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(Information)

COURT OF AUDITORS

SPECIAL REPORT No 3/99**on the management and control of interest-rate subsidies by the Commission, with the Commission's replies***(submitted pursuant to Article 248(4), second subparagraph, EC)**(1999/C 217/01)***TABLE OF CONTENTS**

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INTRODUCTION

1.1. The Commission has granted aid in the form of interest-rate subsidies since 1967 because of the considerable leverage effect this financial instrument is thought to have. It is actually, in theory, non-repayable aid which is intended to promote significant amounts of investment at comparatively low cost to the budget (see *Table 1*).

1.2. In practice, interest-rate subsidies are an accompaniment to certain loans. The loans concerned are granted by either the Commission or banks, one of which is the European Investment Bank (EIB), which also administers the corresponding subsidies as the Commission's agent (except for Madeira and Ireland).

1.3. The Commission is allowed to delegate the management of interest-rate subsidies, and does so for the majority of the mea-

asures, accounting for approximately half of the indicative volume (see *Table 1*). However, by virtue of Article 274 of the Treaty establishing the European Community, its responsibility for implementing general budget expenditure remains unchanged. The same is true of the implementation of the European Coal and Steel Community's (ECSC) and the European Development Funds' (EDFs) operating budgets.

1.4. The purpose of this report is to evaluate the extent to which the Commission is discharging this responsibility and, consequently, carrying out controls to enable it to draw up reliable accounts, ensure the legality and regularity of the underlying transactions and evaluate the effectiveness of these subsidies. The Court has thus examined the procedures applied within the relevant Commission departments to manage and control interest-rate subsidies.

1.5. A number of measures in the form of interest-rate subsidies have been the subject of specific audits and Court reports (see *Table 2*). A horizontal approach has been adopted for this Report, which focuses on aspects that are common to several measures of this type.

Purpose of the report and methodology

Table 1

Financial data concerning measures consisting of interest-rate subsidies

(in million ECU)

Measures	Indicative overall volume	Commitment period	Payments in 1997	Management of subsidies
TF SMEs	100	1994 to 1996	0	Delegated to the EIB
Article 56 of the ECSC Treaty	620	1967 to 1997	18,5	Directly by the Commission
NCI/EIB earthquakes	240	1982 to 1999	3,4	Delegated to the EIB
Madeira	4	1996 to 2007	0,5	Directly by the Commission
Ireland	28	1995 to 1997	p.m.	Directly by the Commission
TENs	Not applicable	1995 to 1999	10,1	Directly by the Commission
EEA-FM	145	1993 to 1997	p.m.	Delegated to the EIB
Sixth EDF	210	1986 to 1990	p.m.	
Seventh EDF	286	1991 to 1995	53,1	
MNCs/MEDA	Not applicable	1992 to 1999	4,5	
SMCs	Not applicable	Since 1978	21,2	
Cyprus and Malta	Not applicable	Since 1976	1,4	
Slovenia	20	1993 to 1997	4,2	

Table 2

Summary of the Courts latest observations on measures consisting of interest-rate subsidies

Measures	Court reports
TF SMEs	Observations currently being drafted
Article 56(2) of the ECSC Treaty	Annual reports concerning the ECSC for the financial years 1996 (OJ C 380, 15.12.1997), 1995 (OJ C 377, 13.12.1996) and 1993 (OJ C 346, 7.12.1994)
NCI/EIB earthquakes	Annual reports concerning the financial years 1996 (OJ C 348, 18.11.1997, paragraphs 18.7 to 18.24), 1994 (OJ C 303, 14.11.1995, paragraphs 8.3 to 8.23), 1993 (OJ C 327, 24.11.1994, paragraphs 10.3 to 10.19) and 1991 (OJ C 330, 15.12.1992, paragraphs 12.12 to 12.48)
Ireland	Observations currently being drafted
EDF	1996 EDF DAS (OJ C 348, 18.11.1997, paragraph 22.46), 1995 (OJ C 395, 31.12.1996, paragraphs 3.9, 3.69 and 3.77) and 1994 (OJ C 352, 30.12.1995, paragraphs 3.9 and 3.29); Annual reports concerning the financial years 1993 (OJ C 327, 24.11.1994, paragraphs 15.87 et seq.) and 1991 (OJ C 330, 15.12.1992, paragraphs 17.42 et seq.)
OCT	Special Reports No 1/98 (OJ C 98, 31.3.1998, paragraphs 137 to 149) and No 3/91 (OJ C 252, 26.9.1991, paragraph 4.21 in particular)

Audit field

1.6. The aid examined comprises all interest-rate subsidies financed by the general budget (GB) of the European Union, the ECSC operating budget or the EDF. The majority of the measures concerned originated with a Council Decision. Measures relating to non-member countries are generally included in the agreements, conventions or protocols concluded with the latter. The principle underlying this type of aid is to reduce the financial burden in terms of the interest payable on certain loans contracted by the beneficiaries by either paying part of the interest on their behalf, or refunding it to them.

1.7. Some forms of interest-rate subsidy are not dealt with in this report, *inter alia*:

- (a) the majority of those relating to measures which have no separate budget heading and are included indiscriminately with other types of subsidy in the budget;
- (b) those paid by national bodies under the Structural Funds, and ERDF 'quasi-subsidies' paid on the basis of loans contracted by the beneficiaries, but in the form of subsidies.

CHARACTERISTICS OF THE MEASURES

2.1. Table 3 sets out the various aid measures in the form of interest subsidies, categorised by their aims. Their objectives and conditions, such as their eligibility criteria, are very diverse and have few common characteristics, in particular because of the divergent economic contexts within which they operate.

2.2. For this reason, the methods of calculation, payment and entry in the accounts vary widely between one measure and another. The only interest-rate subsidies that show significant similarities are those paid in connection with the EDF and in the Mediterranean countries, Malta, Cyprus and Slovenia.

2.3. The annual subsidy rates range from 1,5 % to 4 % of the subsidised amount of the loans, according to the case, over periods ranging from five years to the entire life of a loan. Trans-European networks constitute a special case, as the subsidy may amount to 100 % of the interest payable over five years (see paragraph 2.11).

2.4. The financial data relating to measures that comprise interest-rate subsidies are summarised in Table 1 and set out in brief below.

Temporary facility for SMEs

2.5. The interest-rate subsidies accompanying loans granted to small and medium-sized enterprises (SMEs) by the EIB under its temporary lending facility⁽¹⁾ are intended to increase the competitiveness of European SMEs and to encourage them to create jobs. These subsidies amount to 2 % per annum over five years and the loans are for a minimum of five years and cover no more than 75 % of the investments. The ceiling on such subsidies is ECU 3 000 for each job created.

⁽¹⁾ Council Decision 94/217/EC of 19 April 1994 on the provision of Community interest subsidies on loans for small and medium-sized enterprises extended by the European Investment Bank under its temporary lending facility (OJ L 107, 28.4.1994, p. 57).

Table 3

Classification by objective of measures consisting of interest-rate subsidies

Objectives	Measures	Loan sources	Origin of the subsidies	Annual subsidisation rates	Duration of the subsidies	Specific limits	Intermediaries	Beneficiaries
Job creation	TF SMEs	EIB	EC	2 %	Five years	— ECU 3 000 per job created — ECU 81 000 per small-scale SME — 7,5 % of the investment	EIB, agents and banks	SMEs in the EU
	Article 56 of the ECSC Treaty	Commission	ECSC	3 %		— ECU 2 000 per job created	Banks	Enterprises in the ECSC regions
Reconstruction of stricken regions	NCI/EIB earthquakes	EIB or Commission	EC	3 %	10 years	Not applicable	EIB	Public bodies in regions affected by earthquakes
	Madeira	EIB		3 %	12 years	Not applicable	EIB and the Autonomous Region of Madeira	
Peace-making in a region	Ireland	EIB	EC	4 % then 3 %	Five years	— project cost < ECU 12 million — loan < 50 % of the project — loans between ECU 15 000 and ECU 3 million in Northern Ireland, and between ECU 15 000 and ECU 1 million in the border counties	National bodies and banks	SMEs and other enterprises investing in the region concerned
Development of the trans-European networks	TENs	EIB or other banks	EC	Not applicable	Five years	— Value of the interest over five years — 10 % of the project's cost	EIB or other banks	Public bodies and private companies
Reduction of disparities within the EEA	EEA FM	EIB	EC via EEA FM	2 %	10 years	Not applicable	EIB	Public bodies
Development of non-member countries	Sixth and seventh EDFs	EIB	EDF	Between 3 % and 6 %	25 years maximum	Not applicable	EIB	ACP countries and OCT
	MNCs/MEDA/SMCs		EC	Between 1,5 % and 3 %	From 15 to 20 years on average			Non-member countries concerned
	Cyprus, Malta, Slovenia							

Subsidies under Article 56 of the ECSC Treaty

2.6. The conversion subsidies granted under Article 56(2)(a) of the Treaty establishing the ECSC ⁽²⁾ are intended for enterprises located in ECSC regions that make job-creation investments. In recent years these subsidies have amounted to 3 % per annum over five years, the maximum amount payable being limited to ECU 2 000 for each job created.

2.7. As the ECSC Treaty will expire in 2002, the final commitments (amounting to ECU 1,8 million) in respect of this measure were entered into in 1997 and the Commission now only has to make payments, cancellations or recoveries relating to past commitments, the balance of which amounted to ECU 210 million on 31 December 1997. The Court has in recent years formulated observations concerning this measure ⁽³⁾.

The NCI/EIB earthquake loans

2.8. The subsidies allocated to the regions affected by the earthquakes in Italy in 1980 ⁽⁴⁾ and in Greece in 1981 ⁽⁵⁾ and 1986 ⁽⁶⁾ are intended for the reconstruction of the means of production and economic and social infrastructures in these areas. They amount to 3 % per annum for the life of the corresponding loans (10 years on average), are paid to the EIB on a half-yearly basis by the Commission and are in addition to the reduced-rate interest payable by the beneficiaries. The Court has in recent years formulated observations concerning this measure ⁽⁷⁾.

⁽²⁾ Article 56(2)(a) of the Treaty establishing the European Coal and Steel Community (ECSC).

⁽³⁾ The Court's annual reports concerning the ECSC for the financial years 1993 (OJ C 346, 7.12.1994), 1995 (OJ C 377, 13.12.1996) and 1996 (OJ C 380, 15.12.1997).

⁽⁴⁾ Council Decision 81/19/EEC of 20 January 1981 on Community aid granted by way of exception for the reconstruction of the regions affected by the Italian earthquake in November 1980 (OJ L 37, 10.2.1981, p. 21).

⁽⁵⁾ Council Decision 81/1013/EEC of 14 December 1981 on Community aid granted by way of exception for the reconstruction of the regions affected by the Greek earthquakes in February and March 1981 (OJ L 367, 23.12.1981, p. 27).

⁽⁶⁾ Council Decision 88/561/EEC of 7 November 1988 on Community aid granted by way of exception for the reconstruction of the regions affected by the Greek earthquakes in September 1986 (OJ L 309, 15.11.1988, p. 32).

⁽⁷⁾ Court reports containing criticisms of the NCI/EIB earthquake instruments: annual reports concerning the financial years 1996 (OJ C 348, 18.11.1997, paragraphs 18.7 to 18.24), 1994 (OJ C 303, 14.11.1995, paragraphs 8.3 to 8.23), 1993 (OJ C 327, 24.11.1994, paragraphs 10.3 to 10.19) and 1991 (OJ C 330, 15.12.1992, paragraphs 12.12 to 12.48).

Reconstruction of Madeira

2.9. The loan for the reconstruction of the regions stricken by the cyclone which hit Madeira in October 1993 ⁽⁸⁾ is intended to alleviate the cyclone's effects on the population's economic and social well-being by financing projects for road infrastructure, improving embankments, water distribution, hydroelectric power and housing that were carried out from 1993 onwards. The related subsidy amounts to 3 % per annum over 12 years.

Programme for peace in Ireland

2.10. Among the 30 or so measures provided for in the Community initiative ⁽⁹⁾ relating to the 'programme of special support for peace and reconciliation in Northern Ireland and the border counties of Ireland, 1995 to 1999', the measure comprising interest-rate subsidies is more specifically intended to encourage productive investment that will create and safeguard jobs. However, the number of jobs that are created or safeguarded is not used as a basis for calculating the subsidies, which amount to 4 % per annum from 1995 to 1997 and 3 % per annum in 1998 and 1999.

Trans-European networks

2.11. When this report was adopted, the interest-rate subsidy component of Community aid in respect of trans-European networks (TENs) ⁽¹⁰⁾ represented only a minor proportion of the four types of subsidy provided for under this measure, the aim of which is to increase the interconnection and interoperability of the national transport networks ⁽¹¹⁾ and broaden access to them. It is possible for 100 % of the interest paid by the beneficiary during the first five years of the loan to be covered by these subsidies, provided they do not exceed 10 % of the project's total cost.

⁽⁸⁾ Council Decision 95/250/EC of 29 June 1995 relating to exceptional Community aid for the reconstruction of the areas stricken by the cyclone that hit Madeira in October 1993 (OJ L 159, 11.7.1995, p. 16).

⁽⁹⁾ Commission Decisions C(96) 1592 of 23 July 1996 and C(95) 1789 of 28 July 1995 on the contribution of the ERDF, ESF, EAGGF-Guarantee and FIFG to a Community initiative in the framework of a special support programme for peace and reconciliation in Northern Ireland and the border counties of Ireland.

⁽¹⁰⁾ Council Regulation (EC) No 2236/95 of 18 September 1995 laying down the general rules for the granting of Community financial aid in the field of trans-European networks (OJ L 228, 23.9.1995, p. 1).

⁽¹¹⁾ Subsidies relating to networks other than those of transport, i.e. telecommunications and energy, do not include interest-rate subsidies.

EEA financial mechanism

2.12. The Commission's annual contributions to the financial mechanism for the European Economic Area (EEA-FM) ⁽¹²⁾, which account for approximately 80 % of the latter's receipts, correspond to the contributions formerly paid by Austria, Finland and Sweden. Since these countries became Member States the contributions have been paid by the EU. The EEA-FM pays out subsidies and interest-rate subsidies in order to reduce the economic and social disparities between the regions of the EU. Projects implemented in Greece, Ireland, Portugal and some regions in Spain are eligible, with priority being given to the fields of environment, transport, education and training ⁽¹³⁾.

2.13. The subsidy amounts to 2 % per annum for a maximum of 10 years. When the loan is paid out, the total present value amount of the corresponding subsidy is withdrawn by the EIB from the EEA-FM current account opened at the Bank. Either the EIB pays this amount to the beneficiary, who will then pay the Bank interest at the full rate, or it retains it, in which case the borrower will pay the latter interest at a reduced rate.

The sixth and seventh EDFs

2.14. The interest-rate subsidies included in the sixth and seventh European Development Funds ⁽¹⁴⁾ comprise one of the forms of aid provided for by these Funds, the purpose of which is to assist the development of African, Caribbean and Pacific (ACP) countries and Overseas Countries and Territories (OCT). Priority must be given to financing productive projects and programmes in industry, agroindustry, tourism, mining, energy and in transport and telecommunications linked to these sectors.

2.15. The rate of these subsidies is, in principle, 4 % for the life of the loan, but it is adjusted in such a way that the interest rate paid by the borrower amounts to between 3 % and 6 %. However, the borrower is frequently an intermediary (a central bank or a specialist body) which lends to final beneficiaries at rates that may be very much higher, particularly in the light of the currencies used ⁽¹⁵⁾.

⁽¹²⁾ Part VIII - Financial Mechanism - of the Agreement on the European Economic Area (OJ L 1, 3.1.1994, p. 28).

⁽¹³⁾ Protocol 38 on the financial mechanism annexed to the agreement on the European Economic Area.

⁽¹⁴⁾ Third ACP-EEC Convention signed at Lomé on 8 December 1984 (OJ L 86, 31.3.1986).

⁽¹⁵⁾ Special Report No 24/98 concerning risk capital operations financed from the resources of the European Development Funds (OJ C 389, 14.12.1998 paragraph 3).

2.16. For a given loan, the amounts paid by the Commission to the EIB correspond to the present value total of the subsidies due on each future interest maturity date for the loan concerned. The portion relating to subsequent financial years is not indicated as such in the EDF's financial statements, because of the cash-accounting system which the Commission has decided to use.

Financial cooperation with the Mediterranean countries, Cyprus, Malta and Slovenia

2.17. Interest-rate subsidies are provided for under the following: financial cooperation in respect of all Mediterranean non-member countries ⁽¹⁶⁾ (MNCs), certain protocols relating to financial and technical cooperation concluded by the Community with southern Mediterranean countries ⁽¹⁷⁾ (SMCs), financial and technical measures to support the reform of economic and social structures in the framework of the Euro-Mediterranean partnership ⁽¹⁸⁾ (MEDA, which replaced MNCs and SMCs as of 1 January 1997), and certain financial protocols concluded by the Community with Malta ⁽¹⁹⁾, Cyprus ⁽²⁰⁾ and Slovenia ⁽²¹⁾. As is the case with the EDF, they are paid and entered in the accounts on a present value basis.

⁽¹⁶⁾ Council Regulation (EEC) No 1763/92 of 29 June 1992 concerning financial cooperation in respect of all Mediterranean non-member countries (OJ L 181, 1.7.1992, p. 5), as amended by Regulation (EC) No 1735/94 of 11 July 1994 (OJ L 182, 16.7.1994, p. 6).

⁽¹⁷⁾ Council Regulation (EEC) No 1762/92 of 29 June 1992 on the implementation of the protocols on financial and technical cooperation concluded by the Community with Mediterranean non-member countries (OJ L 181, 1.7.1992).

⁽¹⁸⁾ Council Regulation (EC) No 1488/96 of 23 July 1996 on financial and technical measures to accompany (MEDA) the reform of economic and social structures in the framework of the Euro-Mediterranean partnership (OJ L 189, 30.7.1996, p. 24).

⁽¹⁹⁾ — Council Regulation (EEC) No 939/76 of 23 April 1976 concluding the financial protocol and the protocol laying down certain provisions relating to the agreement establishing an association between the European Economic Community and Malta (OJ L 111, 28.4.1976, p. 1),

— Council Decision 89/378/EEC of 12 June 1989 concerning the conclusion of a protocol on financial and technical cooperation between the European Economic Community and Malta (OJ L 180, 27.6.1989, p. 46).

⁽²⁰⁾ — Council Regulation (EEC) No 2760/78 of 23 November 1978 on the conclusion of the Financial Protocol between the European Economic Community and the Republic of Cyprus (OJ L 332, 29.11.1978, p. 1),

— Council Regulation (EEC) No 787/84 of 26 March 1984 on the conclusion of a Protocol on financial and technical cooperation between the European Economic Community and the Republic of Cyprus (OJ L 85, 28.3.1984, p. 37),

— Council Decision 90/153/EEC of 26 February 1990 on the conclusion of a protocol on financial and technical cooperation between the European Economic Community and the Republic of Cyprus (OJ L 82, 29.3.1990, p. 32).

⁽²¹⁾ Council Decision 93/408/EEC of 19 July 1993 on the conclusion of a protocol on financial and technical cooperation between the European Economic Community and the Republic of Slovenia (OJ L 189, 29.7.1993, p. 152).

OBSERVATIONS CONCERNING THE MANAGEMENT, ENTRY IN THE ACCOUNTS AND CONTROL OF INTEREST-RATE SUBSIDIES

3.1. Table 1 sets out 13 measures, nine of which are managed by the EIB. The comments in paragraphs 3.2 to 3.7 only apply to the subsidies for which the EIB acts as the Commission's agent.

Amounts received by beneficiaries

3.2. The amount of aid actually received by final beneficiaries is determined by the behaviour of the financial intermediaries, who may retain part of the subsidy by manipulating the level of the interest rate or other features of the loans they propose (such as fees, exchange rates or value dates). There is a risk that these intermediaries' remuneration will exceed that stipulated and that the aid intended for beneficiaries will be reduced proportionately, in contravention of the regulations.

3.3. However, where the Commission has delegated the management of interest subsidies, it does not check the terms governing the loans in cases where they are paid out by financial intermediaries and, moreover, generally does not even possess the information needed for this purpose. Furthermore, the fact that interest-rate subsidies may not be paid out by all members of the banking system, but only by a restricted number of intermediaries selected by the EIB, is likely to affect competition within the sector.

3.4. In cases where loans are directly back-to-back with borrowings, the spread between the rates needs to be checked. In the case of ECSC loans, all the benefits the Commission gains in its capacity as a first-class borrower, including cases where it is able to obtain more advantageous refinancing for operations already under way, are passed on to its own borrowers. The EIB enjoys margins on the loans it grants from its outside borrowings that are not subject to auditing by the Court. No provision is made in the contracts for the terms to be adjusted to enable borrowers to benefit from more advantageous terms in the event that market conditions improve.

3.5. As regards loans financed from the EIB's own resources, the rates for such loans are not compared with those in the market. Given that the EIB enjoys special privileges⁽²²⁾ and has a monopoly over the allocation of certain subsidies, the competition mechanism

⁽²²⁾ Protocol on the privileges and immunities of the European Communities, annexed to the Treaty of Brussels of 8 April 1965.

ism does not guarantee that its margins are in accordance with the regulations laid down in its statutes⁽²³⁾. This matter also has a bearing on the volume of administrative expenditure that is invoiced⁽²⁴⁾ by the EIB in respect of its management of operations under mandate from and on behalf of the Commission. Observations were made in this regard in the Court's Annual Reports concerning the financial years 1994 (paragraphs 8.36 to 8.43) and 1993 (paragraphs 10.26 to 10.30).

Eligibility and follow-up of projects entrusted to the EIB

3.6. The selection of projects for which subsidised loans will be granted, and the checking of the projects' eligibility, are tasks that are usually entrusted to the EIB. The Commission, which on occasion has no knowledge of the projects or the final beneficiaries, is thus faced with a *fait accompli*. Decisions to grant subsidies may also be taken by the Commission on the basis of information provided by the EIB, but in practice this merely involves the Commission rubber-stamping the proposals submitted to it by the EIB⁽²⁵⁾.

3.7. Similarly, when the Commission receives reports from the EIB concerning the progress of investments under way, which is not always the case, they are not analysed. The Commission's interest in these documents is all the less as it believes that it is unnecessary to repeat the work already done by the EIB, that the main risk connected with these operations is that of loans not being recovered, a matter that is meticulously monitored by the EIB and, lastly, that the cost to the budget in these cases is often relatively low, especially in cases where subsidies are accompanied by other more costly measures.

Effectiveness of the subsidies

3.8. In the case of most measures the subsidy rates bear no direct relation to market rates, which vary greatly over time and according to the country concerned, and are not based on an analysis to determine the threshold above which the subsidy is likely to be truly effective.

⁽²³⁾ Article 2 of the Statutes of the EIB, which refers to Article 198, of the Treaty establishing the European Community. It is stated that the EIB shall, operating on a non-profit-making basis, grant loans and give guarantees.

⁽²⁴⁾ The EIB is entitled to receive a management fee for administering certain operations to cover the actual managerial costs incurred. The Court has never received satisfactory information enabling it to obtain assurance on an independent basis that this regulation has been respected.

⁽²⁵⁾ The Commission prepares the files itself when cooperation with Mediterranean countries is involved.

3.9. As far as most of the measures involved are concerned, the objectives are defined in an extremely general manner. This being the case and in the absence of costed objectives, it is difficult to evaluate the extent to which the objectives have actually been achieved.

3.10. In practice, the Commission is content to draw up a list of projects implemented and sums spent. In general, the Court believes that a high utilisation rate is not synonymous with effectiveness. In fact, the success (which is different from effectiveness) of this type of aid is not only dependent on, *inter alia*, its appeal to final beneficiaries, but also its attractiveness to financial intermediaries. But the latter promote such aid in the light of their own interests (for example, to attract worthwhile new customers or develop the loyalty of existing customers), which, while not conflicting with them, are not necessarily the same as the EU's objectives.

3.11. With regard to the two measures conceived specifically to create jobs (TF SMEs and Article 56 of the ECSC Treaty), the number of jobs created is used as a criterion for judging their efficiency. However, the Commission presents the results in statistical terms, without analysing the causal connection between the jobs created and the subsidies paid out. The Court carried out audits of both measures on the premises of the beneficiaries, from which it has concluded that the subsidies had almost no real impact and were more like a windfall for the beneficiaries who, by virtue of investing in job creation, had received this Community aid, even though their investments had been made for reasons unconnected with the measures.

Entry of the subsidies in the accounts

3.12. For most measures the Commission enters the subsidies it pays to the EIB in the accounts without checking the related calculations, even when the subsidies concerned were paid in advance and calculated in present value terms. The Court examined the files at the Commission and found no sign of any checks having been carried out before sums were recorded.

3.13. In the case of the general budget and the EDFs (the situation is different as regards the ECSC operating budget), expenditure on interest-rate subsidies is entered in the accounts at the time the respective commitments are entered into and then when the respective payments are made. When the amounts paid to the EIB correspond to the total sum of the present value of the subsidies in respect of a loan lasting several years (see paragraph 2.15), the Bank enters the portion relating to subsequent financial years under its liabilities for as long as it holds this portion (subsidies received in advance amounted to ECU 361,6 million on 31 December 1997), as it could be required to pay part of it back to

the EC or the EDF, for example, in the event of early repayment of the corresponding loans. On the other hand, neither the EC nor the EDF have any sort of indicator (for example, to denote claims or forecast claims) which would require them to focus their attention on what becomes of these subsidies once paid, as the corresponding amounts are not entered on the assets side of the EC⁽²⁶⁾ or EDF balance sheets.

3.14. In connection with the TF SMEs, the problem is different, as the subsidies were paid globally in advance (ECU 93,5 million between 1994 and 1996), basically for reasons of budgetary availability, and were paid over to the beneficiaries by the EIB (ECU 93,4 million) between 1995 and 1998. The time lag involved is not discernible in the EU's financial statements. At 31 December 1997 subsidies that had still not been paid over to beneficiaries amounted to ECU 0,1 million. In addition, the interest earnings generated by the funds held on current account at the EIB (some ECU 9 million) have not been established as budgetary revenue.

3.15. With regard to NCI earthquake loans, and Madeira, the subsidies are paid over on each interest maturity date. Under the cash-accounting system, accrued interest-rate subsidies not yet due are not entered in the accounts. Furthermore, the unaccrued amounts that are to be paid at a later date, which amounted to ECU 6,1 million for NCI earthquake loans and ECU 3,3 million for Madeira on 31 December 1997, are not shown outside the balance sheet.

3.16. The three preceding paragraphs show that the same economic situation is presented in the accounts in different ways, depending on the technical set-up of the operations. It is therefore difficult to gain an understanding of the situation by examining the financial statements.

CONCLUSION

4.1. As regards the sound financial management of the subsidies, the Commission should:

- ensure that where intermediaries are used, they do not receive unreasonable levels of remuneration and that certain financial institutions have not been favoured over other competitors, but have been selected in a satisfactorily transparent and equitable manner,
- evaluate their efficiency by measuring the rate of achievement of the set objectives, wherever possible (see paragraph 3.9), and by determining the real impact of the subsidies (see paragraphs 3.10 to 3.11).

⁽²⁶⁾ The Court's Statement of Assurance concerning activities financed from the general budget for the financial year 1997 (OJ C 349, 17.11.1998 paragraphs 8.6 to 8.7).

4.2. Harmonisation of the entry of the interest-rate subsidies into the accounts contained in the EU's and the EDF's financial statements could be improved to provide a clearer picture, and be accompanied by more comprehensive information (see paragraphs 3.13 to 3.16). The Commission should also check the calculations and verify the appropriateness of the discount rates applied (see paragraph 3.12).

4.3. When the EIB is involved in the distribution of subsidies (see Table 1), the Commission carries out hardly any controls and relies excessively on its agent. Given that delegating management is not tantamount to delegating responsibility, the Commission should:

- ensure that the amounts of the subsidies correspond to the aid actually received by the final beneficiaries, net of the stipulated margins (see paragraphs 3.2 to 3.5),

- ensure on a systematic basis that the planned investments are eligible and that the beneficiaries meet the requisite conditions (see paragraph 3.6),

- ensure in good time that the investments made or being made are in line with estimates (see paragraph 3.7).

4.4. This set of problems requires horizontal treatment. The Commission should introduce centralised control of the financial management of interest-rate subsidies, and even of banking-type instruments in general, to ensure greater homogeneity in the management of the instruments involved and their presentation in the financial statements. This would also facilitate relations with the EIB by limiting the number of Commission staff involved in dealings with the EIB, while increasing control over the management that the Bank has been left to exercise on the Commission's behalf.

This report was adopted by the Court of Auditors in Luxembourg at the Court meeting of 16 and 17 June 1999.

For the Court of Auditors

In the absence of Jan O. KARLSSON

President of the Court

Bernhard FRIEDMANN

Acting President

LIST OF ABBREVIATIONS

ACP	African, Caribbean and Pacific States
ECSC	European Coal and Steel Community
EDF	European Development Fund
EEA-FM	Financial mechanism for the European Economic Area
EIB	European Investment Bank
ERDF	European Regional Development Fund
EU	European Union
GB	General budget of the European Union
MEDA	Measures to accompany the reform to the economic and social structures in Mediterranean non-member countries
MNCs	Mediterranean non-member countries
NCI	New Community instrument
OCT	Overseas countries and territories
SMCs	Southern Mediterranean countries
SMEs	Small and medium-sized enterprises
TENs	Trans-European networks
TF SMEs	Temporary facility for SMEs

THE COMMISSION'S REPLIES

INTRODUCTION

The report adopts a horizontal approach in analysing and assessing a range of interest rebate measures that are not only quite diverse in terms of objectives and eligibility conditions, but also difficult to compare. Indeed, they address different economic realities at different moments in time, and each measure's rationale is largely determined by the general political and economic context in which it originated. The Commission, like the Court, considers that these parameters need to be taken into account in the assessment of the measures' efficiency, impact and management.

CHARACTERISTICS OF THE MEASURES

Sixth and seventh EDFs

2.15. To avoid distortion of the financial markets, the subsidy is used for purposes which are complementary to the financial operation (increasing the capacity of intermediaries, improving project evaluation, partial cover of exchange risks, etc.). This explains the differences in interest rates granted to intermediaries and to final beneficiaries.

OBSERVATIONS CONCERNING THE MANAGEMENT, ENTRY IN THE ACCOUNTS AND CONTROL OF INTEREST-RATE SUBSIDIES

3.1. In cases where the Commission directly manages interest rebates and effects the associated payments, as in the case of Madeira or trans-European networks, it is, of course, fully aware of both the identity of the final beneficiary and the details of the activity being supported.

Regarding trans-European networks, it should be recalled that the Commission established, on its own initiative, a set of guidelines on the use and administration of interest rebates for budget line B5-7 0 0 (these were made available to the Court). These guidelines, whose purpose was to ensure transparent procedures and allow proper verification of physical and financial implementation, were formally adopted by the Member States in the TEN-

Financial Assistance Committee in 1997. The guidelines were especially intended to ensure uniformity between traditional direct grant subsidies and interest rebates in the areas of *ex-ante* evaluation (appraisal), and monitoring of projects. Thus the Commission aggregates both physical and financial data on the progress of projects.

Amounts received by beneficiaries

3.2 to 3.5. Financial intermediaries are not free to manipulate the level of the rate of interest, fees, exchange rates and value dates. Financial markets and financial institutions do have rules and customary procedures which are to a large extent transparent. The beneficiaries are able to compare conditions between various intermediaries, whether the loans concerned are with or without interest-rate subsidies. Of course, financial intermediaries carry the solvability risk of the final borrower and adapt loan conditions accordingly. This applies whether the management of the loans and subsidies is delegated to the EIB or is assured by the Commission.

The EIB works with large networks of intermediaries in all countries in which it operates, in accordance with Article 16 of its Statute, and this is no doubt taken into account when the EIB is conferred the task of allocating interest subsidies decided by the European Union. For example, of all external agencies, the EIB has probably the most extensive network of banking contacts and relationships throughout the ACP countries, financing under Lomé IVa alone around 70 lines of credit to about 50 ACP financial institutions.

Moreover, the EIB applies strict criteria of quality and solvability in selecting its network of financial intermediaries. It is evident that EU subsidies of a limited amount and duration cannot be distributed through an unlimited number of financial intermediaries. For various reasons, not all potential intermediaries corresponding to the EIB's criteria agree to manage global loans or interest subsidies.

As regards the interest rates for loans made from its own resources, the Bank is bound by Article 19 of its Statute and is subject to controls. The grid of interest rates which the Bank fixes for its loans from own resources is controlled and approved by its Board of Directors where the Commission is represented by a regular member and an alternate.

The EIB on-lends funds at a rate reflecting its excellent position in the markets, plus a small margin to cover costs, in accordance with its statutory obligation under the Treaty. Otherwise, the rates

of EIB loans are fixed in accordance with market conditions. Interest rates are usually fixed but are also revisable, variable or convertible according to the client's preferences, and may be set either on signature of the finance contract or on each disbursement (open-rate contract). The method adopted for setting rates is the same for all countries and sectors. The currencies in which disbursements are made depends on the EIB's holdings and the borrower's preferences.

The EIB provides the Commission with information on the administrative costs for the various activities it manages for the Commission. A recapitulation of these costs is communicated to the Court by the Commission.

In its checks on interest-rate subsidies granted under Article 56(2)(a) of the ECSC Treaty, the Commission has found only a very few cases in which the financial intermediaries failed to comply with the conditions imposed.

Eligibility and follow-up of projects entrusted to the EIB

3.6 to 3.7. Interest subsidies under the programmes covered in the Court's report apply not only to EIB loans but also to loans from other public sources (e.g. government loans) and indeed from private markets. In this context, it seems inappropriate to draw general conclusions on either the Commission's control of eligibility or its monitoring of projects. There is no single reliable method for measuring the efficiency of interest rebates. Further, it is important to note that the Commission's evaluation activities should be proportionate. This means that the scope of the Commission's actions to effect *ex-ante* appraisal and ongoing evaluation of individual projects should depend on whether the lender is expected to undertake similar work. Such a consideration would generally need to be taken into account in the case of EIB loans, since the EIB, unlike a private bank, has its own economic evaluation unit and makes detailed use of socioeconomic criteria in both its funding decisions and follow-up.

Regarding EIB lending operations, the Commission receives full and complete information concerning final beneficiaries. Interest subsidies are attributed to EIB loans from own resources in accordance with the various regulations, mandates, decisions and agreements governing the allocation of such funds. EIB management of such subsidised loans and information to its mandator, the Commission, is always in accordance with its undertakings under the particular mandate and, across the board, with its statutory obligations. The control of eligibility of EIB loans from own resources is effected in accordance with Article 21 of the EIB Statute, under which the Commission gives an opinion prior to the approval of a loan.

According to various mandates, there also exist Member State committees which give their opinion on project eligibility on the basis of detailed reports.

The information prerequisite to the decisions on individual allocations varies according to the characteristics of the loans and the operating capacity and technical know-how of the intermediary. For global loans to financial intermediaries outside the Union, the Bank often includes a contractual right to request further information on the final beneficiaries. Although the Bank undertakes periodic spot-checks to verify compliance, it does not systematically enforce its contractual right.

As regards the EIB-Edinburgh facility, the Commission has received a full list of all the final sub-loan beneficiaries. As the job creation criteria are similar to those of the ECSC, and cover the same period, these lists have been analysed and compared to the ECSC sub-loan beneficiaries. A small number of cases of potential double financing have been identified by the Commission and are currently being examined and discussed with the EIB.

Finally, on the broader question of the treatment of information received from the EIB, the Commission insists on analysing this information itself. The Commission is regularly informed by the Bank on the development of projects and there is a dialogue if major problems occur. The Commission is of the view that duplication of work should be avoided.

Effectiveness of the subsidies

3.8 to 3.11. Most measures apply to the whole Union and objectives, whether quantifiable or not, are necessarily of a global character. Not all objectives (e.g. strengthening competitiveness of European industry, fostering development of high tech SMEs) can be precisely quantified. This does not render the objectives less important.

At a macroeconomic level, the effective rate of interest is known to be a factor influencing the level of investment. The Commission would not claim that this is the single determining factor in a beneficiary's decision to undertake an investment project. Rather, interest subsidies form part of a package which also includes measures on a local, regional or national level which together create a favourable context for the achievement of priority EU objectives.

The link between interest rate subsidies and investment cannot be necessarily quantified but this does not mean that there is no causal relationship at all.

Various final beneficiaries have confirmed that the interest rate subsidy received had a positive and significant influence on the investment decision. With respect to the Copenhagen facility, the Commission will present its evaluation report in the near future. At this stage, it seems premature to draw general conclusions as regards the effectiveness of the facility.

The Commission considers that the level of use made of a facility is one indicator among others; however, it has never identified the use of a particular instrument as its sole indicator of effectiveness.

Entry in the accounts of the subsidies

3.12. The relevant Commission departments verify the calculations by conducting spot checks.

3.13 to 3.16. As the Court's observations relate to three different regimes, the general budget, ECSC and EDF, the Commission undertakes to study the best way of entering in the accounts the amounts of interest-rate subsidies paid in advance to the EIB. The Commission will also endeavour to establish how best to harmonise the procedure for entering subsidies in the accounts in so far as the separate agreements permit.

3.14. The Commission agrees with the Court that interest earnings generated by funds held on current account at the EIB should be shown as a receivable item.

CONCLUSION

4.1. Interest rate subsidies are granted in order to contribute to a number of different objectives where economic and political conditions vary considerably within the Union. It is therefore inappropriate to sacrifice the variety of subsidy mechanisms and the

way these are managed for the sole purpose of having a uniform system. The Commission, however, bears the overall budgetary and political responsibility for the measures discussed. The Commission is of the opinion that the procedures established relating to the implementation of the mechanisms in question are appropriate and guarantee the respect of EU legislation and rules.

4.2. The Commission undertakes to look into ways of improving and harmonising presentation of the financial statements from the point of view of interest-rate subsidies.

4.3. The cooperation agreements with the EIB regulate in detail the delegation of the financial and technical work to the Bank, whose long standing activity and solid know-how in the financial field are beyond any doubt. The EIB provides the Commission with sufficient financial and technical data to allow for an efficient control i.e. respecting the principle of avoiding unnecessary duplication of work and safeguarding a reasonable relationship between use of resources and results obtained.

The responsibilities and division of tasks between the Commission and the EIB for operations in the ACP countries under the Lomé Convention are described in the internal agreement, signed by the Member States' Representatives on 20 December 1995. This agreement will be renewed on the occasion of the next Convention.

4.4. The Commission will consider the Court's suggestion and investigate the extent to which management of the interest rate subsidy instruments could be harmonised and centralised.
