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

2006 REPORT ON PHARE, PRE-ACCESSION AND TRANSITION INSTRUMENTS

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Introduction

Together with two other instruments financed by the European Communities, namely ISPA (Instrument for Structural Policies for Pre-Accession) and SAPARD (Special Accession Programme for Agriculture and Rural Development), the Phare Programme aims to assist candidate and acceding countries in their preparations for joining the European Union. In 2006, following the accession of the 10 new Member States, Bulgaria, Romania and Croatia continued to benefit from the three pre-accession instruments; the respective regulations were subsequently amended and credits were assigned in the budget for PHARE and ISPA already in 2005 and for SAPARD starting in 2006. Turkey continued to receive support under its own pre-accession assistance instrument.

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

Programming is based on the Phare Guidelines that were revised in 2004 in order to accompany the further alignment of the *Cross Border Co-operation* (CBC) Regulation with INTERREG, to accommodate the unique approach required in the area of nuclear safety and to emphasise the transition to *Extended Decentralisation Implementation System* (EDIS). The programming and implementation of pre-accession assistance for Turkey largely mirrored the procedures and content of Phare support. In order to prepare for the decentralised approach to programme management established under the Structural Funds, the European Commission has increasingly intensified the support to Bulgaria and Romania to allow for a further transfer of responsibility for the management and implementation of Phare programmes to the national authorities.

This report also contains information on the Transition Facility for new Member States which was introduced to allow for the continuation of institution building support with a view to strengthening and consolidating institutional and administrative capacity to implement the *acquis communautaire*. Programming is based on needs identified in the Commission's Comprehensive Monitoring Report (November 2003).

1. THE YEAR IN REVIEW

1.1. Main evolutions of the Enlargement Process in 2006

2006 was a crucial year for the enlargement policy. The fifth round of EU enlargement was completed with the accession of *Bulgaria* and *Romania* on 1 January 2007. With a view to the present enlargement challenges, in particular the accession negotiations with *Croatia* and *Turkey* and the stabilisation and association process with the *Western Balkan* countries in the framework of a pre-accession strategy, the Commission proposed a strategy for building a renewed consensus on enlargement. This strategy was endorsed by the December European Council.

As regards Bulgaria and Romania, the Commission closely monitored their preparations for accession and created a special regulation to be able to provisionally reduce disbursement of

parts of the agricultural payments in case the criteria for using these funds are not met. On 13 December the Commission took decisions establishing for both countries a mechanism for cooperation and verification of progress on judicial reform, the fight against corruption and organised crime.

In parallel, the accession negotiation process with *Croatia* and *Turkey* continued. The 'screening' process was successfully completed with both countries in October. In view of Turkey not having fulfilled its obligation of full non-discriminatory implementation of the Additional Protocol to the Association Agreement, the Commission issued a recommendation on 29 November on further conduct of accession negotiations, which was largely endorsed by the Council.

The Commission also continued to monitor progress in *Turkey*, *Croatia* and *the former Yugoslav Republic of Macedonia* towards meeting the accession criteria as well as the accession partnership. Financial co-operation programmes were geared to supporting accession related reforms. The commitments in financial assistance to candidate countries in 2006 amounted to €450 million for Turkey, €140 million for Croatia and €43.6 million for the former Yugoslav Republic of Macedonia.

Work on measures aimed at ending the isolation of the Turkish Cypriot community and facilitating the future re-unification of *Cyprus* continued. Following the adoption of the Aid Regulation in early 2006, programming documents and Commission decisions on a €259 million aid programme for the Turkish Cypriot community were prepared.

Work on the implementation of the Stabilisation and Association Process (SAP) in the *Western Balkans* continued throughout 2006. With *Albania*, *Bosnia and Herzegovina*, *the former Yugoslav Republic of Macedonia*, *Montenegro* and *Serbia* negotiations on visa facilitation agreements were opened in December. The negotiations on readmission agreements were launched with the same countries, except Albania where the readmission agreement entered into force in May 2006.

A Stabilisation and Association Agreement (SAA) with *Albania* was signed in June 2006. An Interim Agreement allowed trade-related provisions to enter into force in December 2006, pending ratification of the SAA itself.

As regards the Stabilisation and Association Agreement (SAA), negotiations with *Serbia and Montenegro* began in October 2005. Substantial progress was made in the first months of 2006. However, its commitments on co-operation with the International Criminal Tribunal for former Yugoslavia (ICTY) were not met, the Commission decided to call off the SAA negotiations on 3 May 2006.

In 2006 the Commission contributed to the smooth developments relating to the definition of the state status in *Montenegro*. Following the referendum and the recognition of Montenegro's independence by the EU, the Council adopted the Commission's proposal of a new mandate to negotiate the SAA with Montenegro. Negotiations resumed in September and technically concluded in December; the Agreement will be initialled once the country makes sufficient progress in the areas highlighted by the Commission.

Negotiations on the SAA with *Bosnia and Herzegovina* were technically concluded in December; the Agreement will be initialled once the country makes sufficient progress in the key areas highlighted by the Commission. It has intensified the monitoring of the reform

process, notably through the Reform Process Monitoring (RPM). It formally launched the economic dialogue in January. The Commission has also been deeply involved in preparing a reinforced EU engagement in Bosnia and Herzegovina after the closure of the Office of the High Representative, and has actively participated in the Peace Implementation Council.

The process to settle *Kosovo's* status continued under the auspices of the UN special envoy. The Commission continued to accompany Kosovo in its reform efforts under the SAP Tracking Mechanism.

On 31 July 2006, the European Council adopted a new *Instrument for Pre-accession Assistance, IPA*, which had been proposed by the Commission in the framework of the Financial Perspectives 2007-2013, with a view to providing focussed and effective pre-accession assistance to both candidate countries and potential candidate countries. This single instrument, which replaces five separate legal bases, applies from 1 January 2007. The Commission started the related strategic planning exercise in the last months of 2006 by drafting country multi-annual planning documents (MIPDs) and presented a draft implementing regulation to Member States in December 2006. The first IPA programmes are expected to be adopted in the second quarter of 2007. In 2006, DG ELARG executed commitment credits for €2,3 billion and payment credits for €2,0 billion as overall financial assistance to enlargement countries.

The DG gave priority to *communicating* about enlargement through strategic partnerships, including other EU institutions, regional and local administrations, the media, NGOs and other multipliers, which culminated in a comprehensive media campaign regarding the accession of Bulgaria and Romania at the end of 2006.

Moreover, the Commission continued the implementation of its *civil society dialogue* in particular in Turkey and Croatia, which aims at reinforcing links between civil society in the EU and in candidate countries with a view to improve mutual understanding and address citizens' concerns about enlargement.

1.2. Main conclusions of the 2006 European Council

As shown in the following extracts, the Brussels European Council of 14/15 December 2006 confirmed the conclusions of 15/16 June¹, and endorsed the 2006 enlargement package as the basis for a renewed consensus on enlargement:

"As agreed at the June 2006 European Council and on the basis of the Commission communication on the enlargement strategy and its special report on the EU's capacity to integrate new members, the European Council held an in-depth debate on enlargement. The European Council agrees that the enlargement strategy based on consolidation, conditionality and communication, combined with the EU's capacity to integrate new members, forms the basis for a renewed consensus on enlargement. The EU keeps its commitments towards the countries that are in the enlargement process.

¹ For the full text of the June 2006 Presidency conclusions, please consult http://www.consilium.europa.eu/cms3_applications/Applications/newsRoom/LoadDocument.asp?directory=en/ec/&filename=90111.pdf. For the full text of the December 2006 Presidency conclusions, please consult http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/92202.pdf.

[...] To sustain the integration capacity of the EU the acceding countries must be ready and able to fully assume the obligations of Union membership and the Union must be able to function effectively and to develop. Both these aspects are essential for ensuring broad and sustained public support, which should also be promoted through greater transparency and better communication.

The European Council confirms that the EU keeps its commitments regarding the ongoing accession negotiations. The recently enhanced rules governing the accession process provide for strict conditionality at all stages of the negotiations. The European Council agrees with the improvements suggested by the Commission concerning the management and the quality of the negotiations. [...] The European Council reaffirms that the future of the Western Balkans lies in the European Union. It reiterates that each country's progress towards the European Union depends on its individual efforts to comply with the Copenhagen criteria and the conditionality of the Stabilisation and Association Process. [...]

The European Council stresses the importance of ensuring that the EU can maintain and deepen its own development. The pace of enlargement must take into account the capacity of the Union to absorb new members. The European Council invites the Commission to provide impact assessments on the key policy areas in the Commission's Opinion on a country's application for membership and in the course of accession negotiations. As the Union enlarges, successful European integration requires that EU institutions function effectively and that EU policies are further developed and financed in a sustainable manner."

2. PROGRAMMING AND IMPLEMENTATION OF THE PROGRAMMES: GENERAL OVERVIEW

2.1. Phare and Pre-Accession for Turkey

Total actual commitments amounted to €1401.7 million, comprising:

National Programmes	€ 1086.5 million
cross border co-operation	€ 84.0 million
regional and horizontal programmes (including TAIEX)	€ 168.0 million
nuclear safety	€ 13.2 million
Bulgaria – Kozloduy Decommissioning	€ 50.0 million

National programmes were divided as follows:

Bulgaria	€ 166.8 million
Romania	€ 408.6 million
Croatia	€ 61.1 million
Turkey	€ 450.0 million

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

2.2. Transition Facility

The ten countries which used to receive pre-accession financial assistance under Phare (or specific pre-accession facilities in the cases of Cyprus and Malta) benefited for the first time in 2004 from a special Transition Facility for institution building aimed at allowing the new Member States to strengthen and consolidate institutional and administrative capacity to implement the *acquis communautaire* and thus continue the institution-building measures initiated under Phare. This report covers the final year of the Transition facility programme for the new Member States.

The Transition Facility was created by article 34 of the Act of Accession, as a temporary post accession financial instrument. Programming is based on needs identified in the Commission's Comprehensive Monitoring Report (November 2003). The article gives a non-exhaustive list of examples of key *acquis* where weaknesses exist, but also excludes any area which is eligible for funding under the Structural Funds. Reflecting continuity with Institution Building support funded by Phare, part of each annual envelope of the Transition Facility has been allocated to certain multi-beneficiary programmes.

Total commitments amounted to €67.2 million, comprising:

National Programmes € 63.1 million

Multi-country and horizontal programmes € 4.1 million

National programmes were divided as follows:

Cyprus	€ 3.2 million	Latvia	€ 4.0 million
Czech Republic	€ 7.2 million	Lithuania	€ 4.0 million
Estonia	€ 3.7 million	Poland	€ 22.1 million
Hungary	€ 6.7 million	Slovenia	€ 3.7 million
Malta	€ 3.3 million	Slovakia	€ 5.2 million

2.3. Moving towards Extended Decentralisation Implementation System (EDIS)

The Commission's objective is to enable the recipient countries of Phare assistance to manage Community funds under EDIS in order to acquire before accession, sufficient practical experience in the management of a fully decentralised system, and thus prepare them to effectively manage structural funds upon accession (in a shared management environment).

The acceptance by the Commission of Phare implementing agencies operating under EDIS will be given upon demonstration of having appropriate resources, structures and systems in place for the effective and timely management of Community assistance.

The application for EDIS by **Bulgaria** for its four Implementing Agencies was delayed². The December 2006 draft report indicated a number of issues to be addressed. The Bulgarian authorities are required to finalise an Action Plan to address the findings. Full EDIS accreditation is expected before mid-2007.

In 2006, **Romania** submitted its applications for the waiver of ex ante control and accreditation under EDIS to the Commission. The application concerned the Ministry of European Integration (MEI) and the CFCU as main Implementing Agency. A separate application was submitted by the Ministry of Labour, which was set up as a separate Implementing Agency for ESF type pre-accession programmes. The MEI and CFCU received accreditation on 14 December 2006. The EDIS Decision includes a number of so called "type 2" findings, which require further follow up and improvements to the system within strict deadlines from the date of the Decision. The final report and accreditation will be completed in 2007.

The Commission decision on partial conferral of management for Phare and CARDS under the decentralised implementation system (DIS) to **Croatia** was taken on 7 February 2006.

Turkey moved to a DIS in October 2003, with the indicative target to proceed with EDIS in 2007.

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

- SAPARD³ (Special Accession Programme for Agriculture and Rural Development) aims to help candidate countries deal with the problems of the structural adjustment in their agricultural sectors and rural areas, as well as in implementing the *acquis communautaire* concerning the CAP (Common Agricultural Policy) and related legislation. Detailed information on SAPARD activities can be found in the SAPARD annual report.
- ISPA⁴ (Instrument for Structural Policies for Pre-Accession) is directed mainly towards aligning the applicant countries on Community infrastructure standards. It also finances major environmental and transport infrastructure. Detailed information on ISPA activities can be found in the ISPA annual report.

² CFCU, Ministry for Regional Development and Public Works, the Ministry for Labour and Social Policy, the Ministry of Economy

³ For general information on SAPARD, we refer to the website of DG Agriculture.

⁴ For general information on ISPA, we refer to the website of DG Regional policy.

- The Commission's Co-ordination Committee for the three pre-accession instruments, set at Directors level, has not officially convened during 2005, although several meetings have taken place notably in view of creation of the new Instrument for Pre-Accession (IPA) and its relevant components⁵. A General Assistance Document, through which the Commission informs the Phare Management Committee of the co-ordination of pre-accession aid in 2005 and planned assistance for 2006, was presented to the Committee on 19 May 2006. In particular, this document provided the indicative financial allocations for the year for each country in relation to the three instruments, information on co-ordination with EIB and IFIs and about progress and perspectives for decentralised management. A separate annual report on co-ordination of pre-accession assistance provides more detailed information on co-ordination between PHARE, ISPA and SAPARD.

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

The Commission consults the international financial institutions ("IFIs") and bilateral donors regularly throughout the programming cycle, to identify the scope for joint activities and complementary approaches to addressing pre-accession priorities.

The cooperation and co-financing of projects with the EIB and other IFIs, in particular the European Bank for Reconstruction and Development ("EBRD"), the World Bank and the Council of Europe Development Bank ("CEB"; in association with the German Kreditanstalt für Wiederaufbau "KfW"), is organized under the amended Memorandum of Understanding between the European Commission and participating IFIs for the enlargement countries of 26 April 2006.

In the Phare context, implementation of horizontal programmes have offered wide possibilities of IFI co-operation by allowing extension of IFI loans combined with EU grants in a more flexible way compared with the investment projects financed by national programmes. Nonetheless, the Commission has ensured that the two types of programmes were complementary.

Concerning horizontal programmes financed under Phare, the new programmes launched since 2005 cover Romania, Bulgaria, Croatia and Turkey⁶. The technical nature and the multi-country approach of the successive horizontal finance facilities required the involvement of highly-specialised financial institutions, with a long track record in international finance,

⁵ Of the proposed 6 external relations instruments that are due to apply in the period 2007-2013, one is the new instrument for pre-accession assistance, IPA. At the junction between external assistance and internal policies, the IPA intends to facilitate the entry into the Union of candidate countries (Turkey, Croatia and the former Yugoslav Republic of Macedonia) and potential candidate countries (Albania, Bosnia and Herzegovina, Montenegro, and Serbia including Kosovo under UN Security Council Resolution 1244). IPA will be an accession driven instrument, fulfilling all the requirements stemming from the accession process, notably in terms of priorities, monitoring and evaluation. IPA will replace the current pre accession instruments notably: Phare, the scope of which is support for the implementation of the *acquis communautaire* in the form of institution building and related investments, investments in economic and social cohesion and cross-border cooperation; ISPA, which is the precursor of the Cohesion Fund and deals with environment and transport infrastructure; SAPARD, the precursor of Rural Development plans, dealing with Common Agricultural Policy *acquis* and Rural development, Turkey pre-accession, with the same scope as Phare; CARDS, which covers the Western Balkans.

⁶ Turkey is covered by Pre-accession financial assistance for Turkey

SME and Municipal sector development. The preference was for financial institutions with the status of international public-law bodies, which shared the values of the EU, in particular, in relation to enlargement and had similar public policy objectives, rather than private-sector financial institutions looking for commercial investment terms.

The first facility programme was launched in 1999 with the EBRD. The CEB, which implements the programme in association with KfW, and the EIB have joined the Facility programmes in the following years. Since 1999, 32 Facility Programmes have been initiated by the Commission.

- 18 SME Finance Facilities comprising in total €376 million of EU incentives and €2,328.25 million of credit lines from the IFIs.
- 11 Municipal Finance Facilities comprising a total of €117.8 million of EU incentives and €589 million of loans from the IFIs.
- 3 Energy Efficiency Finance Facilities for the first time in 2006 and comprising €53 million of EU incentives and €212 million of loans from the IFIs. Implementation will begin in April 2007.

The SME Finance Facility is a multi-beneficiary programme which aims to strengthen the capacities of financial intermediaries (i.e. banks, leasing companies) in the Enlargement beneficiary countries, to expand and sustain their financing operations to SMEs.

The mechanism of the Municipal Finance Facility is similar to the SME Finance Facility mechanism. Loan and risk-sharing instruments from resources of IFIs are combined with non-reimbursable financial incentives for local financial intermediaries. It is foreseen that a limited amount of technical assistance for municipalities will be funded by Phare to strengthen the demand side of the municipal credit market.

The Energy Efficiency Facility was launched in 2006 in response to the Energy Efficiency Green Paper and the Directive on Energy Performance of Buildings. It aims at stimulating the energy efficiency investments in all sorts of buildings and in the industry sector, by making appropriate financing available to the end-borrowers. The programme combines IFI credit lines extended to financial intermediaries, with incentives to improve the cost effectiveness of equipment and make the energy investment more attractive, and fees to the benefit of local financial intermediaries to encourage them to lend for the purpose of energy efficiency financing.

The EIB and the Commission have established a facility at border regions, as requested by the Nice European Council, and as outlined in the Commission Communication on Border Regions of 25 July 2001. The project concentrates on the implementation of small municipal infrastructure in border regions to promote integration with current EU regions: It consists of 2 Municipal Infrastructure programmes comprising a total of €40 million of EU incentives and €200 million of loans from the EIB. This programme is still in the process of implementation. The EU contribution has been reduced from €50 to €40 million in 2006 in order to commensurate the size of the programme with potential projects.

4. MONITORING AND EVALUATION

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

4.1. Ex ante evaluation

During 2006, an ex-ante evaluation of IPA focussing on the MIPDs was finalised. The findings and recommendations of this exercise contributed to the deliberations and the results of the Quality Support Group (QSG) process and subsequent revision of the MIPD guidelines/documents.

4.2. Monitoring and Interim Evaluation

In 2006, the interim evaluation (IE) scheme in Romania, Bulgaria and Turkey generated 32 individual country, sectoral, ad-hoc or thematic evaluation reports covering Phare and other pre-accession financial instruments measures.

On the whole, the Interim Evaluation reports on financial support in 2006 showed that the performance of Bulgaria, Romania and Turkey pre-accession assistance was rather mixed and displayed great variation. Specific interim evaluation results for the three countries are described in Part II.3.1.

4.3. Ex post evaluation

A major ex post evaluation of Phare covering national programmes, multi-country programmes and thematic evaluations was completed in 2006. The outputs of the ex-post evaluation exercise include eight multi-country reports, ten country evaluation reports, seven thematic evaluation reports and the Consolidated Evaluation Report. The results of this exercise will serve as inputs for decision-making of current pre-accession assistance and assistance to the Western Balkans. The main findings and conclusion of this ex-post evaluation can be found in Part II.3.2.

5. OTHER ACTIVITIES

A number of other activities were undertaken by the Commission services in order to improve the quality of the programmes for the year 2006, as well as to support the development of local monitoring and evaluation capacity. Specific actions are described in Annex Part II.3.