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*(Information)***COURT OF AUDITORS****SPECIAL REPORT No 11/98****concerning the development of the PHARE and TACIS private sector for the 1991 to 1996 period****(Programmes in support of SMEs, regional development and the reorganisation of businesses) together with the Commission's replies***(submitted pursuant to Article 188 (4) (2) of the EC Treaty)*

(98/C 335/01)

Acronyms

AIDR	— Agency for Industrial Development and Revitalisation
BCC	— Business Communication Centre
EBRD	— European Bank for Reconstruction and Development
BSC	— Business Support Centre
Desiree	— Commission management database
DPS	— Development of the private sector
ESC	— Enterprise Support Centre
GKRP	— State SME Support Committee
LEA	— Local Enterprise Agency
MSDC	— Market Skills Development Centre
NIS	— Newly independent States
PARD	— Polish Agency for Regional Development
CCEE	— Countries of Central and Eastern Europe
RDA	— Regional Development Agency
RIC	— Regional Investment Company
RIF	— Regional Investment Fund
SES	— Subcontracting Exchange for Slovakia
SMEDA	— Small and Medium-sized Enterprise Development Agency
SSTA	— State Sport and Tourism Administration
Struder	— Structural development for selected regions
EU	— European Union
PMU	— Programme management unit

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1. INTRODUCTION

The objectives of the PHARE and TACIS programmes

1.1. Support for the restructuring of the economies of the countries of Central and Eastern Europe and the newly independent States (NIS) was included from the outset in the Regulation governing the PHARE and TACIS programmes ⁽¹⁾. This aid comprises various sectoral components, one of the most important of which is the development of the private sector. As from 1994, a distinction was established between the strategies pursued by PHARE and TACIS, as a result of which PHARE countries aiming to join the EU received, for example, more sustained aid in the regional development sector.

The political context

The PHARE programme

1.2. Since the Copenhagen European Council meeting of June 1993, relations between the European Union and the PHARE countries ⁽²⁾ have been conducted with a view to their accession. The Essen and Madrid European Council meetings (December 1994 and December 1995 respectively) subsequently stressed PHARE's key role as a financial instrument in the 'pre-accession strategy', while association agreements, known as 'Europe agreements', were signed between the European Union and most of the Central and East European countries. A structured dialogue was established at the Head of State ⁽³⁾ and ministerial levels and, in May 1995, the Commission published a White Paper on the preparedness of the associated States of Central and Eastern Europe for inclusion in the Union's single market. Under Agenda 2000 (15 July 1997), the PHARE programme remains the main instrument for preparing these States for membership, but with an emphasis on two major areas: institutional support (30 % of resources) and the financing of investment (70 % of resources) ⁽⁴⁾.

1.3. The central role of the development of the private sector in the PHARE programme has been emphasised several times ⁽⁵⁾. This is reflected in its share of the budget: ECU 999 million ⁽⁶⁾ for 1991 to 1997, or 14 % of the total PHARE budget for that period (see *Table 1*).

⁽¹⁾ Council Regulation (EEC) No 3906/89 of 18 December 1989 (OJ L 375, 23.12.1989), as last amended by Council Regulation (EC) No 753/96 of 22 April 1996 (OJ L 103, 26.4.1996. Council Regulation (EEC) No 2053/93 of 19 July 1993 (OJ L 187, 29.7.1993); Council Regulation (EC) No 1279/96 of 25 June 1996 (OJ L 165, 4.7.1996).

⁽²⁾ Albania, Bosnia Herzegovina, Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia, the Czech Republic and the FYRM.

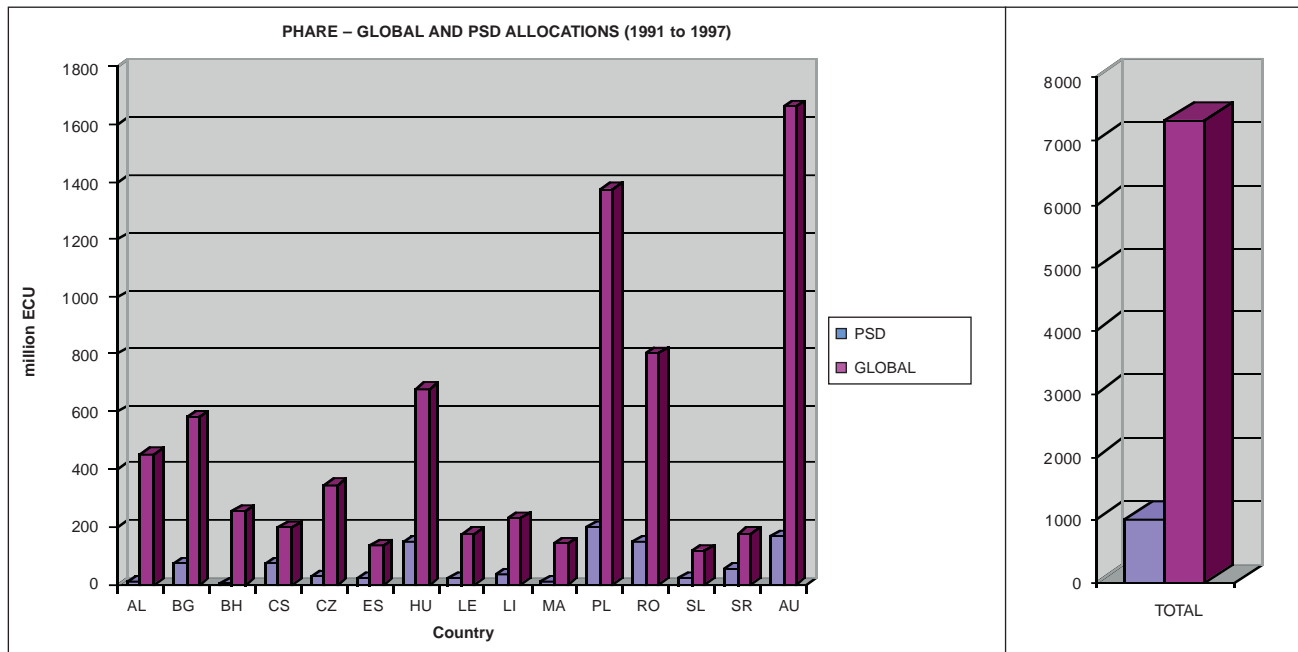
⁽³⁾ European Councils of Cannes and Madrid in June and December 1995 respectively.

⁽⁴⁾ The entry into force of the accession partnerships in March 1998 formalised these new tendencies.

⁽⁵⁾ In particular, the Commission's report on the implementation of the PHARE programme in 1992 to 1993 (20 February 1995), Commission communication to the Council and the European Parliament concerning industrial cooperation with the Countries of Central and Eastern Europe (14 March 1995) and the Commission's report on the implementation of the PHARE programme in 1994 (20 July 1995).

⁽⁶⁾ *Source*: Desiree database.

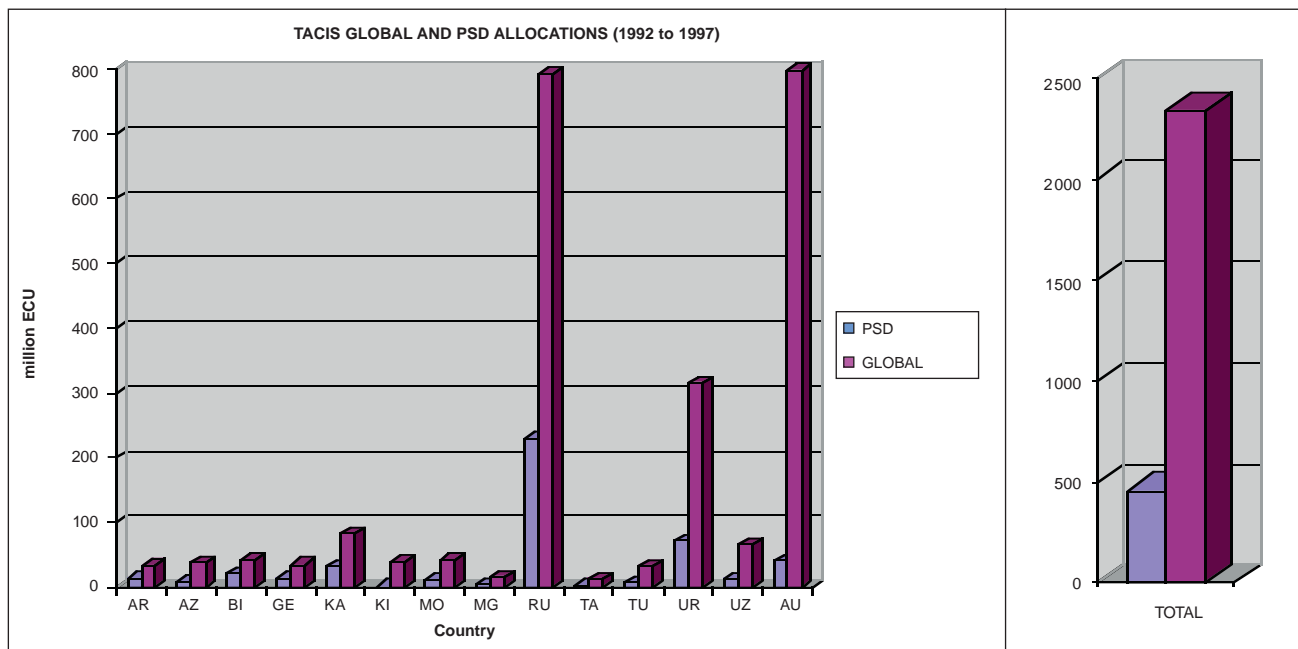
TABLE 1



PHARE PROGRAMMES FOR 1991 to 1997 GLOBAL AND PRIVATE SECTOR DEVELOPMENT ALLOCATIONS BY COUNTRY

million ECU

	ALBANIA (AL)		BULGARIA (BG)		BOSNIA-HERZEGOVINA (BH)		EX-CZECHOSLOVAKIA (CS)		CZECH REPUBLIC (CZ)		ESTONIA (ES)		HUNGARY (HU)		LATVIA (LE)	
PSD ALLOC.	7,00	2%	72,50	12%	3,00	1%	70,00	35%	28,00	8%	21,10	16%	148,50	22%	20,98	12%
TOTAL ALLOC.	453,90	100%	580,50	100%	251,81	100%	199,00	100%	344,00	100%	134,60	100%	680,04	100%	174,60	100%
	LITHUANIA (LI)		FYROM (MA)		POLAND (PL)		ROMANIA (RO)		SLOVENIA (SL)		SLOVAKIA (SR)		OTHERS (AU)			
PSD ALLOC.	35,70	16%	8,80	6%	196,20	14%	147,40	18%	21,05	18%	54,20	31%	164,50	10%	998,93	14%
TOTAL ALLOC.	229,30	100%	143,00	100%	1372,35	100%	804,21	100%	116,00	100%	173,50	100%	1659,39	100%	7316,19	100%



TACIS PROGRAMMES FOR 1992 to 1997 GLOBAL (NATIONAL PROGRAMMES) AND PRIVATE SECTOR DEVELOPMENT: ALLOCATIONS BY COUNTRY

million ECU

	ARMENIA (AR)		AZERBAIJAN (AZ)		BELARUS (BI)		GEORGIA (GE)		KAZAKHSTAN (KA)		KYRGYSTAN (KI)		MOLDOVA (MO)		MONGOLIA (MG)	
PSD ALLOC.	13,54	41%	8,00	21%	19,82	46%	13,65	40%	32,32	39%	0,82	2%	9,31	23%	3,96	27%
TOTAL ALLOC.	33,20	100%	37,47	100%	42,63	100%	34,42	100%	82,60	100%	37,93	100%	41,10	100%	14,60	100%
	RUSSIA (RU)		TAJIKISTAN (TA)		TURKMENISTAN (TU)		UKRAINE (UR)		UZBEKISTAN (UZ)		OTHERS (AU)		TOTAL			
PSD ALLOC.	228,06	29%	1,30	12%	6,10	20%	70,94	23%	12,36	19%	39,53	5%	459,70	20%		
TOTAL ALLOC.	792,63	100%	11,23	100%	31,20	100%	314,13	100%	65,78	100%	797,63	100%	2336,55	100%		

Source: Desiree data base

The TACIS programme

1.4. Relations between the countries of the former Soviet Union and the European Union ⁽⁷⁾ have been consolidated through Partnership and Cooperation Agreements. These agreements define political, commercial, economic and cultural cooperation between the European Union and the NIS. The restructuring and development of companies remain key objectives of the TACIS programme. Between 1992 and 1997, commitments in these areas amounted to ECU 459,7 million ⁽⁸⁾, or 20 % of the total TACIS budget for the period (see *Table 1*).

The development of the private sector

1.5. Basically, the notion of support for the private sector takes the following forms:

- (a) the privatisation of State-owned companies ⁽⁹⁾;
- (b) aid for the restructuring of companies;
- (c) the promotion of foreign investment;
- (d) aid for the SME sector (directly or via regional development).

1.6. Originally, support programmes for the development of the private sector were managed independently of the measures in support of regional development. With effect from 1992, in certain PHARE countries where the Commission wished to encourage the implementation of regional development policies, there were cases, particularly in Poland and Hungary, where SME support programmes overlapped with certain components of the regional development programmes.

2. THE AUDIT FIELD AND OBJECTIVES

Audit field

2.1. The audit concerned programmes in support of SMEs and aid for regional development and the restructuring of companies. Operations involving the promotion of foreign investment and privatisation were not included in the audit because they concern preparations for the transfer of ownership rather than relaunching the activities of companies as such.

2.2. In all the countries SMEs play a central role in the process of economic reform. Their level of development differs according to the country concerned. The Commission has not laid down strict criteria to define which companies may be eligible for PHARE or TACIS SME aid, as it did for SME aid within the EU ⁽¹⁰⁾.

2.3. Aid for SMEs and regional development comprises non-financial aid (advice regarding policy formulation, institutional support, the creation of SME support agencies, training and information) and, in the case of PHARE, financial aid (financial instruments in support of SMEs and minor infrastructures).

2.4. PHARE and TACIS business restructuring support consists of two parts. On the one hand, there is in-depth support for a given sector, company or group of companies: technical assistants make diagnoses in respect of the companies, draw up recommendations and implement them. On the other hand, certain services, similar to those offered by the SME support agencies, are offered on demand (financial instruments, advice, *ad hoc* aid, training, information) and supplied by programme management units or specialised agencies.

⁽⁷⁾ Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Russia, Tajikistan, Turkmenistan, the Ukraine and Uzbekistan.

⁽⁸⁾ *Source*: Annual TACIS report 1996.

⁽⁹⁾ Adaptation of the legal framework, launching of privatisation measures in accordance with different techniques, the transfer of property, etc.

⁽¹⁰⁾ See paragraph 6.47 of the Court's Annual Report concerning the 1996 financial year, concerning the Commission's recommendation of 3 April 1996 on the definition of SMEs (OJ C 348, 18.11.1997).

The objectives and scope of the audit

2.5. The audit concerned the regularity of the use of the funds supplied and the soundness of the financial management of operations conducted on behalf of the private sector in the PHARE and TACIS countries over the 1991 to 1996 period. In particular, an assessment was also made of the extent to which Commission programmes had contributed to establishing viable companies.

2.6. These findings are based on audit visits carried out in 1996 and 1997 in Bulgaria, Hungary, Poland and Slovakia, in the case of PHARE, and in Uzbekistan, Turkmenistan and Russia in the case of TACIS, as well as visits to the Commission's headquarters (see *Table 2*).

TABLE 2
Budget and projects audited

	BG	HU (1)	PL (1)	SK	RU	TM	UZ	Total
SME — Regional development								
Number of projects	12	9	13	7	7	1	2	51
Amount (million ECU) (a)	17,28	55,60	88,80	23,80	14,30	0,90	3,20	203,88
Restructuring of businesses								
Number of projects	11	8	18	15	7	1	2	62
Amount (million ECU) (b)	24,80	14,40	23,80	25,60	33,70	0,95	4,40	127,65
Total amount (a+b)	42,08	70,00	112,60	49,40	48,00	1,85	7,60	331,53
Total private sector budget	72,50	174,50	217,50	54,20	228,06	6,10	12,36	765,22
% audited	58 %	40 %	52 %	91 %	21 %	30 %	61 %	43 %

BG = Bulgaria
RU = Russia

HU = Hungary
TM = Turkmenistan

PL = Poland
UZ = Uzbekistan

SK = Slovakia

(1): Data 1990 to 1997 (31 December 1997).

Source: Desiree database.

2.7. These countries were selected either on the basis of the volume of appropriations that they had been allocated (Poland, Hungary and Russia) or because of the particular difficulties that were being experienced in a given sector (Bulgaria and Slovakia). In the case of Uzbekistan and Turkmenistan, support for the development of the private sector was examined in the context of broader enquiries.

3. SUMMARY OF THE MAIN OBSERVATIONS

The preparation and management of the programmes

3.1. The observations formulated in this report refer to the first wave of PHARE and TACIS programmes, a large number of which were still being implemented at the end of 1997. When appraising these programmes, account must therefore be taken of the particularly uncertain context that prevailed at the time and the lack of previous experience that could serve as a reference point. Thus, the results varied from one country to another. The effects of support for SMEs and regional development may be considered positive in all the countries visited except Bulgaria. For Slovakia, the work carried out to assist regional development was not very conclusive. In the field of support for the reorganisation of businesses, for all the countries, most of the projects provided for interventions in three stages: diagnosis, recommendations and implementation of the recommendations. Things rarely went beyond the first two stages. The fact is that local resistance and the funds needed to carry out the planned changes turned out to be greater than expected.

3.2. On various occasions, the project specifications prepared by the technical assistants (consultants) responsible for the implementation of the projects turned out to be unrealistic when they came to be put into effect. This caused delays and disruptions in the programme schedules, so that projects where the expected results depended on the success of previous projects were started without the necessary results being available. This raises two questions: that of the quality of the project specifications and that of the haste that prevailed when they were being drawn up (see paragraphs 4.1-4.9).

3.3. By emphasising the mobilisation of resources rather than the achievement of results, the contracts did not encourage a sense of responsibility on the part of the technical assistants. Thus, it was possible for them to carry out a series of tasks, even inconsistent and ill-adjusted ones, without having to draw any consequences from actions in relation to the expected results (see paragraph 4.16).

3.4. The implementation of certain programmes suffered from too many interruptions (political changes, staff turnover at the Commission), whereas other programmes that had clearly lost any sense of direction were being carried on by force of inertia (fear of administrative procedures, refusal to disturb budgetary implementation) which prevented them from being abandoned or redirected (see paragraphs 4.12-4.15).

3.5. With regard to the national programmes, inadequate exchanges of information between the PHARE and TACIS departments reduces the efficiency of the management of the programmes in support of the development of the private sector. The Commission's approach encourages neither the sharing of experiences concerning comparable instruments nor the evaluation of the quality of the experts, or their results (see paragraphs 4.17-4.20).

The efficiency of the implementation procedures

3.6. On several occasions, the efficiency of the instruments adopted for the development of the private sector was adversely affected by:

- (a) poor operational rules (see paragraphs 5.2-5.3);
- (b) an inappropriate choice of instruments in relation to the local context (see paragraphs 5.4-5.7);
- (c) competition between different instruments applied in the same region (see paragraphs 5.8-5.9);
- (d) excessively complex financial instruments (see paragraph 5.10);
- (e) insufficient financial resources in relation to the problems to be solved (see paragraphs 4.6 and 5.11).

3.7. Whilst the services provided by the technical assistance teams in most cases complied with project specifications, several failures showed that some of the technical assistants in charge of projects had adopted an excessively passive attitude towards the problems encountered (see paragraphs 5.12-5.16). However, the difficulties noted in respect of coordination and cooperation between participants were essentially the result of bad planning or the absence of a coherent political strategy (see paragraphs 5.17-5.22).

Assessment of the measures implemented

3.8. It continues to be difficult to measure the tangible effects of measures in support of the development of the private sector. The absence of reliable indicators and the lack of summary reports on activities make it impossible to obtain an overall picture of the impact that the programmes have (see paragraphs 6.1-6.3). With regard to the degree of implementation of the measures, the assessments are contradictory and vary from one country to another (see paragraphs 6.20-6.34).

3.9. In most of the countries, the national budgets made it difficult for PHARE or TACIS aid to be co-financed and then replaced by national funds. Furthermore, the possibilities for obtaining funding from local sources are limited by the unstable political and legal environment and the fact that it is difficult to gain access to credit (see paragraphs 6.5-6.8 and 6.11-6.15).

4. THE PREPARATION AND MANAGEMENT OF THE PROGRAMMES

The quality of the preparation, implementation deadlines and the scheduling of measures

4.1. Programmes in support of the development of the private sector are most often characterised by ambitious but very vague objectives which create problems when they come to be translated into operational terms. These problems are made worse by undue haste in the commitment of appropriations and the drafting of technical specifications, owing to a desire to improve budgetary implementation at any price.

Poland

4.2. *The launch in May 1994, with insufficient preparation, of the SME subsidy mechanism (ECU 32 million) under the Struder programme (regional development) resulted in the postponement of its expiry date and in the reallocation of more than ECU 10 million to other components of the programme. The same programme provided for a guarantee fund. This was initially linked to the subsidy mechanism, but had to be separated from it because it had been launched without any evaluation of the SMEs' practical needs and before the banks participating in the programme had been consulted.*

4.3. *In the tourism sector, a second programme had been launched before the first had produced any results. A third programme (ECU 6 million), which was justified above all by a desire to speed up the implementation of the budget at all costs, was adopted despite the fact that no assessment had been made of the first two programmes.*

Bulgaria

4.4. *In the case of the SME programme in Bulgaria, badly conceived specifications and a poor appraisal of the abilities of the successful tenderer in the first phase of technical assistance resulted in several extensions which more than doubled the cost (from ECU 0,54 million to ECU 1,24 million) and length of the initial contract. The second programme in favour of the private sector was also implemented without account being taken of the results of the previous programme, whereas the success of the measures in the second programme depended on it. As a result of this inconsistency, the three financial instruments scheduled (the guarantee fund, the own resources mechanism and the regional investment funds) were discontinued and the programme was completely redirected (see paragraph 5.14).*

4.5. *In the tourism sector, the financing agreement for the 1993 budget year (due to expire at the end of December 1995) was not signed until December 1994 and was not received by the Tourism Committee, the project beneficiary and partner, until April 1995. This delay left only a few months to structure and implement the programme and the corresponding measures could not be correctly ranked. Approximately 50 projects lacking genuine predefined priorities were therefore launched at the same time, including a master plan which should have been available beforehand.*

4.6. *As regards assisting the restructuring of the mechanical sector, the contract (ECU 0,8 million) provided for successive intervention phases: the development of a strategy for restructuring the sector and then the development and implementation of an action plan for 10 preselected companies. Considering these terms of reference to be unrealistic, the consultant asked for the requirements of the second and third phases to be made less stringent. Consequently, priority was given to the search for partners, but only for half of the 10 initially selected companies. As a result, the dimension and scope of the project changed.*

Other countries

4.7. *Similar problems were also uncovered in Russia, with regard to the strengthening of the SMEDAs, and Slovakia, in respect of regional development support.*

4.8. Such practices give rise to project specifications that are subsequently considered unrealistic by the contractors (owing to their implausibility or failure to take sufficient account of local constraints) and which lead either to the extension of programmes or technical assistance contracts or to the cancellation or redirection of measures.

4.9. The delays created by failure to prepare operations disrupt the sequence of the various phases of the programmes and jeopardise the measures undertaken. The content of the programmes and the timetable for planned measures therefore lose both coherence and realism. Thus, projects where the outcome depends on the success of previous projects are nevertheless undertaken in an inappropriate context and without the necessary results being available beforehand.

Russia

4.10. In Russia, a project was undertaken without a named beneficiary. Its project specification (support for SME policy (ECU 1 million)) merely provided for assistance to be given to 'those Russians who are responsible for the design of programmes to promote SME development'. No further details were given. The subsequent designation of the State SME support committee (GKRP) as a beneficiary did not improve the situation. As the GKRP had not participated in the planning of the project, its contribution to the experts' work was remote. In such cases, the 'demand-driven' approach was obviously not applied and the role of the Commission or of the consultants should be clarified.

4.11. As a general rule, in the Commission's project files a clear reference to the consultant responsible for drafting the project specifications must be introduced, since the consultant is often responsible for the difficulties. It would then be possible to draw up a register of competent drafters and remove the names of those whose analyses have not produced satisfactory results. None of the projects contained a reference of this sort.

The implementation of measures and drafting of the consultants' contracts

4.12. In Bulgaria, Uzbekistan and Russia, project suspensions disrupted the implementation of the SME support programmes. Significant changes in management staff at the Commission in Brussels and local political changes were often the cause of these suspensions.

4.13. Other projects suffered from inertia (Hungary, Poland) which prevented them from being redirected or suspended. The sluggishness of the administrative and budgetary procedures ensures that programmes that have lost any relevance are not discontinued. The measures are then pursued with the sole aim of using up committed appropriations.

Hungary

4.14. In Hungary, a convertible loan programme (ECU 1,89 million) was preserved at all costs. The instrument was included in the 1990 programme but could not be developed within the time stipulated. So as not to forego the budget that had been allocated, a framework agreement, which was approved by the Delegation, was signed with a financial intermediary in December 1994. However, in November 1996, not a single loan had been approved.

Bulgaria

4.15. Various suspensions disrupted the implementation of the SME and regional development programmes. First the technical assistance teams were evicted from their offices by the authorities which owned the buildings and were thus prevented from working effectively. Secondly, the lack of any genuine handing-over of responsibilities between successive consultants led the Commission temporarily to suspend the regional development support contract. Lastly, a succession of four different managers at the Commission in Brussels in as many years did not make it possible to overcome the difficulties raised by the Bulgarian authorities.

4.16. Failures of this kind illustrate a problem related to the very nature of the specifications. Although consistent in terms of the aims of the financing agreements, consultants' contracts are too often drafted without adequate attention being given to the local context. Although they include a list of activities to be undertaken and services to be rendered, the objectives to be attained remain vague. This situation suits the contractors, on whom there is little obligation to achieve results and who, in the event of difficulties, can always hide behind the unrealistic nature of the specifications to justify the mediocrity of their own performance. The result is inertia in the implementation of contracts, as it is easier for contractors to perform a series of tasks that are inconsistent and ill-suited to the local situation than to have to learn from their mistakes and risk having operations suspended or contracts renegotiated.

The flow of information

4.17. The exchange of information on programmes between the various PHARE and TACIS operational departments remains a weak point. For example, no information is available on the quality of the performance of consultants ⁽¹⁾. This is especially true of specification drafters, contracting companies and experts.

4.18. Thus, the first technical assistance team for SMEs in Bulgaria was granted several contract extensions (total amount: ECU 1,24 million) although it had achieved no tangible results (see paragraph 5.14). Similar problems were observed in Poland (tourism)(see paragraph 5.13).

4.19. Information of this kind on the background of the consultants (see paragraph 4.11) would, however, be useful as it would enable better informed choices to be made when projects are being planned. It would also clarify procedures by distinguishing more clearly between the successive roles played by each participant in the various stages of a project cycle. The fact is that consultancies too often limit their role to purely organisational work by bringing together a team of staff recruited on the basis of project requirements. Numerous experts are thus approached at the same time by several tendering companies. These latter, who feel little sense of responsibility as they will not be blacklisted in the event of poor performance, are thus more interested in getting paid as intermediaries than in the proper completion of their tasks.

4.20. As results are not recorded for either PHARE or TACIS within the Commission, it is not possible to assess a given sector or instrument. It even appears that the sectoral dimension common to the PHARE or TACIS countries has to all intents and purposes been ignored in the Commission's approach. It is thus difficult for the SME manager of a PHARE or TACIS country to benefit from the experience of a similar policy in another country.

The monitoring and evaluation of programmes

4.21. The situation as regards ongoing monitoring and evaluation has gradually improved. At the end of 1997, both PHARE and TACIS comprised units with specific responsibility for these matters, assisted by external teams working on the spot. The conclusions of these monitoring and evaluation units should improve the control of contracts, projects and programmes (necessary in view of enlargement). However, there are limits to what can be done in this way.

Poland

4.22. The components of the Struder programme launched in 1992 all suffered from a lack of monitoring. The central agency (PARD) paid little attention to the operating expenditure of the regional development agencies. No overall appraisal of training and evaluation measures had been made by mid-1997. Although the SME subsidy system was experiencing teething trouble and plans had originally been made for an appraisal every six months, an intermediate evaluation was not made until May 1996. As the resulting recommendations had only been made six months before the project's expiry date, none of them could be adopted. Furthermore, no monitoring of SME beneficiaries had been organised as of the end of 1997.

⁽¹⁾ Performance scoring.

4.23. *In the case of tourism, the plethora of committees, departments or groups responsible for supervision did not stop several contracts being maintained even though the contractors' performance was mediocre (see paragraph 5.13). Lastly, a loss of revenue totalling approximately ECU 300 000 must be attributed to the lax management of funds received by the tourism programme management unit, which is not supervised by the Commission⁽¹²⁾ (low rates of interest on money deposited in bank accounts).*

Slovakia

4.24. *As only restructuring projects covered by a current technical assistance contract are monitored on a company-by-company basis by the programme management unit, it is impossible to express an opinion on the practical impact of support whose long-term effects (increasing market shares and profits) only become perceptible after technical assistance has been completed.*

Other countries

4.25. *Other cases observed in Hungary, Russia and Uzbekistan also involved monitoring problems.*

4.26. At the end of 1997, monitoring and assessment were characterised by the following shortcomings:

- (a) the time required by the Commission in Brussels to become aware of problems that arise, together with the advantages afforded by proximity, were good reasons for stepping up monitoring at Delegation level;
- (b) monitoring and evaluation were carried out solely by consultants, as the Commission does not analyse the effects of the consultants' work on the organisation, working methods and results of project beneficiaries (see paragraph 6.3);
- (c) at the end of 1997, monitoring and evaluation were neither comprehensive nor uniform.

4.27. The possibility of organising concerted and coordinated monitoring with other donors should be examined.

5. EFFICIENCY OF IMPLEMENTATION PROCEDURES

The choice and conception of instruments

5.1. On several occasions, the instruments implemented in support of SMEs or regional development turned out to be unsuitable. As a result, the effectiveness of the projects concerned was considerably reduced. The reason was either the unsuitability of the instrument to the surrounding context or unsatisfactory operating rules.

Poland

5.2. *As well as a lack of preparation (see paragraph 4.2), many technical obstacles limited the potential usefulness of the guarantee fund. Although initially designed to operate in tandem with SME subsidies, the guarantee fund was uncoupled from these latter because it was introduced late. These delays were compounded by:*

- (a) *a rate of commission considered too high by beneficiaries (3 %, when a government fund would have charged between 1,2 % and 1,8 %);*

⁽¹²⁾ See Special Report No 3/97 concerning the decentralised system for the implementation of the PHARE programme, paragraphs 3.30 and 4.19 (OJ C 175, 9.6.1997).

(b) an excessively long decision-making process within the bank responsible for management;

(c) an application procedure that was too complex and too centralised.

Russia

5.3. The project for strengthening the SME Development Agencies (SMEDAs — ECU 2 million) did not create sufficient cooperation between the parties involved. It presupposed that the regional SMEDAs would provide offices, certain logistical facilities and some of the staff. In a difficult economic context, and despite the agreement of the National SME Agency, such requirements could not fail to create conflicts with the agencies whose financial stability was threatened. By not taking into account what was to become the principal concern of the agencies, namely their financial independence, this project immediately created situations of conflict and produced results that were contrary to the purpose that had been assigned to it. Rather than strengthening the SMEDAs, it deprived them of certain resources for its own needs. For its part, the national agency had no authority to mobilise the regional agencies. This project also lacked coherence because sectoral choices were made without any relation to local realities and because there was nothing to unify the five sites selected. The result was five small independent projects, a fact which prevented the monitoring and assessment unit from delivering its overall conclusions within a reasonable time. This lack of uniformity already characterised the previous project for setting-up the SMEDAS (ECU 3,5 million). Its large number of small assorted modules gathered together under one single contract made management and assessment particularly complicated. The subsequent project was similarly ill-assorted, to the extent that the person responsible judged the terms of reference of the contract to be the worst that he had ever seen.

5.4. Instruments that had proved their worth in a given country and context were sometimes reproduced in a new context without adequate modifications. This was true, for example, of the model selected for regional development in the Czech Republic and also applied in Poland and Slovakia.

5.5. In other cases, instruments that had been developed for a given environment were put to use belatedly, with the result that they became ineffective due to changes in the initial context.

Bulgaria

5.6. The three years needed for the launching of the SME credit line meant that the mechanism in question (loans in hard currencies with the exchange risks to be borne by the borrower) was completely unsuited to the context of economic decay that prevailed in 1995/96, with a 300 % devaluation of the lev against the dollar.

5.7. Cases were also observed of mechanisms that were relatively easy to reproduce being adopted in some countries but not in others. Thus, subsidies for SMEs and minor infrastructure could have been used in support of regional development in Bulgaria or Slovakia but were restricted to Poland.

5.8. Problems also arose from a confusion of roles, or even competition between the various instruments used by a given donor. Examples of this are particularly instructive in the SME and regional development programmes in Hungary and Bulgaria. An excessively vague definition of the tasks entrusted to both the SME support agencies and the agencies concerned with regional development led to a confused situation whenever both types of agency were working in the same geographical area.

5.9. The low success rate of the PHARE SME guarantee programmes is explained by the limited advantage offered by this instrument over credit lines for SMEs. Indeed, as the amounts lent come from budgetary funds, the rates offered are very much lower than market rates. Guarantees can, at best, only offer prime borrower rates on the bank loans that they accompany. Thus, where these two instruments are simultaneously available, the chances of SMEs being steered towards guarantees are very small.

5.10. Evaluation of the results of investment funds needs substantially more time⁽¹³⁾ than for conventional instruments. However, the deadlines envisaged in the financing agreements considerably underestimate reaction times. Instruments that were technically more advanced (e.g. convertible loans for SMEs in Hungary and Bulgaria) turned out to be too complex for an immature banking environment and were not very successful with the SMEs. Moreover, at the expiry of the programmes, the agreements do not clearly establish what is to happen to 'revolving' funds. This problem is particularly sensitive when the body responsible for mobilising loans, guarantees or other instruments (investment funds) is not directly answerable to the public authorities.

5.11. Finally, with regard to the reorganisation of companies in Bulgaria, Slovakia and Russia, the financial resources mobilised for each company turned out to be inadequate for the implementation of the recommendations, even though provision was made for implementation in most of the contracts.

Technical assistance

5.12. For the majority of the projects examined, the technical assistance provided complied with the project specifications and the transfer of know-how therefore took place under satisfactory conditions. However, where failures were found (Bulgaria, Poland, Russia and Slovakia), it turned out that the technical assistants in charge of the projects had been slow to react to the problems encountered or that there had been conflicts with local managers.

Poland

5.13. In the tourism sector, there was an inadequate transfer of know-how and, in two cases, it was found that poor service had been provided. In one of these cases, not only had contracts not been terminated despite the disappointing services provided by the consultant, but the company in question had also benefited from five further contracts amounting to a total of ECU 1,35 million, which subsequently met with further implementation problems.

Bulgaria

5.14. In the SME and regional development sectors, the performance of the first technical assistance teams provided by the same consultant remained well below the level required in their contract specifications. Preparatory work intended to create the conditions necessary for the introduction of the financial instruments was not carried out (insufficient research into the legal, administrative and financial background). Without this preliminary work, the operations envisaged became unrealistic. Subsequently, the consultant did not fully assess the extent of the problems and did not propose the suspension of the contract. The numerous extensions of the contract, which had been negotiated privately with this consultant (ECU 1,24 million), only accentuated a failure which seriously compromised subsequent measures and which was the main cause of the redirection of the programme and the abandonment of three financial instruments (see paragraph 4.4).

5.15. In the case of tourism (Poland) and SMEs (Bulgaria), the difficulties were accentuated by the poor performance of several technical assistance teams. In Slovakia, inadequacies were found in terms of information (knowledge of the project specifications on the part of the regional development agency) and communication between the participants in the regional development support programme.

5.16. The effectiveness and cost of technical assistance could be improved if more systematic recourse were had to firms of consultants combining both local and Western experts⁽¹⁴⁾. Furthermore, this would provide greater scope for the transfer of know-how, as was noted for the assistance provided for the reorganisation of companies in Poland. This need was felt especially in Poland in the tourism programmes and in Hungary within the regional development programme management unit.

⁽¹³⁾ Regional Investment Fund, Seed capital and, Equity schemes.

⁽¹⁴⁾ See the Annual Report of the European Court of Auditors for the 1993 financial year, paragraph 12.36 (OJ C 327, 24.11.1994).

Cooperation between the various parties

5.17. Coordination and close cooperation between the various parties involved⁽¹⁵⁾ are essential for an effective implementation of the programmes. In several cases bad planning or the lack of a coherent political strategy contributed to the implementation difficulties.

Poland

5.18. Cooperation between the tourism programmes and regional development proved to be almost non-existent. In June 1997, no action had been taken and no discussions had taken place in conjunction with the regional development agencies. Cooperation between the regional development agencies and the Polish Agency for Regional Development (PARD) was also inadequate and was limited to mere exchanges of information.

Slovakia

5.19. Ambiguities regarding the composition of the management bodies of the Regional Development Agency and the Regional Investment Company and their respective roles caused major conflicts. The independence of the bodies set up and their composition thus encouraged uncooperative or even hostile behaviour on the part of these two agencies. This behaviour led to the failure of the pilot project.

5.20. Disagreements between the local manager and the foreign experts led to premature termination of the technical assistance contract (ECU 0,3 million) and the pilot project. The person responsible for the Regional Development Agency, who did not possess the specifications for the technical assistance contract, could not secure the services of foreign experts.

Russia

5.21. Cooperation between the EBRD, which managed the SME loan schemes, and the SMEDAs supported by TACIS was non-existent in most regions.

5.22. In practice, failure to define links beforehand results in insufficient active cooperation between programmes whose fields of activity are closely related. This is also true of policies involving regional development and SMEs in Hungary, for which the lack of a clear definition of the fields of intervention creates rivalry between projects (local networks). The solution to these problems therefore depends on the national political authorities' clarifying the responsibilities of each party involved.

6. ASSESSMENT OF THE MEASURES IMPLEMENTED

Measuring the impact

6.1. Even though it is a difficult exercise to measure the tangible impact of policies in support of the development of the private sector, it is nevertheless indispensable and the Commission must ensure that it is done. This difficulty is due, on the one hand, to a lack of reliable indicators in many situations and, on the other hand, to the impossibility of isolating the precise contribution of the measures financed by PHARE or TACIS in terms of measurable effects in situations where other instruments are contributing to the same objectives and the market itself constitutes the main driving force of development.

Bulgaria and Russia

6.2. In Bulgaria, visibility remains mediocre in the SME sector: four years after the launching of the SME programmes (ECU 24,5 million in November 1996), this sector still had no statistics — a major indicator in the assessment of development. This lack of reliable statistics also characterised the programmes implemented in Russia.

⁽¹⁵⁾ The local authorities, the Delegation, the technical assistants, the PMU and the EBRD.

6.3. With regard to the company restructuring programmes in the countries examined, there were no summary data to enable the assessment of either the degree of implementation of the recommendations or the tangible effects on the companies' situations. In Poland, the PMU estimated that approximately 50 % of the beneficiary companies had adopted and applied the recommended restructuring plans. In the other countries, appraisal was even vaguer. This kind of approach makes it impossible to identify success factors that should be included in future projects. Moreover, the shortcomings recorded in programme management (especially in terms of the submission of reports, the consolidation of the results obtained and monitoring and assessment) further underline the unreliable nature of any measurement of the impact of the measures implemented by the Commission.

6.4. Be that as it may, PHARE and TACIS have contributed to the profound change in mentality *vis-à-vis* the private sector that has occurred. In most of the countries visited, private initiative has not only been legalised but also very widely promoted. This success cannot be dissociated from the implementation of support for local SME networks and regional development. Close support is thus always at hand, whether in the form of Local Enterprise Agencies⁽¹⁶⁾ in Hungary, Business Support Centres⁽¹⁷⁾ and Regional Development Agencies⁽¹⁸⁾ in Poland, Slovakia and Bulgaria or Small and Medium-sized Enterprise Development Agencies⁽¹⁹⁾ in Russia, Uzbekistan and Turkmenistan. These networks are all necessary vehicles for training activities, advice and financial measures (micro-credits).

External constraints on the projects

6.5. The cultural divide, the survival of old structures, resistance to change on the part of certain categories of political and economic agents and, in many cases, a deterioration in the standard of living, are all aspects of the context in which the projects are having to operate. The intensity and extent of these elements vary from one country to another, but they must be taken into account in order to ensure that only realistic measures are undertaken.

Bulgaria

6.6. A poor assessment of the political and legislative context, together with resistance (to a considerably underrated degree) to change within the ministries and the public-sector companies caused projects that were too complex or too ambitious to fail (see paragraph 4.4).

Uzbekistan and Turkmenistan

6.7. The principal constraints noted in other PHARE and TACIS countries were felt even more acutely in these two countries. The underdeveloped nature of the banking system and the difficulty companies experience when trying to obtain foreign currency constitute two major obstacles to the rise of the private sector.

6.8. In all the countries, external constraints affected the implementation, the impact and the lasting character of the measures. These constraints belonged chiefly to one of the following three categories:

- (a) insufficient resources in the national budgets to accompany and distribute PHARE and TACIS aid effectively;
- (b) an unstable political and legal environment which was often ill-suited to the programmes that were to be implemented;
- (c) great difficulty in gaining access to credit, especially for SMEs.

⁽¹⁶⁾ LEAs.

⁽¹⁷⁾ BSCs.

⁽¹⁸⁾ RDAs.

⁽¹⁹⁾ SMEDAs.

Budgetary implementation

6.9. The instruments used by DG IA to monitor the accounts are in need of a thorough reform. Under the Desiree system, the only way to access information concerning support for SMEs, regional development, privatisation or the reorganisation of businesses is by measure title. All these types of aid are put together under the same heading (code PR), the only level of analysis accessible. In addition to this serious shortcoming concerning the destination of funds, there is also the question of the nature of the aid. Here too, the aid provided for training, advice, financial instruments etc. could only be grouped together by titles whose reliability was uncertain. Furthermore, support for the financial sector is included under private sector development in TACIS but not PHARE.

6.10. An examination of budgetary implementation using the Commission's management database (Desiree) showed that, overall, for both PHARE and TACIS, the programmes in support of the development of the private sector had progressed considerably more than the overall average for all programmes (see *Table 3*). However, a country by country examination of implementation yields more heterogeneous results (see *Table 4*). From this point of view, as of 31 December 1997, the situation was particularly worrying in Bulgaria and Romania. Payments under the ECU 22,5 million programme committed in 1992 in favour of the development of the private sector in Bulgaria represented only 28 % of the initial commitment (see paragraphs 4.4 and 6.25-6.28). In Romania, two programmes with a total budget of ECU 100 million showed worrying payment rates: a programme of ECU 30 million committed in 1992 and paid out at a rate of 62 % and another of ECU 70 million committed in 1993, whose payment rate was little more than 40 %. In these two countries, these programmes were launched without the necessary legal and institutional frameworks (see paragraph 4.9).

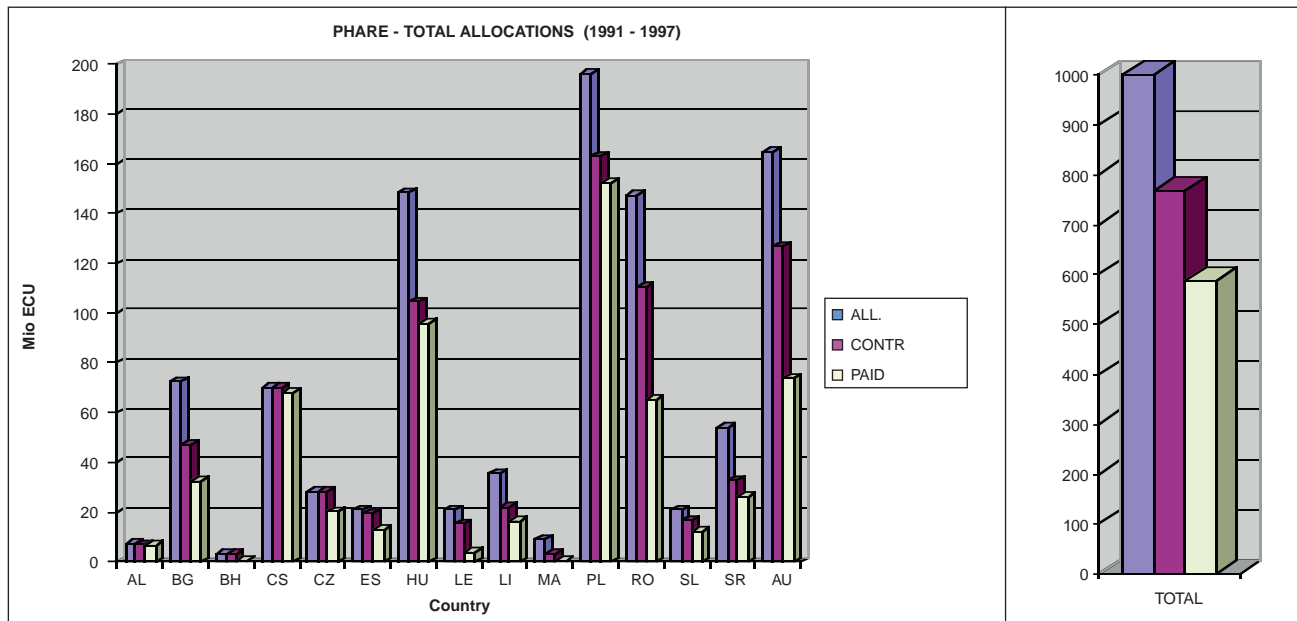
TABLE 3

Implementation rates of PHARE and TACIS programmes as of 31.12.1997.*(in % of commitments)*

	All programmes	Private sector development programme
PHARE		
Agreed	68	77
Paid out	51	59
TACIS		
Agreed	83	87
Paid out	45	51

Source: Desiree database.

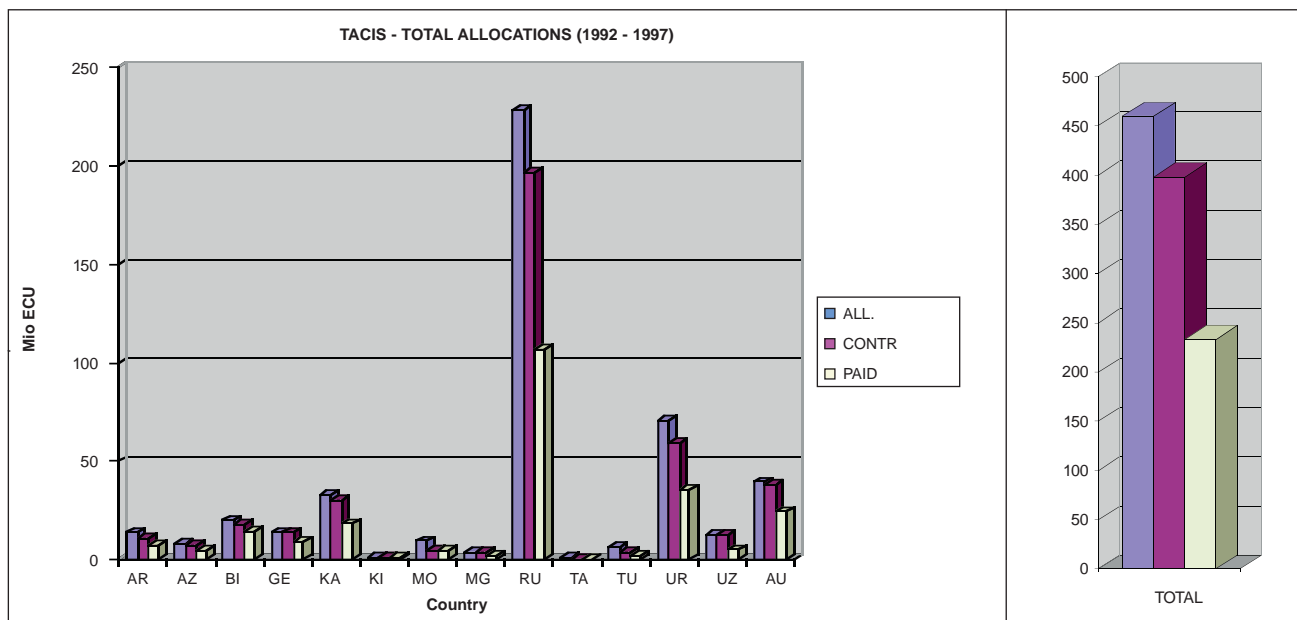
TABLE 4



PHARE PROGRAMMES 1991 - 1997 DEVELOPMENT OF THE PRIVATE SECTOR: ALLOCATIONS BY COUNTRY

In million ECU

	ALBANIA (AL)		BULGARIA (BG)		BOSNIA-HERZEGOV. (BH)		EX-CZECHOSLOVAKIA (CS)		CZECH REPUBLIC (CZ)		ESTONIA (ES)		HUNGARY (HU)		LATVIA (LE)	
ALLOCATION	7,00	100%	72,50	100%	3,00	100%	70,00	100%	28,00	100%	21,10	100%	148,50	100%	20,98	100%
AGREED	6,79	97%	46,73	64%	3,00	100%	69,91	100%	28,13	100%	19,30	91%	104,60	70%	15,06	72%
PAID	6,59	94%	32,39	45%	0,32	11%	67,78	97%	20,27	72%	12,95	61%	95,81	65%	3,71	18%
	LITHUANIA (LI)		FYROM (MA)		POLAND (PL)		ROMANIA (RO)		SLOVENIA (SL)		SLOVAKIA (SR)		OTHERS (AU)		TOTAL	
ALLOCATION	35,70	100%	8,80	100%	196,20	100%	147,40	100%	21,05	100%	54,20	100%	164,50	100%	998,93	100%
AGREED	21,75	61%	2,86	32%	163,05	83%	110,33	75%	16,90	80%	32,68	60%	126,86	77%	767,94	77%
PAID	16,65	47%	0,40	5%	152,52	78%	65,12	44%	12,46	59%	25,90	48%	73,56	45%	586,43	59%



TACIS PROGRAMMES FOR 1992 - 1997 DEVELOPMENT OF THE PRIVATE SECTOR BY COUNTRY

In million ECU

	ARMENIA (AR)		AZERBAIJAN (AZ)		BELARUS (BI)		GEORGIA (GE)		KAZAKHISTAN (KA)		KYRGYSTAN (KI)		MOLDOVA (MO)		MONGOLIA (MG)	
ALLOCATION	13,54	100%	8,00	100%	19,82	100%	13,65	100%	32,32	100%	0,82	100%	9,31	100%	3,96	100%
AGREED	10,82	80%	7,43	93%	18,04	91%	13,62	100%	29,63	92%	0,82	100%	4,80	52%	3,95	100%
PAID	6,89	51%	4,88	61%	13,84	70%	8,82	65%	18,30	57%	0,62	76%	4,29	46%	2,24	57%
	RUSSIA (RU)		TAJKISTAN (TA)		TURKMENISTAN (TU)		UKRAINE (UR)		UZBEKISTAN (UZ)		OTHERS (AU)		TOTAL			
ALLOCATION	228,06	100%	1,30	0%	6,10	100%	70,94	100%	12,36	100%	39,53	100%	459,70	100%		
AGREED	196,51	86%	0,00	0%	3,40	56%	58,67	83%	12,36	100%	38,01	96%	398,06	87%		
PAID	106,31	47%	0,00	0%	2,17	36%	35,36	50%	5,19	42%	24,07	61%	232,98	51%		

Source: Desiree database.

The long-term survival of the institutions

6.11. In spite of the success achieved in setting up the local agencies, they all had to face the same challenge — that of guaranteeing their own future and hence their financial survival. They all also had to face the same constraint — the insufficient number, or even total lack, of SMEs willing to pay them for services that had hitherto been rendered free of charge. Even in the countries where support for SMEs was a government priority, the local networks depended upon PHARE or TACIS funding to balance their operational budgets. In cases where the governments concerned were not fulfilling their co-financing commitments or did not take any interest in the question, the Commission had drawn up no overall strategy for the withdrawal of PHARE or TACIS.

6.12. The risk of seeing part of the local infrastructure created to support SMEs or regional development disappear in a short space of time goes hand in hand with the risk of losing the know-how acquired by the staff of the bodies created. This risk has even been increased because once staff became aware of their employers' financial fragility this knowledge sometimes led them to anticipate the problems and quit their jobs. For example, the director and advisers of the support centre for the Olsztyn SMEs in Poland left their posts in 1996. Even if all is not lost at the level of the country concerned, given that these people, having received management training, can soon find other jobs, the leverage effect expected from these networks is drastically reduced and dependence on foreign technical assistance is increased.

Poland

6.13. The problem of survival affects the Business Support Centres (BSCs), the SME Foundation (Programme Management Unit) and most of the bodies created under both programmes for the development of tourism (ECU 12,5 million). The Regional Investment Companies ('RICs') have only been able to operate thanks to the sums earned on funds placed with banks pending investment in projects. The more participation these bodies take in companies, the more they reduce the resources that allow them to operate and, therefore, survive.

Russia

6.14. Except for the Moscow agency, which enjoys substantial support from the municipal and regional authorities (80 % of its budget), the future of the SME Development Agencies (SMEDAs) remains doubtful beyond 1998 and their need to search for funds is likely to take precedence over their role of providing services for SMEs. The question of survival also affects the Business Support Centres, which are supposed to become local consultancies.

The legality and regularity of transactions

6.15. Where anomalies were found, they mainly involved a failure to comply with the rules for calls for tender introduced for the PHARE and TACIS programmes and the financing of operating costs.

Poland

6.16. In order to commit funds before the expiry date of the regional development programme (31 December 1996), a call for tenders for a training project (ECU 0,4 million) was prepared too hastily (three weeks). At the same time, the criteria for drawing up the restricted list of candidates were not specified and only one company submitted a bid. Haste therefore acted as an obstacle to competition. In the same programme, five contracts amounting to ECU 0,6 million ECU were awarded by private treaty without any suitable justification.

Bulgaria

6.17. A contract for training courses in management techniques amounting to more than ECU 4 million (a basic contract of ECU 1 million plus seven addenda) was concluded by private treaty, which was irregular.

Slovakia

6.18. *The technical assistance contract (ECU 0,3 million) for the Slovak Regional Development Agency was awarded in muddled circumstances. Cross-checks between the companies that provided the experts on the technical assistance team appointed after the call for tenders and those found on the restricted tender list point to the existence of a strong risk of collusion between these companies.*

6.19. Although the rules governing PHARE state that operating costs may only be covered during the launch phase of a project, and must be phased out during that period, these costs were paid for out of the PHARE budget ⁽²⁰⁾, in particular in the following programmes:

- (a) SMEs (ECU 1,5 million) in Poland;
- (b) regional development (ECU 5,4 million) in Poland;
- (c) tourism (ECU 0,4 million) in Poland;
- (d) SMEs (ECU 0,2 million ECU) in Slovakia.

Assessment by country audited**Poland (ECU 217,5 million) ⁽²¹⁾**

6.20. Despite an obsolete legal framework, the SME programmes (ECU 17,2 million) resulted in the correct organisation of the SME Foundation and a clear strategy. For the regional development support programme (Struder, ECU 78,82 million), whose budget was sufficiently large to meet the local needs, the situations of the various components varied:

- (a) the part in support of minor regional infrastructures gave positive results (ECU 18,43 million), in particular in that it sped up numerous investment decisions;
- (b) the SME subsidy mechanism (ECU 31,93 million) had a less marked effect because, apart from the disbursement rate, its objectives were unclear. Thus, in 90 % of the cases examined, investments had already been decided on before the subsidies were granted and only 30 % of the investments were part-financed with bank loans, despite the fact that a leverage effect in favour of bank loans was theoretically one of the objectives;
- (c) six years after the funds had been made available, the two regional investment companies envisaged (ECU 3 million) were operational but only took their first investment decisions in November 1997;
- (d) the guarantee fund (ECU 7 million), on the other hand, was completely unused.

6.21. In the tourism sector, the two main projects aimed at strengthening the institutional framework (the reorganisation of the SSTA and the setting up of a National Tourist Office) were not carried out.

6.22. Regarding support for industrial restructuring, the results of the sectoral studies can be considered satisfactory, except for the steel sector. In the latter case, the technical assistance measures initially envisaged in the financing agreement (ECU 2 million) were replaced by technical modernisation projects for four companies in the sector. However, according to a report drawn up by a Canadian consultant for the Polish Government, the sums made available in this way represented only 0,1 % of those needed for the modernisation of the sector. Finally, the investment fund ('FEDA fund', ECU 5 million) provided for in the 1994 programme had still not seen the light of day in June 1997.

⁽²⁰⁾ See Special Report No 3/97 concerning the decentralised system for implementing the PHARE programme, paragraphs 3.20-3.30 (OJ C 175, 9.6.1997).

⁽²¹⁾ The 1990-1997 programmes.

Hungary (ECU 174,5 million) ⁽²²⁾

6.23. In Hungary, measures in support of SMEs (ECU 63,8 million) differed according to the financial instruments used. The micro-credits distributed through local agencies were popular with the SMEs, while loans distributed by the bank networks had achieved a disbursement rate of only 20 % by the end of 1996. A convertible loan mechanism (ECU 2 million) was not operational in November 1996 although more than six years had been necessary for its development.

6.24. The training measures (ECU 2 million) under the company restructuring support programme have not achieved the aims laid down in the financing agreements. Whereas they were designed for around 12 000 participants, only 1 100 took part. Clearly, the objectives of these training activities were far too optimistic in view of the fact that the market was saturated in this field — more than 100 institutions were offering management courses.

Bulgaria (ECU 72,5 million)

6.25. Aid for SMEs and regional development (ECU 27,4 million) originally involved three financial instruments, all of which were abandoned (the guarantee fund, investment of own funds and regional investment funds). No national SME agency was set up and certain projects were in a precarious state at the end of 1996, in particular in respect of credit lines. Thus, slightly more than ECU 6 million had been reallocated to new projects which did not satisfy the guidelines of the initial financing agreement and ECU 6 million had quite simply been decommitted. In November 1996, compared with the initial forecasts, actual expenditure (less than ECU 6 million on the 1991, 1992 and 1993 programmes) had achieved a much lower impact than the objectives laid down in the financing agreements.

6.26. Support for the restructuring of companies resulted in measures whose lack of realism and breadth allowed little hope for significant results, given the political and economic situation prevailing at the time in the country in question. These sectoral activities were divided into three phases:

- (a) an analysis of the situation of the sector and the companies involved for the development of a strategy;
- (b) the selection of a limited number of viable companies for which a restructuring plan could be adopted;
- (c) the supplying of technical assistance to all or some of the companies selected for the implementation of the recommended measures.

None of the 20 cases examined in the mechanical engineering and metallurgy sectors went beyond the second phase (ECU 2,4 million).

6.27. In the tourism sector, an initial ECU 1,1 million study regarding the drafting and implementation of recommendations on privatisation had to be abandoned and ECU 500 000 was simply written off. A second study relating to the preparation of a legal framework for tourism was also abandoned.

6.28. In respect of support for the restructuring of companies, in addition to the sectoral activities in favour of companies selected in advance, significant sums (ECU 10,5 million) were also committed for services offered by the programme management unit (the 'counter' approach), including a technical assistance component (ECU 5,2 million) and a training component (ECU 4,3 million). In the absence of any *ex-post* assessment of this 'counter' approach, the advantages gained by the companies could not be evaluated and the usefulness of the funds spent remained to be proved. Although, in addition to the organisation of training courses (ECU 4,2 million), the main contract included the setting-up of a body capable of continuing any measures that were launched, this body never saw the light of day.

⁽²²⁾ The 1990-1997 programmes.

Slovakia (ECU 54,2 million)

6.29. In Slovakia, the aid given to SMEs (ECU 23,6 million ECU) was implemented as planned. The network of agencies is active and the various instruments provided (SES, Spinoff) have been well used. The fact that these measures have been concentrated within the National SME Development Agency, which enjoyed unambiguous political support, largely contributed towards its success.

6.30. As regards regional development (ECU 7,5 million), the pilot experiment tried out in one region of the country was a failure. The absence of a clear strategy, the political and economic constraints specific to the region selected and ambiguities in the respective roles of the Regional Development Agency and the Regional Investment Company were the main causes of failure. In such circumstances, the implementation of programmes remained slow and the cost-effectiveness ratio low. In respect of support for company reorganisation (ECU 22,6 million), the diagnosis and recommendation phases were indeed carried out, but were seldom followed by the implementation of the recommendations in question.

Russia (ECU 228,06 million)

6.31. With the exception of the SMEDA reinforcement project, the SME projects have indeed been implemented. Their impact, however, has remained limited because of their small size in relation to the country's vast needs.

6.32. Moreover, the spreading of budgetary resources too thinly also characterised the projects in support of the restructuring of companies. In the programmes examined this support took three directions:

- (a) direct aid for the restructuring of major companies;
- (b) special sectoral assistance: definition of a sectoral policy and aid for the restructuring of companies;
- (c) the setting-up of Enterprise Support Centres (ESCs).

Whilst the final beneficiaries did appreciate the aid provided and modified their working practices and their organisation as a result, the impact of the change was not quantifiable. In addition, the amounts allocated, compared to the size of Russian companies, did not allow much room for hope for significant effects.

Uzbekistan (ECU 12,4 million)

6.33. The setting up of a company support network ('SMEDAs', 'BCCs', 'MSDCs' and regional advisers) constitutes the most visible aspect of the results of support for the development of the private sector in Uzbekistan (ECU 7,6 million). With the exception of the Samarkand agency, the level of activity of the other bodies has remained limited and produced modest results. The same is true for the support given to the silk sector (ECU 0,8 million), which is experiencing serious problems in attracting foreign investors.

Turkmenistan (ECU 6,1 million)

6.34. In spite of an extension of the restructuring programme, studies concerning 10 companies have not gone beyond the diagnosis stage and implementation of the recommendations had still not begun at the end of 1996. In addition, an SME development agency (SMEDA) set up in Ashkabad had little chance of financial independence after the end of its technical assistance contract in January 1998.

7. CONCLUSIONS

7.1. Generally speaking, a clear distinction must be made between the tangible effects of the measures on the intervention sectors and the consultants' activities. When projects did not give the expected results, difficulties were generally the result of management errors, badly designed intervention schemes, sub-standard work on the part of the

technical assistance teams, a lack of cooperation between the various players or external constraints that were not overcome. As for tangible effects, it is difficult to quantify the results of PHARE and TACIS measures (see paragraphs 6.1-6.4) in terms of either the nature of the interventions (e.g. advice on sectoral policies) or groups of beneficiaries (e.g. the effects on SMEs as a whole). This being the case, the Commission should endeavour to define more clearly the objectives of its interventions and establish clear reference points against which the results obtained can be measured.

7.2. However, certain interventions are quantifiable, for example, in terms of the number of training courses or pieces of advice provided or loans and other financial aid granted. These quantitative assessments are carried out on an *ad hoc* basis at local level but are not consolidated, in particular at sectoral level (see paragraph 4.20). Consequently, it is not possible to answer essential questions, such as the overall usefulness of the measures, their effects on employment and the growth of companies' profits, with the aid of tangible and quantified information. Nor is it possible to make comparisons between instruments or geographical areas, even though such comparisons would be useful for the planning and management of the Commission's schemes. Comparisons of loan default rates would have to be made, analyses of the causes of success or failure would have to be carried out and ratios of technical assistance costs to results obtained by intervention type would have to be calculated.

The management of aid

7.3. Certain results are perceptible, despite the lack of quantitative indicators, but to an extent that differs from one project or country to another (see paragraphs 6.10 and 6.20-6.34). Whatever the constraints of the political and economic contexts, if implemented in good time, measures based on sound management would have attenuated some of the failures.

7.4. Greater care should therefore be taken in the planning of the measures. More realistic measures and better organised timetables would be likely to make the projects more coherent. Thus, the Commission should refrain from launching operations whose success depends on the prior existence of a solid legal background that has not yet been set up (see paragraphs 4.1-4.10, 5.1-5.10 and 6.10).

7.5. The technical assistants (consultants) should be made answerable for the results of the projects under their responsibility. From the moment the contract specifications are drawn up tangible objectives to be achieved should be preferred to lists of activities to be undertaken and services to be provided. In this context, it would be possible to envisage the drawing up of a blacklist of consultants who use unrealistic or vague tender specifications as a pretext to justify poor performance on their own part, without having tried to have their brief redefined. Under the current system, the poor work carried out by certain consultants in connection with a given project did not prevent them from being subsequently selected for others. This lack of transparency was particularly critical in respect of the experts responsible for the drafting of tender specifications (see paragraphs 4.11, 4.14-4.16, 5.12-5.14).

7.6. Except for the management of programmes covering several countries, the Commission's geographical approach hindered the free flow of information from one sector of activity to another (see paragraphs 4.17-4.20 and 6.1-6.3). This resulted in an absence of a common approach on the part of the managers of the central departments as regards programme monitoring and an inadequate compilation of the experience gained in the various countries and sectors of activity.

7.7. The creation of special units responsible for monitoring the projects does not relieve the managers of their own responsibilities in the running of the measures. They act more like contract managers than project managers and, despite receiving extensive reports from their consultants, are unable to make succinct quantitative assessments of the programmes under their responsibility. In this connection, proper control of the operations implemented requires progress at three levels:

- (a) strengthening the role of the Delegations;
- (b) better analysis of the impact of the intervention of the consultants;
- (c) improvement of the consistency of monitoring.

7.8. Managers should be provided with implementation reports of a similar and synthetic structure for projects of the same kind. The development of standardised monitoring tools should enable the consolidation of assessment conclusions and the formulation of concrete recommendations by instrument and intervention sector, thus making it possible to learn from experience in a systematic way, to the benefit of future measures. In the absence of standardisation of this kind, situations will only be assessed with considerable delays and it will be impossible to make the necessary adjustments in good time. The question of monitoring is all the more vital because, in the context of accession negotiations, the granting of funds will be conditional on compliance with a schedule adopted for the implementation of the measures.

7.9. When applied in an appropriate context, the instruments adopted in support of SMEs and regional development have proved effective (see paragraphs 6.20(a), 6.29 and 6.31). However, ignorance of the conditions and context necessary for them to operate smoothly remains the weak point of the Commission's aid schemes. This also highlights a divergence between the political declarations of the authorities of the beneficiary States (very favourable to SMEs) and the acts needed to follow them (rapid adoption of suitable legislation and the appropriate budgetary decisions). The most outstanding successes have occurred in countries that have acted consistently from this point of view.

The effect of the aid

7.10. The most noteworthy effect is the political and cultural change to which PHARE and TACIS have probably contributed in all the countries concerned, if only by stimulating private initiative. In these same countries, there have been noticeable changes in the attitudes of the political authorities: SMEs have become a political priority in so far as they constitute the most important or even only source of alternative employment, given the consequences of the industrial reorganisation that is itself inevitable in the context of a market economy (see paragraph 6.4).

7.11. In the fields of SMEs and regional development, the creation of local networks able to give assistance on the spot (information, advice and training) and financial mechanisms in favour of SMEs are the most tangible results of PHARE and TACIS intervention. However, there is still no overall strategy for how the survival of the support bodies is to be ensured when the PHARE and TACIS schemes come to an end. Their survival is all the more hypothetical as both the public authorities and the companies involved are faced with a shortage of funds and the latter are not particularly keen to pay for services that have hitherto been offered free of charge. Rapid integration of these bodies (PMUs) within the corresponding public authorities would avoid the loss of knowledge gained at a high price. Furthermore, it would contribute towards strengthening the public authorities, a priority goal in the new PHARE guidelines (see paragraphs 6.11-6.14).

7.12. The question of the long-term survival of the bodies set up in this context also presupposes clarification of the notions of support for SMEs and regional development. These policies often overlap and networks may compete with each other both in the search for funds and in terms of the services offered to their customers (see paragraphs 5.8 and 5.19-5.22).

7.13. Support for the restructuring of large companies either involves in-depth intervention at sector or company level or the offering of services from 'counters' (local agencies or programme management units).

7.14. The assessment of in-depth intervention is the more complex of the two:

- (a) the projects are only monitored for the duration of the technical assistance contracts, whereas the main effects are expected to emerge in subsequent years (see paragraphs (4.26 and 6.3));
- (b) too often, operations have not gone beyond the diagnosis and recommendation stage, and the recommendations have not been implemented (see paragraph 4.24);
- (c) the financial resources made available for each company are often derisory in relation to the scale of the problems encountered and cannot themselves guarantee the implementation of the recommended changes (see paragraphs 4.6, 5.11, 6.26, 6.28-6.30 and 6.32).

7.15. The à la carte services (see paragraph 6.28) offered by the programme management units or the local agencies are often directed at small businesses and, theoretically, offer several advantages, in that this approach:

- (a) improves the leverage effect produced by the Community funds by stimulating the professional capacities of local consultants;
- (b) requires the active involvement of the beneficiaries and backs their desire for change.

However, no *ex-post* assessment has been carried out with a view to finding out the impact of the approach in question.

7.16. If the experiments carried out on the restructuring of companies have proved to be not very convincing (recommendations drawn up but not carried out), the reason is that, here even more than elsewhere, there is a great divergence between the funds available and the size of the problems to be solved. Only a convergent approach adopted by the EU and the other donors could have enabled convincing results to be achieved. From this point of view and given its role, the EBRD should be the Commission's main partner. The funding of studies by PHARE or TACIS prior to investments, in cooperation with the EBRD, should make it possible for a sufficient amount of capital to be mobilised in their wake (loans) to guarantee effective implementation of the measures recommended. Another method that deserves consideration would be for the Community budget to take over part of the risk by guaranteeing a part of the loans.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 16 and 17 September 1998.

For the Court of Auditors

Bernhard FRIEDMANN

President

REPLIES OF THE COMMISSION

INTRODUCTORY COMMENT OF THE COMMISSION

The Commission considers that the programmes launched under PHARE and TACIS to stimulate development of the private sector have made a sizeable impact in the short time that they have been running.

At the time when the programmes were first proposed, there was neither the concept of a market economy nor the culture of development through the private sector in any of the beneficiary countries. The majority of employment opportunities were restricted to large companies that were primarily state-owned and state-controlled. The EU was thus faced with the task of both developing programmes to physically reform and nurture a market-based private sector, and also with changing the political and cultural environment to enable reforms to be implemented.

Given the immensity of this task, resources under PHARE and TACIS were not sufficient to meet all needs of beneficiary countries. The Commission has therefore targeted the limited resources available towards actions designed to create a catalytic effect and stimulate further internally developed measures. Policies have also been developed to coordinate interventions with those of other international donors such as the EBRD, the World Bank and the EIB. Disbursement of the resources allocated to private sector development has, as the Court acknowledges, been more rapid than that for the PHARE and TACIS programmes as a whole.

The results to date concerning SMEs have been positive. The interim evaluation concluded that 'PHARE activities in SME development have been very relevant to the reform process, have introduced new institutions for SME development and have extended support to SMEs on an unprecedented scale.' The programmes have delivered relevant support to the transition process in most PHARE and TACIS partner States. As mentioned by the Court, awareness of the importance of the private sector and the role of SMEs within a market-oriented economic system has increased considerably to the extent that political and cultural thinking concerning private sector development have both changed markedly.

Programme effectiveness and impact have, in certain cases, suffered as a result of political instability and a

lack of resources on the part of the end beneficiaries to implement recommended restructuring plans.

The Commission has progressively increased its capacity to monitor and evaluate the programmes. Dedicated monitoring and evaluation units were established in October 1996, and the logical framework method for evaluation has been adopted to ensure consistent evaluation methodologies. Contracting procedures have been strengthened by the harmonisation of PHARE and TACIS procedures as from February 1997, and instruction manuals have been revised and updated to ensure that sound guidance is available to all practitioners. The PHARE programme was reoriented in March 1997 to adapt the programme to measures aimed at supporting the accession strategies of candidate countries. Reform of the TACIS regulation is also underway with the aim of more closely adapting the aid regime to the evolving requirements of the beneficiary countries.

These measures will enable the Commission to build upon the results of the private sector measures implemented to date and ensure closer alignment of future measures to the needs of partner States.

2. THE AUDIT FIELD AND OBJECTIVES

Audit field

2.2. In the initial phases of the PHARE programme a flexible definition of SMEs was used since this was considered more appropriate to the reality in the countries concerned. In particular, businesses in those countries were generally much larger than those in the Union as regards the number of employees. More recently the standard EU definition of SMEs has increasingly been used, where appropriate. For example, under a specific PHARE programme targeted towards small firms, the eligibility criteria have recently been restricted to those SMEs which satisfy the Commission recommendation of 3 April 1996.

3. SUMMARY OF THE MAIN OBSERVATIONS

The preparation and management of the programmes

3.1. The Court's report covers primarily the period influenced by the initial set-up phase of the PHARE and TACIS programmes. The situation in the

beneficiary States regarding private sector development has improved since then.

It is also important to note that at the time these programmes were designed they were breaking entirely new ground. While it was clear that private sector development was crucial to a successful transition process, there were few precedents on which to base the design of programmes. In addition, and as recognised by the Court elsewhere in its report, the level of political commitment to private sector development has been crucial. In Bulgaria, for example, the lack of political commitment to agreed private sector development programmes is by far the most important factor in the delays which affected these programmes.

3.2. In view of the urgency of helping the nascent private sector in the recipient countries, it was not usually possible to wait for impact assessments of earlier programmes before taking decisions on follow-on programmes. To have done so would have risked losing momentum in the sector, and would in many cases have undermined the sustainability of the follow-on programmes.

3.3. The main responsibility for the success or failure of programmes rests with the recipient government, which is responsible for ensuring a conducive policy context. There is therefore a limit to the extent to which responsibility for impact can be transferred to technical assistance teams.

3.4. While the Commission has tried to assess and support the development of private sector policy in the recipient countries, it cannot be held responsible for the sudden policy changes which have affected the success of programmes in some countries.

3.5. Contacts and consultations between PHARE and TACIS personnel are carried out on an informal basis, including PHARE officers attending TACIS evaluations of tenders and vice versa. Evaluation reports circulate among the PHARE and TACIS teams, further contributing to cross-fertilisation of ideas and recognition of matters of common concern.

The efficiency of the implementation

3.6. For both PHARE and TACIS, recent independent operational reviews have confirmed the coherence, on the

whole, of the strategy undertaken in the area of support to SMEs.

(a) The Commission accepts that certain problems were encountered (such as the reluctance of certain banks to participate in financing schemes) and such issues are being addressed as part of the follow-up to the interim evaluation.

(b) The efficiency of the instruments implemented depends strongly on the economic context which, as the Court points out in the example of Russia, can be extremely difficult.

(c) The Commission is reviewing draft strategic plans concerning the use of financial instruments in order to avoid overlaps, and to promote synergy and fruitful cooperation.

(d) The Commission accepts that certain instruments, such as guarantee funds, are complex to design and have so far had limited success under PHARE. But given their potential to act as a catalyst to establishing sustainable forms of financing to SMEs, the Commission, in consultation with beneficiary countries, considered their adoption to be worthwhile at the time. However, success has been blunted by the reluctance of local banks to participate in the schemes.

(e) It is agreed that the amount of funds allocated under PHARE and TACIS are not comparable with the needs of the countries concerned. In a climate where a wide range of priorities is competing for the limited resources available it is simply not possible to meet all funding requirements. However, the Commission has sought to focus efforts on actions where the impact of PHARE and TACIS funding in the enterprise restructuring sector can be most effectively deployed and have a catalytic effect of the partner States' own efforts to stimulate development of the private sector. Moreover, efforts have been, and continue to be, made to coordinate funding activities with other donors such as the EBRD, the World Bank and the EIB to maximise the impact of the limited resources.

3.7. Difficult judgements had to be made with regard to programmes that were not making as swift progress as had originally been hoped. In several of the cases mentioned the principal reason for slow progress was a lack of commitment to the programme from the recipient authorities. The continued engagement of the Commission (where the only realistic alternative was to abandon the programme) has been vindicated in some cases. For example, the Struder programme in Poland was slow to start but, in part as a result of active management by the Commission, eventually developed

into a successful programme; the Polish authorities estimating that grants are expected to create over 11 000 jobs.

Assessment of the measures implemented

3.8. The Commission recognises that measuring the impact of private sector development can be difficult for the reasons given by the Court. Units specifically dedicated to the tasks of monitoring and evaluation have been established. Specific evaluations of sectors such as SMEs, privatisation, restructuring are underway. Assessment of programmes on a sampling basis is already provided by the evaluation unit and ongoing assessment is provided by monitoring teams.

3.9. The general climate in the beneficiary countries is an important constraint. But through constructive engagement, the Commission seeks not only to operate within the climate, but also actively to change it. The demonstration effect of a successful SME development programme such as Struder has played an important role in changing attitudes within the beneficiary public administrations to the private sector.

4. THE PREPARATION AND MANAGEMENT OF THE PROGRAMMES

The quality of the preparation, implementation deadlines and the scheduling of measures

4.1. The Court's report covers primarily the period influenced by the initial set-up phase of the PHARE and TACIS programmes. It is important to note that at the time these programmes were designed they were breaking entirely new ground. While it was clear that private sector development was crucial to a successful transition process, there were few precedents on which to base the design of programmes and criteria on which detailed objectives could be formulated. In addition, and as recognised by the Court elsewhere in its report, the level of political commitment to private sector development has been crucial. In Bulgaria, for example, the lack of political commitment to agreed private sector development programmes is by far the most important factor in the delays which affected these programmes.

Poland

4.2. Struder has been an experiment for PHARE and for Poland and the programme has played an important role in improving the situation regarding regional development in Poland.

The Commission has followed up on implementation of the scheme closely and guarantee applications are now being processed. The Commission is of the opinion that reduction of the number of instruments would have reduced the programme's overall impact and character.

4.3. The Commission undertook initiatives to improve the situation and intervened with the government to change the orientation of the tourism programme. While the development of Poland's tourism strategy was a protracted process, it has resulted in a high level of regional involvement and good degree of 'ownership' of the final strategy by the Polish authorities and the private sector.

Bulgaria

4.4. The Commission was aware of difficulties by the end of 1994 in relation to the delayed start (mid-1993). Subsequent reorientation discussions and agreement on reallocation did extend until mid-1995. All the efforts put in the design of the SME programme were driven by the Commission, getting the Bulgarian Government's agreement in each step of the process at a very slow pace and with great difficulties. This perceived lack of political commitment towards the development of a national SME strategic policy became clearer during programme implementation.

The development of the SME sector is to be speeded up by the newly elected government, which has approved a draft SME strategy, including the SME agency for which technical assistance is to be provided.

4.5. The tourism privatisation strategy project was launched at a time when the 1992 privatisation law was in suspense due to internal government controversies. Eventually, the Bulgarian government abandoned the agreed sector approach; this ultimately dictated the premature termination of the project.

4.6. Under the contract and addendum all parties concluded that a certain level of success had been achieved concerning direct contracts with Western partners, transfer of know-how, familiarisation with Western business practices and mechanisms, and fostering of business relationships. However, it was accepted that it would require further initiatives to provide concrete results in broader cooperation and development of deeper relationships since management was still relatively inexperienced in business with foreign partners, thus

justifying the addendum for further support to the sector.

Other countries

4.7. Within Russia, entrepreneurial activity had only been legal for a few years, and so the starting point for SME development was almost zero. In 1992 the EU had no experience of drafting or running projects in this sector in the Russian context. It was not until the 1995 projects began that the situation became somewhat clearer and previous experience both within the TACIS system and on the part of the EU and Russian parties could be taken into account. A recent independent operational review of the TACIS strategy in the private sector development area completed in January 1998 has confirmed the coherence, on the whole, of the strategy undertaken in the SME sector and specifically on the SMEDA network.

4.8. In the beneficiary countries, the political and economic context is continuously changing and when defining or preparing a project, certain developments are difficult to predict. Thus, changes often occur between project definition and project implementation. The inception phase of the project is foreseen to take into account these circumstances and readapt the project work plan to ensure the smooth running of the project. Throughout project execution unforeseen changes might also take place which require project extensions and/or budgetary modifications (usually within the overall value of the original contract) in order to ensure the delivery of the planned outputs and the achievement of impact.

Russia

4.10. The observation refers to a project designed in 1992 when the SME in Russia was a dynamically emerging sector. However, in a country where private entrepreneurship was a new phenomenon, the serious lack of appropriate legislation was apparent. Against this background, it was considered appropriate to provide the assistance. The case pointed out by the Court is an exception which is justified. It is normal practice to have statements of endorsement signed by the beneficiary before launching tenders.

4.11. There is informal consultation across units on the quality of consultants. The quality of the terms of reference (TOR) is ultimately the responsibility of the Commission, and TOR produced by external consultants are subject to careful review by the individual task managers before being issued.

The implementation of measures and drafting of the consultants' contracts

4.12. The Commission considers that changes in policy within the beneficiary countries was the principal factor to adversely affect programme implementation. Such fluctuations in policy made it more difficult to maintain a consistent line in delivery of the actions concerned and inevitably made programme management more difficult.

Changes in the central staff of the Commission in part reflect the difficulties in finding suitably qualified internal personnel. Reliance on short-term external contract staff can lead to frequent staff changes for some projects.

Hungary

4.13-4.14. When work started on the detailed design of the convertible loan scheme, the Commission indicated on several occasions that it had serious doubts over the design of the scheme. Despite the Commission's view, the Hungarian authorities continuously expressed their preference for establishing a quasi-equity type scheme.

The allocation of ECU 1,89 million (now approximately ECU 2 million including accumulated interest) will be recovered from the Hungarian authorities based on the draft final audit report.

Bulgaria

4.15. Notwithstanding the extremely difficult and uncertain political environment characterising SME development in Bulgaria, the technical assistance team did not perform to the standard expected.

4.16. Certain early programmes especially on SME development and enterprise restructuring, were characterised by a reduction of the planning stage in order to respond rapidly to the request of the government when the transformation process in Eastern Europe began in 1990.

The policy context for PHARE and TACIS operations has become clearer with successive programmes. These operations have enabled Commission services and contractors to acquire a far more detailed knowledge of the political and economic conditions that exist within these countries than was possible during the inception stages of the earliest programmes.

Since the early programmes, there has been an evolution in terms of planning and definition of objectives. For example, in Poland, the Struder (regional development) programme designed in 1992, incorporated more clearly defined objectives. This has been instrumental in the development of a regional development policy in Poland, although this process is not yet completed. Under both PHARE and TACIS, contractors are now obliged in an initial progress document (termed the inception report) to list in detail the objectively verifiable indicators of success for each element of the project. This is the basis of the monitoring teams' assessment of contractors' performance.

The flow of information

4.17. Contacts and consultations between PHARE and TACIS are carried out on an informal basis, including PHARE officers attending TACIS tender evaluations for TACIS contracts and vice versa. Evaluation reports circulate among the PHARE and TACIS teams, further contributing to cross-fertilisation of ideas and recognition of matters of common concern.

4.18. Past contract extension practice based on the natural wish to secure continuity within the project management unit (PMU) in Bulgaria has in the meantime been superseded by clear and stringent guidelines on the conditions and limits to contract addenda including amounts.

Concerning the problems cited by the Court relating to Poland, see comments at 5.13.

4.19. See comments at 4.11.

4.20. See comments at 3.5.

The monitoring and evaluation of programmes

Poland

4.22. The lack of experience of regional development agencies in working with experts, the lack of regional development plans, and the language barriers were all part of the environment in which the Struder programme had to operate and why in fact the programme was created. Since 1996, the Commission has established a systematic monitoring and assessment system, and reports relating to the Struder programme were issued in 1997. The Polish authorities are now required to monitor at least 20 % of the SME projects funded by PHARE. In line with the PHARE programme rules, the Commission

approves work programmes every six months, and these constitute an additional monitoring tool.

The impact study, together with regular reporting provided by the Polish regional development agency, have identified the number of SMEs supported, the amount of investment generated, the number of jobs created, and the number and value of municipal small infrastructure projects supported. This information is also available from the monitoring and assessment report produced by the Commission in June 1997.

Having overcome the initial difficulties the Struder programme has proved to be a success.

4.23. The Commission undertook initiatives to improve the situation with the Government to change the orientation of the tourism programme. While the development of Poland's tourism strategy was a protracted process, it has resulted in a high level of regional involvement and good degree of 'ownership' of the final strategy by the Polish authorities and the private sector.

Large balances of funds maintained on accounts result from incorrect estimations of cash needs by the PMU. These are mainly due to an over-estimation of the pace of implementation, the non-acceptance of work performed by contractors, or the late submission of invoices by contractors.

The Commission is well aware of this general problem. Efforts are being made to re-evaluate in a systematic way the actual needs on the basis of the amounts available on the accounts, the actual stage of contracting/implementation, and the PMU's past forecasting records when granting an advance payment.

Other countries

4.25. In the case of Hungary, despite written requests, the Commission has experienced difficulties in obtaining copies of final reports of monitoring activities from certain PMUs. In one case, the difficulty in obtaining such reports was a contributory factor to the Commission's decision not to approve a second extension of a particular technical assistance contract in 1996.

For Uzbekistan, the Court refer to procedures for the monitoring of experts under one specific contract. The Commission can confirm that under TACIS procedures time sheets are now required with all invoices for fees.

4.26. (a) The Commission is in the process of deconcentrating procedures whereby more functions will be devolved to the delegations within the partner States.

Funds authorised under the STAP facility will be used to recruit within the delegations long-term technical assistance directly linked to programme implementation. Short-term technical assistance will also be provided under the framework contracts to enable delegations to recruit independent experts tasked with attending tender evaluations, preparing terms of reference, monitoring and assessment.

(b) In addition to examination of the consultants, from 1996 onwards the monitoring exercise also examines the deliverables to the beneficiary organisation and the adequacy to their needs. The monitoring is completed by the evaluation exercise which is responsible for the assessment of the impact.

(c) An evaluation unit has been operational for little more than a year. Complete coverage of the PHARE and TACIS programmes, evaluated on a sector and country basis, inevitably takes time to complete.

4.27. The Commission has already examined this issue and does not consider it appropriate to take further measures.

5. EFFICIENCY OF IMPLEMENTATION PROCEDURES

The choice and conception of instruments

5.1. For both PHARE and TACIS, recent independent operational reviews have confirmed the coherence, on the whole, of the strategy undertaken in the area of support to SMEs.

The Commission accepts that certain problems were encountered (such as the reluctance of certain banks to participate in financing schemes) and such issues are being addressed as part of the follow-up to the interim evaluation.

Russia

5.3. The Commission agrees with the observations of the Court for this particular case. However, in subsequent projects the lessons learnt were taken into consideration.

5.4 and 5.7. The Commission's view is that the problems facing SMEs tend to be broadly similar across most, if not all, PHARE countries, although the intensity of such problems will inevitably vary between individual regions. For example, political constraints within

individual countries will vary and the prevailing economic conditions may mean that similar financial instruments are not required to the same degree.

It is for this reason that the Commission proposes to implement a horizontal SME programme to tackle the problems common to all PHARE countries. At the same time specific regional problems will be addressed through specific measures defined in regional development programmes applicable to specific countries. In this way both common and specific problems facing SMEs will be addressed.

5.5. It is inevitable that in certain cases particular instruments can be rendered less applicable if the initial conditions subsequently change. The Commission's objective is to adjust the instruments appropriately when such a problem becomes apparent.

Bulgaria

5.6. The long delayed PHARE SME credit line unfortunately coincided with the virtual collapse of the Bulgarian economy during 1996. Improved macroeconomic circumstances, together with the proposed restructuring of the banking sector, mean that it should be possible to disburse the credit line more quickly in the future.

5.7. See comments at 5.4.

5.8. For Bulgaria, see comments at 5.6.

For Hungary, the Commission is reviewing both draft strategic plans (SME and regional development) in order to avoid overlaps, and to promote synergy and fruitful cooperation.

For the 1995 regional development and 1996 SME programmes, PMUs have been requested to provide written agreement concerning the division of tasks. Under the programme for 1997 ECU 3 million for SME development has been allocated under the regional development programme to be implemented through the relevant local enterprise agencies. These measures form part of an ongoing process of review by the Commission, in consultation with the Hungarian Government, aimed at ensuring the most effective positioning of the SME programme within the context of regional development.

5.9. Guarantee funds are complex to design and have so far had limited success under PHARE. However, given their potential to act as a catalyst to establishing sustainable forms of financing to SMEs, the Commission,

in consultation with beneficiary countries, considered their adoption to be worthwhile. However, success was blunted by the reluctance of local banks to participate in the schemes.

5.10. For Bulgaria, see comments at 5.6.

A study on the status of the PHARE loan scheme (PLS) in Hungary is currently under way to determine the arrangements for the future administration of the funds. This will also serve as a source of background documentation to the complete review of the PHARE SME programme (which is included in the 1996 programme).

Concerning the fate of the revolving funds the Hungarian authority concerned (HFEP) holds and implements state funds, and as such, it is fully subject to regular inspection by the State Audit Office and the appropriate Hungarian ministry (MITT).

5.11. Certain activities have often started with soft restructuring, which might have enabled, after a certain time, the companies to free funds (through increased profit) to implement in-depth restructuring recommended by the initial project. Thus, very often recommendations are implemented, but perhaps two, three or even four years after the end of the projects.

Technical assistance

5.12. As the Court acknowledges, the majority of projects under which technical assistance was provided have proved to be satisfactory. The Commission does not consider that setbacks encountered under certain projects were due to the delayed reactions of technical assistants under contract to the Commission.

Poland

5.13. The Court's remarks refer to two different contracts. For the first contract, the Commission recommended informally to close the contract. However, the company was proposed and selected again by the Polish authorities.

The Polish tourism programme has, more than other programmes, benefited from Western consultants. However, it is difficult to strike the right balance between Western and Eastern consultants. The tourism programme suffered mostly from a lack of commitment on the side of both the authorities and the private sector. Political factors and economic dominance within Poland were the principal reasons for this.

Bulgaria

5.14. The principal difficulties stemmed from the uncertain political environment characterising the SME subject in Bulgaria. The Commission has taken steps aimed at preventing similar occurrences in the future.

5.16. The participation of local consultants is already being encouraged. The number of consultants in these countries has expanded rapidly and this field of expertise is a source of knowledge that can provide good value for money and which the Commission constantly seeks to utilise. Terms of reference for new projects within the beneficiary countries require good local knowledge on the part of prospective consultants and this is often best fulfilled by local experts. Moreover, terms of reference now specify that prospective tenderers should submit locally engaged personnel for consideration. For example, the terms of reference for the forthcoming framework contract for audits of PHARE and TACIS programmes state that local experts should be proposed as part of the complement of experts required.

Cooperation between the various parties

5.17. As explained in 5.18 to 5.22 there were other factors contributing to the difficulties concerned.

Poland

5.18. The Struder programme adopted a demand-driven approach on the basis of proposals and requests for assistance from regions. The Polish regional development agency was active in assisting the regional authorities through the elaboration of regional development plans, the SME scheme, tender documentation, and training programmes for project preparation.

Slovakia

5.19. The hostile attitude of the regional development agency led eventually to an unsatisfactory performance of the programme.

Russia

5.21. The cooperation between EBRD's regional venture funds (RVFs) in Russia and TACIS' enterprise support centres (ESCs), has been less extensive than anticipated. However, the Commission is in the process of negotiating a draft agreement between EBRD and TACIS on modalities for future TACIS Support and cooperation to EBRD activities. Agreement has been

reached at technical level pending final approval in both EBRD and with the Commission.

6. ASSESSMENT OF THE MEASURES IMPLEMENTED

Measuring the impact

Bulgaria

6.2. Although there have been a number of surveys and studies of the private sector in Bulgaria, there is still a lack of detailed information. This is particularly due to the rapid changing economic environment, but also due to the fact that the National Institute of Statistics does not currently keep adequate information.

The absence of reliable statistics in Russia continues to be a serious problem and constitutes one of the many restrictions encountered when operating technical assistance projects. When defining projects, to a great extent reliance must be placed on less quantitative data, e. g. experience from previous projects and sector studies make it possible to detect problems at the level of individual enterprises, industrial sectors or particular institutions.

TACIS assistance to the reform of the Russian statistical system started in 1993. A cooperation programme with the Russian ministry concerned is presently under implementation.

6.3. The degree of implementation of recommendations and their impact on enterprises' performance is the objective of the evaluation exercise. Though it may be possible to carry out a qualitative evaluation and identify best practices for dissemination, it will remain difficult to carry out full quantitative evaluations except of specific projects.

External constraints on the projects

6.5. The Commission shares the opinion of the Court on the need to take local constraints into account. It considers that such local constraints and the local economic context have been, and are, taken fully into account in the TACIS countries given as examples.

Bulgaria

6.6. See comments at 4.4.

Uzbekistan and Turkmenistan

6.7. The weakness of the banking sector in Uzbekistan and Turkmenistan is a real constraint on the development

of the private sector. The Commission has sought to tackle this by a large bank training programme providing ECU 2,5 million assistance to the regional bank training centre in Tashkent between 1994 and 1997. Subsequently, an ECU 1,6 million project has been launched that is designed to deliver consultancy services directly into banks, to strengthen the association of banks and to further high-level bank training.

The problem of currency convertibility in Uzbekistan is a severe one. It affects not only inward investment, but also access by domestic enterprises to raw materials, and new technology. The lack of convertibility of the currency, coupled with other macroeconomic rigidities also reduces the incentives for enterprises to restructure, and their capacity to benefit from restructuring.

6.8. See comments at 3.9.

Budgetary implementation

6.9. Although the management information system was improved in 1996, the Commission shares the opinion of the Court on the need to further improve this system. Such an improvement is presently under way. However, it might prove difficult to introduce the detailed levels suggested by the Court.

6.10. The major reason for the low disbursement levels in Bulgaria, is due to the lack of government commitment towards private sector development, and the continuous reorganisation of the key decision-makers.

The long term survival of the institutions

6.11-12. The Commission has sought to progressively decrease PHARE and TACIS support to running costs with other sources providing a correspondingly increasing proportion of funds. However, this approach needs to recognise the role that authorities in the partner States must play in helping to secure the long-term sustainability of these development agencies.

Experience in the EU and other economies with a lively SME sector have proved that training and support structures for SMEs cannot subsist without public funding. The Commission does not have direct influence on the level of support the local and federal governments choose to provide to such organisations.

Poland

6.13. The Commission has also been concerned for the long-term sustainability of the Polish SME foundation (thusfar the driving force behind the country's SME policy). This problem was resolved during the last PHARE implementation review meeting held in May 1997 in Warsaw. The Ministry of the Economy has made a commitment to fund from its budget an equivalent amount of ECU 900 000 towards the payment of the operational costs of the SME foundation. An SME law is now also under preparation in Poland to transform the foundation into a state agency to implement the national programmes for SMEs. In addition, USAid partly contributes to the costs of the SME foundation.

Russia

6.14. Based on experience of SMEDAs in the EU the Russian SMEDAs will not be able to survive without the support from the local administrations. As regards the SME sector, all terms of reference prepared for the action programmes 1996/97 and 1998/99 contain the obligation for the contractor to apply an exit strategy. This entails a phased reduction in the financial contribution to core costs and management support to be matched to a corresponding increase in earned income.

The legality and regularity of transactions

6.15. As outlined in 6.17 to 6.22 certain anomalies can be explained.

Bulgaria

6.17. The possibilities for direct contracting have been significantly restricted as part of the revision of tendering and contracting procedures. A system now exists to verify the principle of open competition in the framework of the decentralised implementation procedures.

Slovakia

6.19. (See the comments at 6.13 on operational costs of the SME foundation). The Commission has already commented on the findings of the Court in the DIS report regarding the payment of salaries, operating costs and high turnover of staff of PMUs in Poland.

In the case of the Polish regional development agency, the number of Polish staff paid by the programme has been reduced from 94 to 67 in 1997 and will be further

reduced to 28 in 1998. Following dialogue with the Government, it was agreed that the 1997 programme for Poland will not contain funds for PMU operational costs in any sector. The government has allocated ECU 4,5 million in its 1998 budget to contribute to PMU operational costs in the PHARE programme from 1998 onwards. This, together with the strategy for phasing out PMUs and the new PHARE orientations, which the Commission issued in March 1997, will allow the complete abandonment in Poland of the payment of PMU operational costs by PHARE.

The PHARE contribution to running costs in the Slovak Republic as concerns the SME agency, has been granted in a digressive way.

Assessment by country audited*Poland (ECU 217,5 million)*

6.20-6.22. In general the PHARE programme in Poland has performed satisfactorily. Certain actions have been less successful, as could normally be expected of any aid programme, where beneficiaries are asked to introduce sometimes difficult reforms.

6.21. The current position concerning the Polish tourism and guarantee fund projects is to be assessed as part of the upcoming PHARE implementation review.

6.22. The privatisation and restructuring of the steel sector in Poland is a highly sensitive issue, as reflected in the recent trade disputes between the EU and Poland. The financing memorandum was approved at the time when the Polish Government was preparing the steel restructuring plan. The plan did not materialise in the time foreseen and resources were focused on a number of activities instead but still with the objective of restructuring and privatisation of the sector concerned. These were approved by the Commission through the work programme system, in line with PHARE rules.

For legal reasons, the investment fund (FEDA) scheme could not be operated by the PMU. It required the establishment of a different legal basis. At the time that the FEDA scheme was approved, the Commission had been assured that this would happen quickly. Discussions on FEDA were therefore pointless until the appropriate legal framework had been established. This finally occurred in June 1996, nearly one and a half years after the signature of the financing memorandum. In the meantime, the FEDA scheme has been reallocated, at the request of the government, to the flood damage reconstruction programme.

Hungary (ECU 174,5 million)

6.23. See comments at 4.14.

6.24 SME business leaders do not always have access to relatively costly private training courses. Training measures organised under PHARE provide a more viable alternative and have had some success.

Bulgaria (ECU 72,5 million)

6.25. The difficulties cited by the Court illustrate the lack of commitment of the former Bulgarian Government. On the one hand financing memoranda were signed committing the government to implement programme objectives. However, these changes either never occurred or were limited to organisational aspects. The new government has created the SME agency, to which the PHARE programme is presently providing technical assistance and institutional strengthening support.

6.26-6.27. The programmed actions were not completed because of a lack of government commitment.

Slovakia (ECU 54,2 million)

6.30. Concerning the pilot enterprise restructuring and privatisation programme, a number of the recommendations in the studies were taken on board by the management of the companies.

Russia (ECU 228,06 million)

6.31-32. It is agreed that the amount of funds allocated under TACIS is not comparable with the needs of the country. In a climate where a wide range of priorities are competing for the limited resources available it is simply not possible to meet all funding requirements. However, the Commission has sought to focus efforts on actions where the impact of TACIS funding in the enterprise restructuring sector has been felt.

Turkmenistan (ECU 6,1 million)

6.34. At the end of the TACIS project concerning the creation of the SMEDA in Asghabat, the financial sustainability had reached approximately 35 % by January 1998. A follow-on project started in May 1998 entitled 'Support for SMEDA Asghabat' for a duration of nine months. The expected financial self-sustainability will be approximately 60 % at the end of this project. The increase is justified by the great number of clients —

both foreign and local — and the enhanced and diversified package of services and training.

7. CONCLUSION

7.1. The Commission agrees that the development of clear objectives and of measures for assessing their achievement is important, while also sharing the Court's view (3.8 of its report) that this can be difficult. The introduction of the log-frame approach is an important step in the right direction, as have been the setting up of the special dedicated monitoring and assessment and evaluation units as described above. But the Commission does not consider that where programmes have not achieved the expected results this is generally due to poor design or management. In some cases these may have been contributory factors, but these are the exception rather than the rule. Overwhelmingly the major factor where programmes have not succeeded as planned has been a lack of political commitment from the recipient; this has normally been impossible to predict, and difficult to manage.

7.2. Contacts and consultations between PHARE and TACIS personnel are carried out on an informal basis, including PHARE officers attending TACIS evaluations of tenders and vice versa. Evaluation reports circulate among the PHARE and TACIS teams, further contributing to cross-fertilisation of ideas and recognition of matters of common concern.

It is difficult to evaluate PHARE or TACIS impact at sectoral level or in relation to specific instruments. However, the new evaluation unit has launched a number of sectoral and instrument evaluations with a view to addressing these issues, to providing required feedback at the level of programming exercise and to allowing for cross-fertilisation between different areas.

The management of aid

7.3. In general the technical assistance under PHARE and TACIS has performed satisfactorily. However, the fact that certain actions have been less successful is inevitable in the context of wide-ranging aid programmes where beneficiaries are asked to introduce sometimes difficult reforms.

7.4. The Commission has taken care in programming to ensure that measures, while ambitious, are also realistic. In the early part of the period covered by the report, governments' policies were at a very early stage of

development, and often subject to unpredictable, significant and sudden change. Nonetheless the Commission could not ignore the need to provide help to reforming governments to set in place a conducive policy environment and to demonstrate concrete results quickly in this vital but fragile sector. While accepting that, with hindsight, some programmes appear over-ambitious, the Commission contends that a more cautious approach would have resulted in missed opportunities.

It is inevitable that in certain cases particular instruments can be rendered less applicable if the initial conditions subsequently change. The Commission's objective is to adjust the instruments appropriately when such a problem becomes apparent.

7.5. Where possible consultants' TOR should include the achievement of objectives rather than simply a list of activities. The Commission seeks to ensure that consultants provide clear outputs such as reports and services rendered which are substantiated by appropriate documentation. Payment of invoices is withheld if consultants have not fulfilled their contractual obligations.

The Commission is seeking to improve the quality of TOR and performance of consultants through:

- (a) informal consultation across PHARE and TACIS units on the quality of consultants,
- (b) review of TOR produced by external consultants by task managers before being issued,
- (c) and greater knowledge of local circumstances by the Commission's central and delegation services and consultants.

It would be difficult to hold consultants responsible for the final results of projects, particularly in cases where their role is the provision of technical assistance and advice. The final decision as to whether the advice is acted upon (and whether the intended results are ultimately achieved) lies with the beneficiary who may, or may not, choose to act upon the advice received from consultants.

7.6. Contacts and consultations are carried out on an informal basis, including PHARE officers attending TACIS tender evaluations for TACIS contracts and vice versa. Evaluation reports circulate among the PHARE and TACIS teams, further contributing to cross-fertilisation of ideas and recognition of matters of common concern. Units specifically dedicated to the tasks

of monitoring and evaluation have been established. The production of evaluation reports on sectors like SMEs, privatisation, restructuring will help to provide some of the necessary answers concerning sectoral issues.

7.7. (a) the Commission is in the process of deconcentrating procedures whereby more functions will be devolved to the delegations within the partner States. Funds authorised under the STAP facility will be used to recruit within the delegations long-term technical assistance directly linked to programme implementation. Short term technical assistance will also be provided under the framework contracts to enable delegations to recruit independent experts tasked with attending tender evaluations, preparing terms of reference, monitoring and assessment.

(b) the Commission's monitoring and evaluation activities include examinations of consultants, the deliverables to the beneficiary organisation and the adequacy of their needs. Evaluations subsequently gauge the impact of actions enabling the success or otherwise of the intervention to be determined and the measures that may need to be taken to improve future performance.

(c) the Commission is taking steps to improve the coherence of monitoring. For example, under PHARE, monitoring and assessment of programmes will be undertaken by an independent contractor (a consortium of EU and CEC companies) comprising 27 long-term experts with appropriate short-term technical support. The monitoring and assessment unit has established a standard template for all assessments to improve regularity, homogeneity and practicality of reports. A system of follow-up of recommendations within such reports ensures that they are not forgotten.

7.8. The evaluation unit, set up in January 1997, has completed or will shortly complete, for both PHARE and TACIS, 14 sectoral evaluations, 10 instrument evaluations and 3 country evaluations. 12 other evaluations are to be launched by the end of year. Complete coverage of the PHARE and TACIS programmes, evaluated on a sector and country basis, inevitably takes time to complete.

Results of completed evaluations and preliminary results for those ongoing have already been provided to Parliament, Member States, Commission services and the Court of Auditors.

A new methodology for monitoring and assessment of programmes is now in place. Homogeneity of approach is ensured through a standard 'template' whereby all reports follow the same format. The template focuses assessments on the achievement of objectives and the provision of concrete and practical recommendations for the management and design of future programmes. Recommendations are systematically followed up by those responsible for implementation of the programme. The reports are given a wide circulation, so that lessons learned from one programme can be applied to similar programmes elsewhere.

7.9. The Commission shares the opinion of the Court on the need to take local constraints and the local economic context fully into account and recognises that such factors and the general climate in the beneficiary countries can be an important constraint on implementation of measures. It does not consider that programme implementation was systematically affected in an adverse manner due to its initial misreading of local conditions. Programmes were developed in the context of the political environment at that time. Thereafter, subsequent changes in the political landscape were apt to affect certain programmes.

The effect of the aid

7.11. The Commission takes note that the Court recognises that the financing of actions undertaken on behalf of SMEs contributes to achieving one of the main objectives of the PHARE and TACIS programmes i. e. bringing about a transition to a market economy. The Commission considers this a commendable achievement given the complete absence of such a culture within these countries when the PHARE and TACIS programmes were first conceived and the relatively short periods during which the programmes have been up and running.

7.12. The Commission has sought to progressively decrease PHARE and TACIS support to running costs with other sources providing a correspondingly increasing proportion of funds. However, this approach needs to recognise the role that authorities in the partner states must play in helping to secure the long-term sustainability of these development agencies.

Experience in the EU and other economies with a lively SME sector have proved that training and support structures for SMEs cannot subsist without public funding. The Commission does not have direct influence on the level of support the local and federal governments choose to provide to such organisations.

7.13. SME development and regional development are linked, and are increasingly being treated together to ensure greater clarity in the support provided for SMEs. In addition, the delegations and project management and coordinating units located in the partner States increasingly ensure coordination on the spot.

7.15. The evaluation unit is attempting to evaluate the impact of projects by undertaking ex post evaluations, evaluating impact of all the projects developed since the beginning of the PHARE and TACIS programmes.

The observation on the lack of financial resources to meet the needs of partner States applies to all EU and other international aid programmes. Availability of financial resources is granted on the basis of various criteria such as absorption capacity and previous performance. There are competing demands and priorities for PHARE and TACIS funds and it will never be possible to meet all funding requirements. However, the Commission has sought to focus PHARE and TACIS funding on actions where the impact can be most effectively deployed and have a catalytic effect of the partner States' own efforts to stimulate development of the private sector.

7.17. See comments at 7.15.

In addition, the Commission has, and is, continuing to coordinate funding activities with other donors such as the EBRD, the World Bank and the EIB to maximise the impact of the limited resources. The special technical assistance facility which PHARE and TACIS is providing to the EBRD for the purpose of preparing investment projects is viewed as working well and efficiently. An evaluation has been launched, and an evaluation report will be available at the end of 1998. In addition to this facility, close cooperation with the EBRD is taking place, in the field as well as between Brussels and London.