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I

(Information)

COURT OF AUDITORS

SPECIAL REPORT No 4/95

on the management of EAGGF-Guidance Section expenditure in Portugal from 1988 to 1993,
accompanied by the reply of the Commission

*(95/C 345/01)**(Observations pursuant to Article 188C, paragraph 4, subparagraph 2, of the EC Treaty)*

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GENERAL INTRODUCTION

The present report summarizes the results of a special audit enquiry undertaken by the Court during the period June-November 1994 in response to a request from the President of the European Parliament in February 1994 ⁽¹⁾ to carry out an audit of the management of EAGGF-Guidance Section expenditure in Portugal since 1988. Total EAGGF-Guidance Section commitments for Portugal during the period amounted to ECU 1 457 million as outlined in Annex I. The principal areas of expenditure were the 'Programa Específico de Desenvolvimento da Agricultura Portuguesa' (PEDAP Programme) for the development of Portuguese agriculture after Accession, measures to improve agricultural structures, measures for the improvement of processing and marketing of agricultural products, and Operational Programmes (OPs) adopted under Objective 1 (promoting the development and structural adjustment of the regions whose development is lagging behind) of the overall programme established on the occasion of the reform of the Structural Funds in 1988. The abovementioned measures, all of which were covered by the present enquiry together accounted for over 95 % of total commitments in respect of EAGGF-Guidance Section expenditure in Portugal during the period under review.

Because of the specific objectives set for the PEDAP programme, namely to make Portuguese agriculture more competitive, the enquiry relative to that programme concentrated in particular, on an evaluation of the extent to which that objective has been achieved. Accordingly the audit results of that enquiry are set out in Part I while those relative to the other structural measures are contained in Part II of the present report.

In the Chapters which follow the amounts of Community aid approved for specific projects and transactions examined are indicated in Esc, with indicative amounts in ECU shown in brackets essentially because, in the decisions approving the projects, the aid was designated in Esc. The comparative amounts in ECU are difficult to establish with precision because they are dependent upon the official exchange rate applicable for the month in which the Community aid was payable by the Commission. The rates of exchange prevailing at the beginning of each year and the average rates applicable during each year and also for the entire period under review are set out in Annex II. The indicative amounts shown for each project are calculated on the basis of the simple average exchange rate prevailing during the period.

PART I

THE SPECIFIC PROGRAMME FOR THE DEVELOPMENT OF AGRICULTURE IN PORTUGAL

CHAPTER 1

INTRODUCTION

1.1. The Act of Accession of Spain and Portugal provided for the implementation of a specific programme, covering the whole Portuguese territory, to facilitate the integration of Portuguese agriculture into the Community. This programme, which was to be spread over 10 years (from 1 January 1986 to 31 December 1995) with a financial allocation of some ECU 700 million, had the following aims:

- the improvement of the overall structural situation in the agricultural sector, of production and marketing conditions, of livestock and of land ownership structures;
- the development of rural and agricultural infrastructures, of agricultural advisory services, training and research;

— the re-orientation of production;

— the correction of the age imbalance in the agricultural population.

1.2. Council Regulation (EEC) No 3828/85 of 20 December 1985 set up the Specific Programme for the Development of Agriculture in Portugal provided for in the Act of Accession (Programa Específico de Desenvolvimento da Agricultura Portuguesa), or PEDAP ⁽²⁾. The Regulation lists the measures that may be financed in the form of sub-programmes ⁽³⁾, and lays down a rate of financing for each measure. This

⁽¹⁾ Letter to the President of the Court dated 11 February 1994.

⁽²⁾ Council Regulation (EEC) No 3828/85 of 20 December 1985 laying down a specific programme for the development of agriculture in Portugal, OJ No L 372, 31. 12. 1985, p. 5.

⁽³⁾ Officially, this is a 'specific programme', but as the PEDAP is itself a 'specific programme' it is preferable to use the term 'sub-programme' which has been adopted by the Portuguese authorities.

Regulation was amended three times, in 1987⁽⁴⁾, 1988⁽⁵⁾ and 1989⁽⁶⁾. The 1987 amending Regulation set up the PEDAP Monitoring Committee and that of 1988 virtually standardized the rate of EAGGF co-financing at 75%.

1.3. Although the PEDAP Programme was scheduled to commence in 1986 no payments of Community aid were made during that year. *Table 1* shows that payments made by the Commission under PEDAP from 1987 to 1994 inclusive totalled ECU 538 million. Taking into account an amount, estimated at ECU 101,1 million, which will be paid during 1995 and 1996, the total figure of ECU 700 million laid down in the Act of Accession is unlikely to be reached, for reasons that are mainly attributable to the Commission (see paragraph 2.9).

1.4. The Court made several audit visits to the competent departments of the Commission and of the Portuguese authorities, in Lisbon and in the regions of Alentejo, Beira Litoral, Madeira and Trás-os-Montes, where it examined some sixty projects (out of 13 sub-programmes representing more than half the aid approved as at 31 December 1993). The regions and projects were selected with a view to covering the most representative aspects of agricultural activity during that period.

CHAPTER 2

IMPLEMENTATION OF THE PROGRAMME

2.1. The sub-programmes are submitted by the Portuguese authorities and approved by the Commission after it has obtained the Opinion of the Standing Committee on Agricultural Structures, (replaced in 1989 by the Committee on Agricultural Structures and Rural Development the STAR Committee). Since the start of the implementation of PEDAP, 32 sub-programmes have been adopted with 93 subsequent amendments having been made to them. These sub-programmes, which must comply with the principle of additionality, may cover part or all of the Portuguese territory for variable lengths of time. More than 36 000 projects have been approved under the approved sub-programmes, the development and management of which are the sole responsibility of the Portuguese authorities. The Commission has paid the aid to the Portuguese authorities in two annual payments:

— an advance, generally paid during the year in question; and representing 80% of the planned expenditure for a given year,

⁽⁴⁾ Council Regulation (EEC) No 3464/87 of 17 November 1987, OJ No L 329, 20. 11. 1987, p. 4.

⁽⁵⁾ Council Regulation (EEC) No 2182/88 of 18 July 1988, OJ No L 191, 22. 7. 1988, p. 13.

⁽⁶⁾ Council Regulation (EEC) No 1008/89 of 17 April 1989, OJ No L 109, 20. 4. 1989, p. 1.

— the balance, which was paid during the following year on the basis of actual expenditure incurred for the year.

2.2. The PEDAP Programme was initially managed by the central and regional departments of the Ministry of Agriculture. The reform of the Structural Funds ('the reform'), which entered into force on 1 January 1989, modified the management of the PEDAP programme and also the system of financing. Since 1993 the management of the programme was delegated to the autonomous agricultural institute IEADR (Instituto de Estruturas Agrárias e Desenvolvimento Rural). Payments are made by IFADAP (Instituto Financeiro de Apoio ao Desenvolvimento da Agricultura e Pescas).

2.3. With the indexation of the Community Support Frameworks (CSFs) an inconsistency was introduced in the implementation of the PEDAP programme. Article 12 of Regulation (EEC) No 2052/88⁽⁷⁾, the basic Regulation of the reform, provides for the doubling of the Structural Funds in real terms between 1987 and 1993. As the overall schedule of the Funds was established at constant prices, the Commission concluded that it was necessary to index the annual allocations of the CSFs and the Operational Programmes (OPs) by applying an appropriate inflation coefficient, or 'deflator'. However, the measures in force prior to the reform, which had been allocated funds in ECUs at current prices — like PEDAP — were not to be indexed. In spite of that provision, the PEDAP allocation was also indexed.

2.4. The Monitoring Committee of the CSF was required to monitor the consumption of the CSF's resources at the planned rate, by periodically adjusting the allocations among the programmes on the basis of their implementation rates. As a result, PEDAP's allocations were amended on two occasions. However, it is difficult to monitor over the whole period of the first CSF the amount set aside for PEDAP and, in particular, to compare the Monitoring Committee's documents with the CSF's indexation document for 1991 (because for that year the effects of indexing and those of the amendments to the allocation decided by the Monitoring Committee are not distinguished).

2.5. It was intended that the multiannual measures that had come into force before the adoption of the reform would not be affected⁽⁸⁾ and that the Commission would be able to apply certain provisions of

⁽⁷⁾ OJ No L 185, 15. 7. 1988, p. 9.

⁽⁸⁾ Article 15 (1) of Council Regulation (EEC) No 2052/88 of 24 June 1988, OJ No L 185, 15. 7. 1988, p. 9.

the reform to old measures only with the prior agreement of the Member State concerned⁽⁹⁾.

2.6. However, the second phase of the forestry sub-programme and the agro-pastoral sub-programme for the Azores, which were integral parts of PEDAP from the financial point of view, were adopted in 1991 in the form of an OP under the reform. The Commission sent these two draft sub-programmes back to the Portuguese Ministry of Agriculture on the grounds that 'the adoption of sub-programmes submitted in the context of PEDAP would henceforth be carried out in accordance with the procedures laid down in the reform of the Structural Funds'.

2.7. The abovementioned Commission decision proved to be particularly inappropriate for the Portuguese authorities with regard to the forestry sub-programme because it obliged them to suspend their examination of projects presented for financing. This interruption in the evaluation procedures was found necessary to guarantee the financing of projects already approved under phase I but which could not have been financed under phase II due to the strict separation of the financial resources earmarked for each phase. Notwithstanding the suspension of approvals, however, the resources available were still not sufficient and the Commission granted an additional amount of ECU 51 million, thereby more than doubling the original allocation of ECU 41 million approved for the sub-programme, without consulting the STAR Committee or making a formal Decision amending the first phase. This additional amount allocated subsequently turned out to be excessive and ECU 13 million were transferred to an OP that was not related to PEDAP. If the second phase had retained the usual form of PEDAP sub-programmes it would have been possible to finance the completion of the first-phase projects out of the second-phase allocation, thereby obviating such complications. The abovementioned adjustments demonstrate a distinct lack of precision in the estimation of resources budgeted for this sub-programme as well as in monitoring the subsequent use of those resources.

2.8. Far from accepting the transformation of the sub-programmes into OPs, the Portuguese authorities had on several occasions indicated their preference for the old procedures and stressed the problems involved in the system imposed by the Commission. In the end, Portugal agreed to operate the Commission's system. However, the Commission partly reversed its position subsequently

because, even after the adoption of the two OPs in 1991, three sub-programmes were approved under the old system.

2.9. Finally, the Commission decided that Portugal could no longer undertake new PEDAP projects after 31 December 1993, but that the payments relating to the projects approved up to that date could be honoured up to 31 December 1995. This Decision represents a two-year shortening of the expected duration of the PEDAP, because the period covered by Community programmes is generally taken as referring to commitments and not to payments. This shortening constitutes a violation of the Act of Accession, which provided for a duration of 10 years, lasting until 31 December 1995.

CHAPTER 3

MANAGEMENT OF THE PROGRAMME

3.1. The selection of projects

3.1.1. The opinion of the STAR committee and the Commission's Decision on each sub-programme submitted by the Portuguese authorities are issued on the basis of a proposal document drawn up by the Commission, which indicates the nature of the measures envisaged, conditions for eligibility and financing arrangements. However, these proposal documents are very brief, and give no indication of the supporting documents submitted for the programmes nor an evaluation of programme contents nor of the desirability and feasibility of the measures proposed.

3.1.2. For many sub-programmes, there was a lack of selectivity of projects, because of the abundance of resources, with the result that few projects were rejected by the national authorities, because qualitative criteria were not added to the formal eligibility criteria. Thus, in Beira Litoral, all the cooperatives that submitted a valid PROAGRI project were accepted. Nearly all the projects of the banana tree sub-programme were accepted (5 were rejected and 77 approved), as were those for the 'production of vegetative propagating material' and 'research' sub-programmes. In contrast, for other sub-programmes as in Trás-os-Montes, only 30% of the applications for olive-growing projects were approved and applications under the forestry sub-programme were rejected because of a lack of resources. Moreover, in May 1994, 140 PROAGRI projects had been approved

⁽⁹⁾ Article 33 (3) of Council Regulation (EEC) No 4253/88 of 19 December 1988 laying down implementing provisions for Regulation (EEC) No 2052/88 as regards coordination between the various Structural Funds, on the one hand, and between the Structural Funds and the European Investment Bank and other existing financial instruments, on the other hand, OJ No L 374, 31. 12. 1988, p. 1.

and 100 more were awaiting a decision. Finally, whereas nearly all applications for electrification were accepted on Madeira, there was, in Alentejo, a waiting list of 3 000 applications, which, at the current rate, will only be accepted in five or 10 years' time. The above examples indicate that the distribution of resources among sub-programmes has not been optimal thereby calling into question the effectiveness of the Monitoring Committees. While it must be recognized that disparities in selectivity are sometimes dependent on the relative autonomy of the regions, as in the case of Madeira, the inter-regional distribution of resources would have been substantially improved by a more comprehensive prior evaluation of needs and by the establishment of clearer priorities before individual sub-programmes were approved.

3.2. Monitoring by the Portuguese authorities

3.2.1. Good administrative procedures would require that all project applications should be appropriately evaluated and that approvals and rejections should be explicitly justified and the reasons stated in the relevant files of the managing department that took the decision. This requirement would guarantee objectivity of choice. In fact, in the files examined by the Court no evaluation reports had been prepared with the result that approvals or rejections were indicated by nothing more than a dated signature on the application forms. Furthermore, in three projects examined, although the beneficiaries were connected with or belonged to the Regional Agricultural Departments, there was no independent evaluation of the projects prior to their approval.

3.2.2. The forms on which the project budgets were recorded were often neither dated nor signed. Moreover, there was a lack of follow-up of project implementation in that the managers did not always deduct the initial annual advance from their applications for successive payments or did not include in their files details of payments that had been carried out, making it difficult to monitor the financial implementation of the projects.

3.2.3. Although the projects were generally multi-annual, they were nevertheless either broken down into annual budgets or were subsumed within a global budget for the whole period. The latter system is preferable, because it avoids inflationary drift. Comparison of the annual budgets and expenditure of a Beira Litoral health protection group showed that the budget estimates had been substantially overstated. Instead of the Esc 484 million provided for in the budgets (some ECU 2,7 million) actual expenditure amounted to Esc 385 million (about ECU 2,2 million) which was some 30% higher than the original global estimate (Esc 293 million, or about ECU 1,6 million).

3.2.4. It sometimes happened that the Regional Agricultural Directorates were, at one and the same time,

both authorizing authority and paying agent, contrary to the important internal control principle of separation of duties. Thus, the Madeira Regional Agricultural Directorate managed PEDAP and received funds from IFADAP to pay the beneficiaries. The same system was used for the Regional Agricultural Directorates on the mainland for certain public programmes in which the Administration was the promoter and, at the same time, was responsible for paying the contractors.

3.2.5. In the Azores, it was the Regional Agriculture and Fisheries Secretariat that received the EAGGF-Guidance aid from IFADAP (Lisbon) and then paid the amounts in question out to IFADAP's regional delegation, which, in turn, paid the beneficiaries. For the projects with public beneficiaries, the Regional Secretariat prefinanced the payments to the beneficiaries and then obtained reimbursement from IFADAP.

3.2.6. The separate roles of authorizing authority and paying agent were therefore combined in the cases quoted above (3.2.4 and 3.2.5). However, the general management system used for PEDAP had the advantage over the other EAGGF-Guidance programmes in that IFADAP, the paying agent, did not, at the same time, play the role of authorizing Authority, which function remained within the jurisdiction of the Agricultural Departments. Yet, managers could not ignore a negative opinion by IFADAP with regard to the regularity of a payment. It should be noted, nevertheless, that, since the implementation of the second CSF, IFADAP has participated in management decisions both at national and regional levels with the result that the desirable separation of authorizing authority and paying agent is no longer assured.

3.2.7. Some payments are made by IFADAP with excessive delays. Thus in November 1994, the Mangualde cooperative (Beira Litoral) had, despite several reminders, not yet received its advance of Esc 4,8 million (about ECU 27 000) for 1994, although it should have been paid in December 1993. Similarly, after the payment of an advance of 20%, the balance of the Madeiran Electrification project No 620-00-016 was paid in one instalment (of Esc 35,6 million, or about ECU 200 000) in November 1992, some three years after it had been confirmed that the work had been carried out. Finally, the cost of the Vila Nova de Foz Coa Agricultural training school project was 52,8% higher than estimated, partly because of the application of price revision formulae as the result of delays in payments. The overrun was about ECU 0,3 million.

3.2.8. National regulations required the regularization of the advance for a given year before the end of that year. Such regularizations are normally accounted for

when making the last payments of the year, but are sometimes deducted from final payments for the following year. It would be preferable to provide for the earlier regularization of advances to ensure that there is no allocation of excess cash resources to projects and to diminish the risk of advance payments not having been properly accounted for by year-end.

3.2.9. IFADAP pays beneficiaries in response to a request for payment accompanied by a list of supporting documents but without having sight of the said documents (except in certain rare cases concerning very large-scale projects and in Madeira). Such procedures are unsatisfactory as the independent checks inherent in the separation of duties cannot function.

3.2.10. Only systematic ex-post checks could make up for the weaknesses of ex-ante monitoring (and in particular payments by IFADAP without scrutiny of supporting documents). However, whereas IFADAP indicated that its services verified around 40% of projects of some other EAGGF-Guidance programmes, it used its limited responsibility in the management of PEDAP as a justification for checking only 3,3% of the approximately 33 700 projects approved for the period 1986-1993. Moreover, for the limited number of projects verified IFADAP did not send audit reports to IEADR, which relied on the limited number of selective checks carried out by the Ministry of Agriculture's Directorate General for Audits. Furthermore, there is little evidence of ex-post evaluation of sub-programmes other than a once-off evaluation of strategic choices carried out by the Ministry of Agriculture.

3.3. Follow-up by the Commission

3.3.1. The publicity given to the Commission Decisions concerning the sub-programmes has continued to decline. Up until April 1989, these Decisions were published in full in the *Official Journal of the European Communities*. Subsequently, they were simply mentioned. Since February 1992, they have not even been mentioned. It is of critical importance that the policy should be reviewed by the Commission in the interests of transparency.

3.3.2. Until 1988, there was a separate budget heading for PEDAP. As from 1989, it was no longer even mentioned in the remarks to the budget. Since 1991 as PEDAP is included in a budget line containing numerous other EAGGF-Guidance Section measures it is no longer possible to determine the budgetary expenditure involved. While this presentation of budgetary expenditure is common to all EAGGF-Guidance Section expenditure, it is particularly inappropriate, in view of the specific objectives of the PEDAP programme to charge expenditure to a common heading which also includes all

the other Objective 1 programmes, irrespective of the country concerned.

3.3.3. Despite Commission Decision 88/169/EEC of 28 January 1988⁽¹⁰⁾ which provides that, as from the sixth year of the financing of the health protection groups, the beneficiaries should pay 20% of the eligible expenditure, supplementary contracts were granted to the groups in Macedo De Cavaleiros (Trás-os-Montes) and Oliveira de Azemeis (Beira Litoral) in order to permit the financing of these groups for a sixth year until the end of 1993, but at the rate of 85%.

3.3.4. Beneficiaries liable for value-added tax (VAT) were entitled to declare it as eligible expenditure while those who could reclaim VAT or pass it on were required to declare their expenditure exclusive of tax. Between 1988 and 1993, however, there was a great deal of confusion about which system the health protection groups came under. As a result, the VAT was sometimes included in the expenditure accepted as eligible and sometimes not. Where it was included, the Portuguese government should be asked by the Commission to reimburse it.

3.3.5. The Commission pays IFADAP on the basis of declarations of expenditure, with no supporting documentation attached (and without even a list of projects). Furthermore these declarations are drawn up by IFADAP without any scrutiny, of the supporting documents (see paragraph 3.2.9). Notwithstanding the weak national verification procedures and the non presentation of supporting documents at the different verification levels, the Commission has carried out very few on-the-spot audits. To date, DG VI-G5 carried out only two audits, one together with DG XX in 1988 and the other in the two autonomous regions in 1993. The financial control department of the Commission carried out two further audit visits in 1992. The results of the abovementioned audits largely confirm the Court's audit findings (for details of the results of previous audit findings by the Court, see Annex V, paragraph 2). Finally, although the protocol to the Act of Accession states that the Commission should submit to the Council an assessment report concerning the execution of PEDAP before 1 January 1991, no such report has been prepared.

CHAPTER 4

EVALUATION OF THE PROGRAMME

4.1. Delays in implementation

4.1.1. Although the PEDAP Programme was scheduled to have commenced operations immediately after

⁽¹⁰⁾ OJ No L 76, 22. 3. 1988, p. 24.

Portugal's accession, the first sub-programmes were not approved until November 1986⁽¹¹⁾. In most cases, the Commission took an excessively long time to approve the sub-programmes submitted by Portugal. Out of 74 sub-programmes or amendments thereto, three to five months were required in 21 cases, six months in 16, seven to 10 months in 27 cases, 11-14 months in nine cases, and 16 months in one case. These delays which are mainly attributable to the Commission's slow appraisal procedures are a significant contributing factor to the delays in implementing the PEDAP and also to its limited overall effectiveness.

4.1.2. Delays of this kind have caused a great deal of confusion over the time-period in which items of expenditure are eligible. In effect, Portuguese proposals are designed to be implemented on a multi-annual basis, but since the Commission's decisions are taken after a delay of several months and are usually backdated they nevertheless have the effect of shortening the implementation period. In addition, the decisions never specify the date on which the period of eligibility ends. Overall, neither the Commission, nor the Portuguese authorities, have been able to indicate with precision whether the delayed start resulted in an extension or in a shortening of the eligible period.

4.1.3. The majority of the sub-programmes concerning the two autonomous regions of Madeira and the Azores were in reality only able to get under way in 1991, after the Commission had agreed to change the maximum financial amounts into indicative amounts. In fact, in these two island regions, costs are often significantly higher than in mainland Portugal with the result that few applicants were interested in undertaking investments on the basis of the initial financial terms which were identical to those obtaining on the mainland.

4.1.4. Delays caused by the Commission are compounded by the time-lag in the Portuguese authorities' implementation of the sub-programmes. The health-protection groups approved in January 1988 did not really get off the ground until 1990. The Training Centres for Agricultural Advisers provided for in two stages were completed only by the end of 1994 instead of by the end of 1992 as originally foreseen. The new collective irrigation systems approved in February 1989 should have been completed by the end of 1993, yet, work on the majority of the 52 projects had not even started by that date. The project for the Centre for Advanced Technicians in Coimbra, which was foreseen as far back as 1986, was only approved during the second stage (1990-1992) of the sub-programme 'Personnel Training Centres for Agricultural Advisers' and had still

not been completed by November 1994. Likewise, the rural road started in Lousa (Beira Litoral) in 1987 was only completed in 1993.

4.1.5. Notwithstanding the ambitious overall objectives set for the PEDAP programme, the most innovative and dynamic sub-programmes have been fewest in number and have been submitted last by the Portuguese authorities. For example, the vocational agricultural colleges sub-programme was not submitted until 1989 and research, experimental development and demonstration sub-programmes were not submitted until 1990. A revision of the rules governing PROAGRI (intended to support the cooperatives) in December 1992 delayed the sub-programme, since a significant number of the projects under way had to be redefined. As at May 1994, around 40 other projects were expected to undergo the same treatment. The NOVAGRI sub-programme, which was concerned with 'restructuring and innovation', was presented as late as 1991 with the very last sub-programmes. The sub-programme for the standardization of products and for the promotion of sales gave rise only to a very limited number of applications. Finally, none of the sub-programmes provided for collective measures for Land Reform notwithstanding its inclusion in the overall PEDAP objectives. The foregoing examples indicate that there was a less than enthusiastic commitment to the types of reform which the PEDAP overall objectives would have required to achieve a successful outcome.

4.2. Selection of operations to be financed

4.2.1. Granting aid to very small farms which are wholly unviable, or to large-scale farms which are already sufficiently viable to carry out their own projects without being subsidized, has no perceptible beneficial effect. In the case of very small farms it would have been more useful to orientate aid towards restructuring holdings and collective organization, although this type of reform is faced by obstacles that are often more psychological and legal than financial in nature. On the other hand landowners who entrust their land to managers are usually large scale and are financially independent. Of a representative sample of farms visited by the Court some 50% were run by salaried managers and some 70% could be considered large compared with the regional average. The application of minimum and maximum eligibility criteria would have resulted in better use of the limited resources available.

4.2.2. The Portuguese authorities have become aware that there is an urgent need to retrain and motivate farmers to change their methods *inter alia* by conferring certain public-service responsibilities upon them. For example, in the Beira Litoral, use of the Viseu Training Centre for Farmers, which is financed by PEDAP, has

⁽¹¹⁾ Decision 86/599/EEC of 27 November 1986 concerning the approval of six programmes drawn up by the Portuguese government in implementation of Council Regulation (EEC) No 3828/85 of 20 December 1985 laying down a specific programme for the development of agriculture in Portugal, OJ No L 347, 9. 12. 1986, p. 10.

been granted free of charge to a cooperative for a period of five years. However the cooperative did not abide by the terms of the agreement. In effect, it reduced its training programme and the centre's premises were used instead for various other activities unconnected with this public-service function even to the extent of obtaining payment for the hire of rooms from other similar centres that needed to use them.

4.2.3. A number of sub-programmes also finance operating expenditure, as well as capital investments. One example of this, in the Azores, is the sub-programme 'Training Centres for Farmers', which financed not only the construction of the buildings and equipment, but also the salaries and expenses relating to training activities. The PROAGRI sub-programme finances salaried posts which have been created: hence, in a cooperative in Beira Litoral almost three-quarters of the finance comprised recurrent operating costs (Esc 62,4 million, or about ECU 0,2 million). Most of the health-protection groups' costs financed by the PEDAP are operating costs and they will continue to be financed during the second CSF by EAGGF-Guidance. The allocation of Community resources in this manner simply amounts to an ongoing subsidy of the State budget. Furthermore, notwithstanding the substantial sums involved, claims for reimbursement of expenditure which are accepted and paid without any supporting documentation, other than simple declarations of the beneficiaries, are never subject to independent check or audit. Further to the Court's recommendations the Portuguese authorities have undertaken to introduce independent audits in future.

4.2.4. The rural exodus (between 1988 and 1991 the population in the coastal areas fell by 6,6% and by 13,7% in the interior regions⁽¹²⁾ and an ageing agricultural population, which is often bereft of any prospect of succession by a younger generation, has reached serious proportions and requires the most effective counter-measures. Although it is true to say that most of the sub-programmes provide that young farmers (under 40) should be given priority and more favourable financial circumstances should be created for them, these limited incentives fall far short of effectively dealing with a problem of such considerable proportions.

4.3. The impact of other policies

4.3.1. Prior to Portugal's accession, its agriculture was highly protected. The opening of its borders, although gradual, had a major impact between 1991 and 1993. For example, the prices of imported potatoes in Portugal were so low that transport costs were not even covered.

The sub-programme for planting seed-potatoes was suspended in the face of the influx of seed coming from other Member States. As was the case in Beira Litoral, in Trás-os-Montès the farmers gave up cereal production almost completely. Furthermore, Madeira is in a very weak position to compete with bananas from the Canary Isles, South America or even ACP countries. The low prices in Portugal for agricultural produce originating in other Member States are due, in large measure, to the fact that the Portuguese market is seen as marginal by certain other community producers who consequently use that market to 'dump' surplus produce while at the same time protecting their principal markets.

4.3.2. Similarly, the development of large shopping centres is also having a negative effect on the marketing of Portuguese agricultural produce because of the demand for large quantities of standardized high-quality products. Because the Portuguese agricultural organizations are not yet effectively organized, these centres import almost all of their goods. Although NOVAGRI has belatedly embarked on measures to promote Portuguese fruit, such promotional measures need to be increased dramatically in order to produce the required results of finding market outlets for Portuguese agricultural produce.

4.3.3. In addition, the policy of maintaining a strong Escudo has meant exceptionally high interest rates, of the order of 17-21%, which has penalized the most dynamic farmers in particular, who have borrowed in order to buy modern equipment.

4.3.4. Moreover, while large sums have been paid out of the Structural Funds, particularly EAGGF-Guidance, to enable Portugal to catch up in development terms and to increase agricultural revenue by improving production or productivity, at the same time, other measures, mainly connected with the EAGGF-Guarantee, discourage farmers from increasing their production, for instance by restricting the number of animals for which premiums are payable to compensate for loss of revenue, as in the case of sheep- and goatmeat, the restrictions imposed by the tobacco-processing quota system, restrictions of compensatory payments to producers of high-protein products, and the premiums paid to banana growers who cease production. These conflicting objectives of the two sections of the EAGGF Fund weigh particularly heavily on the Portuguese agricultural sector and substantially constrain the effectiveness of PEDAP measures to achieve their stated objectives. In effect Portugal's deficit in the agri-foodstuffs sector is increasing continually.

⁽¹²⁾ See the last two population censuses.

4.3.5. Finally, Portugal has accepted the Commission's request to shorten the transitional period concerning the protection of agricultural markets laid down in the Accession Treaty. While acknowledging 'the distinctive lag observed in Portugal's creation of producer organizations', Council Regulation (EEC) No 746/93 of 17 March 1993⁽¹³⁾ relates to the principle of 'the advance removal of a large number of the mechanisms for the provisional protection of the Portuguese market'. A series of Council Regulations⁽¹⁴⁾ dealt with the immediate realignment of the common price of various products (rice, powdered skimmed milk, olive oil, and fruit and vegetables). In addition, the new CMO for bananas⁽¹⁵⁾ makes no reference to the transitional arrangements from which bananas produced in Madeira benefited. Regulation No 746/93 quoted above certainly provides for an increase in subsidies to support producer organizations, but whereas the abolition of the transitional period has an immediate impact, the effectiveness of compensatory subsidies affecting the structures will only become evident in the medium or long term.

CHAPTER 5

CONCLUSIONS

5.1. As explained in the general introduction to this report the Court's audit of the PEDAP programme concentrated, in particular, on an evaluation of the sound financial management of the Community resources committed to the programme. In view of the specific objectives of the PEDAP programme such an approach is considered especially appropriate in order to determine if the funds were expended in a manner which took due account of criteria of economy, efficiency and effectiveness.

⁽¹³⁾ Council Regulation (EEC) No 746/93 of 17 March 1993 concerning the granting of aid intended to encourage the constitution and facilitate the operations of producers' organizations, as provided for in Regulations (EEC) Nos 1035/72 and 1360/78 in Portugal, OJ No L 77, 31. 3. 1993, p. 14.

⁽¹⁴⁾ — Council Regulation (EEC) No 738/93 of 17 March 1993 amending the transitional regime in respect of the common organization of the markets in cereals and rice in Portugal provided for by Regulation (EEC) No 3653/90, OJ No L 77, 31. 3. 1993, p. 1.

— Council Regulation (EEC) No 741/93 of 17 March 1993 concerning the extension of the common intervention price for olive oil to Portugal, OJ No L 77, 31. 3. 1993, p. 7.

— Council Regulation (EEC) No 742/93 of 17 March 1993 abolishing the compensation mechanism for fruit and vegetables in trade between Portugal and the other Member States, OJ No L 77, 31. 3. 1993, p. 8.

⁽¹⁵⁾ Council Regulation (EEC) No 404/93 of 13 February 1993 organizing the common market in the banana sector, OJ No L 47, 25. 2. 1993, p. 1.

5.2. In terms of all three criteria the Court concludes that, while certain sub-programmes achieved some positive results (e.g. the animal health protection groups), even if financial control over their operations was less than satisfactory (see paragraph 4.2.5) the results of some important sub-programmes fell short of needs or objectives (see table 2). In terms of the effectiveness of the measures, in particular, the overall results achieved have been somewhat disappointing.

5.3. The effectiveness of the programme was compromised by the lack of, or late development of, the most dynamic and appropriate initiatives necessary for the encouragement of a more progressive behaviour among farmers. In this respect the measures which received the most widespread promotion and financial support were too frequently aimed at maintaining the continuation of existing production arrangements rather than inciting a more fundamental change in agricultural activity. While such an approach could go some way towards meeting the immediate requirements of the farming community it failed to incorporate the necessary dynamism to overcome the basic structural deficiencies.

5.4. It is particularly regrettable to note that the necessary measures for a more efficient re-organization, re-orientation and re-structuring of agricultural activities were either not adequately provided for, or were introduced too late when available resources were already limited. The more effective re-organization of agricultural activities can only be achieved by the development of a more dynamic and extensive cooperative movement through which individual small producers can hope to gain access to appropriate marketing channels. With regard to the re-orientation of the farming sector it is noteworthy that the required emphasis on research and marketing activities was only adopted at a relatively late stage in the overall programme's implementation (e.g. Novagri sub-programme). In terms of re-structuring of agricultural holdings the PEDAP programme did not even include a sub-programme for land reform while the Operational Programme adopted for this purpose has had very limited success to date (see Chapter 9 paragraphs 9.2.2-9.2.4).

5.5. In terms of its effectiveness it can be noted that while the PEDAP programme constituted an opportunity to achieve a large number of useful, even essential results, its positive impact was diminished for a number of reasons including the following:

(i) the shorter than planned time period for its implementation due to the late start (see paragraph 4.1.1) and premature termination (see paragraph 2.9);

(ii) the reduction in its funding (see paragraph 1.3);

(iii) the delays in adopting sufficiently dynamic measures as outlined at paragraph 5.3 above.

5.6. Added to these circumstances are the fact that the constraints imposed by the production limits set on agriculture within the framework of EAGGF-Guarantee Section expenditure are diminishing the possibilities for increasing agricultural productivity in Portugal. Also, the opening up of the Portuguese agricultural sector to competition from other Member states has further limited the possibilities for growth in an ill-prepared and fragile sector.

5.7. While primary responsibility for the implementation of such programmes is attributed to the national authorities, the Commission services responsible for monitoring the development of Portuguese agriculture must also share the responsibility for the unsatisfactory situation described in paragraphs 5.2 to 5.5 above.

5.8. In terms of the economical use of Community resources it is to be noted that while the Commission placed an effective limit on the maximum amounts which could be paid in respect of each sub-programme the decision to accept the use of budgetary resources for the

funding of operational expenditure is considered by the Court to be inappropriate. In particular, the acceptance of up to 80% of operating expenses in respect of on-going salaries and administrative charges for the animal health groups and for the training services must be considered as a direct subvention to the national budget and diminishes by a material amount the already scarce resources available for authentic structural measures.

5.9. The PEDAP was not in a position to solve all of the fundamental problems in Portuguese agriculture by itself, in spite of its merits. Portugal's weak organization, particularly with regard to marketing (see paragraph 4.3.2), land structures, typified by the parcelling of small farms, and low productivity are jeopardizing the country's agricultural sector. Agricultural revenue is falling more rapidly than in other Member States. The average age of the farmers is high and there is no guarantee that they will be succeeded by the young (see paragraph 4.2.8). This precarious position may not be able to withstand the impact of high-performance agricultural sectors in some of the other Member States, or even in third countries (see paragraph 4.3.1). As a result there is an alarming depopulation of a significant proportion of agricultural areas and this phenomenon is posing grave problems with respect to national and regional development (see paragraph 4.2.6).

PART II

OTHER EAGGF-GUIDANCE SECTION MEASURES

CHAPTER 6

INTRODUCTION

6.1. In order to ensure extensive audit coverage it was decided to visit three regions during the audit. Because of their distinctive characteristics the areas chosen for this part of the audit were Ribatejo e Oeste (intensive exploitations with farm sizes approaching the national average of 7 hectares), Entre Douro e Minho (small complex family holdings where agricultural activity is frequently a part-time occupation) and Alentejo (extensive nature of agriculture, where farms of up to 1 000 hectares are not uncommon: 'latifundia'). For the measures selected, these regions together accounted for approximately 55% of total expenditure, in terms of commitments, during the period under review (1988-1993).

6.2. The audit was based on a systems approach incorporating, in particular, an evaluation of the overall reliability of the internal control system put in place for the administration and control of Community funds. This

approach involved an examination and testing of national procedures for an extensive series of operations (321), both individual payments and entire projects, selected at random, and the physical inspection of a limited number (21) of grant-aided projects on-the-spot, to verify the correct implementation of the aided projects and the respect by beneficiaries of the conditions attached to the receipt of Community aid. The audit objective was to inspect a representative selection of transactions rather than concentrating on specific transactions which had already been identified as being of doubtful eligibility for Community aid.

6.3. The audit was carried out at the central offices of the paying agency appointed for the administration of EAGGF-Guidance Section in Portugal — the Instituto Financeiro de Apoio ao Desenvolvimento da Agricultura e Pescas (IFADAP) — and at selected regional offices. Visits were also made to the administrative bodies at central and regional level responsible for specific measures selected for audit. The principal bodies included were: Instituto de Estruturas Agrárias e Desenvolvimento Rural (IEADR), Instituto dos Mercados Agrícolas e Industria Agro-Alimentar (IMAIAA), the Regional Directorates of Agriculture (RDA), and the Forestry Institute.

6.4. In particular, the audit involved an examination of:

- (i) procedures for approving projects for Community and national aid;
- (ii) administrative and control procedures implemented at central and local level to ensure that approved projects were fully implemented as planned prior to payment of the aid;
- (iii) procedures for final approval and payment of Community aid;
- (iv) where applicable, an evaluation of measures in force to verify the on-going respect of conditions attached to the granting of Community aid;
- (v) a reconciliation of sums declared as paid by the Portuguese central and regional authorities with those entered in the Commission's records;
- (vi) for the selected OPs, an evaluation of their monitoring by the Member State and the Commission.

CHAPTER 7

MEASURES PROVIDING AID FOR THE PROCESSING AND MARKETING OF AGRICULTURAL PRODUCTS

7.1. Outline of the administrative and control procedures

7.1.1. Prior to the reform of the Structural Funds in 1988 these measures were governed by the provisions of Council Regulation (EEC) No 355/77⁽¹⁶⁾. Under this Regulation Member States were required to draw up specific programmes for the development of the markets in agriculture and, in particular, for common measures to be introduced to facilitate the development or rationalization of undertakings engaged in the treatment, processing or marketing of agricultural products. Retailing activities were excluded from projects submitted to the Commission for approval.

7.1.2. With a view to preparing such programmes the Portuguese authorities commissioned, in 1984-85, an extensive survey of the state of Portuguese processing facilities for agricultural produce. The survey covered such aspects as the capacities of existing processing facilities as well as their technical and sanitary condition. The results of this survey, which covered the principal

agricultural markets, formed the basis of establishing both the specific programmes provided by Council Regulation (EEC) No 355/77, and the Sectoral Plans provided for by the reform of the Structural Funds at a later date.

7.1.3. The Portuguese authorities submitted 10 specific programmes to the Commission for approval. Subsequently a total of 235 individual projects were submitted for Community aid under Regulation (EEC) No 355/77, for which total Community funding of ECU 94 million was approved. The maximum rate of aid was set at 50% of eligible expenditure subject to the requirement for the Member State to furnish a minimum national grant of 5% of approved eligible expenditure with the balance being provided, either by way of bank loans or own funds, by the promoters of the projects. The minimum contribution required of the promoters of grant-aided projects is set at 25% of eligible costs. Responsibility for evaluating the eligibility of projects was assigned to IFADAP subject to final approval of the Commission.

7.1.4. Since the reform of the Structural Funds, the Community aid provided for processing and marketing of agricultural products is governed by the provisions of Council Regulation (EEC) No 866/90⁽¹⁷⁾. With the adoption of this regulation responsibility for approving specific projects, which were to be incorporated into Operational Programmes drawn up within the framework of the Sectoral Plans, was assigned to the designated national authorities. Nevertheless, the Commission retained responsibility for giving final approval to both the Sectoral Plans and the individual Operational Programmes adopted in accordance therewith, although the level of information made available to the Commission for this purpose was of a more general nature than heretofore.

7.1.5. The Portuguese authorities submitted and had approved by the Commission a total of 12 Sectoral Plans⁽¹⁸⁾ covering the principal activities of the Portuguese agricultural sector. During the period under review, 15 Operational Programmes were approved incorporating 301 individual projects with total Community financing approved at ECU 137 million.

7.1.6. IFADAP has primary responsibility for receiving aid applications for the above-mentioned measures as well as for evaluating and approving projects, for controlling

⁽¹⁷⁾ OJ No L 91, 6. 4. 1990, p. 1.

⁽¹⁸⁾ Sectoral plans were approved for the agricultural markets in cereals, rice, olive oil, wine, milk and milk products, fresh fruit, vegetables, processing of fruit and vegetables, eggs and poultry, slaughtering of animals and processing of meat products, structures for the marketing of live animals, processing and marketing of wood products and processing and marketing of cork products.

⁽¹⁶⁾ OJ No L 51, 23. 2. 1977, p. 1.

their implementation and for paying both Community and national aid. IFADAP has a staff of some 500 officials located at a central office in Lisbon and at 7 regional Directorates and at 2 regional Delegations in Madeira and the Azores in a network of 20 regional offices. IMAIAA is responsible for a technical evaluation of projects and has a staff of some 200 of which 50 are specialized in evaluating the eligibility and economic desirability of projects submitted for national and Community assistance.

7.2. The Court's audit and findings

General

7.2.1. In the three regions visited a total of 65 projects relating to Community aid for processing and marketing of agricultural products were examined. Twelve of the projects representing total Community aid of Esc 1 506 million (ECU 8,43 million) had been approved under Council Regulation (EEC) No 355/77 and fifty three projects representing total Community aid of Esc 6 482 million (ECU 36,27 million) under Council Regulation (EEC) No 866/90.

7.2.2. In the three regions visited the general and administrative control procedures in operation were found to have been generally in accordance with the administrative instructions issued by IFADAP. Nevertheless, certain essential elements for the proper functioning of the system were found either to have been lacking or were not sufficiently verified in all cases. To a large extent weaknesses in the system were due to the limited staff resources available in the IFADAP regional offices to administer the scheme with only one full-time official responsible in each region visited. As a result there were limited possibilities for in-depth analysis of applications for aid and of payment claims submitted. Furthermore, the possibilities for detailed on-the-spot verifications of aid claims were equally constrained.

7.2.3 The following principal observations arise:

- (i) applicants for aid were not required to furnish audited accounts in respect of previous years except in cases governed by Article No 262 of the 'Codigo das Sociedades Comerciais' but even this requirement was not always respected so that the reliability of the underlying figures supporting the viability of the beneficiary firms applying for aid, could not be independently established;

- (ii) furthermore, in 5 of the projects examined ⁽¹⁹⁾, the previous or projected results indicated in the aid application could be considered as endangering the viability of the project, yet those projects were approved without any specific conditions to take account of such results; in this respect unrealistic (relative to past results) and unsupported projections of future results are frequently presented and accepted without adequate evaluation of their attainability;
- (iii) for the projects examined, while all invoices and documents supporting the payment of amounts claimed are submitted to IFADAP offices for verification, very few such invoices and payments (in most cases only 2 or 3) are traced through to the company's accounts during on-the-spot visits, with the risk that sums initially paid but subsequently refunded and not declared as such by the beneficiaries are not detected;
- (iv) overall there was a lack of selectivity in the approval of projects which was granted strictly on the basis of the respect of formal eligibility criteria rather than on the basis of more stringent commercial criteria to assure the project's long-term viability;
- (v) in particular, inadequate attention was paid to verifying that the increased production from the projects would find market outlets, as predicted, or if the enterprise concerned had a formal marketing plan other than vaguely expressed expectations to find local or export markets;
- (vi) in certain Sectoral Plans, e.g. slaughter houses, processed tomatoes, olive oil production, grants in aid for new productive capacity were subject to the requirement that there should be no increase in overall productive capacity; yet the files examined gave no indication that the respect of this important requirement had been verified or that this condition had been respected in all instances;
- (vii) in certain sectors, notably fruit and vegetables, producers had encountered difficulties in procuring market outlets for their produce; while these problems were, no doubt, aggravated by the opening up of the Portuguese market to intra-Community trade, there have also been difficulties encountered due to the failure to adapt traditional outlets to current market requirements; as a result Portuguese producers appear to have

⁽¹⁹⁾ PROJECT Nos 86.61.6005.4, 87.11.6931.4, 90.61.6137.7, 92.53.6023.2 and 93.64.6001.3.

lost significant market share due, for example, to their inability to supply the newly-installed supermarket chains; there appears, therefore, to be an urgent need to encourage the creation of new marketing arrangements for agricultural produce by the adoption of an appropriate Sectoral Plan for this purpose;

- (viii) although investments in respect of which work commenced more than six months before the date on which the Commission receives the application for assistance are specifically excluded from Community aid, there is no provision for making on-the-spot visits prior to the approval of projects to verify the respect of that condition; accordingly, a valuable opportunity is also lost to formulate a more concrete opinion on the viability of the proposed project and on the commercial acumen of the promoters.

7.2.4. The examples set out in the following paragraphs illustrate some of the weaknesses highlighted in the general observations made above.

Evaluation of aid applications, financial information presented and profitability record

7.2.5. Although IMAIAA furnished statistics indicating that to date, 106 applications, representing 16% of applications presented by IFADAP, were rejected by its services on technical grounds, no such statistics were available at the regional offices of IFADAP visited. The explanation offered was that rejections at regional level are very rare as every effort is made to encourage the re-formulation of doubtful applications to ensure their acceptability.

7.2.6. A project with a total investment of Esc 373 million (ECU 2,09 million) and Community aid approved at Esc 102 million (ECU 0,57 million) involved the construction of a meat processing plant. In its application the firm indicated accumulated losses of Esc 80 million (ECU 0,44 million) for the years 1984-1986, furnished no financial results for 1987-1989, indicated a budgeted loss of Esc 31 million (ECU 0,17 million) for 1990 and budgeted a return to profits only in 1992 (Esc 31 million (ECU 0,17 million)). The above figures indicated a precarious financial position putting in jeopardy the viability for the proposed project from the outset. Furthermore, the grant submission was prepared in 1987 and, although the project was finally approved by the Commission only in 1991, no updated figures were sought. The long delay in approving this project and the failure to obtain up to date financial details are contrary to the provisions of Council Regulation (EEC) No 355/77 under which this project was initially submitted. The Portuguese authorities have indicated that

the project was concluded in May 1994 and the final payment of Community aid was made in October 1994.

7.2.7. The accounts presented for one approved project, involving the construction of an olive oil mill, (Community aid Esc 323 million (ECU 1,81 million)) indicates a first year's trading loss of Esc 40 million (ECU 0,2 million). According to the explanations furnished by the responsible official these projected losses may have been established on a cash, rather than on an accrual, accounting basis. Such accounting practices call into question the reliability of the other financial information furnished in support of the project. Furthermore, there was no evidence on file, that the provisions with respect to overall olive oil milling capacity, which is not allowed to be increased by the Sectoral Plan, have been respected.

7.2.8. One project involving the construction of storage and grading facilities for locally produced fruit, and representing a total investment of Esc 187 million (ECU 1,05 million) and Community aid of Esc 90 million (ECU 0,5 million), faces serious financial difficulties raising doubts about the overall viability of the project from the outset. Furthermore, a visit on-the-spot revealed that the company is using the facilities for a purpose other than intended, including the packaging, on occasions, of imported vegetables. As a result it is failing to respect an essential condition governing the receipt of Community aid.

Adequacy of marketing plans presented

7.2.9. One project involved a business start-up for the production and commercialization of wine. Total investment in the project amounted to Esc 262 million (ECU 1,47 million) with approved Community aid totalling Esc 131 million (ECU 0,74 million). The available information on file indicated a superficial analysis of the project's economic viability and, in particular, contained no proper evaluation of market outlets, which in this instance were indicated in very general terms (internal market), or of the feasibility of budgeted sales or financial results. While the Portuguese authorities have subsequently indicated that the project was implemented successfully the fact remains that the initial evaluation of the project was not sufficiently exhaustive.

7.2.10. Another project involving total investment of Esc 804 million (ECU 4,5 million), with Community aid approved at Esc 215 million (ECU 1,2 million), was for the construction of storage and grading facilities for potatoes. Notwithstanding the ambitious scale of the project, involving an annual throughput of some 30 000 tonnes in a business start-up situation, no marketing plan was sought or furnished. Although at the date of the audit no aid had, as yet, been paid, the amount of Community aid approved for the project represents a legal obligation to pay the aid. The Portuguese authorities

have since indicated that the delay in starting the project was due to the difficulties encountered by the promoter in procuring the own portion of the project's financing, an essential element which should have been clarified prior to approving the aid for the project. In this particular instance the low rates of Community and national aids granted (26,7% and 8,2% respectively) may have contributed to the abovementioned financial difficulties. In cases of doubtful viability of such large capital projects it is preferable to refuse Community and national aids rather than approve inadequate sums. The Court recommends that the viability of this project be re-assessed in view of the implementation delays and financial difficulties encountered by the promoter.

7.2.11. Another project involved aid to finance a new cooperative venture with plans to process and sell 3 000 tonnes of fruit into the local market within a short timescale without furnishing any precise details of how this was to be achieved. The project involved a total investment of Esc 593 million (ECU 3,32 million) with Community aid totalling Esc 296 million (ECU 1,66 million).

7.2.12. An investment of Esc 300 million (ECU 1,68 million) with Community aid of Esc 148 million (ECU 0,83 million) was approved for the grading and marketing of kiwi fruit. It is one of a number of approved investment projects in this newly developing sector all of which failed to give any clear indication of market outlets, concentrating instead on the continuously increasing productive capacities of European producers with vague references to general market growth prospects. In the event the exaggerated market expectations failed to materialize, notwithstanding the high import requirements in this sector, with the result that this and other kiwi-related projects are in serious financial difficulties leading to the collapse of the companies concerned and the waste of Community aid.

Adequacy of marketing plan and control of capacity limit in respect of a major project

7.2.13. In the case of two related grant aided projects concerning the construction of a new abattoir, involving a total investment of some Esc 2 000 million (ECU 11,19 million) and Community aid amounting to Esc 913 million (ECU 5,11 million), a number of specific observations arise:

- (i) the project was presented by IFADAP to the Commission in two phases, the first in 1989 under Council Regulation (EEC) No 355/77 and the second in 1992 under Council Regulation (EEC)

No 866/90; although the local IFADAP office recommended a deferral of the second phase on the grounds that there was adequate capacity already available in the region and that the majority shareholder's stated intentions were not in the best interests of the project⁽²⁰⁾, the project was approved by the IFADAP Management Board; in reality the project was implemented on an integrated basis by deferring the first phase until approval for the second phase had been granted;

- (ii) although the project increased available capacity by a significant amount there was no evidence in the files made available nor did subsequent discussions with national and Community officials clarify that the condition, contained in the Sectoral Plan that no overall capacity increase should occur, was controlled and respected;
- (iii) the project submitted by the promoters failed to give a clear indication as to the sourcing of supplies of animals and the development of market outlets for the production, other than indicating an initial plan to provide slaughtering services for the local market, thereby building up the enterprise's resources to develop additional markets; it is astonishing that such a large undertaking, providing for an hourly throughput of 60 cattle, plus 240 sheep, plus 240 pigs, and involving such a substantial investment, was approved on the basis of such vague production and marketing plans; it should be noted that, as the first phase of this project was approved under Council Regulation (EEC) No 355/77, the Commission was responsible for final approval; for further comments see paragraph 7.2.16 (iv);
- (iv) an audit visit to the enterprise found that:
 - (a) the abattoir is working at some 50% of capacity; principally providing slaughtering facilities for local butchers;
 - (b) according to management their problems were due to the fact that local abattoirs, which their installation was scheduled to replace, were continuing to operate, indicating an overall capacity increase contrary to the provisions of the Sectoral Plan;

⁽²⁰⁾ The locally prepared evaluation report contained a number of doubts about the project:

- conflicting interests of the society that holds majority shareholding (indicated a desire to retain their current production facilities elsewhere),
- lack of agreement to close other abattoirs,
- low projected profitability.

- (c) the project included the construction and equipping of two state-of-the-art cutting and deboning rooms which have never been used to date, which is not surprising given that the targeted market for the utilization of productive capacity is the killing requirements of local butchers;
- (d) IMAIAA officials indicated that the viability of this project appeared to have been assured from the outset because, among the promoters of the project were a number of existing meat processors who undertook to use the facilities of the new abattoir for their slaughtering requirements⁽²¹⁾; in the circumstances it is a matter of concern that those promoters have subsequently not been obliged to respect such undertakings.

7.2.14. With regard to the establishment of modern abattoir facilities it should be noted that the Portuguese authorities undertook a programme for the creation of a national abattoir network (Rede Nacional de Abate) agreed prior to Adhesion. The Programme, which was implemented by the Instituto Regulador e Orientador dos Mercados Agrícolas (IROMA) was also commenced prior to Adhesion. In all, 31 abattoirs were granted Community aid as outlined in Annex III. However, the available evidence suggests that overall capacity was not closely monitored and controlled and that existing facilities were allowed to continue operating side by side with the new plants. A number of the aided abattoirs are now encountering economic difficulties either because of weak marketing arrangements or of over-capacity in the respective sectors.

7.2.15. The foregoing paragraphs indicate that a major weakness in the administrative procedures was that the economic viability of projects was not always sufficiently evaluated.

7.2.16. The following reasons can be advanced for this unsatisfactory situation:

- (i) the limited staff at IFADAP regional offices with responsibility for evaluating projects cannot in the available time conduct sufficient in-depth evaluations and may not have either the necessary professional background or have been given adequate training in this important area; the increased involvement of the centralized IFADAP

services to provide additional specialized support is essential to overcome these weaknesses;

- (ii) in the initial stage of its development following its Accession the perceived processing and marketing requirements of the Portuguese market were such that assured outlets were considered to have been available for all eligible projects; however, the availability of a market for products cannot, in itself, assure the success of a given industrial project;
- (iii) although the specific responsibilities of the respective services of IFADAP and IMAIAA with regard to project evaluations are set out in the national legislation there appears to have been a lack of clarity in their application; IFADAP has relied heavily on the approval of IMAIAA which, in turn, considered its competencies in respect of the projects submitted to be strictly limited to a technical evaluation;
- (iv) there was also a strong element of confusion, particularly with respect to projects approved under Council Regulation (EEC) No 355/77, as to the respective responsibilities of the national authorities and the Commission; in these instances the former considered that ultimate responsibility for approval or rejection of projects was vested in the Commission; the latter, on the other hand, with limited resources available for the purpose of conducting detailed evaluations of projects submitted, have placed strong reliance on the prior approval of individual projects by the national authorities.

7.2.17. Notwithstanding the acknowledged weaknesses and potential for role confusion in the procedures with regard to projects approved under Council Regulation (EEC) No 355/77, it is clear, however, that the primary responsibility was vested in the national authorities, following the adoption of Council Regulation (EEC) No 866/90. The results of the present audit indicate that current arrangements for approving projects and for controlling their implementation need to be substantially improved.

7.2.18. In their reply the Portuguese authorities have acknowledged that in the context of the first Community Support Framework adequate attention was not always granted to an evaluation of the marketing potential of new projects. They undertook to introduce more stringent evaluation criteria in the application of the second Community Support Framework.

⁽²¹⁾ This is in contradiction with the evaluation report by local IFADAP office. See footnote ⁽²⁰⁾ above.

CHAPTER 8

MEASURES FOR THE IMPROVEMENT OF
AGRICULTURAL STRUCTURES

8.1. Outline of the administrative and control procedures

8.1.1. The range of Community measures designed to improve the efficiency of agricultural structures was initially incorporated into Council Regulation (EEC) No 797/85⁽²²⁾. With the adoption of Council Regulation (EEC) No 2328/91⁽²³⁾ the measures were consolidated and extended.

8.1.2. The principal measures incorporated into Council Regulation (EEC) No 2328/91 can be summarized as follows:

- set-aside of arable land (Article 2),
- extensification of production (Article 3),
- conversion of production towards non-surplus products (Article 4),
- system of aid for investments in agricultural holdings, (Article 5) comprising:
 - investment aids in the form of capital grants or interest rate subsidies (Article 7),
 - setting-up aid to young farmers under 40 years of age (Article 10),
 - additional investment aid for young farmers (Article 11),
- back-up measures to assist agricultural holdings comprising:
 - a scheme to encourage the introduction of accounting,
 - aid granted to recognized groups,
 - contributions to the management costs of agricultural associations (Article 15);
- specific measures, in the form of compensatory allowances to assist mountain and hill farming and farming in certain less-favoured areas (Article 19);
- forestry measures on agricultural holdings (Article 25);
- adjustment of vocational training to the requirements of modern agriculture (Article 28).

With the exception of the measures for the set-aside of agricultural land (financed from the EAGGF-Guarantee) the above measures are financed from the EAGGF-Guidance Section budgetary resources.

⁽²²⁾ OJ No L 93, 30. 3. 1985, p.1.

⁽²³⁾ OJ No L 218, 6. 8. 1991, p. 1.

8.1.3. Expenditure in Portugal on the above measures during the period under review amounted to ECU 468 million. The Court's audit covered expenditure incurred under investment aids (Article 7), setting-up aid for young farmers (Article 10), additional investment aid paid to young farmers (Article 11) and compensatory allowances (Article 19). These audited measures, which represented some 90% of total expenditure under Regulations (EEC) No 797/85 and (EEC) No 2328/91 during the period under review, are administered by IFADAP which is also the designated paying agency.

8.1.4. In order to qualify for investment aid the farmer must:

- (a) practise farming as his main occupation, deriving at least 50% of his total income from farming;
- (b) possess adequate occupational skills and competence;
- (c) submit a plan for materially improving his holding;
- (d) undertake to keep simplified accounts.

8.1.5. The Regional Directorates of the Ministry of Agriculture (RDAs) are responsible for certifying the eligibility of applicants, in so far as they satisfy the conditions outlined at indents (a) and (b) above.

8.2. The Court's audit and findings

Investment aids and special allowances to young farmers

8.2.1. In the regions visited some 90 files relating to investment projects were examined. Depending on the personal circumstances of the individual beneficiaries, the basic investment aid provided in Article 7 of the Regulation was supplemented by aid for the first installation of young farmers (Article 10) and/or supplementary aid for young farmers (Article 11).

8.2.2. With regard to the certification, by the RDAs, of the eligibility of beneficiaries, it was observed that:

- (i) the RDAs are not in possession of any information which would allow them to certify agricultural earnings as the principal source of revenue of applicants;
- (ii) the requirement for applicants to have the necessary training or experience is interpreted liberally, again without adequate information, with the result that, in certain cases examined, the eligibility of beneficiaries was doubtful, particularly for cases involving new participants in the agricultural sector.

8.2.3. An example of the bad application of the latter eligibility criterion is the case of a wine producer. The candidate, a teacher by profession and living in Porto, took over the family farm some 60 kilometres from Porto on the death of an uncle. The IFADAP desk officer expressed surprise at the sudden change of career and expressed doubts as to whether the candidate had sufficient experience in the agricultural sector to satisfy the conditions of the scheme. However, the Regional Directorate of Agriculture testified that the candidate had more than 4 years experience in agriculture without having any documentary basis to do so and accordingly the candidate was dispensed with the requirement to follow a fundamental training course in agriculture. Although the candidate did participate in a short training course on wine production, and a visit on-the-spot indicated that the project had been well implemented, the laxity in the application of the conditions stipulated for Community aid, in this and in other cases, is a cause for concern. Furthermore, it was noted that, in a number of cases examined by the Court, the files had been closed without having received any proof that the condition of having successfully completed the required training had been respected.

8.2.4. As regards administrative and control arrangements implemented by IFADAP the following general observations arise:

- (i) the national legislation implementing the Community measures also provides for supplementary measures financed exclusively by the national budget which are subjected to different eligibility criteria; this mixture of eligibility criteria complicates the control task (see paragraph 8.2.7) which is further complicated by the delays on the part of the Commission in approving the frequent amendments to the relevant national legislation;
- (ii) in view of their nature, to ensure that the eligibility conditions attaching to these Community aids are fulfilled a high level of physical inspections is vital; the delegation of the principal administrative and control tasks to the regional services of IFADAP, with limited personnel resources relative to the significant numbers of aid applications received, results in the control of applications being limited, for the most part, to documentary checks; nevertheless the level of physical checks undertaken (IFADAP have indicated a rate of 38%) have detected irregularities in some 5% of cases examined leading to a high number of contract cancellations (807), indicating the desirability of extending such checks;
- (iii) in two cases examined relative to the first installation of young farmers there was a free transfer from a family member to the applicant, of a very small parcel of land (1 ha) with a minimum of formalities; apart from the undesirability of such practices encouraging the break-up of agricultural holdings into non-viable small holdings, a practice which other Community measures are attempting to reverse, in these two cases the contractual conditions attached to the receipt of Community aid were not fully respected indicating that such arrangements were made primarily to maximize receipts of Community aids; since 1991 the practice of free transfers has no longer been accepted by the Portuguese authorities;
- (iv) as for other measures, insufficient attention is given to marketing aspects relating to aided investments; consequently, while the productive capacities of aided investments are frequently well established, the lack of well developed marketing plans for assuring market outlets, for what is frequently perishable produce, results in certain aided projects not realizing their full potential; in certain instances this lack of attention to such an essential element and undue reliance on local markets can endanger the overall viability of the projects (see paragraph 8.2.5 below);
- (v) in three cases beneficiaries had, contrary to Community regulations, been grant-aided for a number of projects in excess of the stipulated maximum of two projects per six-year period; the Portuguese authorities have indicated that the additional projects were financed by national resources according to national legislation indicating once again the incompatibility of national and Community eligibility criteria (see (i) above);
- (vi) although there were significant discrepancies in five files examined between the surface areas declared for aid and those declared for other national measures (e.g. tax rebates for diesel fuel) and Community measures (e.g. compensatory allowances), such discrepancies had not been investigated;
- (vii) there was lack of attention in seven specific cases to following up the respect of all the conditions attached to the granting of aid and, in particular, that training courses had been completed, as stipulated, or that other essential documents (e.g. title) had been furnished in due course; also in practically all cases the requirement to maintain an accounting system was not verified; concerning the undertaking to maintain an accounting system the Portuguese authorities rely on the general system of checks in force and on the procedure that a second project for an individual beneficiary will only be

accepted subject to proof of an accounting system being furnished.

Full details of individual cases referred to above have been communicated to the Portuguese authorities and to the Commission with a recommendation that appropriate follow-up action be taken.

8.2.5. The following case illustrates the insufficient attention to marketing aspects of grant-aided projects. The project, involving Community aid of Esc 59 million (ECU 0,33 million), was for the construction of greenhouses, primarily for the production of tomatoes and lettuces. Although a visit on-the-spot showed that the project had been correctly implemented and the productive capacity had been well established, the problems associated with marketing the production had, once again, been underestimated. In effect, the relatively simultaneous ripening of such perishable products in such large quantities, posed considerable problems to find local market outlets, the only market exploited in this case. There is an urgent need to ensure that better marketing arrangements are in place in such instances to diminish production losses, in order to assure the long term commercial viability of the investments.

8.2.6. In four cases examined during the audit including the case illustrated at paragraph 8.2.7 below and one visit on-the-spot, it was considered that Community aid paid should be recovered either because the beneficiaries had not fulfilled the required conditions or had not implemented the projects in conformity with the approved plans. Details of these cases have been communicated to the Portuguese authorities and to the Commission.

8.2.7. In one case, project No 88.63.6261.5, approved for Community aid on 16 August 1988, the local IFADAP office, having observed during an on-the-spot visit, that the conditions attached to Community aid had not been respected, recommended that the aid paid should have been recovered. Yet, although Community aid was cancelled by IFADAP on 8 October 1992 in this case, the aid granted was not reimbursed by the beneficiary, but was on the same date transformed instead to a national aid. Such actions do nothing to discourage the non-respect of the necessary conditions attached to the granting of aid and frustrate the objectives of the measures, namely the improvement of agricultural structures, and, in this particular case, the setting-up of young farmers.

Compensatory allowances

8.2.8. Article 17 of Council Regulation (EEC) No 2328/91 provides that 'in regions which appear on the Community list of less-favoured farming areas within

the meaning of Directive 75/268/EEC⁽²⁴⁾, Member States may grant an annual compensatory allowance to be fixed according to the permanent natural handicaps described in Article 3 (of that Directive) within the limits and subject to the conditions laid down in Articles 18 and 19 of this Regulation'. The compensatory allowances are payable either on the basis of the number of animals maintained within a stipulated holding period or on the basis of the area farmed. Payment of the compensatory allowances is subject both to a maximum amount per hectare and to a maximum amount per holding.

8.2.9. In Portugal almost the entire country is classified as a less-favoured farming area but with differing levels of natural handicaps. The scheme is administered and controlled by the RDAs with the payment of approved amounts being effected by IFADAP.

8.2.10. During the period under review commitments in respect of compensatory allowances amounted to ECU 176 million or 12 % of total Community commitments for Portugal (see Annex I). On a regional basis the principal expenditure occurred in Trás os Montes (30 %) and Entre Douro e Minho (21 %) in the North, Beira (Litoral and Interior) in the centre (20 %), Alentejo in the South (13 %) and the Azores (12 %), with marginal expenditure in the other regions.

8.2.11. There were significant annual variations, in terms of the total numbers of beneficiaries, total livestock units (LUs) and area units (ha) submitted for aid and total amounts paid as indicated in Annex IV. The variations noted between 1988 and 1989 and between 1992 and 1991 and 1993 respectively, were particularly significant.

8.2.12. Because the Court had already carried out an extensive audit in this area, during 1990, the examination in the context of the present enquiry was limited to a documentary verification of a small sample of 62 transactions relating to 1993 payments in the regions of Entre Douro e Minho (37 transactions) and Alentejo (25 transactions).

The following observations arise:

- (i) the payment files contained a minimum of supporting documentation to justify, on the one hand, the agricultural areas for which the allowances were paid or, alternatively, the number of animals justifying the payment; in addition, there was a big difference between the available documentation in each region;

⁽²⁴⁾ OJ No L 128, 19. 5. 1975, p. 1.

- (ii) although applicants must present the requisite animal sanitary cards in Alentejo (except for sheep and goats) at the time of confirming the application, there is no evidence on file to verify that such documentation had been presented or to indicate what checks had been carried out;
- (iii) although the auditors were informed that a sample of physical inspections is carried out in respect of compensatory allowances as stipulated by Community regulations, no precise statistics were furnished; furthermore in the files selected, no evidence was found that physical inspections had taken place;
- (iv) although certain possibilities exist to confirm the general reasonableness of aid claims (notably the results of physical inspections and testings carried out by the veterinary services in the context of disease eradication programmes), these possibilities are not used; in particular, the link-up of the computerized data base of such veterinary inspections with the compensatory allowance applications, would make possible an automatic feasibility check of applications, and would significantly improve the reliability of the system;
- (v) the eventual implementation of the Integrated Management and Control System, as required by Council Regulation (EEC) No 3887/92⁽²⁵⁾, will provide the opportunity to improve the control over compensatory allowances; however, the absence of a land register, particularly for the North of Portugal and the Islands, is also likely to considerably delay the installation of a reliable integrated control system;
- (vi) attempting to reconcile the amounts declared to the Commission and the amounts contained in the computerized files made available at regional level was especially difficult. In particular, a number of important differences were noted for 1993, between the totals declared by IFADAP to the Commission and data available at both the IFADAP regional offices and at RDA offices visited. Subsequent explanations by IFADAP indicate that some of the differences related to corrections made by IFADAP headquarters which were not communicated to the local levels. Other differences are apparently due to the payments made in 1993 in respect of prior years which were not separately identified in the reimbursement claim submitted to the Commission.

8.2.13. While the Court's audit in this area was, of necessity, limited, its results indicate a need to significantly improve the administration and control of the scheme. In this respect, there is nothing to indicate that the weaknesses highlighted by the Court in its 1990

Annual Report, Chapter 9 have been overcome (see Annex V).

CHAPTER 9

OPERATIONAL PROGRAMMES APPROVED UNDER OBJECTIVE 1 OF THE REFORM OF THE STRUCTURAL FUNDS

9.1. Outline of the administrative and control procedures

9.1.1. For the purposes of implementing the reform of the Structural Funds all of Portugal was declared as a zone qualifying under Objective 1 — promoting the development and structural adjustment of the regions whose development is lagging behind.

9.1.2. During the period under review a total of 23 OPs were approved in the abovementioned context for a total value in terms of commitments, of nearly ECU 229 million (see Annex VI).

9.1.3. The Court's audit included an examination of four of the most important OPs in value terms. These were:

- the OP for Land Reform and the Cessation of Agricultural Activity,
- the OP providing assistance to farmers affected by drought,
- the OP providing aid for farmers affected by bad weather,
- the OP for Forestry Measures.

Together, these four OPs accounted for ECU 167 million, or 73% of total commitments provided for Objective 1 operations. Community aid for those OPs ranged from 50 to 75% of eligible expenditure with the balance being funded from the national budget.

9.1.4. The selected measures are administered and controlled by diverse national organizations notably, the services of IEADR for structural measures, IFADAP for financial measures relating to interest rate subventions and the Forestry Institute for the measures provided in the OP for Forestry Measures. However, IFADAP acts as paying agent for all OP expenditure.

9.2. The Court's Audit and Findings

9.2.1. The Court's audit involved an evaluation of the administrative and control procedures in force for the measures selected for audit. A total of 103 payment files were examined including 40 relating to the Bad Weather

⁽²⁵⁾ OJ No L 391, 31. 12. 1992, p. 36.

OP, 44 relating to the Drought OP, 18 relating to Forestry measures, including 10 payments effected under the provisions of Council Regulation (EEC) No 797/85, and one collective measure for Land Reform. In addition eight of the projects examined were verified on-the-spot.

The OP for Land Reform and the Cessation of Agricultural Activity

9.2.2. It was noted that the financial resources allocated to this OP were significantly reduced from an initial sum of ECU 24,5 million to ECU 14,7 million and that the principal element of the original OP, the measure for Land Reform, was almost halved from ECU 18,4 million to ECU 10,9 million. At the same time, however, the Community element of financing for the programme was increased from 65% to 75%. An even greater reduction was noted in the implementation of the programme with only 20 actions indicated by the 1993 implementation report as having been undertaken, of the 70 which had been planned initially. This substantial reduction in activity is surprising in view of the generally-accepted perceived need for land reform in Portugal, especially in northern regions.

9.2.3. The collective measure for land reform examined was at Valença in the region of Entre Douro e Minho. The project, comprising the regrouping of 296 hectares had been substantially completed at the time of the audit. In general it was noted that the project had been implemented in a satisfactory manner and was no doubt facilitated by the homogeneous nature of the land, situated in a plain on the banks of a major river. It was observed, however, that an important number of new land parcels had a total area of less than one hectare, thereby diminishing the overall efficiency of the measure from the viewpoint of encouraging a mechanical exploitation of the re-grouped landholdings.

9.2.4. The total cost of the Valença collective measure amounted to Esc 356 million (ECU 2 million) representing an average cost per hectare of Esc 1,2 million (ECU 0,007 million), without taking account of costs of preliminary studies and for the general preparation of the project. In view of the relatively straightforward nature of the project, the abovementioned costs incurred seem particularly high relative to the estimated costs for three other projects currently underway which were given as in Annex VII.

The OP providing assistance to farmers affected by drought

9.2.5. This OP was intended to deal with the problems associated with the extensive period of drought which affected Portugal during 1991 and which, for many farmers, resulted in the loss of their harvest with, as a consequence, their inability to reimburse debts incurred. For this reason a considerable percentage of the funds provided for the OP (88% out of a total sum of ECU

39 million) was earmarked for the payment of interest rebates. Other significant elements of the OP were:

- measures for encouraging the cultivation of sorghum wheat, and
- measures for the encouragement of water retention.

9.2.6. Concerning the measures for encouraging the cultivation of sorghum wheat it was observed that:

- very limited on-the-spot inspections took place to verify if beneficiaries had respected the conditions required for the measures;
- while certain beneficiaries furnished invoices from seed merchants to justify the entitlement to receive Community aid other beneficiaries received payment of the aid on the basis of a declaration to the effect that they had used their own-produced seed grain and, as a consequence, no independent evidence was available to justify entitlement to aid apart from a general attestation by the local RDA official;
- furthermore, in the case of utilization by producers of own-produced grain the provisions of Community Directives relative to the certification of seed grain have not been adhered to; also, given that Community aid was paid to such producers, it would have been appropriate to stipulate that only the costs of certified seed would be reimbursed in order to improve the prospects of the success of re-planted harvests.

9.2.7. Finally, as regards the measures for the retention of water, the OP provided for the realization of a collective irrigation project comprising the construction of a canal between the Odivelas and Sado rivers. However, the project was cancelled due to the lack of available commitments as the amount originally earmarked for this project had been used for interest rebate purposes. In the circumstances it is regrettable that an authentic structural measure, which would have served to alleviate the effects of future droughts, had to be cancelled in order to satisfy short-term requirements. Furthermore it is difficult to accept that the debt burden on farmers was as a result of the period of drought to the extent that financial resources had to be earmarked for interest rebates over a period of six years.

The OP providing aid for farmers affected by bad weather

9.2.8. This OP provided for measures to alleviate the effects of bad weather, including flooding, arising from the torrential rains and violent storms which affected certain regions of Portugal in Autumn 1989. The audit gives rise to the following observations:

- (i) as in the case of projects financed under the OP for drought there was an inadequate level of physical inspections of projects grant-aided under this measure;

(ii) although the objective of the OP was to part-finance the expenses incurred to repair damage caused, a number of beneficiaries profited from the aid to improve their installations and to increase their productive capacities; notwithstanding the fact that an improvement of the quality of installations is understandable and even desirable in certain instances, such an improvement was not provided for in this OP; the increase in capacity, on the other hand, is a matter having much wider consequences and was also not provided for in this OP; the following two projects which were controlled on-the-spot, illustrate the problem:

- structural repairs to a pig-rearing facility (total aid approved Esc 7,7 million (ECU 0,04 million)) — not only was the facility substantially improved but the capacity was increased in a sensitive sector with excess capacity,
- repair and extension of a water dam for irrigation purposes (total aid approved Esc 7,5 million (ECU 0,04 million)) — both the structure was improved and the capacity increased;

(iii) although the OP presented to, and approved by, the Commission did not specifically include aid for the region of Porto a number of projects were grant-aided in this region by a decision of the Portuguese Secretary of State for Agriculture;

(iv) furthermore, two such projects examined in the Porto region had benefited from a total amount of aid in excess of the maximum provided for in the OP; the principal reason for this situation was the acceptance of expenditure for the replacement of inventory which was not eligible for aid; full details of these two projects are set out in the following paragraphs.

9.2.9. The projects in question were submitted by related private companies which share the same site and a common administrative address in the administrative Commune of Porto. One of the companies operates a commercial garden centre selling potted house plants. The second is an enterprise growing ornamental shrubs and trees. Based on an analysis of the files and on detailed discussions with the responsible IFADAP officials and with the representative of the joint enterprises, the following facts were noted:

(i) one company was approved Community aid totalling Esc 29,8 million (ECU 0,17 million) of which Esc 19,8 million (ECU 0,11 million) was justified by the purchase of potted house plants, for stock replacement purposes, with the balance

representing the costs associated with the repair and reconstruction of fixtures and equipment, notably the replacement of damaged greenhouses;

(ii) the second company was approved Community aid totalling Esc 17,3 million (ECU 0,1 million) of which Esc 15,4 million (ECU 0,08 million) was justified by the purchase of ornamental trees and shrubs for stock replacement purposes with the balance representing costs incurred for the repair of fixtures and equipment and the replacement of topsoil;

(iii) the total aid approved was reduced by an amount of Esc 14,1 million (ECU 0,08 million) representing the recovery of Community aid paid in respect of a failed investment project (approved under Council Regulation (EEC) No 797/85), original aid Esc 6,9 million (ECU 0,04 million) plus accumulated interest and penalties amounting to Esc 7,2 million (ECU 0,04 million), although the beneficiary in question was a minority partner (25 %) in the failed project (see also paragraph 9.2.11 below concerning the majority partner).

9.2.10. A review of the abovementioned files raises a number of observations:

(i) apart from the fact that the region involved was not specified as eligible in the OP approved by the Commission, the location of the two projects, in the heart of an industrial centre, in the urban area of Porto, raises doubts as to whether the projects can be assimilated to agriculture; further details have been requested on the precise zoning of the affected locality at the time the flooding took place;

(ii) the auditors were informed that the enterprises had been refused insurance cover some months prior to the flooding; in the circumstances, it is questionable whether Community financing should, in any event, have been used effectively to provide basic insurance cover for the projects;

(iii) the replacement of stock should, by its very nature, have been disallowed; furthermore the costs in respect of damaged stocks were never reimbursed in other regions, even those costs directly related to agricultural crops;

(iv) at the time of the audit (October 1994) a significant portion of the respective sites had been compulsorily acquired for the purposes of the construction of the Porto ring road / Douro Second crossing; as a result the enterprises were scaling down activities in preparation for a transfer to another location; to the extent that the compulsory purchase of the site is

likely to have been public knowledge prior to the payment of Community aid (November 1992) it could be considered that the costs associated with the rebuilding and repair of installations and the replacement of topsoil were unable to provide appropriate term benefits and should not have been incurred from the perspective of sound financial management.

9.2.11. With regard to arrangements for the recovery of sums unduly paid, in the particular instance outlined at paragraph 9.2.9 above, while the sum recovered represented over 200% of the sum initially paid, due to the imposition of interest and penalties, only the original sum paid was credited to the Commission, since there is no provision in Community regulations for the recovery of interest or penalties, which accordingly accrue to the national authorities. Full details of all such amounts retained by the national authorities have been requested. More important, however, the sum was recovered from the minority partner in September 1992, while the majority partner had, just two months earlier, been approved albeit via two separate limited companies a further substantial sum of aid, representing in excess of Esc 2,7 billion (ECU 15 million) or 45% of the relevant OP with payments amounting to Esc 400 million (ECU 2,2 million), scheduled to be made on 30 June 1992 some 16 days prior to the signature of the respective contracts. In addition, while the total amount of aid paid was subsequently reduced to Esc 1,6 billion (ECU 8,8 million), the second project, which would appear to have been wildly optimistic, has since failed, thereby calling into question once again the adequacy of evaluation procedures and raising the question as to how such an important sum of Community aid could have been approved in this instance, given the experience of the abovementioned previously failed project. As a very minimum such an ambitious project, involving the establishment of some 300 hectares of glasshouses, should only have been approved on a more realistic phased basis.

The OP for Forestry Measures

9.2.12. The Forestry OP, approved in June 1991, incorporates a series of existing measures previously included in the PEDAP Programme. It includes actions exclusively for forestry purposes such as afforestation of marginal lands, reforestation of areas destroyed by fire and improvement and value-added actions. Its overall objective is the increase of wood production and the diversification of sources of revenue for forestry related activities. The total amount earmarked for the OP was ECU 61,3 million. Outside the OP other forestry measures are provided for within the framework of Council Regulations (EEC) No 797/85 and 1609/89⁽²⁶⁾, the objective of which is to improve the revenues of

farmers with multiple activities in agriculture, forestry and tourism.

9.2.13. The audit of this OP gave rise to the following observations:

- (i) the projects approved under the OP are recorded in two separate registers, one maintained by the Forestry Institute and the other by IFADAP; there was a lack of correspondence between the two registers in a number of instances, a factor which makes it difficult to ensure adequate administrative control and accounting transparency for the measures;
- (ii) in the case of one project examined the Forestry Institute had already detected an irregularity which was being further investigated at the time of the audit; specific details of this case, to the extent that they were made available, are set out in the following paragraphs.

9.2.14. The case referred to above was in the region of Entre Douro e Minho and involved a public forestry project covering 1 375 hectares in a total forestry programme covering 4 360 hectares. It involved the over-statement of the surface area approved for planting and improvement under the grant-aided project, which was approved in 1990 and implemented directly by the local services of the General Directorate of Forests, a service which, at that time, was part of the Ministry of Agriculture and Forests. Although the project envisaged the planting of 813 hectares of forest land belonging to the State, the local Forestry Service certified in 1993 that 541 hectares had been planted. Accordingly the amount of Community aid initially approved amounting to Esc 277 million (ECU 1,5 million), was subsequently reduced, to Esc 177 million (ECU 1 million), in the first instance, and later to Esc 157,1 million (ECU 0,9 million), corresponding to the amount which would have been due had the reduced area been approved for planting. Fourteen payments have already been made for the project for a total sum of Esc 157,1 million (ECU 0,9 million). However, an on-the-spot control by the Forestry Institute staff found that, in reality only 256,1 ha had been planted, contrary to the area certified by the local service, with actual expenditure established at Esc 94,5 million (ECU 0,5 million). As a result an overpayment amounting to Esc 62,6 million (ECU 0,4 million) was made.

9.2.15. More specifically the abovementioned on-the-spot control revealed that:

- (i) contracts for planting work had been granted to three separate private firms for specified areas of 71,5 ha, 270,0 ha and 199,5 ha respectively, for a total area of 541 hectares;

⁽²⁶⁾ OJ No L 165, 15. 6. 1989, p. 1.

- (ii) areas actually planted under the three contracts were found to have been 71,5 ha, 168,1 ha and 16,5 ha respectively;
- (iii) the trees to be planted were supplied by the local services of the General Directorate of Forests and were invoiced for a total value of Esc 9,2 million (ECU 0,05 million), although the actual quantities used had an invoice value of Esc 7,2 million (ECU 0,04 million);
- (iv) of the additional activities, which had been approved as part of the project, and assigned to the services of the General Directorate of Forests for the opening and improvement of 39 km of forest roads only 30 km were found to have been carried out, while an approved dam had not been constructed.

9.2.16. While the case has been referred to the specialized service of IFADAP (DINS) for further investigation, the gravity of the case, with the complicity of the services of a State body, gives rise to the following preliminary observations:

- (i) given that the project was not implemented as contracted for, a full recovery of Community funds is appropriate;
- (ii) it is imperative to modify the administrative and control procedures to overcome the weaknesses which allowed the irregularity to occur;
- (iii) the extent to which collusion might have occurred between the authorizing service and the forestry service's own nursery or private outside suppliers needs to be fully investigated;
- (iv) the services of the Commission should be informed by the Portuguese authorities of the full facts of the case in order to undertake an independent outside investigation of the matter.

CHAPTER 10

MANAGEMENT BY THE COMMISSION

10.1. An evaluation by the Court of the management of EAGGF-Guidance Section expenditure by the Portuguese authorities for the period under review is contained in Chapters 7-9 of this report. In addition, the Commission has specific administrative and control responsibilities as set out hereunder.

10.2. Prior to the reform of the Structural Funds in 1988 the Commission had direct responsibility for managing the major projects approved under the EAGGF-Guidance Section expenditure, particularly

relating to individual projects approved under the provisions of Council Regulation (EEC) No 355/77, for the processing and marketing of agricultural products. The management of other horizontal measures was assigned, in the first instance to the designated authorities in the Member States. The principal such measures were those provided for by Council Regulation (EEC) No 797/85 for the improvement of agricultural structures (subsequently covered by Council Regulation (EEC) No 2328/91).

10.3. The only other direct measures of significance implemented in Portugal during the period under review were those provided under Council Regulation (EEC) No 2239/86 on a common measure to improve wine growing structures in Portugal and which only represented approximately 1% of Community budgetary commitments during the period.

10.4. The results of the present audit indicate a number of weaknesses in the Commission's monitoring of Community budgetary expenditure incurred in Portugal under Council Regulation (EEC) No 355/77. In particular, the Commission procedures have been inadequate for:

- (i) approving individual projects submitted by the Member State; where the Commission services have placed undue reliance on the evaluations carried out by the national authorities which, in turn, considered that the ultimate responsibility for approving projects rested with the Commission; in the circumstances, the evaluations conducted by the Commission on such projects were superficial and, on occasions, quite inadequate taking account of the important sums involved; the example cited at paragraph 7.2.13 above is a case in point, where the Court considers that even a limited evaluation of the proposed project submitted should have raised considerable doubts as to its viability;
- (ii) monitoring that the requirement for no overall capacity increases in sensitive sectors was respected;
- (iii) ensuring that national administrative and control procedures were adequate to safeguard the use of Community funds.

10.5. In the application of Council Regulations (EEC) No 797/85 and 2328/91 the Commission should have been more vigilant in ensuring that the approved national implementing measures were coherent with the provisions of those regulations and that legal arrangements were not used to maximize the receipt of Community funds.

10.6. With the reform of the Structural Funds, the majority of expenditure was classified as indirect with primary administrative and control responsibility assigned to the national authorities. As far as the OPs are

concerned the Commission has a limited possibility to oversee the implementation of the programmes through its participation in the Monitoring Committees. To date three meetings of the Monitoring Committees have taken place, in June 1991, November 1992 and July 1993. Each meeting was held over two days during which the progress of the entire range of approved OP was reviewed. It is evident that, in the time available, monitoring of the implementation of 38 OPs had to be kept to a very superficial level.

10.7. During the period 1991-1993 the Commission services carried out control visits to Portugal covering the following:

- an analysis of the financial circuits of IFADAP;
- expenditure incurred under Council Regulations (EEC) Nos 866/90, 2328/91 and 2239/86;
- the PEDAP programme;
- expenditure incurred under the LEADER programme.

While these audit visits led to a series of specific observations and suggestions for improvements in the systems examined, the overall conclusions were that the administrative and control procedures observed were satisfactory.

10.8. Overall the Commission services consider that the administrative procedures implemented by the Portuguese authorities are reasonably reliable mainly because the specialized service of IFADAP-DINS (Direcção do Inspeccão) is responsible for the functions of an internal audit service. However, as already observed by the Court (see Annex V, paragraph 5), this service has to rely on the local administrative services to carry out the bulk of audit checks on its behalf. In effect, as the service assigns almost its entire staff resources to investigating specific problem cases highlighted by the regional offices, it does not operate as an internal audit service in the generally accepted meaning of such a service.

10.9. The Court has, previously, drawn attention to the lack of pertinent information available to the Commission services to effectively manage and control EAGGF-Guidance Section expenditure. The principal inadequacies are:

- (i) failure to fully exploit the provisions of Article 23, Council Regulation (EEC) No 4253/88⁽²⁷⁾, which provides for details of controls effected by the Member States to be furnished to the Commission;
- (ii) when information is presented, essential elements for verifying its veracity and completeness are

missing, namely adequate details of individual amounts paid to beneficiaries to enable the correctness of those individual payments to be checked;

- (iii) the reliance on out-dated paper based communications rather than electronic presentations restricts the possibilities for the exploitation of financial information for control purposes.

10.10. Better access by the Commission to the individual data bases of the Member States would improve the possibilities for its services to properly plan and carry out on-the-spot controls.

10.11. Finally, in the important area of communicating cases of irregularities detected to the relevant service of the Commission, Unité de Coordination de la Lutte Anti-fraude (UCLAF), the Portuguese authorities have, to date, communicated only two cases of very minor importance. Without adequate information in this key area, the Commission has very limited possibilities to take appropriate action. In effect, the non respect of the provisions of the relevant Community regulations⁽²⁸⁾ concerning the communication of cases of frauds and irregularities, has negated, or at least minimized what the Commission has long considered to be one of its principal weapons in the fight against the improper use of Community funds.

CHAPTER 11

CONCLUSIONS

11.1. The foregoing Chapters in Part II of this report indicate an important number of weaknesses in the administrative and control procedures implemented by the Portuguese authorities for the EAGGF-Guidance Section expenditure. In addition, a significant number of specific cases were highlighted where Community funding was incorrectly granted or inadequately controlled. While the seriousness of the specific weaknesses detected varied with the size of the sums involved and the extent to which appropriate measures would have eliminated them, it is illustrative nevertheless, that of the 321 projects and transactions examined, spread over the entire period from 1988 to 1993, 43 cases contained some degree of error calling into question the justification for the respective payments. In certain specific instances highlighted in this report undue payments or overpayments occurred. Furthermore systems weaknesses observed in the majority of the projects/transactions examined lead to the

⁽²⁷⁾ Council Regulation (EEC) No 595/91, OJ No L 67, 14. 3. 1991, p. 11, subsequently implemented by Commission Regulation (EEC) No 1681/94, OJ No L 178, 12. 7. 1994, p. 43.

⁽²⁷⁾ OJ No L 374, 31. 12. 1988, p. 1.

conclusion that the reliability of the underlying administrative system is not assured. This is a material level of errors or weaknesses and indicates that, overall, there is an urgent need for the implementation of appropriate procedures to improve the reliability of the system.

11.2. However, it is important to note that a number of the weaknesses are inherent in the system. As such, those weaknesses are not unique to Portugal. In that respect certain eligibility criteria, for example those applicable for aid under Council Regulations (EEC) Nos 797/85 and 2328/91 (see paragraphs 8.2.2-8.2.3) are neither easily controllable nor is the justification for them entirely evident. Furthermore, aid payable in the form of compensatory allowances is largely based on trust because no reliable data exists on the key elements upon which the aid is calculated. In addition, the implementing rules for this type of aid are of such complexity that even the majority of beneficiaries are incapable of determining whether or not they have been paid the correct amounts and an important element of counter checks is therefore absent.

11.3. A number of mitigating circumstances have contributed to some of the weaknesses highlighted in this report. Firstly, the optimism for agricultural development in Portugal after Accession was later tempered by two difficult seasons, which resulted in poor returns on investments, on the one hand because of the extensive period of drought and, on the other, because of exceptionally bad weather. As a result certain beneficiaries, even these who had acted in good faith, were forced to abandon their investment projects.

11.4. Secondly, the severe competition, which Portuguese agriculture experienced due to the opening up of the internal market caused a significant shake-up in a market which was inadequately prepared for its impact. These conditions, together with the negative effects of the high interest charges no doubt pushed a number of agri-food firms into economic difficulties.

11.5. Thirdly, it was a legitimate predictable reaction that a country which had suffered from severe shortages of capital for investment would seek to maximize its receipt of available Community funds for such investment purposes. Yet, inadequate verification procedures were implemented to control the use of such inflows. In this context, however, it should also be borne in mind that, although EAGGF-Guidance Section funds represented a small part of such overall transfers, their re-distribution among large numbers of beneficiaries, many of which received relatively small amounts, created a significant control task for the national authorities concerned, which were not always granted the necessary resources to

ensure that a fully reliable control system could be put in place.

11.6. Notwithstanding the mitigating circumstances, however, the Court considers that many of the errors and weaknesses highlighted by the audit could have been avoided. In this respect, both the Portuguese authorities and the Commission must share the responsibility, particularly with respect to the principal material errors and weaknesses summarized in the following paragraphs for the measures examined.

11.7. In the case of aid for the processing and marketing of agricultural produce, the principal weaknesses, already highlighted in Chapter 7 of this report, can be summarized as follows:

- (i) inadequate attention to verifying the economic viability of aided projects due, in large measure, to a failure to seek properly developed marketing plans for the increased output from the new plants;
- (ii) lack of monitoring by the Commission of the implementation of the Sectoral Plans and a confusion between the Commission and the Portuguese authorities as to the specific responsibilities of each party for the ultimate approval of projects; as a result each party relied on the other to carry out appropriate project evaluations, particularly for those projects approved under Council Regulation (EEC) No 355/77 and, in the circumstances, no thorough evaluations of projects took place;
- (iii) likewise, in the case of projects approved under Council Regulation (EEC) No 866/90, the evaluation and approval of which was the clear responsibility of the national authorities, similar deficiencies in the project evaluation procedures were observed;
- (iv) there was also a failure, on the part of the national authorities and the Commission, to properly monitor the capacity limits imposed by the Sectoral Plans on sensitive sectors, with the result that there was continuing competition for new installations from plants which they were supposed to replace.

11.8. Concerning the increased competition arising from the opening up of the Portuguese market to Community manufacturers, while the authorities agreed to bring forward the planned date, it would appear nevertheless that the number of years available for structural adjustment had not been adequately availed of to mitigate the effects of such inevitable increased competition. This failure must be attributed to deficiencies in the procedures for planning and implementation of structural improvements, with the

result that appropriate supply and distribution channels had not been put in place during the intervening period of full protection.

11.9. As regards the measures provided for the improvement in agricultural structures the weaknesses highlighted in Chapter 8 of this report indicate in particular:

- (i) laxity in the application of eligibility criteria;
- (ii) the acceptance up to 1990 of arrangements for the maximization of Community aid by means of free transfers of very small plots to family members, with a minimum of formalities;
- (iii) a low level of verification of investment projects and of on-going monitoring to ensure that conditions attaching to aid continued to be respected;
- (iv) the implementation of national measures which undermined the application of Community eligibility criteria in certain instances and contributed to diminishing their impact; furthermore, two projects examined which had benefited from Community aid were, once it was detected that they had failed to qualify, later converted into national aid thereby avoiding the recovery from beneficiaries of sums unduly paid or no longer eligible under Community regulations.

11.10. Concerning the implementation and control of compensatory allowances, it has already been noted, that this measure is difficult to control due to the lack of a reliable database for the elements establishing entitlement to aid and also due to the very large number of beneficiaries. Nevertheless significant improvements in the system are required as detailed at paragraph 8.2.12 of this report. Furthermore the discrepancies in the numbers of beneficiaries and the amounts paid as recorded at the different administrative levels, as well as the elements establishing entitlement to aid from one year to the next, need to be investigated in greater detail.

11.11. With regard to the implementation of the OPs selected for audit detailed findings are set out in

Chapter 9 of the present report. The principal weaknesses detected can be summarized as follows:

- (i) very slow progress in implementing the generally perceived urgent measures for Land Reform with only one measure implemented to date at an average cost per hectare significantly higher than amounts budgeted for more complicated projects (see paragraphs 9.2.2-9.2.4);
- (ii) inadequate levels of physical inspections of projects approved for both the drought and bad weather OPs, as well as the acceptance of capacity increases in sensitive sectors (see paragraphs 9.2.6 and 9.2.9 (i) and (ii));
- (iii) in the case of the bad weather OP, the acceptance of aid applications in regions not covered by the OP approved by the Commission as well as the acceptance of ineligible expenditure (see paragraphs 9.2.9 (iii)-9.2.11);
- (iv) an apparent irregularity involving a material amount in the Forestry OP which has serious consequences in that it would appear to have been perpetrated by employees of the Forestry Institute, a State body; furthermore there was a failure to inform the responsible Commission services and accordingly, no independent investigation of the incident has, as yet, been undertaken (paragraphs 9.2.14-9.2.16).

11.12. Finally, with regard to arrangements for the recovery of sums unduly paid, the audit revealed, as outlined at paragraph 9.2.11 of this report, that while the sums recovered represent significantly more than the sums initially paid, due to the imposition of interest and penalties, only the original sums paid are credited to the Commission, since there is no provision in Community regulations for the recovery of interest or penalties. Full details of all such amounts retained by the national authorities have been requested. Furthermore, in the specific case mentioned above, while a recovery was effected against the minority partner of a failed project, the majority partner was approved a further grant in aid of Esc 1,6 billion (ECU 8,8 million) for a second project which turned out to have been wildly optimistic and which has since failed with the possibility of the loss of the entire Community aid (paragraph 9.2.11).

The present report was adopted by the Court of Auditors in Luxembourg at its meeting of 12 October 1995.

For the Court of Auditors
André J. MIDDELHOEK
President

TABLE 1
DISBURSEMENTS BY THE COMMISSION UNDER PEDAP
as at 31 December 1994

Year	Million ECU	Nature	Million ECU
1987	23,1	1987 advance	23,1
1988	50,6	1987 balance	9,2
		1988 advance	41,4
1989	65,8	1988 balance	5,4
		1989 advance	60,4
1990	95,2	1989 balance	14,1
		1990 advance	81,1
1991	165,8	1990 balance	4,5
		First 1991 advance	77,8
		1992 advance	80,0
		Indeterminate ⁽¹⁾	3,5
1992	75,2	1991 balance	5,0
		First 1993 advance	60,4
		Indeterminate ⁽¹⁾	9,8
1993	43,9	1992 balance	-1,3
		Indeterminate ⁽¹⁾	18,8
		Second 1993 advance	26,4
1994	18,4	1993 balance	8,8
		Indeterminate ⁽¹⁾	9,6
Total at the end of 1994	538,0		538,0
1995 and 1996	101,1	Forecasts ⁽²⁾	
Total at the end of 1996	639,1		

⁽¹⁾ Concerns the two OPs: these payments are not related to any particular financial year in Portugal.

⁽²⁾ Payments relating to the Azores and Madeira OPs will be added to this amount.

TABLE 2
OVERVIEW OF RESULTS OF THE PRINCIPAL PEDAP SUB-PROGRAMMES

A. Sub-programmes which achieved a high rate of coverage of needs or objectives

1. *Animal health protection groups*: coverage close to 100% of needs for sanitary protection. However, relatively long-term programme with on-going requirements in view of difficulties in achieving eradication of most persistent animal diseases.
2. *Production of seed plants*: high rate of achievement in respect of forest and olive saplings but failure to achieve substantial progress for seed potatoes, fruit trees and vine plants.

3. *Training centres*: increase in number of training centres from six to 46 which appears to be adequate for requirements. However, the use of these centres for the purposes intended is frequently less than satisfactory.
 4. *Traditional irrigation systems*: covered approximately 39 000 ha representing close to 90 % of objectives set (overall level of needs not quantified).
 5. *Rural routes*: 2 900 km completed representing some 70 % of objectives set (overall level of needs not quantified).
- B. Sub-programmes which achieve low or marginal rates of coverage of needs or objectives
1. *Professional agricultural school*: only seven schools created (as provided in the first phase) of the 21 foreseen (for the two phases), notwithstanding the high perceived need for such schools.
 2. *Seed for cereals and animal feed products*: although the objectives set in the sub-programme were practically achieved (60 000 tonnes) this only covers some 30 % of overall requirements.
 3. *Forestry sub-programme*: 384 000 ha covered by the sub-programme measures, representing approximately 48 % of the objectives set and some 13 % of national afforestation surface.
 4. *Olive oil cultivation*: notwithstanding the importance of this cultivation the measures provided for covered only 43 % of area used for this purpose with the measures for improvement of production covering only 4 % of utilized agricultural surface and that for grubbing-up representing 9 %.
 5. *Rural electrification*: only 3 % of potential beneficiaries grant-aided under individual sub-programmes although it must be recognized that overall needs were substantially in excess of PEDAP programme potential.
 6. *PROAGRI sub-programme — strengthening of producer organizations*: only 10 % of eligible organizations participated in this critically important programme.
 7. *NOVAGRI — support for restructuring and innovation measures*: covered 2 661 projects involving 16 201 ha which represents only 0,4 % of utilized agricultural surface.
 8. *Sub-programme for drainage and conservation of soil*: only four projects approved which, although covering 16 810 ha represented only 0,4 % of utilizable agricultural land.
 9. *Sub-programme for bananas in Madeira*: notwithstanding the importance of banana production in this mono-cultural area the sub-programme covered only 0,8 % of utilizable agricultural land for banana production with only 1,4 % of producers benefiting from the measures.

SUMMARY OF ABBREVIATIONS USED

IEADR	Instituto de Estruturas Agrárias e Desenvolvimento Rural
IFADAP	Instituto Financeiro de Apoio ao Desenvolvimento da Agricultura e Pescas
IMAIAA	Instituto dos Mercados Agrícolas e Indústria Agro-Alimentar
OP	Operational Programme
PEDAP	Programa Específico de Desenvolvimento da Agricultura Portuguesa
RDA	Regional Directorate of Agriculture
IROMA	Instituto Regulador e Orientador dos Mercados Agrícolas

ANNEX I

EAGGF-Guidance expenditure (agricultural sector) in Portugal for the period 1988/1993 (commitments)

(million ECU)

Regulation	Measures	1988	1989	1990	1991	1992	1993	Total	%
R.1035/72	<i>Producers' organization:</i> Fruit and vegetables	0,0	0,0	0,0	0,0	0,0	0,1	0,1	0,0
R.2239/86	<i>Wine-growing sector:</i> Portugal programme	1,2	11,8	0,2	1,7	2,1	0,5	17,4	1,2
R.355/77	<i>Marketing and processing:</i> Projects	28,3	36,7	29,0	0,0	0,0	0,0	94,0	6,5
R.866-7/90	Objective 5(a) operational programmes	0,0	0,0	2,1	29,3	40,8	63,8	136,0	9,3
		28,3	36,7	31,1	29,3	40,8	63,8	230,0	15,8
R.797/85 and R.2328/91	<i>Effectiveness of structures:</i> Investments	12,8	22,0	32,3	32,7	40,8	46,9	187,5	12,9
	Young farmers	5,0	8,7	11,2	10,9	13,9	17,2	67,0	4,6
	Compensatory allowances	19,4	24,6	35,2	28,5	51,9	16,4	176,0	12,1
	Others	0,0	1,6	4,9	3,7	3,5	3,6	17,3	1,2
R.503/89	Emergency aid	0,0	0,0	18,5	1,5	0,0	0,0	20,0	1,4
		37,2	56,9	102,1	77,3	110,1	84,1	467,8	32,1
R.3828/85	PEDAP	50,6	65,8	95,2	162,4	65,4	25,1	464,5	31,9
R.4256/88	Objective 1 operational programmes	0,0	0,0	12,1	22,7	55,7	138,4	228,9	15,7
R.797/85	Pilot projects	0,8	0,0	0,8	2,7	2,5	2,1	9,0	0,6
R.4256/88-8	<i>Community initiatives:</i>	0,0	0,0	0,0	0,0	0,0	0,0	0,0	
	ENVIREG	0,0	0,0	0,0	0,1	0,0	0,0	0,1	0,0
	INTERREG	0,0	0,0	0,0	0,9	0,0	0,0	0,9	0,1
	POSEIMA	0,0	0,0	0,0	0,0	7,2	9,0	16,2	1,1
	LEADER	0,0	0,0	0,0	16,4	5,8	0,0	22,2	1,5
		0,0	0,0	0,0	17,4	13,0	9,0	39,4	2,7
	Total	118,1	171,2	241,5	313,5	289,6	323,1	1 457,1	100,0

Source: DGVI-G5.

ANNEX II

Exchange rates (Escudos/ECU) for the period 1988 to 1993

Year	Rate at beginning of year	Average rate for year
1988	169,342	169,896
1989	171,600	173,221
1990	179,103	181,001
1991	182,569	178,825
1992	180,645	175,047
1993	176,580	187,525
Simple average rate (1988-1993)		178,710

ANNEX III

Details of community-aid projects for the establishment of a national abattoir network

	No of projects	Amount of Community aid (million ECU)
Pre-accessions aid	5	12,2
Regulation (EEC) No 355/77	21	24,0
Regulation (EEC) No 866/90	2	3,4
Operational programmes	3	2,5
Total	31	42,1

ANNEX IV

Compensatory allowances

Number of beneficiaries, number of livestock units and area units submitted to aid compared to total amounts paid per year

Year	No of beneficiaries	Animals (LU)	Amounts (million Esc)	No of beneficiaries	Surface (ha)	Amounts (million Esc)	Total (million Esc)
1988	130 357	555 825	5 401,2	82 359	433 327	1 369,0	6 770,2
1989	89 897	452 218	4 521,9	77 173	231 538	1 329,5	5 851,4
1990	102 618	522 949	5 301,3	86 790	325 619	1 874,9	7 176,2
1991	105 125	565 515	6 006,5	90 466	306 249	1 913,5	7 920,0
1992	110 174	608 706	6 565,7	97 897	360 268	2 375,6	8 941,3
1993	95 209	535 719	5 760,4	82 592	299 259	2 008,1	7 768,5

ANNEX V

Previous audits by the Court and results

1. During the period under review the Court has conducted four audit enquiries in Portugal in respect of EAGGF-Guidance Section expenditure, the results of which are summarized below.
2. The principal findings of the audit of the PEDAP programme during 1987 were that there was poor coordination of the sub-programmes, inadequate verification of operations by the national authorities and by the Commission and inadequate reporting by the national authorities to the Commission of the progress achieved in implementing the approved measures (See Annual Report 1988, paragraphs 7.36-7.63).
3. During 1990 an audit of the implementation of Council Regulation (EEC) No 797/85 covered the payment of compensatory allowances in six Member States. In Portugal the regions of Entre Douro e Minho, the Azores and Trás-os-Montes were visited. The principal results of the audit with respect to Portugal (see Annual Report 1990, Chapter 9) were:
 - (a) very low levels of on-the-spot inspections of claims (9.25b);
 - (b) difficulties in reconciling the official statistics of animal numbers (the principal basis for paying the aid) with those claimed for (substantially higher) in the region of Entre Douro e Minho (9.26);
 - (c) inadequacy (i.e. out of date) or non-existence of registers for cattle and lack of a land register in the Northern regions and the Islands meant that declarations of claimants were largely accepted on trust (9.27 and 9.28).
4. During 1991 the Court audited the implementation of Council Regulation (EEC) No 2239/86⁽¹⁾, providing for a common measure to improve wine growing structures in Portugal (see Annual Report 1991, Chapter 11). The principal findings were:
 - (a) although the system of control provided for an on-the-spot check before and after each grubbing-up and replanting operation, a certain number of anomalies detected for the operations checked confirm the need for a comprehensive system for the permanent identification of vineyards;
 - (b) even though the need to restructure wine-growing areas, in the form of reparcelling of holdings was given particular emphasis in the restructuring programme submitted by Portugal, almost all of the subsidized operations took the form of individual replanting operations without reparcelling actions.
5. During 1992 the principal audit observations arising from a general financial audit were:
 - (a) the internal audit service of IFADAP was understaffed and relied on staff of the normal administrative services to carry out controls on its behalf, a procedure which significantly diminished the independence and effectiveness of these controls;
 - (b) certain difficulties were encountered in reconciling the expenditure figures for the Islands with the returns made to the Commission; the fact that the Island's systems were not computerized may have contributed to the lack of transparency in the system;
 - (c) expenditure for OP's was very low due to the difficulties encountered in commencing those programmes and there was very little evidence, at that time, of Monitoring Committee supervision.

⁽¹⁾ OJ No L 196, 18. 7. 1986, p. 1.

ANNEX VI

Operational programmes (Objective 1) adopted for Portugal between 1988 and 1993

No	Title	Total commitments — EAGGF aid (million ECU)
90.PT.06.001	Bad weather	21,7
90.PT.16.002	Sotavento Algarvio	0,2
90.PT.16.003	Alto Minho	0,5
90.PT.16.004	Trás-os-Montes e Alto Douro	0,6
90.PT.16.007	Area metropolitana do Porto	0,4
90.PT.16.009	Vale do Tejo	0,7
90.PT.16.010	Oeste	0,1
90.PT.16.013	Norte	0,5
90.PT.16.014	Barlavento Algarvio	0,1
90.PT.16.017	Entre Mira e Guadiana	0,7
90.PT.16.018	Raia Central	0,3
90.PT.16.019	Pinhal Interior	0,2
90.PT.16.020	Centro	0,7
91.PT.06.015	Pasturage and stock-breeding	10,1
91.PT.06.016	Forestry programme	38,2
91.PT.06.017	Rural development	14,6
91.PT.06.019	Land redistribution/early retirement	11,1
91.PT.06.020	Restructuring of vineyards	27,4
92.PT.06.021	Investment in farms	9,7
92.PT.06.022	Protection of environment/animal welfare	6,8
92.PT.06.018	Drought	80,1
92.PT.06.023	Restructuring vineyards	2,7
93.PT.06.018	Ren. transform. marketing	1,2
		228,6

Source: DGVI-G5.

ANNEX VII

Land reform

Average cost in million Escudos/ha

Commune	Number of ha	Estimated cost (million Escudos)	Average cost/ha
Basto/Cerva	1 000	1 027	1,03
Fontão e Bertandos	782	909	1,16
Correlha, Vitorino das Donas	1 650	1 423	0,86

REPLY OF THE COMMISSION

PART I

THE SPECIFIC PROGRAMME FOR THE DEVELOPMENT OF AGRICULTURE IN PORTUGAL

CHAPTER 1

INTRODUCTION

1.3. The PEDAP was adopted in circumstances very different from those which now prevail. EAGGF Guidance actions were subject to a limited multiannual financial envelope and each framework programme was decided by the Council. Faced with the need for major structural assistance, Portugal obtained guarantees on the broad conditions and financing of such an action by means of Protocol 24 of the accession Treaty.

Since 1988, guarantees of an equivalent nature have been given to Objective 1 countries and regions, including Portugal, by means of the financial provisions of Regulation (EEC) No 2052/88. In the 1989-1993 programming period the financial assistance available to Portugal for measures of the type available under the PEDAP already exceeded substantially the annual amount foreseen in Protocol 24 (ECU 130 million on average as against ECU 70 million). However, the transitional provisions in the reform legislation allowed Portugal to continue with the PEDAP legal base and thus to maintain the identity of this politically important programme within the agricultural part of the 1989-1999 CSF.

The further increase in financial resources for the 1994-1999 programming period made it even less necessary to maintain this distinction after 1993. The Portuguese authorities were thus able to accept that this distinction be abandoned in the 1994-1999 CSF, enabling a clearer and more rational presentation of the agricultural and rural development measures to be made.

It follows from the above that any specific analysis of the extent to which the PEDAP financial allocation was used after 1988 is of relatively little significance.

CHAPTER 2

IMPLEMENTATION OF THE PROGRAMME

2.2. The PEDAP was initially managed by the Ministry of Agriculture, in particular by the Directorate-General for Planning and Agriculture. In 1993, as the result of a reorganization of the Ministry, the Directorate-General became the IEADR (Instituto de Estruturas Agrárias e Desenvolvimento Rural). Although the Institute has some

autonomy, it is still subordinate to the Ministry of Agriculture.

2.3. See reply to point 1.3.

2.4. See reply to point 1.3.

For 1991, the financing plan for the CSF relating to the EAGGF-Guidance Section was indexed as follows:

(million ECU)

Year	1989 price	1991 indexed
1989	175	175,0
1990	245	254,8
1991	225	243,8
1992	240	260,1
1993	288	312,1
Total	1 173	1 245,8

The CSF Monitoring Committee decided on 26 November 1991 to allocate that amount to the EAGGF-Guidance Section sub-priorities as follows:

(million ECU)

Priority 4	CSF amounts	1991 indexed	Requirements	Readjustment
PEDAP	452,50	470,82	470,82	
Wine sector structures	60,00	62,20	51,03	(11,17)
Rural development	46,00	49,70	78,30	28,62
5(a)	609,50	657,80	640,35	(17,45)
Priority 6	5,30	5,30	5,30	
Total	1 173,00	1 245,80	1 245,80	

2.6. In the Commission's opinion, the procedure and the form of adoption of the programmes presented

under Regulation (EEC) No 3828/85 (PEDAP) are in accordance with the provisions of the reform of the Structural Funds, taking particular account of Regulation (EEC) No 4253/88. For that reason, approval in the form of an Operational Programme of those two PEDAP programmes (second phase of the forestry sub-programme and the agro-pastoral sub-programme for the Azores) followed the procedures in force following the reform of the Structural Funds.

2.7. The events described by the Court of Auditors had no significant effect on project approvals. The first phase concerned projects approved up to the end of 1989 whereas those approved from 1990 onwards were eligible under the operational programme for the second phase.

The first phase decision, in accordance with the old procedures under Regulation (EEC) No 3828/85, was a decision attesting to the conformity of the measures with the Regulation. It was not a decision to grant aid and the financial estimates presented to the STAR Committee (ECU 41 million) concerned only the amounts payable up to the end of 1989. The 'additional' ECU 51 million concerned subsequent payments on projects authorized by Portugal during the first phase. No amendment to the original decision nor consultation of the STAR Committee was needed for these payments to benefit from the annual advance and reimbursement decisions taken by the Commission under these old procedures. However, a consolidated financial situation of the PEDAP specific programmes was presented to the Committee in 1994.

The adjustments between the different components of the 1989-1993 CSF were small compared to the overall volume of expenditure and taking into account the difficulties of accurately forecasting the uptake of aids by private investors. The situation described above results from the changes in financing methods introduced by the reform

2.8. The main consequences of the approval of the OPs or programmes under PEDAP concerned the procedures for financial implementation and payment of the Community assistance. There are in fact two different commitment and payment procedures, according to whether the programmes are specific (procedure under Regulation (EEC) No 3828/85) or operational (Fund reform procedure).

After examining those questions, and taking account of the Portuguese authorities' constant requests for maintenance of the Regulation (EEC) No 3828/85 procedure, the Commission decided in November 1991 that the rules implementing that Regulation would remain in force until 31 December 1993 and that the

PEDAP would only be generally adjusted to the new Structural Fund rules with effect from January 1994.

2.9. From 1994 onwards, the measures set out in the PEDAP have been implemented by application of the new Structural Fund rules.

Article 33 of Regulation (EEC) No 4253/88, as amended by Regulation (EEC) No 2082/93, states that measures already approved by the Commission or the Council before the entry into force of Regulation (EEC) No 4253/88 must be included in the new Community support frameworks. As a result, when the Regional Development Plan for 1994-99 was being prepared the Portuguese authorities provided for the PEDAP measures to be integrated into the regional programmes covering various types of assistance in the agricultural sector and whose form and procedure conformed with the new Structural Fund rules. The measures set out in the PEDAP will therefore be implemented under the Agriculture sub-programme for 1994-99 approved by the Commission on 4 March 1994 with the full agreement of the Portuguese authorities.

CHAPTER 3

MANAGEMENT OF THE PROGRAMME

3.1. The selection of projects

3.1.1. The Court is right to state that the documentation presented to the STAR Committee is not exhaustive. However, the programmes are presented to the Committee by the Commission and the Member State concerned, and if other Member States have questions these are answered. All the Member States therefore have the opportunity to ask for whatever information they require.

3.1.2. All the specific programmes approved by the Commission under the PEDAP respected the provisions of Regulation (EEC) No 3828/85, in particular Articles 2, 3 and 4. In conformity with the principle of subsidiarity, it is the Member State's duty to ensure the effective regional distribution of resources when projects are approved and implemented.

However, the Commission would like to point out that many of the measures are implemented by private investors whose uptake can be difficult to predict. More comprehensive evaluation would have further delayed implementation and would not necessarily have yielded a significantly better regional distribution.

3.2. Monitoring by the Portuguese authorities

3.2.4. In principle the Commission agrees with the Court on this point. However, it should be pointed out that such a situation is relatively less common in Portugal than in many other Member States.

3.2.7. The Commission takes a serious view of excessive payment delays with no proper justification. It will be asking the Portuguese authorities for an explanation on this point.

3.2.9. It should be pointed out that the payment request is based on a certification made by the programme manager who is an official of the Ministry of Agriculture. See also the reply to point 3.3.5.

3.2.10. It is noted that for the period 1989-1992 the Agriculture Ministry's Directorate-General for Audits (IGA) audited eight programmes, five Directorate-General of Agriculture programmes, six forestry administration programmes, five health protection group programmes and 109 PEDAP projects.

Moreover, the Inspectorate General of Finance (IGF) audited IFADAP, six regional services of the Directorate-General of Forestry, five of the Directorate-General of Agriculture, and four specific programmes which concerned 61% of public aid approved up to the end of 1991. Moreover the IGF has analysed 435 projects of which 143 were audited in detail.

3.3. Follow-up by the Commission

3.3.1. The desire for publicity is now covered by the second stage of the reform, with the publication of the annual report and other information sheets.

Publication of the decision approving Operational Programmes in the *Official Journal of the European Communities* is not obligatory and does not include details which would allow the content of the measures to be implemented to be determined.

Moreover, the CSFs and SPDs are discussed in the STAR Committee, in which all the Member States are represented and therefore kept informed of what is happening in other countries. The costs of publication in the *Official Journal* should also be borne in mind.

In addition, since the first phase of the PEDAP there has been a series of television programmes in Portugal which has guaranteed that the public there has received information on all the measures available under that Programme.

3.3.2. It is true that the Budgetary Authority has decided to group together the large number of

EAGGF-Guidance budget headings which existed previously. But this was desired as part of the new budget structure linked to the Structural Fund reform. On the other hand, it is also true that the Commission's accounting procedures include very detailed distinctions. Commitments and payments are broken down by Member State, Objective and measure.

3.3.3. According to the Portuguese authorities, an administrative decision to account for expenditure on a calendar year basis rather than on successive 12-month periods from the date of constitution of the groups led to expenditure in the sixth year after constitution being included for Community part-financing. The Commission agrees with the Court that this has led to undue expenditure and will ask the Portuguese authorities to make a corrected expenditure claim.

3.3.4. The Commission will ask the Portuguese authorities for specific information on the number of cases in which VAT was wrongly considered to be a legitimate expense and to what extent this occurred.

3.3.5. The Commission would like to point out that its payments to the Member State are made in compliance with Council Regulation (EEC) No 3828/85 and with Commission Decision No 87/340/EEC.

The first verification level is that of the managers who are officials of the regional offices of the Ministry of Agriculture (DRA). The documents providing evidence are examined by these officials and are kept at the regional offices. In other words, there is a verification by officials even if it would have been preferable for the IFADAP to examine them systematically so as to draw full benefit from a separation of functions.

With regard to the controls carried out by the Commission itself during 1988-93, it can confirm that it carried out five controls for the PEDAP. The report stipulated in the protocol was not done in 1991 because the 1988 reform laid down an overall system of follow-ups and reports. Under those circumstances, a separate report on the progress of part of the measures would have been a purely formal act.

CHAPTER 4

EVALUATION OF THE PROGRAMME

4.1. Delays in implementation

4.1.1. Here, the Court is touching on a problem of a general nature. To arrive at the best possible programmes it is necessary to examine and analyse them carefully. It is very often necessary to ask Member States several times for additional information. This generally means long delays. After this, translations must be done

and inter-departmental consultations are necessary (environment, competition, etc.) and, when the decisions have to be presented to the STAR Committee working papers need to be drawn up for transmission in advance to the Committee members. It is difficult to speed up these deadlines.

4.1.2. With regard to the start of an eligible period, as a general rule expenses paid under a specific programme after receipt by the Commission of that programme are eligible once the programme has been approved.

The time limit for eligibility of expenditure is fixed by Article 23 of Regulation (EEC) No 3828/85 and is 10 years from the date of Portugal's accession. However, that Regulation does not lay down a time limit for specific programmes, only that a provisional timetable must be presented.

With regard to the effect of delays at the start of the programme, the Commission would draw the Court's attention to the fact that the Act of Accession provided for annual average expenditure of about ECU 70 million. As the table in the reply to point 2.4 indicates, that amount was greatly exceeded during the period 1989-93, which indicates that a certain degree of catching-up has taken place despite the economic problems which Portuguese investors have had to face.

4.1.5. Although there are no specific programmes for land reform in the PEDAP, the Commission approved on 17 February 1992 under the 1989-93 CSF an Operational Programme for land reform and the cessation of activities.

4.2. Selection of operations to be financed

4.2.1. It is clear that the objectives of Regulation (EEC) No 3828/85 were much broader than the restructuring of landholdings or the reduction of income disparities within Portuguese agriculture. The development and modernization of Portuguese agriculture required investments on all classes of farms. Moreover farmers had to raise capital to fund their own contribution to the investments. The exclusion of large or professionally managed farms in particular would have greatly reduced the impact of the PEDAP in terms of its wider economic development objectives.

4.2.3. Expenditure linked to the operation of training centres is eligible under Title II of Regulation (EEC) No 3828/85.

With regard to health protection for livestock farming, Title III, Article 10, makes expenditure intended to help cover administration costs eligible.

In both cases current expenditure can be deemed to be intangible investment, as necessary for the future of Portuguese agriculture as capital investments.

4.3. The impact of other policies

Firstly, it is necessary to make a distinction between the specific measures contained in the PEDAP and other measures relating to implementation of the common agricultural policy which are horizontal measures obligatory throughout the Community.

Even though there may appear to be a certain contradiction between the financing of measures intended to increase productivity and therefore production as contained in the PEDAP, and the financing of other measures which restrict such production via the application of the reformed CAP, it should be recalled that the PEDAP was adopted in 1985 and its objective was to help eliminate the structural backwardness of Portuguese agriculture by comparison with the rest of the Community. The second reform of the CAP was implemented in 1992, one of its main objectives being to reduce or eliminate structural surpluses by means of a policy of direct payments to producers (aid per hectare or per head of livestock, etc.) instead of high and guaranteed intervention prices for unlimited quantities, as had been the case before (even though stabilizers had made their appearance in 1988).

The reason why the Portuguese agri-food deficit nevertheless continues to increase is the switch from a situation which was semi-autarchic or broadly protectionist to a gradual free-trade system. In addition, the population has seen its standard of living increase and, along with it, its range of agri-food needs.

4.3.5.

1. Firstly, it is useful to recall why the removal of the Portuguese accession mechanisms was envisaged (as also was the case with Spain). The reasons are as follows:

- (a) at the time of the completion of the single market for all Member States, the transitional accession mechanisms were (pursuant to the Act of Accession itself) abolished for most products (mainly industrial products). For such products, then, Spain and Portugal could be integrated into the single market without problem;
- (b) pursuant to the Act of Accession the transitional mechanisms continued to apply until 31 December 1995 only for a number of agricultural products; these mechanisms were managed on the basis of frontier checks;
- (c) maintaining those checks for the few products in question appeared even more disproportionate since, given the need to determine whether the products traded were indeed those subject to the transitional mechanisms as a result of the Act of Accession, this would necessarily have meant that all trade operations would have to be

checked and not merely trade in products subject to those mechanisms;

- (d) application of the majority of the above-mentioned mechanisms without border checks but on an *ex-post* basis (accounts checks or declarations by the enterprises) would have given rise to substantial frauds.

These practical reasons can be added to those of principle, which make the completion of the single market a priority. In the opinion of the Commission they fully justify the political choice made, that is, the abolition of all transitional mechanisms of accession, with the exception of the supplementary trade mechanisms which,

- because of their quantitative and non-financial nature, are less likely to be susceptible to fraud,
- were in any case restricted to a very small number of products and were designed to be applied without border checks.

- II. In making that choice the Council did not, however, abolish the basic guarantees afforded by the Act of Accession to the producers concerned.

Far from restricting itself to the measures introduced by Regulation (EEC) No 746/93, as quoted by the Court, it laid down for Portuguese producers a series of allowances offering more or less equivalent guarantees and a number of measures intended to guarantee their structural development.

They consisted of:

- (a) transitional and reducing aids for products for which prices in Portugal were higher than Community prices (i.e. cereals and rice ⁽¹⁾, milk powder ⁽²⁾).

Such aid is not laid down for olive oil simply because prices for that product in Portugal are below Community prices;

- (b) aids intended to make possible structural improvements; these have to allow the accession mechanisms to be abolished without risk.

Aids were not provided for to offset the abolition of the compensation mechanisms in the fruit and vegetables sector because the supplementary trade mechanism was maintained in this sector and this was considered sufficient to guarantee its protection.

⁽¹⁾ Regulation (EEC) No 738/93 which provides for aids of a particularly long duration (until the end of the 2002/03 marketing year) for cereals.

⁽²⁾ Regulation (EEC) No 739/93.

CHAPTER 5

CONCLUSION

5.2. While the Commission would not pretend that every action in the PEDAP was a complete success, the Court's conclusions do not appear well-founded. As regards effectiveness in reaching the targets, the indications in Table 2 only occasionally permit a judgment to be made (B1 to B3). In the cases under B1 and B2 it is clearly stated that the objectives were practically achieved though the Court judges this to be poor performance. Most of the negative judgments of the Court result from comparisons with possible alternative targets and not with those fixed in the programme.

In order to arrive at pertinent conclusions on such a wide range of measures, implemented in a variety of situations, it is necessary to carry out a much deeper analysis of the results of the 29 specific programmes.

The Commission intends shortly, within the framework of the current structural policy and given the actual period of implementation of the PEDAP, to launch an *ex-post* assessment study on the qualitative and quantitative impact of the programme. However, the Commission would like to point out that results of studies already exist on the impact of certain measures under a programme of studies financed by the PEDAP and intended to promote the effectiveness of its implementation.

5.3. It is clear that the more innovative measures are harder to set up and more likely to meet resistance from potential beneficiaries. Moreover, some of the recent developments in the CAP would have been difficult to predict in the first years after accession. In any case, traditional production patterns are linked to local agronomic conditions and are likely to remain the mainstay of Portuguese agriculture.

5.4. The opening-up of the Portuguese market has accentuated structural problems. The Commission shares the Court's view that inadequate attention to marketing remains an obstacle to the successful implementation of measures at the production level. Discussions will be held with the Portuguese authorities on the best way to address this problem. Land reform, on the other hand, is always a very slow process.

5.5.

- (i) The fact that the PEDAP measures have been incorporated into the new 1994-1999 programmes neither diminishes their effectiveness nor results in their premature termination.

- (ii) Agricultural measures in Portugal have benefited fully from the successive doublings of Structural Fund allocations. It is therefore wrong to speak of a reduction in funding. The range of measures contained in the PEDAP is similar to those introduced in the 1989-1993 programming period and continued in 1994-1999. It would have been inefficient and confusing to have maintained the distinction between them for purely formal reasons (see reply to point 1.3).
- (iii) See reply to point 5.3.

5.6. The Commission hopes that the Court is simply noting these circumstances and not taking positions against the measures introduced in order to control EAGGF spending and against the early achievement of the single market.

5.7. See reply to the points in question.

5.8. The Commission believes that investments in improved animal health and farmer training are just as valuable as those in bricks and mortar.

PART II

OTHER EAGGF-GUIDANCE SECTION MEASURES

CHAPTER 7

MEASURES PROVIDING AID FOR THE PROCESSING AND MARKETING OF AGRICULTURAL PRODUCTS

7.2. The Court's audit and findings

General

7.2.3.

(i) It would be unreasonable to oblige potential beneficiaries to furnish audited accounts for the sole purpose of possibly obtaining aid some years later. In general, enterprises are obliged to keep normal accounts which give an adequate basis for assessing the viability of the enterprise.

(ii) and (iv) The Court has found numerous examples of funding which has not produced the projected result. It justly points out that this is partly due to climatic and economic circumstances. However, it is clear that the finger is also being pointed at the *ex-ante* assessment of measures. The Commission believes that it is necessary to refine the respective responsibilities, in other words, its own and those of the national authorities. When Regulation (EEC) No 355/77 was implemented there was a sharing of responsibilities at the individual project level.

The 1988 reform, anticipating the application of the principle of subsidiarity, introduced the concept of the financing of programmes, rather than of projects, for the three Structural Funds. That reform was vital because the Commission is not in a position to assess individual measures systematically and in depth from its offices in Brussels.

Among the cases raised by the Court it appears that the assessment shortcomings mainly concern product marketing. The Commission therefore proposes to examine, in partnership with the Portuguese authorities, the practical opportunities for improving that aspect of project assessment.

(iii) It should be added that IFADAP also uses bank statements to certify the amounts debited.

(v) and (vi) On the basis of the Court's observation, the Commission must conclude that the IMAIAA has not exercised its duties and correctly checked the productivity aspect. The Commission will therefore examine the possibility of reducing or cancelling and recovering the aid in accordance with Article 24 of Regulation (EEC) No 4253/88.

(vii) The Portuguese authorities and the Commission are well aware of the difficulties noted by the Court with regard to the marketing of fruit and vegetables since the Portuguese market has been opened up to the rest of the Community. The implementation of Regulation (EEC) No 866/90, being an important instrument in improving distribution channels, cannot in itself solve the problem. The initiative of producer organizations plays an important role in this.

The programming of the implementation of Regulation (EEC) No 866/90 over the period 1994-99 takes account of the difficulties. The measure 'Processing and marketing of agricultural products' in the 'Agriculture' sub-programme, as regards the fruit and vegetables sector, gives priority to investments designed to improve the effectiveness of distribution channels, taking

account of the situation created by the recent entry of supermarkets into the market.

- (viii) In practice the date of receipt of a programme is not predictable. A physical control on-the-spot during the preceding six months would therefore have made no sense since the precise start-up date for eligibility would only be known later. For this reason the six-month retroactivity rule has now been dropped. As regards the separate question of a policy of systematic visits in order to better evaluate the projects before starting, the Commission is not convinced that this would necessarily be cost effective. Initial assessment of projects by Member States is normally based on a complete application file and on the opinion of officials with local knowledge. In most cases, if not all, this should be sufficient.

Evaluation of aid applications, financial information presented and profitability record

7.2.6. This project was not approved under Regulation (EEC) No 355/77 but was inserted into, examined and approved in Operational Programme 91.CT.PT.01 under Regulation (EEC) No 866/90, so the assessment of its viability must be updated at the responsibility of the Member State.

The information requested for the operational programmes did not contain the elements allowing the Commission to verify the financial problems mentioned. That verification, in accordance with point 3 of Annex V to Regulation (EEC) No 1935/90, falls within the competence of the national authorities, which undertook at the time the operational programme was submitted to examine the financial situation, that is, the balance sheet and accounts, of the beneficiary and to verify whether the investments offered an adequate guarantee as to their profitability.

As mentioned by the Court, from the time of presentation of the project to the present date no information has been submitted to the Commission which would call into question the viability of the investment.

7.2.7. See reply to point 7.2.3 (v) and (vi)

7.2.8. According to current practice, the Commission accepts the use of a limited quantity of raw material imported from third countries for the production of certain products or for certain requirements from time to time to maintain the financial viability of the investments (e.g. the use of installations during exceptional periods when they cannot be used for Community products).

The national authorities have to judge to what extent there has been a deviation from the objectives of the

project and also the extent and justification of the use of non-Community products.

Adequacy of marketing plans presented

7.2.10. The national and Community aid rates were proposed by the national authorities and became an integral part of the Community support framework approved by the Commission.

The Commission is concerned to ensure, above all in the Objective 1 regions, that public aid rates are sufficiently high to stimulate investment without being too high, which risks diminishing the commitment of private investors. The difficulties encountered by the beneficiary in obtaining the own portion of the financing confirm the Commission's concerns.

It is the Commission's belief that it is not possible to verify systematically that finance for the beneficiary's share is available before the project is approved, all the more so given that the possibility of obtaining bank loans often depends on the availability of Community and national funding.

In addition, the Portuguese authorities had until 31 December 1994 to replace that project and others whose beneficiaries had withdrawn, in the operational programmes. However, at a legal level it is unclear whether aid, once granted, can be withdrawn merely because of a reassessment of the viability of a project.

Within the forum of the Monitoring Committees the Commission will discuss in partnership with the Member States possibilities for improving the *ex-ante* evaluation of projects.

7.2.12. Guaranteeing outlets for finished products is always a problem for projects on improving the processing and marketing of agricultural products. In addition, given the increasing restrictions on the part-financing of investments in traditional products, the Commission encourages investments in new products, even though the development of their markets is unpredictable and the risks involved are therefore higher.

Moreover, projects normally take a considerable amount of time before they are terminated and the market situation can change dramatically between the planning and the marketing phases. This poses a risk, both for private capital and for Community and national funds.

Since kiwi fruit was a new product for the Community and given the considerable time-lag between planting and

marketing the fruit, the risk associated with such a project, albeit difficult to estimate, was higher than for other projects.

Adequacy of marketing plan and control of capacity limit in respect of a major project

7.2.13.

(i) The Commission was unaware of the fact that the IFADAP, at regional level, had given a negative opinion on the continuation of this project under Regulation (EEC) No 866/90, given that it is not involved in the final position of the IFADAP and that this was part of the IFADAP's internal procedures. The project involved a significant investment at regional level, which was the main reason for dividing it into two phases; it seems logical for the beneficiary to decide to implement the project on an integrated basis by waiting for approval of the second phase before commencing work.

(ii) The project financed under Regulation (EEC) No 355/77 justified the installation of a new slaughterhouse with the following reasons:

— the other slaughterhouses in the region did not possess the technical and hygienic conditions laid down in national rules resulting from the translation of Community Directives into national law;

— the beneficiary (Matadouro Central de Entre Douro e Minho), in which the majority stockholders are a public body (IROMA), the mayor and private promoters, gave the Commission assurances as to the closure of its six slaughterhouses in the region belonging to IROMA;

— closure of IROMA's six slaughterhouses (3 000 tonnes of pigmeat) and the total capacity to be abandoned by private slaughterhouses belonging to the promoters of the investment (19 000 tonnes) demonstrated that total slaughtering capacity in the region would not be increased and, as a result, the terms of the specific programme approved by the Commission had been met.

(iii) The guarantees given by the Portuguese authorities on the closure of small public slaughterhouses not conforming to hygiene standards and their replacement by new capacity along with the participation of operators of private slaughterhouses in the region, seemed to the Commission to provide a credible argument for the success of the initiative.

Several factors probably contributed to the lack of success of the initiative. It can be seen from an analysis of the Court's observations on this point

and on footnote 21 that the main problem suffered by the project was poor management owing to a conflict of interests between several operators in the sector.

(iv) The second project (Regulation (EEC) No 866/90) was presented as part of a strategy for the vertical integration of the meat sector in the region and seems a logical development of the first. Concentrating meat processing activities would help to improve distribution channels particularly with a view to supplying supermarkets.

In the case of the slaughterhouses whose closure was planned but which are still operational, responsibility must be borne by the Portuguese authorities, given that closure of the slaughterhouses was one of the basic factors in approving the project.

The Commission will therefore examine the possibility of reducing, or cancelling and recovering the aid in accordance with Article 24 of Regulation (EEC) No 4253/88.

7.2.14. The special situation of Matadouro Central de Entre Douro e Minho cannot be extended to the entire country. There has been a wide-ranging operation to close slaughterhouses, intended to rationalize the sector and bring it into line with health and hygiene standards. In 1984, 1 112 private slaughterhouses and 151 slaughterhouses with public capital existed; in 1993 the total was no more than 113 slaughterhouses and the trend to concentrate continues. Within a restructuring of such a magnitude it is not surprising that some enterprises will encounter difficulties.

7.2.17. It is now clear that Member States have complete responsibility for the choice of individual projects within the framework fixed by the sectoral plans, operational programmes and general selection criteria, as well as for their implementation.

CHAPTER 8

MEASURES FOR THE IMPROVEMENT OF AGRICULTURAL STRUCTURES

8.2. The Court's audit and findings

Investment aids and special allowances to young farmers

8.2.2.

(i) In principle it is possible to ask the beneficiary to provide proof that his income derives mainly from agriculture, and this could be his tax returns.

- (ii) On the basis of the Court's audit the Commission will examine the possibility of making a lump-sum deduction in accordance with Article 24 of Regulation (EEC) No 4253/88.

8.2.4.

- (i) Article 12 of Regulation (EEC) No 2328/91 provides for Member States to be able to introduce national aids in this field under certain conditions.

The late communication and the amendment of national rules create problems for the approval of these texts by the Commission within the time limits set by Regulation (EEC) No 2328/91. The Commission constantly reminds the Member States to restrict and consolidate the number of amendments to these rules.

- (v) The national legislation approved by the Commission only provided for the presentation of two projects for each six-year period, as required by Regulation (EEC) No 2328/91. Unless these are investment aids not satisfying the conditions of Article 5 of Regulation (EEC) No 2328/91, there is apparently an infringement, either of national or of Community law. The Commission will ask the Member State for clarification.
- (vi) The Commission agrees in principle that where possible different declarations should be cross-checked. It will therefore contact the Portuguese authorities in order to see if this would be practicable in cases of the type observed by the Court.
- (vii) The Commission will examine, together with the Portuguese authorities, the cases mentioned by the Court in order to see what improvements can be made in administrative practices.

The general condition of keeping simplified accounts for an investment aid is scarcely applicable since most holdings in Portugal are very small and only those with more than one man-work unit and investing more than ECU 25 000 have to keep them (Regulation (EEC) No 1137/88 of 29 March 1988). Even in the other cases it is not the primary requirement for the aid but one condition among many for its grant. Under such conditions a verification by sampling seems reasonable.

8.2.5. The plans for the improvement of the physical assets of holdings must demonstrate that the investments are justified from the point of view of the situation of the holding and of its finances and that their implementation will lead to a sustainable improvement in that situation (Article 5 (c)). Examination of that requirement is the

task of the Member States. It is clear that that demonstration must include aspects linked to outlets, particularly where there is an increase in production. It should be noted that Regulation (EEC) No 2328/91 does not contain any sectoral restrictions on investment aids in the fruit and vegetables sector.

8.2.6. The Commission will remain in contact with the Portuguese authorities concerning these cases.

8.2.7. This case will be checked with the Portuguese authorities. However there do exist situations where recovery of aid would not be appropriate. For example national aids are often payable to part-time farmers whereas the corresponding Community aid is not. If a farmer is obliged to seek other employment for financial reasons but continues as a part-time farmer, it is reasonable that the eligibility for EAGGF part-financing be withdrawn but that national aid remains available.

Compensatory allowances

8.2.9. It should be noted that 85,9% of the agricultural land is classed as less-favoured.

8.2.13. The Court's main recommendation concerning the control of the compensatory allowances, when it reviewed this scheme in its 1990 report, concerned the introduction of a unified system of verification, particularly as regards livestock. As promised at that time the Commission proposed and the Council has since adopted Regulation (EEC) No 3508/92 which provides for just such a system. Its implementation in Portugal is not yet satisfactory so the principal weakness noted by the Court at that time (inadequate verification of livestock numbers) has not yet been eliminated. The Commission will use all possible means to ensure the proper implementation of this measure.

CHAPTER 9

OPERATIONAL PROGRAMMES APPROVED UNDER OBJECTIVE 1 OF THE REFORM OF THE STRUCTURAL FUNDS

9.2. The Court's audit and findings

The Operational Programme for Land Reform and the Cessation of Agricultural Activity

9.2.3. Given the small size of agricultural plots, particularly in northern Portugal, it is not a surprise to

note plots of less than one hectare. Even after reparable measures it is not always possible in practice to arrive at better results.

The Operational Programme providing assistance to farmers affected by bad weather

9.2.8 to 9.2.11. The Commission is taking steps to recover the aids indicated in point 9.2.9 (i) and (ii). As regards the large investment referred to in point 9.2.11, the Commission has been in contact with the Portuguese authorities for some time but the case is difficult to settle while discussions and litigation continue among the various interested parties (banks, etc.). The Commission is insisting that all possible means be deployed to recover the assets and/or the Community aid.

The Operational Programme for Forestry Measures

9.2.12 to 9.2.16. The case discovered by the Portuguese authorities and on which the Court makes its observations is currently subject to legal proceedings and the Commission has asked the Member State to keep it informed. If necessary, recoveries will be effected.

CHAPTER 10

MANAGEMENT BY THE COMMISSION

10.4. The Commission considers that its evaluation procedures under Regulation (EEC) No 355/77 were satisfactory, taking into account the joint responsibility of the Member States. It is clear however that sharing responsibilities in this way was unsatisfactory. For this reason and accepting that individual project approval on this scale by a central authority in Brussels is no longer practicable, the Commission has sought to clarify its role in the implementation of Regulation (EEC) No 866/90 for the new programming period. Since 1994, the Commission approves programmes which contain no project details. However it has fixed general priorities and excluded categories of investments as well as approving the Member States sectoral and strategic priorities in the plans and programmes. It will continue to ensure that Member States properly implement the programmes by carrying out regular system audits with examination of a sample of projects.

10.5. The Commission confirms that the national implementing measures it approved for Portugal were in conformity with a Regulation (EEC) No 2328/91. It points out that the approval decisions also received a favourable opinion from the STAR Committee. The legal

arrangements referred to by the Court are no longer possible, since 1991.

10.6. For the period 1994-1999, the Commission has adopted stricter rules of procedure for the Monitoring Committees. Documents relating to programme monitoring which have to be analysed during Monitoring Committee meetings must be received by the Commission for examination three weeks before the date set for the Committee meeting.

If that deadline is not respected, the Committee meeting will be postponed to a later date and the Member State must explain the delay in sending the documents.

10.8. In the Commission's view the administrative separation between the various services of the Ministry of Agriculture (IEADR, IMAIAA, DRAs) on the one hand and IFADAP on the other is basically sound. In addition, the DINS service of IFADAP carries out spot checks and follow-up enquiries when information on potential problems comes to light. Since early 1994 a separate internal audit service has been set up in IFADAP though the Commission has no information on its activities to date. See also the reply to point 3.2.10.

10.9. The Commission began using the possibilities offered by that Article in February and March 1994, and intensified the process in March 1995. To that end it contacted all the Member States, first asking them to provide a list of checks carried out and the main conclusions drawn from the checks carried out in 1993, and later asking them to forward a description of the administration and inspection systems in force. Replies from the Member States were reasonably complete. Portugal's replies were not as complete as they ought to have been and the Commission therefore intends to contact the Portuguese authorities once more.

With regard to computerization, the Commission should point out that, after an examination, it has concluded a framework contract for the development of a data communications system by electronic data transmission between itself and the Member States relating to the execution of measures part-financed by the EAGGF Guidance Section.

In addition, only Spain is currently in a position to transmit data electronically to UCLAF on cases of irregularities on the basis of Regulation (EC) No 1681/94.

10.11. It is true that the Commission has received two communications from Portugal pursuant to Regulation (EC) No 1681/94.

However, prior to the entry into force of that Regulation the Portuguese authorities had also transmitted a large number of irregularities with minor financial

consequences (less than ECU 4 000 per case) relating to the application of Regulation (EEC) No 2328/91.

Both the Commission and the IFADAP felt the need to inform officials responsible for administering and controlling the funds in question in Portugal by organizing a seminar specifically concerning the Commission's anti-fraud policy on 14 and 15 June 1993.

CHAPTER 11

CONCLUSION

11.1. The Commission is very much aware of the Court's conclusions concerning Portugal's administrative and control procedures. If, in certain specific cases, financial corrections have to be undertaken, the Commission believes it must also study with Portugal to what extent adjustments to procedures and administrative practices need to be carried out.

11.2. The various rules and conditions attached to the part-financed aids available under Council Regulation (EEC) No 2328/91 reflect a choice of policy priorities applicable in all Member States. The means for their control must be adapted to the conditions of each Member State though it is clear that this will be more difficult in some Member States than in others.

11.7.

(ii) The Commission considers that its monitoring was sufficient and in any case no new approvals have been made under Regulation (EEC) No 355/77 since 1990. The revised procedures for the implementation of Regulation (EEC) No 866/90 place the responsibility for project evaluation and selection squarely on the Member States.

(iii) The Commission will examine with the Portuguese authorities the question of improving evaluation procedures.

(iv) Commission Regulation (EEC) No 860/94 requires Member States to provide extensive information on existing and planned capacities for the 1994-1999 programming period. The Commission is in no position to check that the conditions imposed on beneficiaries are respected except in the limited number of cases covered in its audits.

11.8. The Commission feels it only reasonable to point out that deficiencies in the public planning and implementation of structural improvements cannot alone explain the difficulties of the Portuguese distribution sector. It may be that ultimately only the loss of full protection will provide the stimulus needed to bring about structural change.

11.10. The legislative provisions needed to obtain the improvements required by the Court are already in place at Community level (reply to point 8.2.13). Now they must be put into effect on the ground.

SALES AND SUBSCRIPTION PRICES

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