatives (e.g. Regional Cooperation Council, Regional School of Public Administration, disaster risk reduction, cultural heritage rehabilitation, the Central European Free Trade Agreement) to be developed further, in addition to encouraging civil society development and dialogue (Civil Society Facility). Around one third of the TAIB envelope has been programmed to enhance governance, encourage administrative and judicial reform, strengthen the rule of law, support the fight against corruption and organised crime, promote human rights and develop civil society.

The financial envelope is, so far, deemed adequate although some additional resources have been necessary to address Kosovo's needs (under UNSCR 1244/1999). In the absence of major changes of circumstances in the beneficiary countries, it should be possible to deliver on the political commitments and keep up the momentum of the enlargement process within the 5% flexibility of the legislative financial envelope. Possible changes in the status of IPA countries from potential candidate to candidate would require the Annexes to the Council Regulation to be adapted using the procedure provided for in Article 23 of the IPA.

4.3 The Development Cooperation Instrument (DCI)

The Development Cooperation Instrument (DCI) has proven able to respond to the objectives set in terms of coherence, effectiveness, and efficiency. The first wave of strategy papers and the first three years of Annual Action Programmes (AAPs) were drafted based on donor coordination, dialogue with partner countries and participation by civil society. Besides the need to cover non-ODA activities under another legislative instrument, and the tax issue, no major issues have emerged and it is expected that implementation will continue smoothly. As regards the financial envelope, based on the final budgets for 2007 and 2008 and the 2009 Budget it appears that the reference amount of EUR 16 897 million has increased by EUR 239 million (+ 1.4%). Most of the increase (EUR 176 million) stems from the environment and energy thematic programme to tackle international challenges linked to climate change. The other programmes are in line with the indicative financial allocations set out in Annex IV of the Regulation, with the geographic programmes benefiting from the rest of the increase (EUR 60 million).

The adoption of the DCI Regulation was accompanied by a Commission Declaration on Article 5 of the DCI relating to geographic programmes, in which the Commission reaffirmed that the eradication of poverty and the pursuit of the Millennium Development Goals are at the core of the primary objectives of its development assistance. The 35% benchmark on social infrastructure and services has been superseded, but the Commission's commitment is to continue reporting annually on actual expenses in these sectors. The Commission has further committed itself to prioritising basic health and education through the 20% benchmark. The Commission took this into account in its dialogue with recipient countries/regions and does not foresee any difficulties in achieving that target. In 2007, direct support for basic and secondary education and basic health already accounted for some 17% of total commitments under the relevant geographic programmes, even without including general budget support linked to these sectors. The follow-up on that benchmark has been included in the Annual Report on EC External Assistance.

4.4 The European Instrument for Democracy and Human Rights (EIDHR), the Instrument for Stability (IfS), the Instrument for Nuclear Safety Cooperation (INSC), and the Instrument for Cooperation with Industrialised and other High-income Countries and Territories (ICI)

As regards these four instruments, no problems have been encountered in policy formulation and the Regulations have proven adequate to support the policy objectives (except for the requested amendments on the IfS and for the tax issue for EIDHR dealt with in section 3.2). From 2011, the ICI will include support for the development of transatlantic methods for handling global challenges which now takes the form of a pilot project started at the initiative of Parliament. This will not require a change in the reference amount. However, a separate financial envelope will be added to the amended ICI Regulation relating to its extension to the DCI countries.

Finally, the Commission is also respecting its commitment to limit electoral observation missions to no more than 25% of the total available EIDHR funds over the period 2007-2013.

5. CONCLUSION

The new architecture of external action financial instruments fully meets the objective of supporting EU policies and cooperation with more efficient and coherent tools. Implementation so far has been smooth and the Commission is fully meeting the various commitments made in the negotiations leading to the adoption of the Regulations.

The Commission has nevertheless identified a small number of problems requiring legislative action and invites the European Parliament and the Council to adopt the following proposals:

- the amendment to the ICI Regulation to allow financing measures for non-ODA activities in DCI countries;
- the amendments to the IfS Regulation;
- the amendment to the DCI and EIDHR Regulations aligning the wording on taxes, duties and charges;
- the amendment to the ENPI Regulation giving the option of setting up revolving funds; this proposal was submitted in May 2008.

In case an agreement on bananas would be reached over the coming weeks within the framework of the WTO, this may require supporting measures in main ACP banana exporting countries, for which the Commission would propose an adjustment of the DCI at the appropriate time.

To be able to put the necessary changes into effect, the Commission would hope that these proposals will enter into force at the beginning of 2010.