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Court of Auditors

Report in response to the conclusions of the European Council of 18 June 1983 . . . 1

I

*(Information)***COURT OF AUDITORS****REPORT
IN RESPONSE TO THE CONCLUSIONS****of the European Council of 18 June 1983**

This report, requested by the Council of Ministers of the European Communities on 25 July 1983, was adopted by the Court of Auditors at its meeting of 6 October 1983, pursuant to Article 206a of the EEC Treaty.

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1. GENERAL

1.1. Introduction

1.1.1. The Declaration adopted by the European Council in Stuttgart on 18 June 1983 said that the European Court of Auditors would be asked to review the sound financial management of Community activities and to submit a report by the end of 1983. This report would be followed up in the Court's Annual Reports. On 25 July the Council of Ministers formally invited the Court to comply with this request. The Court interprets the request from the Council as seeking not an audit report as such, but rather a more general expression of the Court's views in relation to the sound financial management of Community activities.

1.1.2. The Court would like to take this opportunity to emphasize that in its opinions and its annual and special reports in the past, it has already clearly expressed its views on many aspects of the problems which are the subject of this report. Against this background it regrets that the Council has never introduced any special procedure for a systematic follow-up to its special reports.

1.2. Community revenue

1.2.1. Much has been made in the past decade of the financial independence which the own resources system was intended to provide for the Communities. But in practice, in so far as value added tax is concerned, it has not been seen as imposing a levy on the taxpayer in the same way as a national tax. The general budget has remained primarily expenditure-determined. Furthermore, there is no function, at the European level, corresponding to that of the Minister of Finance in a national administration.

1.2.2. Consequently the own resources system has not led to greater financial consciousness about the effectiveness of the Communities' expenditure policies, which are intended to replace national policies, and achieve higher overall effectiveness on the European level. It was only when the risk of reaching the limit of

1% VAT own resources became a reality that public attention was focused on the possibilities of making Community expenditure more effective. Until then interest was in fact only centred on how to increase revenue.

1.2.3. The present system has resulted in special agreements to limit the net contributions to the budget by the United Kingdom and, more recently, Germany. The implementation of these agreements has taken the form of new programmes - e.g. the special measures for the UK - which have simply transferred part of the cost of existing programmes to the Community budget and have therefore had little merit from a Community point of view.

1.2.4. Another feature of the system is the reimbursement of 10% of customs duties and agricultural levies to the Member States to cover their costs of administration. This rate is not based on actual costs.

1.3. Community expenditure

1.3.1. Expenditure is dealt with in the following sections of this report. Section 2 relates to the Guarantee Section of the EAGGF. The subject and the problems inherent in it are complex; consequently the Court's observations and suggestions necessarily require in-depth treatment. The broad conclusions are to be found in paragraph 2.5.1.

1.3.2. Section 3 contains the Court's observations on the so-called Structural Funds (Agricultural Guidance, Regional Development and Social) and final observations on these three Funds are provided (paragraphs 3.5.1 to 3.5.6). Section 4 deals with development aid, covering the development funds and food aid.

1.3.3. Concluding remarks are contained in Section 5.

2. EAGGF-GUARANTEE

2.1. Introduction

2.1.1. The attention of the public and of the political authorities has for many years been focused on the major role played by the common agricultural policy (CAP) in Community activities, but also, and especially at certain times, by the volume of agricultural guarantee expenditure in relation to Community financial intervention measures as a whole. Successive budgets have endeavoured to reduce the relative share of this type of expenditure, but in the budget implementation, as shown in the accounts, this share has not fallen below 70 % except in the last few years.

2.1.2. During the last decade, the total gross costs (excluding Greece) of the policy concerning the organization of agricultural markets rose from 3 927 million ECU in 1973 to 11 717 million ECU in 1982. It therefore virtually tripled (+ 198 %) in nominal amounts. The net costs, after deduction of the agricultural own resources (levies, sugar levies), showed an increase of 183 %. In real terms, bearing in mind an average annual rate of inflation of 10,2 %, this increase is brought down to 18 %, or an annual rise of 1,9 %.

2.1.3. This relative increase in the cost of the CAP can be assessed by a comparison:

- (a) with the proportion of the Community GDP which is devoted to it: 0,34 % on average in the first five-year period, 0,44 % during the second;
- (b) with the expenditure on food in the Community, of which it represented 1,8 % on average in 1973 to 1977 and 2,2 % in 1978 to 1982.

2.1.4. The Treaty clearly subordinates the main rules concerning the operation of the common market, especially those on competition, to the specific objectives of the common agricultural policy. These objectives aim simultaneously:

- (a) to increase agricultural productivity and to ensure the rational development of agricultural production;
- (b) to maintain a fair standard of living for farmers;

- (c) to stabilize markets;
- (d) to assure the availability of supplies and
- (e) to establish reasonable prices for consumers.

These aims are partly complementary and partly contradictory. Neither the Treaty nor the secondary legislation gives any indication of their respective order of priority and the criteria for assessing the extent to which they have been achieved.

2.2. The defects of the management system

The automatic nature of Guarantee budgetary expenditure

2.2.1. In practice, policy choices have alternately given priority to the objective of fair income and to that of availability of supplies. This has been done by means of decisions on the introduction of basic regulations for each market and annual price decisions for the marketing year (usually from 1 April to 31 March), all of which are the responsibility of the Council of Ministers of Agriculture. The financial consequences of these decisions are considered, by transposition of the terms of Article 203 (4) of the Treaty, to be 'necessarily resulting from the Treaty or from acts adopted in accordance therewith', and are thus incorporated in the budget. Chronologically, the budget is therefore voted by the budgetary authority at a time when the decisions on regulations and on prices have already been taken for the marketing year in progress, whilst subsequent price decisions relating to the forthcoming marketing year will very often necessitate an amending and supplementary budget.

2.2.2. The 'compulsory' nature of agricultural expenditure has a twofold consequence:

- (a) the budgetary authority, for its part, can neither ensure the consistency of the agricultural policy nor effectively exercise any choice whatsoever regarding priorities;
- (b) the budget can put very few constraints on the expenditure of the year to which it relates, since it is only the overall allocation to the EAGGF, Guarantee Section, which is of a limiting nature, the expenditure for each Chapter simply being recorded *ex post facto*.

It would however be possible to strengthen the limitative nature of the budget estimates by, for instance, combining it systematically with contributions from producers to finance any cost over-run affecting these estimates.

2.2.3. Against this background, the framework provided by the single general budget seems to be ill-adapted to the management of agricultural markets. A system could be set up whereby, for each product, the producers would share in financing any over-run of budgetary authorizations. On this assumption the EAGGF, Guarantee Section, would finance out of its allocations – fixed under the budgetary procedure – as many special accounts as there were market organizations. These accounts would pool the various kinds of financing specific to each market: agricultural own resources, producers' contributions, EAGGF, Guarantee Section, allocations.

Dispersion of financial responsibility regarding implementation

2.2.4. The measures implementing the basic regulations or price decisions of the Agricultural Council are adopted either by this same Council, which can thus intervene in the management, or by the Commission under the 'management committee' ⁽¹⁾ procedure; these committees are composed of representatives of the Member States voting according to the same rules as the Council. In both cases, this procedure is effectively a day-to-day joint management of the agricultural markets in so far as decisions having a financial impact, such as the fixing of the rates for import levies and export refunds, or the fixing of the volume and tender prices for public stocks, are adopted at meetings of national and Community experts.

2.2.5. This joint management is carried out at best according to criteria specific to each market, and most frequently simply produces compromises between national and sectoral interests rather than according to an overall logic for European agriculture, and still less the necessarily global logic of financial management. The

⁽¹⁾ 19 committees (cf. list in OJ No L 19, 24. 1. 1983, p. 314).

measures decided on under these conditions usually become 'acquired rights' and assume an irreversible nature.

2.2.6. There are several ways which, collectively or individually, could help to improve this state of affairs. They concern first and foremost ways of increasing the Commission's own responsibility for budget implementation, as defined in Article 205 of the Treaty, as against that of the agricultural experts. They also concern ways of increasing the influence of the financial experts of the Member States, as opposed to the agricultural experts, and in general anything that would permit periodic reviews of the effectiveness of the existing situation.

2.2.7. The Court considers it must stress very strongly that the key factors for better control by the Community of its agricultural expenditure are:

- (a) the review of the decision-making procedures along the lines suggested above;
- (b) the improvement of the Commission's own information tools in order to make the definition of the objectives of Community activities more consistent and the assessment of their results more systematic.

Malfunctioning of the decentralized management system

2.2.8. The system of financing set up in 1970 has meant that the implementing rules for the management of appropriations derogate substantially from the rules applicable to the general budget. In its successive annual reports, the Court has criticized this system which, though sound in principle, has over the years not worked well in practice. Examples are:

- (a) the appropriations required for the expenditure in each of the Member States are made available to them in the form of monthly advances which they themselves distribute between the paying agencies (36 paying agencies, of which the number and the internal regulations vary constantly at the sole discretion of the Member States); for the Member States, this procedure lends itself to excessive

requests which the Commission cannot easily check, thus enabling cash funds to be formed at the expense of the Community;

- (b) the system of global advances carries the risk of over-spending appropriations at the end of the financial year, since it is only subsequently that the Commission can ascertain the actual expenditure of the Member States, especially that relating to public storage; conversely, by means of the system of anticipated reduction in value of stocks, the Commission has been authorized by the Council to utilize any appropriations which may remain available at the end of the financial year;

- (c) it is only after a considerable delay – five to six years after the financial year in question, instead of one – that the Commission, having checked the transactions effected by the paying agencies, carries out the clearance of the accounts of the Member States including, if necessary, making them responsible for amounts disallowed; the last decision, dated 14 January 1983, clears the 1976 and 1977 accounts, i.e. 27 300 million ECU cleared out of 81 700 million ECU disbursed between 1971 and 1982; this situation, which was thoroughly analyzed by the Court in its Special Report of 12 October 1982⁽¹⁾, reveals a shortcoming in the internal control, in the broad sense of the term, of the whole system of Community agriculture expenditure. This control is at present split between the financial controller and the management departments. The latter are responsible for the checks involved in the clearance of accounts and for the coordination of the measures to combat irregularities, although they do not have the independence of the financial controller. On the whole, it seems that the decisions on the clearance of accounts tend more and more to resemble a compromise negotiated with each Member State rather than a judgement on the quality for the financial management.

2.2.9. The reforms to be made are compatible with maintaining a decentralized system in principle, i.e. leaving the responsibility for implementing the Community measures with the Member States.

⁽¹⁾ OJ No C 313, 29. 11. 1982.

Nevertheless, in comparison with the present situation, it should in future be possible to avoid at least some inconsistencies, at the level of the paying agencies.

- (a) The paying agencies should be accredited by the Commission, so as to avoid too great a diversity in their powers and structures, between the various Member States.
- (b) Likewise, the paying agencies should be directly accountable to the Community and not through the national treasuries.
- (c) Lastly, the national and the various Community controls should be integrated to produce a more economical and more reliable system. This harmonization should be accompanied by more emphasis on the scrutiny of commercial documents, on the lines provided for by Directive 77/435/EEC, which as yet has unfortunately been applied only in part.

2.3. Factors governing the cost of the market policy

The relativity of the costs according to the market organization

2.3.1. Attention is very often drawn to the total budgetary amounts relating to the main markets. The most costly have always been:

- (a) milk, sugar, cereals and meat (altogether 65 % of expenditure in 1982);
- (b) olive oil and tobacco (altogether 10 % in 1982);
- (c) more recently, oil seeds, fruit and vegetables and wine (altogether 18 % in 1982).

2.3.2. The rate of aid (i.e. ratio of net budgetary cost of the market to the final value of the product), however, reveals a different hierarchy in the relative cost of the products: those receiving most aid are tobacco, olive oil and oil seeds with a rate of 40 to 60 %, those receiving least are sugar, wine, meat and fruit and vegetables with a rate lower than 10 %, whilst cereals and dairy products fall in between, with a rate of aid ranging from 10 to 20 %.

2.3.3. These disparities reveal widely varying situations which are chiefly due to the quality of the

instruments of guidance and regulation which have been implemented. The organization of the market in sugar is undoubtedly the best developed: its net budgetary cost (300 to 500 million ECU in 1981/82) corresponds strictly to the financial compensation paid for an import agreement in favour of the ACP countries, and its guarantee system incorporates full application of the co-responsibility rule whereby the producers contribute by means of levies to the internal market regulation and bear the entire cost of exporting surpluses.

2.3.4. All the other markets, on the other hand, suffer from several weaknesses, combined in varying degrees:

- (a) the inconsistency of the way markets are influenced by prices, since their hierarchy as between the products no longer corresponds to the current agricultural economic situation;
- (b) the imbalance of the instruments of internal regulation (intervention buying on the open market, controlled storage measures and withdrawal operations) and external regulation (system of levies-refunds).

These defects result in:

- (c) considerable extra costs due to Community non-preference;
- (d) the excessive burden of the compensatory measures;

and are aggravated by:

- (e) the effect of monetary compensatory amounts.

Inconsistency of the relative price levels

2.3.5. It is questionable whether the initial decisions on prices, taken when the main market organizations were being set up (cereals 1966, milk 1968, meat 1968), are still appropriate to the present situation on the internal and world markets, given that their structure (relationship between the prices) has not been significantly altered since the beginning.

2.3.6. Several events have, however, altered the circumstances on the market, the most important being

the change of policy in the United States in 1971 which sought to reduce the support given to basic products, first and foremost cereals, and thus to bring about, at the least cost, an improvement in the income of the milk and meat producers. The effect of this measure was twofold: firstly, it widened the gap between the price of European and United States cereals, thus making it more expensive to export European grain in years of surplus production, and secondly, it made the United States basic products (feed grains, soya and other protein seeds, etc.) more competitive. It therefore became more costly to support both the corresponding European products and the end products (milk, meat). At the same time, the total production of European cereals, over-stimulated by the prices, tended to move into surplus as from 1979/80 (especially those intended for human consumption), thus inevitably widening the gaps and increasing the costs of Community support.

2.3.7. It was under these conditions that the question arose, as from 1981 ⁽¹⁾, of changing the key to the whole system in the same way as the Americans, i.e. by bringing the support prices for European cereals into line with those outside the Community, thus lowering the relative price of cereals in comparison with the prices of all the products derived from cereals of their substitutes: beef and veal, pigmeat, eggs, poultry, milk. This would result in the balance being restored on all the markets concerned, which at present represent over 60% of the value of Community farm production, while their total budgetary cost accounts for 60% of EAGGF expenditure. The expected saving could only be achieved gradually and is difficult to quantify, but it may be estimated at several thousand million ECU in current budgetary terms.

The imbalance of the instruments of internal and external regulation

2.3.8. This imbalance is particularly evident in two of the main markets, those in milk and meat, which have developed structural surpluses.

⁽¹⁾ Ref. Doc. COM(81) 608 final. Guidelines for European agriculture, paragraphs 59 to 64.

The milk market

2.3.9. In this market (gross expenditure: 3 800 million ECU in 1982), the system of co-responsibility set up in 1977 has proved to be incapable of curbing production. The surpluses, whether stored or not, have had to be disposed of at low prices on the external market (butter) or for use as animal feed, where they have encountered strong competition from imported products (skimmed milk). The levy of 537 million ECU in 1982 on producers has tended to encourage additional expenditure because part of the revenue has been allocated to a programme of new measures, whose justification has never been established.

2.3.10. The only effective measure envisaged in 1977, the supplementary levy on producers creating new surpluses, which would also have brought in 500 million ECU in revenue every year, has not been applied. It should be remembered that any system of internal levy with the characteristics of a tax generates high administrative costs at national level and, with the present Financial Regulation, budgetary anomalies at Community level, since it has to be recorded as a deduction from expenditure rather than revenue ⁽¹⁾.

The beef and veal market

2.3.11. This market (1 200 million ECU in 1982) has long been in imbalance because of the effects of the import agreements applying to an annual 400 000 tonnes of meat, processed or otherwise. There has been a string of consequences:

- (a) a constant pressure on the market price, which has remained well below the guide price;
- (b) the need to export the surpluses at a loss;
- (c) an inversion of the effects of the intervention measures which, instead of helping to make up the difference with the guide price, have tended to devalue the meat at the expense of the Community by recycling 300 000 tonnes of meat per year at a loss.

2.3.12. The recent easing of the intervention mechanisms seems to have made it possible to improve the situation, although the market is still burdened by the

⁽¹⁾ Cf. in particular the Court's Special Report published in 1980 and Annual Reports for the financial years 1979, 1980 and 1982.

need to compensate for the disparity between the guide price and the market price by expensive subsidies whose effectiveness is questionable.

The extra costs of Community non-preference

2.3.13. All the extra costs of non-preference can be specified; the main items responsible, apart from ACP sugar imports, relate to the markets in milk (New Zealand butter, cheese, fats competing with butter), beef and veal and sheepmeat (non-levy quotas), olive oil and oil seeds (competing fats and oils) and, having an effect on several markets, the imports of cereal substitutes. The estimated total extra costs arising from non-preference varies between two thousand million and four thousand million ECU, in terms of income lost and expenditure incurred.

The burden of compensatory measures

2.3.14. A feature of a number of measures financed by the EAGGF, Guarantee Section, is that they have hardly any effect on the balance of the markets but nevertheless entail not inconsiderable expenditure. The Court has made a number of observations about such situations in its annual and special reports, especially with regard to the various aid measures for the disposal of dairy products (distribution of milk to schools, supplying of butter to the armed forces, the 'Christmas butter' operation and other aid for the disposal of butter on the internal market, aid for the disposal of skimmed milk, either as powder or in the form of casein). It is clear from these observations that in many cases these measures (costing 1 800 million ECU in 1982) resulted only in costly transfers, which were difficult to reverse, to the advantage of certain consumers, private or industrial, without stimulating any marked rise in consumption.

2.3.15. The Court also draws attention to a number of other measures, whose results in relation to budgetary cost seem minimal, for example:

- (a) aid to the starch industry, which has again become competitive in relation to the competing petroleum-based products (135 million ECU in 1982);
- (b) aid to durum wheat, which is intended solely to reduce the price of pasta products (165 million ECU in 1982);
- (c) the tobacco premium, designed to support the income of a small category of producers by paying

them three times the world-market price (575 million ECU in 1982).

2.3.16. Generally speaking, the total amount of the price compensatory measures is considerable (5 500 million ECU in 1982). Their profusion (some 100 permanent measures) seems to stem more from a concern for a redistribution by category or geographically, than from any attempt to organize the markets rationally. It is also the result of the shortcomings mentioned earlier in respect of the guarantee systems – the price structures and non-preference cases.

2.3.17. These measures are the source of the main difficulties for management and control, at the levels both of simple regularity and of assessing the results obtained, which in most cases are minimal in comparison with the high administrative cost for the Member States. This category of expenditure should therefore be subjected to a particularly rigorous, critical review. Any cutback will inevitably encroach on the interests of certain categories. But by implementing the structure and levels of prices described in paragraph 2.3.7 above, it should be possible to solve most of the difficulties.

The aggravating effect of the agri-monetary measures

2.3.18. The functioning of all the markets is affected by the monetary compensatory amounts (MCAs), whose continued existence has had lasting and now familiar effects on the very structure of European agriculture. But it is usually overlooked that:

- (a) the MCAs involve a system of collecting or paying a total amount of one to two thousand million ECU per year;
- (b) this system greatly encourages speculation and/or fraud, but is very difficult to control without excessive restraints at frontiers, including the internal frontiers of the Community;
- (c) the net budgetary cost has varied over recent years, according to the speed with which the 'green' currencies have adapted to the fluctuations of the real currencies, between the levels of 700 to 800 million ECU in 1977 to 1979 and 200 to 300 million ECU in 1980 to 1982.

2.3.19. The only valid solution to the various aspects of the problem of the MCAs is the introduction of a system of automatic and accelerated phasing out. The constraints inherent in such a process would in turn be a burden on all the other agricultural policy decisions and in particular the annual decisions on prices, but would, on this occasion, arise from an attempt to return to a single market.

2.4. The results of the policy

The level of aid to farming according to country

2.4.1. It may be interesting to compare, in order of size, the amount of Community expenditure in each Member State with the importance of that country's agriculture. This rate of aid to agriculture (i.e. the relationship between the Community expenditure in the Member States and the gross value-added of their agriculture) has varied considerably from one country to another during the five most recent years when it has been possible to measure it. From 1977 to 1981, it was $\pm 30\%$ for four countries (in the order Belgium, the Netherlands, Ireland, Denmark), dropping to 15 to 20% for the Federal Republic of Germany and the United Kingdom, then to 13% for France and Luxembourg and to 8% for Italy.

2.4.2. Although the geographical spread of Community expenditure does not always correspond exclusively to the farming activities of a particular country, such pronounced disparities can only encourage doubts as to the suitability of the policy of market organizations in relation to the real situation of the agricultural activities concerned.

The results achieved compared with the objectives of the Treaty

2.4.3. For want of any prior definition of the criteria which would enable the results of the CAP to be evaluated in relation to the objectives laid down in Article 39 of the Treaty (cf. paragraph 2.1.4), the performance of European agriculture may be assessed on the basis of an examination of the main trends which have characterized its development over the last 10 years, in particular by drawing comparisons with other developed countries. Thus:

- (a) Agricultural productivity: Employment in agriculture has steadily declined over the past 20 years with a tendency to fall more slowly over the last decade, and the total production of the Community has continued to grow. In physical terms productivity has improved more, and at a somewhat faster rate than that of comparable countries.

- (b) **Income from agriculture:** Agricultural income per unit of work remained stable from 1973 to 1978. It then fell slightly, before rising again in 1982, but has not undergone the sharp fluctuations witnessed in some countries such as Australia and New Zealand.
- (c) **Stabilization of the markets:** It is difficult to isolate this criterion from all the others and it has of course to be assessed market by market. Stabilization has on the whole been attained for those products normally subject to international speculation, such as sugar and cereals, and to a lesser extent for the other products whose balance depends on a combination of the uncertainties of the marketing year and of international influences of a political as opposed to a commercial nature; this applies especially to milk by-products, oils and fats and cereals substitutes.
- (d) **Security of supplies (and, implicitly, the balance of trade):** Self-sufficiency has increased on most markets; the normal consequence of this is the risk of limited surpluses which for a period of time are difficult to carry over or to dispose of on the world market. An abnormal consequence may also arise when the relationship between the Community's supply (production plus imports) and demand produces a structural surplus. It must also be stressed that livestock production methods (milk, meat) have been developed in such a way that the Community is more dependent, because of 'upstream' consumption (feedingstuffs).
- (e) **Prices for consumers:** Against the background of general stagnation in consumption and a gradual harmonization of consumer habits, linked with the opening up of markets, consumer prices for food within the Community have increased in line with the general price rise, whereas in the other OECD countries prices of this kind have generally risen more swiftly than those of other products or services.

The overall result

2.4.4. The foregoing suggests that Community self-sufficiency in most products has been developed without detriment to the consumer and without excessive profit for the producer, but that it has been gained at the expense of a relative increase in the cost to the budget.

Moreover, dependence on external trade has been transferred rather than reduced.

2.4.5. Lastly, in 1981, 70 % of guarantee funds were channelled into payments to agri-foodstuffs undertakings. This development, which involves agriculture in an increasingly complex processing system, results effectively in an uplift in the value of the basic products. The intervention mechanisms should obviously take this into consideration so as to ensure that the measures reach those whom they are supposed to benefit – farmers or consumers.

2.5. Conclusion: the scope for action and possible savings

2.5.1. The scope for action by the responsible political authorities of the Community, while respecting the objectives and basic principles of the CAP, is probably greater than is usually admitted. On the one hand, there is a marked trend towards an increase in the costs of agriculture combined with a slowing down in the improvement of output, a trend which accelerated in budgetary terms in the latter half of the second decade. On the other hand, a number of solutions exist, such as:

- (a) organizing co-responsibility and its corollary, the limitation of guarantees;
- (b) restructuring relative prices;
- (c) implementing Community preference in markets where it is not fully applied;
- (d) automatic and accelerated readjustment of the 'green' currencies so as to limit the budgetary effect of the MCAs and to encourage a return to economic balance by means of competition;
- (e) reviewing and systematically pruning direct subsidies which are ineffective or generate windfall profits.

The budgetary effects of these solutions are not fully cumulative but, taken as a whole, they undoubtedly represent a large proportion of the 16 to 18 000 million ECU currently at stake.

3. THE STRUCTURAL FUNDS

3.1. Introduction

3.1.1. The three Funds generally referred to as 'structural' are the EAGGF, Guidance Section, the Regional Development Fund and the Social Fund.

3.1.2. One of the objectives of the common agricultural policy contained in Article 39 of the EEC Treaty is 'to increase agricultural productivity by promoting technical progress and by ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labour'. To help achieve this goal, the Guidance Section of the EAGGF grants financial aid for so-called 'horizontal' measures, which affect the Community as a whole, and for 'regional' measures intended for specific regions of the Community. The commitment appropriations entered in the 1983 budget amount to 802,2 million ECU.

3.1.3. The European Regional Development Fund (ERDF), set up by Council Regulation (EEC) No 724/75 of 18 March 1975, is designed to correct the main regional imbalances, which stem chiefly from the predominance of agriculture, from industrial change and structural under-employment. The commitment appropriations entered in the 1983 budget amount to 2 010,0 million ECU.

3.1.4. The European Social Fund was established by Article 123 of the EEC Treaty 'in order to improve employment opportunities for workers in the common market and to contribute thereby to raising the standard of living' and '(to) render the employment of workers easier and (to) increase their geographical and occupational mobility within the Community'. The present system, which came into force on 1 January 1977 and will be replaced next year, is the result of a Council Regulation and basically consists in the co-financing with the Member States of vocational training for certain categories of job-seekers. The commitment appropriations made available for this purpose in the 1983 Community budget total 1 696,5 million ECU.

3.1.5. Although the resources made available to these funds have increased markedly over recent financial years, rising from a total of 1 442,1 million units of account in 1977 to 4 508,6 million ECU in 1983, there has not been a corresponding change in the conditions under which they are managed, as illustrated by the observations in the following sections.

3.2. EAGGF, Guidance Section

3.2.1. The reflections below relate in particular to two of the most representative 'horizontal' measures: Council Regulation (EEC) No 355/77 intended to improve the conditions under which agricultural products are processed and marketed, and Council Directive 72/159/EEC on the modernization of farms. There are also some general remarks on measures for specific regions.

Weaknesses in the use of aid for the processing and marketing of agricultural products

3.2.2. The investments which are subsidized must, under the current provisions, form part of specific programmes.

- (a) The programmes studied by the Court usually contain a good analysis of the production sectors in question, stating the changes of approach needed and the global objectives. But the human, technical and financial resources for implementation tend to be glossed over, thus making it impossible to identify the type of investments to be financed, their volume, the production processes and the desired impact on farms.
- (b) The selection criteria defined by the Commission clearly demonstrate the factors governing the choice of projects. But the criteria determined each year stipulate above all those types of production which are to be excluded from Fund aid measures, rather than the operations to receive priority: they do not therefore constitute the best guidelines for developing and selecting the projects.

3.2.3. Some of the aid recipients fail to send the Commission the report on the financial results of the subsidized investments which they must usually submit, in a standard form, within two years. This information is, however, indispensable for assessing whether the projects are properly adapted to the economic situation. The Commission for its part does not carry out any systematic analysis of the information it does receive.

Shortcomings in the management, monitoring and evaluation of aid for farm modernization

3.2.4. Directive 72/159/EEC calls for a development plan as the basic instrument for developing farms and

increasing their modernization and income, and it provides for the granting of aid for implementing these development plans.

- (a) The system presupposes the keeping of detailed farm management accounts as well as appropriate management skills on the part of the farmer. It is technically demanding, especially since it is intended for the less-favoured socio-occupational groups.
- (b) Without suitable administrative and technical back-up, farmers cannot assess, in terms of the return on their investments, the medium-term effects of the opportunities afforded by different types of agricultural production. It is therefore primarily in the regions where such support services exist that the Directive can bear fruit.
- (c) Despite efforts made by the national administrations and the professional organizations, no real method has yet been worked out for measuring and appraising the success of the plans. Too many external factors – first and foremost the rise in prices and in the standard of living – affect the outcome of the plan for the results to be realistically compared with the forecasts. The plan thus seems to be a development instrument, control of which remains illusory.

Failings in management of aid for less-favoured regions

3.2.5. In recent financial years there has been a large increase in the number of measures for less-favoured regions. These relate in particular to infrastructure work, and to activities concerning forestry, training and the improvement of agriculture. The Council Regulations establishing these measures lay down the subject, the general terms on which the aid is granted and the timescale of the operations. These Regulations usually require the Member States concerned to draw up and to submit to the Commission for approval, programmes for implementing the financing.

- (a) An increase in the number of such measures carries the risk that Community intervention may be too thinly spread, especially in the light of the very limited financial resources of the Guidance Section.
- (b) The preparing of the programmes stipulated in the Regulations is frequently purely a formality. The Commission is then in the situation of having either to approve a vague programme for implementing the financing which is of little practical use, or to prolong the time needed for the measure to be put

into effect initially, whilst waiting for improvements to be made to the programme.

- (c) The effectiveness of the programmes is also governed by whether or not the authorities responsible in the Member States possess the financial, technical and administrative means required to implement them. To date this condition has not always been observed. In some cases, advance payments for financing projects which have been granted out of the Community budget, have remained unutilized owing to long delays in carrying out the work, and have had to be refunded to the Commission.

Link with the agricultural markets policy

3.2.6. In defining objectives and implementing measures, there seems to be insufficient concern about modifying the agricultural structures in order to achieve a balance between types of farming most suited to the demands of both the internal and the international markets. The EAGGF, Guidance Section, has virtually no clear and stringent programme designed to help farmers abandon production in surplus sectors. The only measures to have been attempted along these lines have failed for want of detailed definition of their objectives and a sufficiently strict selection among the recipients of aid.

3.2.7. On the contrary, many investments in various types of agricultural production (dairy products, viticulture) have been financed without due consideration of the adverse effects on the equilibrium of the market. Thus, instead of distributing subsidies serving to create or develop production capacity in sectors already in surplus, it might have been preferable, for example, to pay compensation for the closure of dairies, in conjunction with adequate aid to producers in geographical areas defined according to the special features of their production. The Guidance policy must be developed along the lines of restoring the balance between all the markets and all forms of farming.

3.3. European Regional Development Fund

3.3.1. The following points deal mainly with factors which influence the effectiveness of ERDF operations, particularly in respect of the so-called 'quota' section which represents 95% of the aid and is allocated to finance investments included in regional development programmes.

Weaknesses in the selection of subsidized investments

3.3.2. In order to be effective, the operations should focus on priority areas. Commercial operators should

possess the information necessary to make their own decisions. The objectives, conditions governing the operations financed and the Fund's resources should be clearly stipulated. However, it has been found that:

- (a) the programmes of the Member States are not submitted to the Commission for approval, they are only sent to enable it to determine the priority areas for the operations of the Fund. But the vagueness of the programmes makes them of little use in assessing and selecting the projects;
- (b) the examination of the programmes by the Commission has not resulted in the determination of priority areas for the operation of the Fund, nor have criteria been established for selecting the projects to be adopted from those considered as eligible. Little is known of the processing work that may be carried out or the reasons behind the choices finally made;
- (c) the Member States' tendency to submit only sufficient applications for assistance from the Fund to exceed slightly their share of the financing, has the result of greatly reducing the scope for project-selection at Community level. Relevant provisions should be adopted to afford the Community a genuine choice on selecting projects;
- (d) there is a closer link between subsidized investments and Community policies for the so-called 'non-quota' measures. These measures are, however, slow in getting off the ground (in 1982, four years after their creation, only some 22% of appropriations available for commitment were used) and their management faces problems mainly arising from the difficulty in attaining a satisfactory level for the separate identification of projects.

The additional nature of the aid from the Fund

3.3.3. Aid from the Fund should not lead the Member States to reduce their own efforts in the sphere of regional development but should complement them. The purpose of the Fund's subsidy would in fact not be achieved if it led to a reduction in the aid granted by the public authorities of the Member States for the same types of operation. The Member States do not, however, provide the information necessary to ensure that the Community aid is really

additional in nature. It does not indicate either the total amount or evolution of financing by the public authorities for the development of the various regions.

The creation or maintenance of jobs

3.3.4. One of the objectives of the ERDF is to contribute to the creation or maintenance of jobs. Decisions to grant aid from the Fund are mainly made according to the direct or indirect effect of the investment on employment, and in industrial, handicraft or service activities a project is only considered eligible for aid if it creates or maintains at least 10 jobs.

- (a) Job estimates are of a differing value since they are conditioned, both at the level of undertakings and of their economic environment, by multiple variables whose evolution and interaction are very much uncertain.
- (b) With regard to the infrastructure projects which constitute by far the major part of the operations financed, there is no estimate or other information in the Fund's files concerning the effect of the investment on employment. It is much the same for the indirect effect of industrial investments.
- (c) For industrial, handicraft or service activities, the estimates or information in respect of employment contained in the Fund's files refer only to the direct effect of investments and are presented in the form of the number of jobs to be created or maintained by the recipient of the aid. This number does not show the net overall effect that the investment may have, in terms of employment, on all of the undertakings of the region and is therefore of little real value.

The procedure of accelerated payments

3.3.5. The procedure of accelerated payments, established in 1979, allows public aid paid by Member States to be reimbursed up to 75% of the Community assistance, on condition that at least 30% of the payments constituting the basis for aid from the Fund has already been made. An enquiry carried out by the Court reveals that this system has in no way contributed to reducing the time required to complete the projects. The number of files closed has tended to fall rather than increase.

3.4. Social Fund

Absence of objectives and criteria

3.4.1. Article 125 of the Treaty initially spelt out precisely the objectives of the Fund. The system then in force responded to the requirements of a situation of full employment. Vocational retraining and resettlement operations – co-financed by the Community – were intended to encourage the mobility of the labour force within the Community. However, under the present system, in force since 1977, the Council has limited itself, in terms of objectives, to defining the categories of recipients and the nature of eligible expenditure – so as only to accept those having a direct link with the measure – and to fixing the percentage of Community intervention (generally 50 and 55 % for projects located in the six priority regions).

3.4.2. The Commission, for its part, lays down each year the criteria that it intends to apply in selecting the national applications for assistance. These criteria, referred to as 'guidelines' are apt to exclude certain activities although they are eligible under the Regulation. Three factors are taken into consideration: the categories of recipients, the types of activity and, above all, the regional origin.

3.4.3. These 'guidelines' are subsequently taken into account when the Commission draws up its draft budget. Any amendments made by the Council and Parliament do not automatically result in the guidelines being changed. The former therefore lose a part of their initial significance. Moreover, the budgetary ceiling may only be observed at the price of the 'weighted reduction' applied by the Commission in response to each Member State's requests. The weighted reduction coefficient is calculated on the basis of national socio-economic statistical data, without taking account of the real situations prevailing in the sectors. The Community nature of this procedure and its effectiveness in the sectors are thus greatly reduced.

3.4.4. This brief description reveals that the social policy financed by the Fund is not defined at Community level either in terms of objectives or specific measures which should be related. In effect, these are national measures and do not stem from a Community initiative.

The role of the Member States

3.4.5. Of the measures financed in the Member States, it should be established whether they correspond

to the obligations assumed by the public authorities under their national legislation. If so, the Community contribution does not constitute a real incentive for such measures; it is simply a reimbursement to the Member State for an operation that it should have financed anyway. This is not the case for the measures initiated by financially autonomous public or private organizations. It is only in the latter case that Community intervention may play a supplementary role.

3.4.6. The harmonization of national legislations on the measures financed by the Social Fund would greatly assist in focusing the measures on the priority objectives for each category laid down by the Community. This is unfortunately not the case, and the Member States themselves are therefore led to select the projects likely to yield the best anticipated financial return from those considered eligible under the joint guidelines. These are submitted in random fashion.

Shortcomings in the management of aid

3.4.7. In accordance with the Fund Regulation, the Commission is responsible for adapting its guidelines to the economic and social situation of the Community. To the Court's knowledge, however, no systematic study has been carried out for this purpose. Even the 'pilot schemes and studies' financed by the Fund are not fully or systematically exploited.

3.4.8. Projects are not monitored during their lifetime. The Commission is content to settle the advances against certification by the Member States that various stages of the project have been completed. At the final stage, the requests for payment are examined mainly on the basis of a report on the project's implementation, which serves to demonstrate the eligibility of the expenditure. No attempt is made here to assess the consequences and effectiveness of the measures financed.

3.4.9. The Court has also noted that there has been no monitoring or appraisal of the system of delegating the responsibility for management to the Member States, to ascertain its reliability. Neither has the Commission effected the *ex post facto* assessments required by law so as to adapt its policy to the situation of the employment market.

3.4.10. Faced with the practical need to determine common conditions for eligibility, the Commission has

merely accepted the definition used in each Member State, for example, to assess the public or private nature of the recipient organizations, or of the situations of young job seekers, those threatened with unemployment, migrant workers and the disabled.

3.5. Final observations on the structural funds

3.5.1. The present situation is marked by the absence, in a considerable number of cases, of clearly defined objectives. Regional aspects have gradually been introduced into the EAGGF, Guidance Section, and the Social Fund, outside the framework of the Regional Fund. This trend, resulting in some confusion between the concept of regional policy and the regional element of a sectoral policy, explains why many aims are expressed in such vague terms. Consequently the implementing measures are often quite unsuited to the objectives.

3.5.2. The shortcomings as regards objectives frequently make it difficult for suitable instruments and criteria to be defined by Council Regulations. The Commission, for its part, has not always taken advantage of the opportunities proffered to supplement the eligibility criteria by adopting rules concerning order of priority. In these circumstances, the Community's contribution does not serve as additional financing and the system degenerates into partial reimbursement of national budgetary expenditure.

3.5.3. The Commission concentrates its attention on securing the maximum utilization of available appropriations. Too absorbed in its task of day-to-day management, however, the Commission scarcely follows

the activities of the structural funds in the Member States and does not have sufficient information to make any worthwhile assessment of the results of Community financing measures. It does not, therefore, systematically evaluate the results of the policies being pursued.

3.5.4. Coordination is a problem at three levels: objectives, regulations and management. It is above all at the stage of on-the-spot implementation that the application of suitable procedures should make it possible to prevent conflicting effects and duplication. Such coordination is at present being attempted by the Commission, but without adequate knowledge of the actual situation in the regions.

3.5.5. By and large, the current evaluation of the financial management of the structural funds is all the more disappointing since they are well-suited to an efficient management system. The Commission could work in conjunction with the Member States from the decision-making stage to that of on-the-spot monitoring, within the framework of detailed multi-annual plans.

3.5.6. In applying a concerted policy of this kind, it should be ensured, as a matter of priority, that:

- (a) clear objectives are defined by the Council, on proposals from the Commission;
- (b) precise criteria for the allocation of Community subsidies are determined by the Commission;
- (c) the projects subsidized by the Community are systematically appraised by the Commission.

4. DEVELOPMENT AID

4.1. Introduction

4.1.1. The European Community has concluded a series of agreements which aim to establish a new pattern of relations between the developed and developing States. Development aid, financed by the European funds or by the Community budget, has all the features of a truly Community policy. Drawn up in conjunction with the recipient States under a multi-annual programme, the aid is implemented, financed and monitored to a large extent by Community bodies.

4.1.2. The aid is greatly valued by the recipient countries because, free from all political constraint, it constitutes a valuable influx of foreign currency and is usually accompanied by sound technical assistance. In 1982 development aid amounted to 1 600 million ECU, i.e. 10% of the total aid from the Member States of the Community, including 893 million ECU for technical and financial cooperation and 707 million for food aid.

4.1.3. Since the number of countries in receipt of Community aid is still rising and the amount available has

suffered increasingly the erosive effect of inflation, those responsible for managing the aid should endeavour to ensure optimum utilization and avoid needless wastage.

4.2. Limited results of the aid

4.2.1. A general comparison of results with initial objectives reveals that technical and financial cooperation, the major part of development aid, has not succeeded in integrating the economies of the recipient States more vigorously into the world market by developing crops for exports, or creating competitive industrial centres. Nor has it succeeded, for lack of resources, in rectifying the structural deficiencies threatening the natural and human environments of these regions in the form of desertification, deforestation, soil depletion and the growth of shanty towns within the urban centres.

4.2.2. Nevertheless, this assistance has afforded a useful contribution to the development of sectors within the recipient countries, especially in the spheres of health, education and communication infrastructures. The benefit to agriculture is more difficult to evaluate but has improved owing to the move towards integrated projects, which take more account of human aspects and fulfil the need to give priority to the supply of food products.

4.3. Structural deficiencies of technical and financial cooperation

4.3.1. The planning of the aid, effected by country and overall budget, is based more on the criterion of fairness of geographical and political distribution than on a critical assessment of the merits of the individual projects to be undertaken. Furthermore, the Commission does not attach the same importance to project-evaluation, either at the design stage or during *ex post facto* control, as do the World Bank and the International Development Association.

4.3.2. The management of Community aid is characterized by unwieldy administrative procedures, lengthy processing periods, a multiplicity of decision-making bodies and the absence of a data-bank which would allow lessons to be drawn from the experience, good or bad, of similar past projects.

4.3.3. The Community is inclined to overestimate the financial and administrative ability of the recipient countries, in particular the poorest ACP States, to

identify, co-finance and maintain the projects. At the present rate, Community assistance will be more and more committed in advance to meeting recurrent costs of previously financed projects.

4.4. Legal and administrative shortcomings of cooperation

4.4.1. Unlike the World Bank and the International Development Association which refuse to include any element of national taxation in the financing of the aid projects, the Community continues to pay duties, taxes and other fiscal items levied in various forms by the governments of the recipient countries. This omission, which also applies to the Mediterranean agreements, should be the subject of negotiations and of a general rule aiming at national exemption for all Community contributions, to replace the existing partial and empirical agreements.

4.4.2. In order to improve the utilization of resources, the Community should reduce the duplication of work and poor synchronization caused by the lack of coordination of aid revealed by the Court both at the level of the Community institutions and as regards bilateral and multinational aid.

4.4.3. The aid from budgetary resources, managed increasingly on behalf of the Community by the European Investment Bank, is not governed by the principle of priority to Community supplies, is inadequately supervised by the Community bodies and costs more than those for similar services rendered by the other international development banks.

4.4.4. Administrative problems have caused considerable delays and the under-utilization of appropriations in the framework of the cooperation agreements concluded with the Mediterranean countries. These difficulties are partly due to the fact that the draft Financial Regulation, dating back to 1978, relating to the application of Protocol 1 of the cooperation agreements with the Maghreb and Mashreq countries and the protocols concluded with Malta and Cyprus, has still not been adopted.

4.4.5. It is regrettable that the Commission and the Mediterranean countries have been unable to agree upon a set of standard clauses and conditions applicable to the markets financed by the Commission. The co-existence of

Community and national rules therefore continues to waste time and cause legal disputes.

4.5. Food aid

4.5.1. The nutritional deficiency of recipient countries is very often the result of a centralist policy that discourages the exploitation of production potential and prevents subsistence-level economies from becoming trading economies. Consequently, any strategy directed towards achieving greater self-sufficiency in food production for ACP countries, above all those with tropical or sub-equatorial climates, should take account of the political and structural rigidity which prevents production and marketing initiatives from succeeding fully.

4.5.2. A major role should be played, at least at the outset, by encouraging simple procedures, such as small-scale irrigation and the use of animals on

cultivating and fertilizing the soil as in the age-old practices of the Asian farmers who manage to feed a multiple of the African population using comparable areas.

4.5.3. The Court points out that, from 1978 onwards, and particularly in its special report on food aid, it has continued to draw the attention of the budgetary authorities and the Commission to a series of basic technical defects whose eradication would have considerably reduced wastages and assisted in bringing timely relief to populations in need. The Court also wishes to stress that the laxity in the observance of the allocation of counterpart funds to which the recipient countries are committed on collecting the food aid intended for resale or on receiving Stabex transfers, has very often deprived the aid of the multiplier effects provided for in the relevant conventions.

5. CONCLUDING REMARKS.

5.1. In this report the Court has not only drawn attention to the weaknesses which it considers are undermining the financial management of Community affairs, but it has also offered specific suggestions as to how the situation might be improved. These suggestions are of two kinds. The first kind, mainly concerned with agricultural guarantee expenditure (see paragraph 2.5), deals with ways in which substantial savings might be made without adversely affecting the impact of the measures concerned. The second kind identifies ways of getting better value from existing levels of expenditure. This applies particularly to the structural funds and development aid. There is constant pressure to increase the funds devoted to these areas which, in the Court's view, is due, at least in part, to the fact that the resources at present used are not producing the effects they could. If their effectiveness could be enhanced (see paragraphs 3.5.1 to 3.5.6), the pressure for greater expenditure might be reduced.

5.2. The question may also be asked whether many of the activities financed by Community funds represent real Community policies. In some areas the Community is doing little more than meeting part of the cost of measures that are of purely national interest (see, amongst others, paragraphs 3.3.2 (c) and 3.4.4 to 3.4.6). Even in the case

of Agricultural Guarantee where there is, in general, a common policy, certain categories of expenditure reflect only national and sectional interests (see, amongst others, paragraphs 2.2.5, 2.3.14, 2.3.15 and 2.3.16).

5.3. The Court would like to conclude this review of financial management in the Communities by focusing attention on a persistent difficulty which runs through most of the major fields of activity. In spite of the Commission's responsibility under Article 205 of the EEC Treaty (and corresponding provisions) for implementing the budget, that task is in practice shared between the Commission and national administrations or management committees which effectively represent the Member States. This, in turn, blurs the responsibility for the financial consequences of the actions and decisions concerned.

The text of this Report was adopted by the Court at its meeting on 6 October 1983.

For the Court of Auditors
Pierre LELONG
President

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